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Ratings

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Research Update:

Commerzbank AG Ratings Raised To 'A/A-1' On Strengthened Performance And Capitalization; Outlook Stable

August 7, 2024

*(**Editor's Note:** On Aug. 12, 2024, we republished this research update, originally published on Aug. 7, 2024, to correct the support section of the Ratings Score Snapshot. It now correctly states that ALAC support carries a two-notch uplift.)*

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Overview

- Commerzbank AG is delivering stronger and more consistent risk-adjusted profitability based on its enhanced solid domestic market position and diversification.
- We forecast Commerzbank to maintain sustainably higher capitalization even as it increases shareholder distributions.
- We therefore raised our long- and short-term issuer credit ratings on Commerzbank AG to 'A/A-1' from 'A-/A-2', and our long-term resolution counterparty rating to 'A+' from 'A'.
- Additionally, we raised our issue ratings on Commerzbank's senior unsecured (senior preferred), senior nonpreferred, tier 2, and additional tier 1 debt instruments by one notch.
- The stable outlook reflects our expectation that Commerzbank demonstrates sound financial and capital performance in the next two years.

Rating Action

On Aug. 7, 2024, S&P Global Ratings raised its long- and short-term issuer credit ratings on Commerzbank AG to 'A/A-1' from 'A-/A-2'. The outlook is stable. We also raised our long-term resolution counterparty ratings on Commerzbank to 'A+' from 'A' and affirmed the 'A-1' short-term resolution counterparty ratings.

At the same time, we raised our issue ratings on Commerzbank's senior unsecured (senior preferred), senior nonpreferred, tier 2, and additional tier 1 debt instruments by one notch.

Rationale

The rating action reflects the strengthening of Commerzbank's business model and financial performance. On Aug. 7, 2024, Commerzbank reported a sound 8.9% return on tangible equity for half year 2024, consistent with its steadily improving performance over the past three years. We anticipate that Commerzbank will execute its strategy and demonstrate improved risk-adjusted profitability based on its enhanced solid domestic market position and diversification. The bank has delivered on most of its 2024 targets one year ahead of plan, finalizing its multiyear transformation and realignment of its business model. The transformation success is rooted in Commerzbank management's consistent execution of business realignments in recent years with deep cost and efficiency measures. Higher interest rates in the eurozone and in Poland also strongly support the transformation.

Commerzbank's management will maintain sustainably higher capitalization while prudently balancing stronger earnings power with its high capital return policies. We anticipate that Commerzbank will soundly manage sustainable higher capitalization, which we now consider a rating strength. We project that Commerzbank will maintain its risk-adjusted capital (RAC) ratio consistently above 10.0% in the medium term, and we forecast 10.0%-10.5% as of end-2026 down from 11.6% as of Dec. 31, 2023, as shareholder distributions offset stronger earnings. Commerzbank's capital return policy until 2027 guides for a capital return of 70% or more of net income (after deducting additional tier 1 coupons), but not more than the net result between 2025 and 2027. Our forecast also assumes a return to a more significant business growth. We also think that the bank's regulatory buffers remain solid given that its common equity tier 1 ratio was at 14.8% on June 30, 2024, which was 450 basis points above the 2024 maximum distributable amount and the bank's 13.5% medium-term target.

Solid going- and gone-concern capital, liquidity buffers, and good asset quality supporting the ratings underpins our assessment.

mBank is taking significant steps to derisk its exposure to Swiss franc-indexed mortgages. We expect the majority-owned Polish subsidiary mBank to incur significant costs from its exposure to legacy foreign currency-denominated mortgage loans because the associated litigation risk remains high. We view this primarily as a risk to mBank's earnings, rather than capital, since mBank delivers strong operational performance absent any exceptional costs. Following a series of negative rulings by local and European courts, mBank has set aside provisions for legal costs totaling Polish zloty 13.8 billion (about €3.2 billion) between 2018 and end-June 2024. In our base-case scenario, we expect high provisions in 2024 supported by waning high interest rates, and mBank should deliver strong underlying profits.

Our negative comparable rating analysis adjustment in the rating reflects Commerzbank's need to further narrow the gap to higher rated peers. The adjustment is informed by peer analysis and captures attributes not fully captured in our other rating factors. Specifically, we think the improvements outlined above in Commerzbank's business position, and capital and earnings position warrant a higher assessment for those individual factors but cumulatively merit a slightly weaker rating outcome. We consider that Commerzbank management's "Strategy 2027" targets, including a 11.5% return on tangible equity by 2027 (up from 7.7% as of end-2023) appear in line with peers and achievable from Commerzbank's business profile improvements in recent years. However, achieving these goals remains somewhat sensitive to market conditions beyond management's control (notably falling interest rates), and from the development of legal risk at mBank.

Outlook

The stable outlook reflects our expectation that Commerzbank demonstrates sound financial and capital performance in the next two years. We anticipate that Commerzbank will deliver toward its main strategic targets, maintain sound capital and liquidity, and further improve the bank's resilience to unexpected stress.

Downside scenario

We could lower the ratings if Commerzbank's sustainable risk-adjusted profitability weakens due to unexpected material asset quality problems from economic and geopolitical risks. We could also consider lowering the rating if Commerzbank's RAC ratio falls sustainably below 10% due to single event risks or a more aggressive capital return policy.

Upside scenario

A further upgrade is unlikely over the outlook horizon but could occur if Commerzbank strengthens its creditworthiness closer to peers with 'a-' group stand-alone credit profiles. We would look for evidence of franchise growth, stronger and more consistent performance, balanced divisional earnings contributions, and robust balance sheet metrics.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A/Stable/A-1	A-/Positive/A-2
SACP	bbb+	bbb
Anchor	bbb+	bbb+
Business position	Adequate (0)	Moderate (-1)
Capital and earnings	Strong (+1)	Adequate (0)
Risk position	Adequate (0)	Adequate (0)
Funding and liquidity	Adequate (0)	Adequate (0)
Comparable ratings analysis	-1	0
Support	+2	+2
ALAC support	+2	+2
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile. ALAC--Additional loss absorbing capacity. GRE--Government-related entity.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- mBank S.A., June 3, 2024
- German Banks In 2024: Rating Resilience Despite Economic Underperformance, Jan. 24, 2024
- Commerzbank AG, Dec. 18, 2023

Ratings List

Upgraded

	To	From
Commerzbank AG		
Senior Unsecured	A	A-
Senior Unsecured	Ap	A-p
Senior Subordinated	BBB	BBB-
Subordinated	BBB-	BB+
Junior Subordinated	BB	BB-
Commercial Paper	A-1	A-2
Commerzbank U.S. Finance Inc.		
Commercial Paper	A-1	A-2
Dresdner Funding Trust I		
Junior Subordinated	BB	BB-

Upgraded; CreditWatch/Outlook Action

	To	From
Commerzbank AG		
Issuer Credit Rating	A/Stable/A-1	A-/Positive/A-2

Upgraded; Ratings Affirmed

	To	From
Commerzbank AG		
Resolution Counterparty Rating	A+/--/A-1	A/--/A-1