



Fitch Upgrades Commerzbank to 'BBB+'; Outlook Stable

Fitch Ratings-Frankfurt/Warsaw/London-07 March 2016: Fitch Ratings has upgraded Commerzbank AG's (CBK) Long-term Issuer Default Rating (IDR) to 'BBB+' from 'BBB' and its Viability Rating (VR) to 'bbb+' from 'bbb'. The Short-term IDR is affirmed at 'F2'. The Outlook on the Long-term IDRs is Stable. A full list of rating actions is available at the end of this rating action commentary.

The upgrades reflect CBK's improved profitability and capitalisation, aided by ongoing de-risking, which resulted in a steady narrowing of losses from the bank's non-core-assets (NCA) segment.

KEY RATING DRIVERS - IDRs, VRs AND SENIOR DEBT

CBK's IDRs are based on the bank's VR, which reflects CBK's overall improved, albeit still moderate, profitability, stronger asset quality, sound progress in de-risking and reduction of non-core assets, improved and adequate capitalisation and stable funding and liquidity.

The improvement in CBK's performance was underpinned by overall satisfactory revenue generation in the core bank. In addition, 2015 net income benefitted from lower one-off charges compared with 2014, when results were significantly burdened by provisions for litigation.

Within the core bank, retail banking reported improved profit on the back of a significant increase in new mortgage lending, stable operating expenses and low loan impairment charges. However, CBK's largest profit-contributor, the Mittelstandsbank segment, reported a weaker operating result, driven by low interest rates, impaired participation interest in a technology provider and higher regulatory costs. We expect CBK's performance to remain stable in 2016.

CBK's asset quality has improved as its gross impaired loans/gross loans ratio fell to 3.8% at end-3Q15 from 5.5% at end-2014. Asset quality in the core bank is sound. Downside risks in CBK's NCA portfolio have been reduced materially and now relate primarily to the bank's shipping finance portfolio, which in view of the continuing overcapacity still bears risk of further credit quality deterioration. However, the size of this exposure has declined, and we expect that moderate further asset quality deterioration in the segment would be manageable.

CBK has announced that it will dissolve the NCA segment and transfer the stable and less complex parts of the portfolio back into the core bank. The remainder will be transferred to a newly created "Asset & Capital Recovery Unit (ACR)". Fitch understands from management that CBK does not intend to resume new business origination in shipping finance and only selectively in commercial real estate.

We believe that CBK may incur substantial charges from a possible mandatory conversion of Swiss franc-denominated mortgages in its Polish subsidiary if the Polish government decides to implement a legislative proposal. This would significantly affect CBK's Polish subsidiary mBank. Reliable estimates of the magnitude and timing of possible write-downs are, however, difficult to make at this stage. Today's rating actions take into account our view that any write-downs will be manageable for CBK, without materially denting capitalisation.

CBK's Basel III fully-applied CET1 ratio increased to 12% at end-2015 from 9.3% at end-2014, supported by a EUR1.4bn capital increase in April 2015 as well as risk-weighted assets (RWAs) reductions. Capitalisation should remain adequate as performance is stabilising and capital requirements from non-core assets are expected to decrease further. CBK's funding and liquidity remain stable. CBK's unsecured wholesale funding is moderate.

Fitch believes that CBK has addressed most of its conduct and litigation risks, when it recognised

provisions for the settlement reached in March 2015 regarding alleged breaches of US sanctions and money laundering laws and agreed to pay a fine of USD1,452m. The bank also provided for litigation following the ruling of the German Federal Court of Justice on loan processing fees. Fitch does not expect any further material litigation or conduct charges.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

The SR and SRF reflect Fitch's view that senior creditors cannot rely on receiving full extraordinary support from the sovereign in the event that CBK becomes non-viable.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid capital issued by CBK is notched down from CBK's VR in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risks, which vary considerably.

CBK's legacy Tier 1 securities, including HT1 Funding Capital, which have a distributable profit trigger, are rated four notches below CBK's VRs, two notches each for loss severity and for non-performance risk.

Dresdner Funding Trust I's Tier 1 securities, which have a regulatory capital ratio trigger, are rated three notches below CBK's VR, two notches for loss severity and one notch for non-performance risk. Dresdner Funding Trust I has always paid its coupons whereas CBK's Tier 1 instruments with a distributable profit trigger have not, which is reflected in the one-notch difference between the securities.

UT2 Funding plc securities are legacy upper Tier 2 instruments and Fitch applies a smaller notching for loss severity (one notch) to these than to the bank's legacy Tier 1 securities. However, they have higher non-performance risk (three notches) compared with Tier 1 debt (two notches) because coupon payments are dependent on profits in the profit and loss account.

Other subordinated debt securities issued by CBK and Dresdner Funding Trust IV's (Dresdner IV) subordinated notes are rated one notch below CBK's VR to reflect greater loss severity than senior unsecured debt instruments.

SUBSIDIARY AND AFFILIATED COMPANY

Commerzbank U.S. Finance Inc is a wholly owned subsidiary of CBK. The Short-term rating of its commercial paper programme is equalised with CBK's Short-term IDR and reflects our view of the likelihood that CBK would support its US commercial paper programme, in case of need.

The IDRs of mBank and mBank Hipoteczny and the ratings of mBank's and mFinance France's senior debt are driven by institutional support from CBK, which holds a near 70% stake in mBank. Fitch believes that mBank and its subsidiaries remain strategically important for CBK. Their IDRs, Support Ratings and senior debt ratings reflect our view of a high probability that Polish subsidiaries would be supported by CBK, if required.

mBank Hipoteczny's IDRs are equalised with those of its direct parent, mBank, to reflect our view of the subsidiary's role for its parent. Debt issues by mFinance France is fully guaranteed by mBank. Potential support from CBK for mBank's subsidiaries could be extended directly or could flow through mBank.

RATING SENSITIVITIES

IDRS, VR AND SENIOR DEBT

Further upside to CBK's VR and IDRs is currently limited, as the ratings are constrained by the bank's earnings capacity in a highly fragmented domestic market. The ratings incorporate our expectation that asset quality will remain stable, and increasing risk costs in the core bank will be counterbalanced by the gradual reduction of non-strategic assets.

An upgrade of CBK's Long-term IDR and VR would be contingent on further significant improvements

in profitability and capitalisation, a reduction of higher-risk exposures, resilient asset quality and low risk costs in the core portfolio through the economic cycle.

The rating of the commercial paper is primarily sensitive to changes in CBK's Short-term IDR.

Downside pressure on CBK's VR could arise from unexpected credit losses arising from the bank's non-core assets, which we do not expect as such exposure has been reduced significantly. A possible mandatory conversion of Swiss franc mortgages in Poland could significantly affect CBK's Polish subsidiary mBank. While it is difficult to reliably estimate the timing and magnitude of the write-downs that mBank would face as a result, we believe that the mandatory conversion could cost mBank multiples of its annual profit, which would significantly slow down CBK's progress in the improvement of its performance and capitalisation.

The VR is also sensitive to significant changes to CBK's strategic objectives following the bank's CEO replacement announced for May 2016. Our ratings assumption is for the strategy to remain broadly unchanged.

SR AND SRF

An upgrade of the SR and upward revision to the SRF would require a positive change in the sovereign's propensity to support its banks. While not impossible, this is highly unlikely in Fitch's view.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

CBK's debt ratings are sensitive to changes of CBK's VR or to a change in their notching, which could arise if Fitch changes its assessment of the notes' loss severity or its relative non-performance risk.

SUBSIDIARY AND AFFILIATED COMPANIES

The IDRs of mBank and mBank Hipoteczny and the senior debt ratings of mBank and mFinance France are sensitive to changes in CBK's IDRs. They are also sensitive to changes in our assessment of CBK's propensity to provide support, which could arise if the subsidiaries' role in CBK changes.

The rating actions are as follows:

Commerzbank AG

Long-term IDR: upgraded to 'BBB+' from 'BBB'; Outlook Stable

Short-term IDR: affirmed at 'F2'

Viability Rating: upgraded to 'bbb+' from 'bbb'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'No Floor'

Commercial paper and certificates of deposits: affirmed at 'F2'

Senior unsecured debt: upgraded to 'BBB+' from 'BBB'

Market-linked securities: upgraded to 'BBB+emr' from 'BBBemr'

Subordinated debt (Lower Tier 2): upgraded to 'BBB' from 'BBB-'

Subordinated debt (Dresdner Funding Trust IV (XS0126779791, 26157HAA6)): upgraded to 'BBB' from 'BBB-'

Commerzbank U.S. Finance, Inc.'s Short-term rating: affirmed at 'F2'

Hybrid capital instruments issued by Commerzbank:

Dresdner Funding Trust I's dated silent participation certificates (XS0097772965, 26156FAA1): upgraded to 'BB+' from 'BB'

UT2 Funding plc upper Tier 2 securities (DE000A0GVS76): upgraded to 'BB' from 'BB-'

HT1 Funding GmbH Tier 1 Securities (DE000A0KAAA7): upgraded to 'BB' from 'BB-

mBank

Long-term foreign currency IDR: upgraded to 'BBB' from 'BBB-'; Outlook Stable

Short-term foreign currency IDR: upgraded to 'F2' from 'F3'

Support Rating: affirmed at '2'

Long-term senior unsecured debt rating: upgraded to 'BBB' from 'BBB-'

Short-term senior unsecured debt rating: upgraded to 'F2' from 'F3'

Viability Rating: unaffected at 'bbb-'

mFinance France

Long-term senior unsecured debt rating: upgraded to 'BBB' from 'BBB-'

mBank Hipoteczny

Long-term foreign currency IDR: upgraded to 'BBB' from 'BBB-'; Outlook Stable

Short-term foreign currency IDR: upgraded to 'F2' from 'F3'

Support Rating: affirmed at '2'

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Applicable Criteria

Global Bank Rating Criteria (pub. 20 Mar 2015)

([https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiJlE0NjE3OTkzNzYsInNlc3Npb25LZXkiOiJHV0pFRU5LNUZBTUpaV1FIRlpZTVZUR0IHSTFDM0xBWkFaMUZSQ05Bln0.THJE3AUuGTsHj2I1u84fgj_vKJUKb0XrTBr8Ar7PePI)

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