MOODY'S

# Rating_Action: Moody's upgrades Hamburg Commercial Bank AG's senior unsecured debt and deposit ratings to A3; outlook stable

17Feb2023

Frankfurt am Main, February 17, 2023 -- Moody's Investors Service (Moody's) has today upgraded Hamburg Commercial Bank AG (HCOB)'s long-term senior unsecured debt, issuer and deposit ratings to A3 from Baa1. The outlook on these ratings has been changed to stable from positive. At the same time, the rating agency upgraded HCOB's Baseline Credit Assessment (BCA) and Adjusted BCA to baa3 from ba1. Concurrently, the rating agency affirmed the bank's Baa2 junior senior unsecured debt ratings, and its P-2 short-term deposit, issuer and commercial paper ratings.

Ratings of liabilities issued by HCOB's predecessor banks under a public law guarantee were unaffected by today's rating action.

A full list of affected ratings and rating inputs can be found at the end of this press release .

RATINGS RATIONALE

-- UPGRADE OF HCOB'S BASELINE CREDIT ASSESSMENT

The upgrade of HCOB's BCA to baa3 from ba1 reflects the bank's sustainably strengthened solvency profile, including a resilient asset quality during the pandemic, paired with the achieved improvement in profitability driven by higher revenues and strict cost discipline, while its strong capital levels provide a substantial cushion against potential losses from its still largely asset-based finance risk exposures. The rating agency's assessment of the achieved resilience in the bank's combined solvency is an important consideration in the context of its quasi- monoline business model and represents a fundamental precondition for the upgrade of HCOB's intrinsic, fundamental credit profile to investment grade.

The upgrade furthermore incorporates the bank's stable funding and solid liquidity profile, which has remained largely unchanged since the bank's privatization in 2018.

HCOB's reduced operating and funding costs combined with rising net interest income have improved its capacity to absorb potential loan losses from its still asset-based focused lending activities, without negatively impacting its capitalisation. HCOB's focused underwriting of higher-yielding, higher risk-weighted lending activities has started to translate into rising margins and supports the plausibility of the bank's ambitious profitability targets.

Moody's expects the bank's capitalisation to remain strong but to consolidate from its current level of a 20% Common Equity Tier 1 (CET1) ratio as of year-end 2022, towards the bank's announced CET1 target ratio of 17%, with payouts of profits to rise from full earnings retentions in most years prior to 2022.

HCOB's asset risk profile continues to be marked by the bank's focus on higher risk loans, predominantly asset-based lending activities, in particular commercial real estate (CRE) and shipping finance, though the bank has increased and diversified into corporate lending activities.

The rating agency considers particularly CRE and shipping to be generally more exposed to cyclical risks. Consequently, HCOB's nonperforming loan ratio, which has stabilized around 2%-3% in recent years, can be vulnerable to increases from concentrated exposure risks in these areas. Moody's continues to view concentration risk as a key vulnerability for HCOB and thus the very high focus on asset-based finance is a key constraint for HCOB's BCA. Moody's reflects this in a negative qualitative adjustment due to HCOB's quasi-monoline business model.

-- UPGRADE OF HCOB'S LONG-TERM DEPOSIT, SENIOR UNSECURED DEBT AND SUBORDINATED PROGRAMME RATINGS

The upgrade of HCOB's long-term deposit, senior unsecured debt, issuer and subordinated programme ratings reflects the upgrade of its BCA and Adjusted BCA, unchanged results from Moody's Advanced Loss Given Failure (LGF) analysis and unchanged results from the rating agency's assumption for government support.

In its LGF analysis, Moody's has considered the bank's current organic asset growth and funding plan. Because of strong protection from more junior instruments outstanding, including the planned replacement of targeted long-term refinancing operations (TLTRO) funding with senior unsecured debt, the rating agency's Advanced LGF analysis continues to result in three notches of uplift for deposits and senior unsecured debt for HCOB, based on an extremely low loss given failure.

For HCOB's liabilities that were to be drawn under the subordinated debt programme, Moody's Advanced LGF analysis indicates an unchanged high loss given failure, because of the limited loss protection from more junior capital instruments and the volume of outstanding subordinated debt, which results a rating of (P)Ba1, one notch below the bank's (Adjusted) BCA.

Because Moody's considers HCOB to be an institution with limited systemic relevance, the rating agency assumes a low probability of government support, resulting in no uplift to the bank's ratings.

-- AFFIRMATION OF HCOB'S JUNIOR SENIOR UNSECURED DEBT RATINGS

The affirmation of HCOB's junior senior unsecured debt ratings reflects the upgrade of its BCA and Adjusted BCA, as well as a lower uplift from Moody's Advanced LGF analysis for this liability class, because of a decline in outstanding volume, resulting from the bank's strategy to predominantly issue senior unsecured debt and covered bonds. The rating agency's forward-looking Advanced LGF analysis now results in one notch of rating uplift for junior senior unsecured debt instruments, down from two notches previously.

-- OUTLOOK CHANGED TO STABLE

The stable outlook on the long-term deposit, issuer and senior unsecured debt ratings reflects Moody's expectation that HCOB will be able to protect its achieved solvency, in particular that neither its capitalization nor its profitability will drop below the rating agency's expectation. Furthermore, the stable outlook reflects the assumption that the outstanding volumes of junior senior unsecured and subordinated debt instruments do not significantly drop below indicated levels in relation to the bank's balance sheet.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

HCOB's rating could be upgraded in case of an upgrade of its BCA, which could result from a significant risk and earnings diversification from its current asset-based finance business model.

The bank's junior senior unsecured debt and subordinated debt ratings could be upgraded in case of significant additional volumes of capital instruments (Tier 2 and Additional Tier 1) being issued.

HCOB's ratings could be downgraded if the bank's BCA is downgraded or if its liability structure leads to a less favourable outcome under Moody's Advanced LGF analysis, which could for example result from a significant reduction in the volume of debt instruments subordinated to senior unsecured liabilities.

A downgrade of HCOB's BCA could result from a weakening of the bank's combined solvency profile, in particular if this were to be caused by a meaningful reduction in the bank's achieved profitability or a less conservative capital management, beyond the bank's current targets.

LIST OF AFFECTED RATINGS

Issuer: Hamburg Commercial Bank AG

..Upgrades:

....LT Counterparty Risk Rating (Foreign Currency) , Upgraded to A3 from Baa1

....LT Counterparty Risk Rating (Local Currency) , Upgraded to A3 from Baa1

....LT Bank Deposits (Foreign Currency) , Upgraded to A3 STA from Baa1 POS

....LT Bank Deposits (Local Currency) , Upgraded to A3 STA from Baa1 POS

....LT Counterparty Risk Assessment , Upgraded to A3(cr) from Baa1(cr)

....LT Issuer Rating (Foreign Currency) , Upgraded to A3 STA from Baa1 POS

....LT Issuer Rating (Local Currency) , Upgraded to A3 STA from Baa1 POS

....Baseline Credit Assessment , Upgraded to baa3 from ba1

....Adjusted Baseline Credit Assessment , Upgraded to baa3 from ba1

....Senior Unsecured Regular Bond/Debenture (Local Currency) , Upgraded to A3 STA from Baa1 POS

....Senior Unsecured Medium-Term Note Program (Local Currency) , Upgraded to (P)A3 from (P)Baa1

....Subordinate Medium-Term Note Program (Local Currency) , Upgraded to (P)Ba1 from (P)Ba2

..Outlook Actions:

....Outlook, Changed To Stable From Positive

..Affirmations:

....ST Counterparty Risk Rating (Foreign Currency) , Affirmed P-2

....ST Counterparty Risk Rating (Local Currency) , Affirmed P-2

....ST Bank Deposits (Foreign Currency) , Affirmed P-2

....ST Bank Deposits (Local Currency) , Affirmed P-2

....ST Counterparty Risk Assessment , Affirmed P-2(cr)

....ST Issuer Rating (Foreign Currency) , Affirmed P-2

....ST Issuer Rating (Local Currency) , Affirmed P-2

....Junior Senior Unsecured Regular Bond/Debenture (Local Currency) , Affirmed Baa2

....Junior Senior Unsecured Medium-Term Note Program (Local Currency) , Affirmed (P)Baa2

....Commercial Paper (Local Currency) , Affirmed P-2

....Other Short Term (Local Currency) , Affirmed (P)P-2

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at https://ratings.moodys.com/api/rmc-documents/71997. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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