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## Research Update:

# Germany-Based Deutsche Genossenschafts-Hypothekenbank Upgraded To 'A+' On Bank Criteria Change; Outlook Stable

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## Research Update:

# Germany-Based Deutsche Genossenschafts-Hypothekenbank Upgraded To 'A+' On Bank Criteria Change; Outlook Stable

## Overview

- Following a review of Deutsche Genossenschafts-Hypothekenbank AG (DG HYP) under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we have raised our long-term rating on DG HYP to 'A+' from 'A' and affirmed the 'A-1' short-term rating.
- In our view, DG HYP has a weak business position, weak capital and earnings, moderate risk position, average funding, and adequate liquidity, reflecting a stand-alone credit profile of 'bb'.
- We assess DG HYP as "highly strategic" to the German cooperative banking sector. To reflect this and our view of potential extraordinary group support for DG HYP in a crisis, the long-term rating on DG HYP benefits from seven notches of uplift from the SACP.
- The stable outlook mirrors the outlook on Germany's cooperative banking sector. In our view, the ratings on the sector are unlikely to change over the next one to two years, assuming continually robust credit metrics. We also believe the solidarity support within the sector will remain unchanged.

## Rating Action

As previously announced, on Dec. 5, 2011, Standard & Poor's Ratings Services raised its long-term counterparty credit rating on Germany-based Deutsche Genossenschafts-Hypothekenbank AG (DG HYP) to 'A+' from 'A'. The 'A-1' short-term counterparty credit rating was affirmed. The outlook is stable.

At the same time, we raised our issue ratings on DG HYP's nondeferrable senior subordinated debt to 'A' from 'BBB+'.

## Rationale

Standard & Poor's bases its ratings on DG HYP on its "weak" business position, "weak" capital and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity. The stand-alone credit profile (SACP) is at 'bb'.

Under our bank criteria, we use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Germany is 'a-', based on an economic risk score of '1' and an industry risk score of '3'.

Our economic risk assessment reflects Germany's highly diversified and competitive economy and lack of major economic imbalances. Nevertheless, as an export-led nation, Germany remains vulnerable to swings in global economies, trade flows, and capital market trends.

Industry risk benefits from Germany's extensive funding market and banks' domestic funding surpluses from low domestic credit growth and high savings rates. However, the sector's competitive dynamics result in relatively low profitability, which is fueled by significant disparities in the commercial targets and business and risk profiles of market players.

We assessed the economic risk for DG HYP by analyzing the weighted exposure at default (EAD) from DG HYP's customer loans to nonbanks in each country in which it operates. About 35% of DG HYP's EAD stems from lending in countries with weaker economic risk scores than that for Germany. Consequently, the weighted economic risk score for DG HYP is somewhat weaker than that on German lending institutions with higher proportions of domestic loans, but not to the extent that it affects the anchor of 'a-'.

In our view, DG HYP has a "weak" business position, relative to the industry risk score of '3' for the average German bank. Our view is based on DG HYP's purely wholesale bank model, building on its position in commercial real estate (CRE) financing in Germany and prominent role in the German Pfandbrief (covered bond) market. We believe that, as a pure CRE lender, DG HYP will remain dependent on support from its parent, DZ BANK AG Deutsche Zentral-Genossenschaftsbank (DZ BANK) through economic cycles. This is because its business model and funding remain highly sensitive to investor confidence, attract tail risk from concentrated exposures, are vulnerable to cyclicity from higher risk asset classes, and build upon very limited earnings and business diversification. The bank's business strategy, in our view, will be closely aligned to core markets of the German cooperative banking sector.

We consider DG HYP's capital and earnings as "weak" for its concentrated risk profile. We project the risk-adjusted capital (RAC) ratio to remain at 4%-5% until 2013, which is weak considering the bank's increasing wholesale business and a larger share of hybrid instruments. Moreover, we don't expect DG HYP to generate material capital internally over the medium term, although we have observed stringent, ongoing cost reduction to support its bottom-line performance and transformation. On a positive note, a profit-and-loss transfer agreement obliges DZ BANK to offset DG HYP's losses, which largely neutralizes the risk of weakening capital ratios.

Our risk position assessment for DG HYP is "moderate". This is due to the bank's increasing tail risk from CRE financing and exposure to remaining financial legacies, such as investments in asset-backed securities. However, in the short to medium term, we expect DG HYP to benefit from its unseasoned CRE business. This is because most of this business went on the books after the financial market crisis when risk-adjusted margins had generally improved, and market conditions in Germany are currently relatively favorable.

DG HYP's funding is "average" and its liquidity "adequate", in our view, and likely to remain so. This reflects our anticipation of ongoing support for DG HYP from DZ BANK. We expect funding and liquidity to stay strong in the cooperative banking sector and to remain adequate in the DZ BANK group, which includes DG HYP. We believe DG HYP would find it difficult to replace DZ BANK as a source of unsecured funding. In our view, international funding and capital resources remain scarce for narrow wholesale business models like DG HYP's, particularly those concentrated on highly cyclical businesses such as CRE financing. DG HYP's funding costs depend heavily on its standing in the capital markets, and the bank benefits from its position as a larger issuer of covered bonds.

The long-term rating on DG HYP is one notch below that on its parent DZ BANK. This seven-notch uplift from our assessment of DG HYP's SACP at 'bb' incorporates our expectation that DG HYP would receive extraordinary support from DZ BANK and ultimately from the German cooperative banking sector in an emerging stress scenario. This is based on our view of DG HYP as "highly strategic" to the DZ BANK group according to our group methodology. Our group classification is based on DZ BANK's 100% ownership of DG HYP, DG HYP's membership of the sector's protection scheme, the profit-and-loss agreement with DZ BANK, and demonstrated and ongoing support from DZ BANK in the form of funding, liquidity, and capital. However, the rating on DG HYP is one notch lower than the ratings on core members of the sector due to our view of its relatively weaker strategic importance and business integration within the sector.

We regard DG HYP's importance to the German banking system as low, reflecting its smaller size and exclusive wholesale operations. Consequently, the ratings rely solely on implicit and explicit cooperative sector support and do not incorporate the likelihood of extraordinary government support.

The 'A' issue ratings on DG HYP's nondeferrable senior subordinated debt reflect our belief that the cooperative banking sector will support payments on these instruments. This notwithstanding, Germany's legal and regulatory framework, in our view, allows the authorities to instigate restructuring of a failing bank to the detriment of nondeferrable subordinated debtholders.

## Outlook

The stable outlook reflects the stable outlook on Germany's cooperative banking sector. We expect the rating on DG HYP to remain at least one notch lower than the rating on the sector's core entities. This reflects DG HYP's "highly strategic" importance to DZ BANK according to our group methodology and our expectation of ongoing support for DG HYP from the DZ BANK group and ultimately the cooperative banking sector.

The outlook on Germany's cooperative banking sector is stable because we believe the ratings are unlikely to change over the next one to two years. In

In addition, we believe the solidarity support within the sector will remain unchanged. Although we currently anticipate a weakening of economic and financial market conditions globally, we believe that the sector's key credit metrics should remain more resilient and superior than the average for the German bank industry.

Any rating actions on Germany's cooperative banking sector and DZ BANK could affect the ratings on DG HYP. A positive rating action that relates only to DG HYP, is unlikely over the medium term. However, this could result if DZ BANK were to firmly integrate DG HYP into the group as a core member as defined in our group methodology.

## Ratings Score Snapshot

Issuer Credit Rating	A+
SACP	bb
Anchor	a-
Business Position	Weak (-2)
Capital and Earnings	Weak (-2)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	7
GRE Support	0
Group Support	7
Sovereign Support	0
Additional Factors	0

## Related Criteria And Research

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Ratings On German Banks' Lower Tier 2 Sub Debt Lowered Due To Bank Restructuring Act; Other Debt Ratings Not Affected, Feb. 28, 2011
- S&P Comments On Decision To Lower Ratings On German Banks' Lower Tier 2 Sub Debt Due To Bank Restructuring Act, Feb. 28, 2011

## Ratings List

Upgraded; Ratings Affirmed

	To	From
Deutsche Genossenschafts-Hypothekenbank AG		

*Research Update: Germany-Based Deutsche Genossenschafts-Hypothekenbank Upgraded To 'A+' On Bank Criteria  
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Counterparty Credit Rating	A+/Stable/A-1	A/Stable/A-1
Senior Unsecured	A+	A
Subordinated	A	BBB+
Certificate Of Deposit	A+/A-1	A/A-1

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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