

## CREDIT OPINION

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Update



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## Commerzbank Finance &amp; Covered Bond S.A.

Update following outlook change to positive

## Summary

[Commerzbank Finance & Covered Bond S.A.](#)'s (CFCB) ratings and rating inputs are aligned with those of its parent bank, [Commerzbank AG](#) (A1 positive/A2 positive, baa2)<sup>1</sup>, reflecting our assessment that CFCB is a highly integrated entity of Commerzbank.

CFCB's A2 issuer rating, therefore, reflects Commerzbank's baa2 BCA and Adjusted BCA; the results of our Advanced Loss Given Failure (LGF) analysis of its parent bank's liabilities, resulting in two notches of uplift for CFCB's issuer rating; and the moderate probability of CFCB receiving indirect government support through Commerzbank, resulting in one additional notch of rating uplift.

We consider CFCB a highly integrated subsidiary of Commerzbank, reflecting its limited proprietary franchise; the magnitude of management integration and its role as a group service provider, being fully integrated into Commerzbank's treasury operations; and Commerzbank's influence on CFCB's financials, in particular asset exposures and funding. Our assessment is further supported by the existing letter of comfort between CFCB and Commerzbank, as well as several service-level agreements between these two entities, all of which supports CFCB's operational stability.

In the case of resolution, we expect CFCB to form part of Commerzbank's resolution perimeter. We therefore apply Commerzbank's LGF analysis, as well as the same government support assumption for Commerzbank's long-term senior unsecured debt ratings to CFCB.

In accordance with Commerzbank's strategic overhaul, CFCB further reduced its total assets to €5.3 billion at the end of 2023 (2022: €6.4 billion) and finalised the relocation of its agency and syndicated loans function to Germany.

For further details, please refer to the Credit Opinion of [Commerzbank AG](#).

## Credit strengths

- » CFCB is fully integrated into its parent bank's risk management and treasury operations, thereby benefiting from Commerzbank's credit strength and access to liquidity and funding
- » CFCB's creditors benefit from a letter of comfort (*Patronatserklärung*) which link its ability to repay funding to the credit strength of Commerzbank

## Credit challenges

- » CFCB exhibits high concentration risks from public sector lending, albeit being significantly downsized
- » Optically high capital ratios, driven by low risk-weights for public sector exposure, balanced by market values which are significantly lower than book values
- » Focus on public sector lending drives CFCB's low standalone profitability

## Outlook

- » The positive outlook on CFCB's issuer rating follows the positive outlook on Commerzbank's senior unsecured debt rating.

## Factors that could lead to an upgrade

- » An upgrade of CFCB's ratings would require an upgrade of Commerzbank's ratings.
- » For factors that could lead to an upgrade of CFCB's parent please refer to the Credit Opinion of Commerzbank AG.

## Factors that could lead to a downgrade

- » A downgrade of CFCB's issuer rating would follow a downgrade of Commerzbank's ratings.
- » In addition, CFCB's ratings could be downgraded if our assumption of CFCB as a highly integrated and harmonised subsidiary of Commerzbank is undermined by Commerzbank no longer being committed to orderly unwinding CFCB's legacy portfolios; reducing funding support or separating CFCB from its treasury operations; or withdrawing the letter of comfort or the existing service-level agreements with CFCB.
- » For factors that could lead to a downgrade of CFCB's parent please refer to the Credit Opinion of Commerzbank AG.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 1

### Commerzbank Finance & Covered Bond S.A. (Consolidated Financials) [1]

	12-22 <sup>2</sup>	12-21 <sup>2</sup>	12-20 <sup>2</sup>	12-19 <sup>2</sup>	12-18 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (EUR Million)	5,953.5	6,931.5	7,064.6	8,222.5	10,720.8	(13.7) <sup>4</sup>
Total Assets (USD Million)	6,353.8	7,854.2	8,644.0	9,229.8	12,255.4	(15.1) <sup>4</sup>
Tangible Common Equity (EUR Million)	1,056.0	1,109.0	1,141.7	1,173.6	1,188.2	(2.9) <sup>4</sup>
Tangible Common Equity (USD Million)	1,127.0	1,256.6	1,396.9	1,317.3	1,358.3	(4.6) <sup>4</sup>
Tangible Common Equity / Risk Weighted Assets (%)	62.3	56.9	58.4	55.8	44.5	55.6 <sup>6</sup>
Net Interest Margin (%)	1.6	1.6	1.7	1.4	1.6	1.6 <sup>5</sup>
PPI / Average RWA (%)	-2.7	-2.0	-1.5	-1.5	2.1	-1.1 <sup>6</sup>
Net Income / Tangible Assets (%)	-0.9	-0.5	-0.5	-0.2	0.5	-0.3 <sup>5</sup>
Cost / Income Ratio (%)	-83.2	-138.9	-305.8	-155.5	31.7	-130.4 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	77.6	85.5	86.2	87.5	89.8	85.3 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	69.8	73.0	73.9	74.2	53.8	68.9 <sup>5</sup>
Gross Loans / Due to Customers (%)	244384.6	--	7416.7	4765.0	535.6	64275.5 <sup>5</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

## Profile

Based in Luxembourg, Commerzbank Finance & Covered Bond S.A. (CFCB)<sup>2</sup> is a specialized lender and covered bond bank and solely performs public sector lending (*Kommunalkreditgeschäft*) in accordance with Luxembourg's Covered Bond law. CFCB is a wholly owned subsidiary of Commerzbank and benefits from a letter of comfort (*Patronatserklärung*) from its Frankfurt-based parent bank.

## Detailed credit considerations

### Close integration into Commerzbank drives alignment of BCA

We align CFCB's BCA with the BCA of Commerzbank, based on our rating approach for highly integrated entities (HIE). Our assessment reflects CFCB's close integration with and dependence on its parent bank with regard to funding and capital support, as well as key controlling and risk management functions:

- » Letter of comfort (*Patronatserklärung*) from Commerzbank and various service-level agreements in favour of CFCB;
- » The majority of CFCB's unsecured funding is sourced from its German parent and it is part of its treasury operations;
- » CFCB relies on capital support from Commerzbank to meet regulatory requirements; and
- » CFCB's credit risk management is integrated into Commerzbank's group-wide risk management and control systems, including limit allocations and risk monitoring.

In addition, CFCB's status as a Luxembourg covered bond bank limits its lending activities and thus its standalone proprietary franchise. Therefore, CFCB's credit exposure almost exclusively relates to the financing of the public sector<sup>3</sup> because these loans used to be pledged as collateral in order to issue covered bonds (*Lettres de Gage*) in accordance with Luxembourg's Covered Bond law. However, the discontinuation of public finance business at Commerzbank also stopped CFCB's new business and it intends to reduce its remaining public finance portfolio in a value-preserving manner. Since October 2015, the European Central Bank also no longer considers *Lettres de Gage* eligible securities under its repo program.

Overall, we believe that CFCB's probability of failure, as measured by its BCA, is similar to that of its parent bank.

## Structural and support considerations

### Affiliate support

Because of its strong integration into Commerzbank and the existing letter of comfort (*Patronatserklärung*), we believe that CFCB benefits from a "very high" probability of affiliate support. Our assessment also takes into account the sizeable funding which CFCB receives from its parent bank. As a result of this assumption, CFCB's baa2 Adjusted BCA is aligned with Commerzbank's BCA.

### Loss Given Failure (LGF) analysis

We perform our Advanced LGF analysis on the consolidated financials of Commerzbank, based on the assumption that resolution would be addressed for the German parent bank and its Luxembourg subsidiary<sup>4</sup> at the same time. Common resolution with the parent is likely, given that CFCB is strongly interconnected with its parent, as illustrated by its funding reliance for most of its balance sheet. Such interconnectedness implies limited options for a subsidiary's ring-fencing in resolution.

For CFCB's long-term issuer ratings, our Advanced LGF analysis indicates a very low loss given failure, leading to two notches of rating uplift from the bank's baa2 Adjusted BCA.

### Government support

As a result of the Luxembourg-based bank's close integration with its Germany-based parent, we expect any potential German government support to be available for the benefit of CFCB's senior creditors, in case of need. Such support from the [Government of Germany](#) (Aaa stable) would likely be made available to and through Commerzbank in the event of stress.

Therefore, CFCB's long-term A2 issuer rating benefits from one additional notch of rating uplift from government support, mirroring our moderate support assumption at the level of Commerzbank for this class of debt.

### A1/P1 Counterparty Risk Ratings

The bank's CRRs are four notches above the baa2 Adjusted BCA, reflecting the extremely low loss given failure from the high volume of instruments, primarily junior senior unsecured debt, which are subordinated to CRR liabilities as well as our moderate assumption of government support for these liabilities.

### A1(cr)/P-1(cr) Counterparty Risk Assessment

The bank's CR Assessment is four notches above the baa2 Adjusted BCA, based on the substantial buffer against default provided by more subordinated instruments, primarily junior senior unsecured debt, to the senior obligations represented by the CR Assessment. In addition, CFCB's CR Assessment benefits from one notch of rating uplift provided by government support.

## Methodology

The principal methodology we use in rating Commerzbank Finance & Covered Bond S.A. is the [Banks Methodology](#), published in March 2024.

## Ratings

Exhibit 2

Category	Moody's Rating
<b>COMMERZBANK FINANCE &amp; COVERED BOND S.A.</b>	
Outlook	Positive
Counterparty Risk Rating	A1/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating -Dom Curr	A2
<b>PARENT: COMMERZBANK AG</b>	
Outlook	Positive
Counterparty Risk Rating	A1/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A2
Senior Unsecured	A2
Junior Senior Unsecured	Baa2
Junior Senior Unsecured MTN	(P)Baa2
Subordinate	Baa3
Pref. Stock Non-cumulative	Ba2 (hyb)
Commercial Paper -Dom Curr	P-1
Other Short Term	(P)P-1

Source: Moody's Ratings

## Endnotes

- The ratings shown are Commerzbank's deposit ratings and outlook, its senior unsecured debt ratings and outlook, as well as the bank's BCA.
- CFCB resulted from the merger of two former Luxembourg-based Commerzbank subsidiaries that used Lettres de Gage (covered bonds) to refinance their portfolios of public-sector loans. On 4 July 2016, [Julius Baer Group Ltd.](#) acquired selected parts of Commerzbank's Luxembourg private banking and wealth management business (former Commerzbank International S.A. [CISAL], renamed Bank Julius Baer Luxembourg S.A.). As part of the deal, some of former CISAL's assets and liabilities, as well as certain businesses from Commerzbank's Luxembourg branch, were transferred to CFCB or were reintegrated into Commerzbank, thereby finalising the restructuring of Commerzbank's Luxembourg operations.
- As of the end of 2022, CFCB's public sector loans accounted for around €4.8 billion or 76% of assets (2021: 73%), with around three quarters allocated to public sector entities in the [United States of America](#) (around 60%) and [Italy](#) (around 15%). CFCB's most important group of creditors from loans and financial securities are public sector entities, banks, and financial institutions.
- CFCB is subject to the European Union Bank Recovery and Resolution Directive (BRRD), which we consider an operational resolution regime. In the case of resolution, we expect CFCB to form part of Commerzbank's wider resolution perimeter. We therefore apply Commerzbank's LGF analysis to CFCB, considering the risks relating to different debt and deposit classes across the bank's liability structure at failure. Our Advanced LGF analysis follows the [insolvency legislation](#) in Germany. In line with our standard assumptions, we assume a residual TCE of 3%, as well as asset losses of 8% of tangible banking assets in a failure scenario. We also assume a 25% runoff of junior wholesale deposits and a 5% runoff in preferred deposits. Moreover, we assign a 25% probability to junior deposits being preferred to senior unsecured debt. We apply a standard assumption for European banks that 26% of deposits are junior.

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