

Rating Action: Moody's upgrades HSH Nordbank AG's debt and deposit ratings to Baa2 from Baa3 following ownership change

28 Nov 2018

HSH's Baseline Credit Assessment (BCA) upgraded to ba2 from b3

Frankfurt am Main, November 28, 2018 -- Moody's Investors Service today upgraded the long-term deposit, senior unsecured debt and issuer ratings of HSH Nordbank AG (HSH) to Baa2 from Baa3; the outlook on these ratings has been changed to Stable from Ratings under Review. At the same time, Moody's upgraded HSH's Baseline Credit Assessment (BCA) and Adjusted BCA to ba2 from b3 and b1, respectively. Furthermore, the rating agency upgraded HSH's short-term issuer and deposit ratings to P-2 from P-3, its subordinate program rating to (P)Ba3 from (P)B2, its Counterparty Risk Ratings to Baa2/P-2 from Baa3/P-3, and its Counterparty Risk Assessments (CR Assessments) to Baa2(cr)/P-2(cr) from Baa3(cr)/P-3(cr).

The rating action was triggered by the announcement made by the bank of the successful closing of the sale of HSH to a group of private investors as initially agreed on 28 February 2018 with the prior owners, the City State of Hamburg and the Land of Schleswig-Holstein.

Today's rating actions conclude the rating review for upgrade initiated on 28 February 2018.

For a list of all affected ratings, please refer to the end of this press release.

RATINGS RATIONALE

UPGRADE OF HSH'S BCA AND ADJUSTED BCA REFLECT SIGNIFICANT RELIEF FROM LEGACY ISSUES

Moody's considers HSH's standalone credit profile to have significantly improved as a result of a balance sheet clean-up that accompanied the ownership change as expressed by the upgrade of its BCA to ba2 from b3. The rating agency considers the bank to now be significantly de-risked and simplified, with asset quality metrics developing more in line with its peers and improved cost structures. In particular, the carve-out of non-performing assets has, in conjunction with the sustainably improved capitalisation of the bank, resulted in an improved overall solvency profile. Key medium-term challenges include achieving adequately diversified funding sources and extending the maturity profile of its liabilities.

As part of the sale to a group of private investors, the bank will carve out an asset portfolio. This portfolio consists of the bulk of the bank's remaining non-performing legacy assets as well as a portion of its performing shipping loans. In parallel, HSH fully settled and terminated a €10 billion asset guarantee scheme that had been granted by the bank's prior owners to absorb losses on HSH's underperforming assets. However, the guarantee had also rendered the bank's asset, liability and capital structure more complex and opaque than that of its banking peers. Following the closure of the sale, the bank will be re-named to "Hamburg Commercial Bank".

Because HSH is now owned by private investors, the bank will need to leave the public-sector Sparkassen-Finanzgruppe (S-Finanzgruppe, corporate family rating Aa2 stable, BCA a2) and its institutional protection scheme after a three-year transition period. Thereafter, HSH will become a full member of the voluntary deposit guarantee fund for Germany's private banks, subject to a positive assessment of its financial strength at that point by the Bundesverband deutscher Banken (BdB). This fund protects the claims of retail and small- and medium size enterprise investors that exceed the coverage of the statutory deposit guarantee scheme and to a lesser extent also covers deposits of select institutional investors. HSH's new owners have committed to additional capital strengthening measures for HSH in case the BdB would otherwise reject HSH's full-membership application in three years.

The material improvement in the bank's standalone creditworthiness outweighs the removal of affiliate support uplift that the rating agency previously incorporated into HSH's Adjusted BCA.

UPGRADE OF HSH'S LONG-TERM DEPOSIT AND SENIOR UNSECURED RATINGS REFLECT

IMPROVING STANDALONE CREDIT PROFILE AND UNCHANGED BENEFICIAL LIABILITY STRUCTURE

Because HSH will leave S-Finanzgruppe and its sector support scheme following a three-year transition period, Moody's today removed the one notch of rating uplift that the rating agency so far incorporated into HSH's ratings due to the moderate possibility of government support becoming available in case of need. This previous uplift was directly related to Moody's assessment of the domestic systemic importance of the public sector S-Finanzgruppe in Germany's financial sector and therefore benefits all direct members of S-Finanzgruppe rated by Moody's. Under the new private sector ownership, the rating agency attributes only low systemic support assumptions to HSH, resulting in no ratings uplift.

Notwithstanding, today's BCA and Adjusted BCA upgrades, in conjunction with unchanged loss-given-failure results under Moody's Advanced Loss Given Failure (LGF) analysis, led to one notch upgrades for the bank's deposit and senior unsecured debt ratings. This also led to upgrades of all of the bank's short-term programme, issuer and deposit ratings.

CONFIRMATION OF HSH'S LONG-TERM JUNIOR SENIOR UNSECURED DEBT RATINGS AND AFFIRMATION OF HSH'S HYBRID DEBT INSTRUMENTS

HSH announced on 6 November that it evaluates measures to optimise its liability and capital structure, which may result in a call or a repurchase offer for its outstanding Basel III non-compliant Additional Tier 1 instruments, which include those issued through the C(hyb)-rated issuance vehicles RESPARCS Funding Limited Partnership I, RESPARCS Funding II Limited Partnership, HSH N Funding I and HSH N Funding II. Following this announcement, Moody's now believes that the bank's junior senior unsecured creditors will no longer benefit from an extremely low loss-given-failure, as remains the case for HSH's deposits and senior unsecured debt. This higher assumed loss severity results in a reduction of the rating uplift for junior senior unsecured debt and program ratings of HSH to two notches from previously three.

The reduced structural support considerations, which include the elimination of the remaining notch of government support and of previously two notches of affiliate support, fully offset the four notches BCA improvement for the junior senior unsecured debt class.

Moody's C(hyb) ratings assigned to HSH's non-cumulative preferred shares issued out of HSH's issuance vehicles reflect the rating agency's expectation that the present value of principal and coupon losses will exceed 65% when investors receive final repayment of instrument book values upon a call of these. Moody's high loss expectation for the hybrid instruments incorporates the high likelihood of HSH calling its silent participations with a two-year notice period, in conjunction with the bank's announcement that it expects to allocate additional significant losses, including losses carried forward from 2017.

WHAT COULD CHANGE THE RATING - UP / DOWN

Higher long-term ratings could be prompted by a BCA upgrade. HSH's senior unsecured debt and deposit ratings already benefit from the highest possible uplift under Moody's Advanced LGF analysis, so that increases in the volume of subordinated instruments in the liability structure could only result in an upgrade of junior senior unsecured or lower-ranking liabilities.

An upgrade of HSH's BCA would be subject to (1) the establishment of a track record of sustainable profit generation without incurring significant new asset risks, (2) an economically successful optimization of its capital structure and improvement of its capitalization, (3) the bank's ability to maintain an ample cushion of liquid resources and/or (4) a successful diversification of the bank's funding profile if this results in a lower dependence on market funding.

A lower BCA or lower uplift from the rating agency's Advanced LGF analysis would result in a downgrade of HSH's long- and short-term ratings. In particular, the bank's junior senior debt and programme ratings could be downgraded if the volume of lower-ranking liabilities is not replenished within the context of the bank's planned liability and capital structure transformation.

A downgrade of HSH's BCA could result from a pronounced negative deviation of HSH's future financial performance from the solvency and liquidity metrics that Moody's currently anticipates. In particular, (1) underperformance within HSH's cyclical exposures to commercial real estate as well as in its remaining portfolio of performing shipping loans or (2) a failure of HSH to execute on its transition plan for its funding profile may result in a BCA downgrade.

LIST OF AFFECTED RATINGS

Issuer: HSH Nordbank AG

..Upgrades:

-Long-term Counterparty Risk Ratings (Local and Foreign Currency), upgraded to Baa2 from Baa3
-Short-term Counterparty Risk Ratings (Local and Foreign Currency), upgraded to P-2 from P-3
-Long-term Bank Deposits (Local and Foreign Currency), upgraded to Baa2 Stable from Baa3 Rating under Review
-Short-term Bank Deposits (Local and Foreign Currency), upgraded to P-2 from P-3
-Long-term Counterparty Risk Assessment, upgraded to Baa2(cr) from Baa3(cr)
-Short-term Counterparty Risk Assessment, upgraded to P-2(cr) from P-3(cr)
-Long-term Issuer Ratings (Local and Foreign Currency), upgraded to Baa2 Stable from Baa3 Rating under Review
-Short-term Issuer Ratings (Local and Foreign Currency), upgraded to P-2 from P-3
-Baseline Credit Assessment, upgraded to ba2 from b3
-Adjusted Baseline Credit Assessment, upgraded to ba2 from b1
-Senior Unsecured Regular Bond/Debenture (Local and Foreign Currency), upgraded to Baa2 Stable from Baa3 Rating under Review
-Senior Unsecured Medium-Term Note Program (Local Currency), upgraded to (P)Baa2 from (P)Baa3
-Subordinate Medium-Term Note Program (Local Currency), upgraded to (P)Ba3 from (P)B2
-Other Short Term (Local Currency), upgraded to (P)P-2 from (P)P-3

..Confirmations:

-Junior Senior Unsecured Regular Bond/Debenture (Local and Foreign Currency), confirmed at Baa3
-Junior Senior Unsecured Medium-Term Note Program (Local Currency), confirmed at (P)Baa3

..Outlook Action:

-Outlook changed to Stable from Rating under Review

Issuer: HSH N Funding I

..Affirmation:

-Backed Preferred Stock Non-cumulative (Foreign Currency), affirmed C(hyb)

..No Outlook assigned

Issuer: HSH N Funding II

..Affirmation:

-Junior Subordinated Regular Bond/Debenture (Foreign Currency), affirmed C(hyb)

..No Outlook assigned

Issuer: HSH Nordbank, Luxembourg Branch

..Upgrades:

-Long-term Counterparty Risk Ratings (Local and Foreign Currency), upgraded to Baa2 from Baa3

...Short-term Counterparty Risk Ratings (Local and Foreign Currency), upgraded to P-2 from P-3

...Long-term Counterparty Risk Assessment, upgraded to Baa2(cr) from Baa3(cr)

...Short-term Counterparty Risk Assessment, upgraded to P-2(cr) from P-3(cr)

...Commercial Paper (Foreign Currency), upgraded to P-2 from P-3

..Outlook Action:

...Outlook changed to Stable from Rating under Review

Issuer: RESPARCS Funding II Limited Partnership

..Affirmation:

...Backed Preferred Stock Non-cumulative (Foreign Currency), affirmed C(hyb)

..No Outlook assigned

Issuer: RESPARCS Funding Limited Partnership I

..Affirmation:

...Backed Preferred Stock Non-cumulative (Foreign Currency), affirmed C(hyb)

..No Outlook assigned

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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