S&P Global
Ratings

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Research Update:

Commerzbank AG Upgraded To 'A-/A-2' On Stronger Bail-In-Able Debt Buffer; Outlook Stable

March 23, 2023

Overview

- We expect Commerzbank's sizable and sustainable amounts of additional loss-absorbing capacity (ALAC) to provide further protection to senior creditors in a resolution scenario.
- We now expect net positive issuance volumes in bail-in-able instruments supporting the bank's ALAC buffer to stay above 6% and think that improved profitability prospects allow Commerzbank to absorb higher funding costs from these instruments.
- We therefore raised our long-term issuer credit rating on Commerzbank to 'A-' from 'BBB+' and affirmed our 'A-2' short-term rating. We also raised our resolution counterparty ratings to 'A/A-1' from 'A-/A-2'.
- Our stable outlook reflects our expectation that Commerzbank will reach its financial targets, keep its solid financial profile, and sustain an ALAC buffer above 6%.

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Rating Action

On March 23, 2023, S&P Global Ratings raised its long-term issuer credit rating on Commerzbank AG to 'A-' from 'BBB+'. We affirmed the short-term issuer credit rating at 'A-2'. The outlook is stable. We also raised our resolution counterparty ratings to 'A/A-1' from 'A-/A-2'.

We raised our issue ratings on the long-term senior unsecured instrument to 'A-' and affirmed all other instruments including senior subordinated, and other hybrid issue ratings.

Rationale

Commerzbank's substantial and sustainable buffer of bail-in-able debt instruments provides additional protection to senior preferred creditors. The raising of the long-term issuer credit ratings to 'A-' follows our revised forecast that Commerzbank will now likely sustainably exceed our 6% threshold required for a two-notch rating uplift for ALAC support. We expect the existence of these buffers to protect senior creditors in the event of a resolution. Despite difficult capital market conditions in 2022 and ample buffers against its subordinated minimum requirement for own funds and eligible liabilities (MREL), Commerzbank increased its issuance volume of senior nonpreferred and Tier 2 instruments to about €2.3 billion compared with €0.6 billion in 2021. Based on full-year 2022 data, our ALAC ratio was 6.5% and we now forecast a positive net issuance for bail-in-able instruments throughout 2025 supporting the ALAC ratio close to current levels. In 2023, the bank has already issued further €1 billion of senior nonpreferred instruments, supporting our forecast. We think the bank's progress in its transformation and improved profitability prospects bring it into a solid position to bear higher refinancing costs from additional bail-in-able instruments compared with a year ago.

Our ratings reflect our expectation that Commerzbank will reach its 2024 financial targets. We think Commerzbank is on track in its multiyear transformation since it exceeded its interim financial targets, thanks largely to interest rate hikes in the eurozone and Poland. However, meeting its 2024 financial targets of return on tangible equity of over 7.3% and a 60% cost-efficiency ratio would still mean the bank's profitability remains below its cost of capital, which has risen lately with interest rate hikes. Therefore, in our base case we expect profitability will remain a rating-constraining factor as the bank continues to meet its current financial targets. However, we might consider an upward revision to the 'bbb' stand-alone credit profile (SACP) if the bank continued to deliver on its strategy and we expected it to build a track record of stronger earnings that came closer to its cost of capital.

Increasing interest income is the most important lever for improving profitability. Rising contributions are required to more than compensate for the increase in costs due to high inflation, stagnating fee income, and credit losses close to 2022 levels amid economic and geopolitical risks, particularly for its corporate portfolio. A significant risk to earnings comes from further significant special charges that are still expected at mBank, mainly costs from legal risk related to its legacy Swiss franc retail mortgage portfolio and from government support programs in Poland. In 2022, strong operational performance at mBank largely offset extraordinary costs of €928 million. We see additional uncertainty to improving profitability from higher deposit costs since there is already some evidence of stronger price competition in Germany. Additionally, interest rate margins in Poland could fall again from 2024, resulting in further earnings pressure.

We think Commerzbank is set to distribute meaningful amounts of capital, reducing its risk-adjusted capital buffers over time. Transformation risk has reduced and we think the bank's capital pay-outs will increase materially as it continues to improve its profitability. We also see sufficient buffers, given a common equity Tier 1 (CET1) ratio of 14.1% on Dec. 31, 2022, which is a 400-basis-point (bps) buffer against the 2023 maximum distributable amount threshold. In line with management's guidance, we expect the pay-out ratio to increase to 50% in 2023 and consider additional sizable capital returns through additional dividends or share buybacks as increasingly likely. Based on this and our expectation that Commerzbank will return to more significant net loan growth from 2024, we forecast our risk-adjusted capital (RAC) ratio (our main measure of a bank's capital adequacy) will decrease to close to 10% by year-end 2025, compared with 10.9% at year-end 2022, taking into account the negative 40-bps impact from our economic risk assessment revision for Germany in February (see "Bulletin: Robust German Banking Industry Weathers Increased Geopolitical Economic Risk," published Feb. 16, 2023). The current RAC level is not sustainable, in our view, and the latest increase was mainly due to improved net income but still low pay-outs, temporary effects from business exits as portfolio optimization continued, and reduction in regulatory charges related to more cyclical market risks.

Outlook

The stable outlook reflects our view that Commerzbank's transformation will succeed and that it will achieve its financial targets. We anticipate a steady improvement in structural profitability and efficiency over the coming 12-24 months and continued sound capital levels.

Downside scenario

We see the most likely downgrade scenario for Commerzbank as one in which our economic forecasts weaken materially, implying depressed fee income and far weaker asset quality, including higher risk provisioning needs than expected.

We could also lower the issuer credit rating on Commerzbank and our issue ratings on its senior preferred instruments if we believed that the bank would not sustain an ALAC buffer that comfortably exceeds our 6% threshold for two notches of uplift.

Upside scenario

We could revise up the SACP and raise all the ratings over our two-year horizon if we see Commerzbank delivering improved profitability almost covering its cost of capital.

We may also raise the rating if we have certainty that, despite anticipated capital distributions, our RAC ratio would remain well above 10% on a sustainable basis, while the bank maintained strong asset quality.

Ratings Score Snapshot

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

SACP--Stand-alone credit profile.

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- 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

- Update: Commerzbank AG, Feb. 22, 2023
- German Banks In 2023: The Sector Is Well Placed To Handle Economic Challenges, Feb. 21, 2023
- Bulletin: Robust German Banking Industry Weathers Increased Geopolitical Economic Risk, Feb. 16, 2023

Ratings List

Ratings Affirmed	
Commerzbank AG	
Senior Subordinated	BBB-
Subordinated	BB+
Junior Subordinated	BB-
Commercial Paper	A-2
Commerzbank U.S. Finance Inc.	
Commercial Paper	A-2
Dresdner Funding Trust I	
Junior Subordinated	BB-

Upgraded

	To	From
Commerzbank AG		
Resolution Counterparty Rating	A/--/A-1	A-/--/A-2
Commerzbank AG		
Senior Unsecured	A-	BBB+
Senior Unsecured	A-p	BBB+p

Upgraded; Ratings Affirmed

	To	From
Commerzbank AG		
Issuer Credit Rating	A-/Stable/A-2	BBB+/Stable/A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914