MOODY'S

Rating_Action: Moody's upgrades Covered Bonds issued by Hamburg Commercial Bank AG

17Feb2023

Frankfurt am Main, February 17, 2023 -- Moody's Investors Service ("Moody's") has taken today the following rating actions:

- Covered bonds issued by Hamburg Commercial Bank AG under its Hamburg Commercial Bank AG - Mortgage Covered Bonds: Upgraded to Aaa from Aa1;

- Covered bonds issued by Hamburg Commercial Bank AG under its Hamburg Commercial Bank AG - Ship Covered Bonds: Upgraded to Aa3 from A1.

RATINGS RATIONALE

Today's rating action follows Moody's upgrade of Hamburg Commercial Bank AG's (HCOB / the issuer) (deposits A3; adjusted baseline credit assessment baa3; counterparty risk (CR) assessment A3(cr)) CR assessment to A3(cr) from Baa1(cr) on 17 February 2023.

As a result, the covered bond (CB) anchors for HCOB's mortgage and ship covered bonds are now one notch higher.

For HCOB's mortgage covered bonds, the over-collateralisation (OC) in the programme is consistent with a covered bond rating of Aaa, which is equal to the local currency country ceiling, the highest rating achievable in Germany.

For HCOB's ship covered bonds, the OC in the programme is consistent with a covered bond rating of Aa3.

For further details on the rating actions on Hamburg Commercial Bank AG, please refer to Moody's press release: https://ratings.moodys.com/ratings-news/399052

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (such cessation, a CB anchor event); and (2) the estimated losses that will accrue to covered bondholders should a CB anchor event occur. We express the probability of a CB anchor event as a point on our alpha-numeric rating scale (i.e. the CB anchor), which is typically one notch higher than the issuer's CR assessment.

The CB anchor for HCOB's mortgage and ship covered bonds is A2, being the CR assessments of Hamburg Commercial Bank AG plus one notch.

The cover pool losses of HCOB's mortgage covered bonds are 19.7%, with market risk of 6.3% and collateral risk of 13.4%. The collateral score for this programme is currently 20%. The present value over-collateralisation in this cover pool is 21.0%, of which the issuer provides 2% on a "committed" basis. Besides 2% committed OC on a present value basis, in accordance with the German Pfandbrief Act, the issuer is also required to hold an additional 2% of OC calculated on a nominal basis. Under Moody's COBOL model, the minimum OC consistent with the Aaa rating is 15.5%. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

The cover pool losses of HCOB's ship covered bonds are 54.7%, with market risk of 11.1% and collateral risk of 43.6%. The collateral score for this programme is currently 65%. For further details on the collateral score, refer to Moody's press release dated 22 June 2022: https://ratings.moodys.com/ratings-news/389797. The present value over-collateralisation in this cover pool is 19.4%, of which the issuer provides 2% on a "committed" basis. Besides 2% committed OC on a present value basis, in accordance with the German Pfandbrief Act, the issuer is also required to hold an additional 5% OC calculated on nominal basis. Under Moody's COBOL model, the minimum OC consistent with the Aa3 rating is 9.5%. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

The cover pool losses are an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk and collateral risk. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk is derived from the collateral score, which measures losses resulting directly from the cover pool assets' credit quality.

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's please refer to "Covered Bonds Sector Update", published quarterly.

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which is our assessment of the likelihood of timely payment of interest and principal to covered bondholders following a CB anchor event. TPIs are assessed as Very High, High, Probable-High, Probable, Improbable or Very Improbable. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

For HCOB's mortgage covered bonds, Moody's has assigned a TPI of High.

For HCOB's ship covered bonds, Moody's has assigned a TPI of Improbable.

RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in November 2022 and available at https://ratings.moodys.com/api/rmc-documents/396015. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

FACTORS THAT WOULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "High", the TPI Leeway for HCOB's mortgage covered bonds is two notches. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by two notches all other variables being equal.

Based on the current TPI of "Improbable", the TPI Leeway for HCOB's ship covered bonds is two notches. Additionally, because of the high volatility associated with shipping loans, Moody's restricts the rating of the covered bonds at two notches above the CB anchor. This implies that Moody's might downgrade the HCOB's ship covered bonds if it lowers the CB anchor by one notch, even if (i) the modelled expected loss remains consistent with the current rating and (ii) the TPI cap remains at or above the current rating.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB anchor and the TPI; (2) a multiple-notch downgrade of the CB anchor; or (3) a material reduction of the value of the cover pool.

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.

Moody's did not use any stress scenario simulations in its analysis.

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