Fitch Affirms Postbank at 'BBB+'; Outlook Stable; Assigns 'bbb+' VR

Fitch Ratings-Frankfurt/London-26 August 2016: Fitch Ratings has affirmed Deutsche Postbank's (PB) Long-Term Issuer Default Rating (IDR) at 'BBB+' with a Stable Outlook and assigned a Viability Rating (VR) of 'bbb+' to the bank.

PB's Support Rating (SR) of '2' remains on Rating Watch Negative (RWN). We expect to resolve the watch after the bank is divested by its parent, Deutsche Bank AG (DB, A-/Stable/a-), which is likely to take more than six months. A full list of rating actions is available at the end of this rating action commentary.

KEY RATING DRIVERS - VR, IDRS AND SENIOR DEBT
The newly assigned VR reflects the progress in preparing the separation of PB from its parent, which is now sufficiently advanced for Fitch to assess PB's standalone creditworthiness. This is evidenced by recent organisational, reporting and system enhancements at PB's level to ensure its full operational independence from DB upon its sale. Concurrently, DB withdrew its declaration of backing for PB at end-1H16. DB initiated the separation in 2Q15, when it announced its intention to sell PB.

PB's Long-Term IDR with a Stable Outlook and its senior debt ratings are now driven by the VR as we believe that despite the uncertain timing DB will most likely dispose of its subsidiary in the form of an IPO, as opposed to an institutional sale. A buyer with the ability and propensity to support PB at a higher level than 'BBB+' may trigger an upgrade of PB's IDRs and senior debt ratings. While this cannot be ruled out, we consider this significantly less likely than an IPO. Consequently, we have removed the IDRs and senior debt ratings from Rating Watch Evolving (RWE). Our rating assumption is for the strategy to remain broadly unchanged.

The VR reflects PB's adequate nationwide retail franchise as well as a stable and transparent business model, with a strong focus on domestic retail banking, particularly deposit-taking as well as residential mortgage and SME lending. It also reflects the bank's solid asset quality, modest profitability and efficiency, improving capitalisation and strong funding and liquidity.

The VR is primarily constrained by PB's moderate profitability, which has been weighed down by recurring negative contributions from the bank's non-core operating unit (NCOU), due to a large overhang of high-yielding and long-dated legacy liabilities. Additional costs have arisen in recent years from regulation and PB's integration into (and, since 2015, separation from) DB. Positive momentum is expected from the gradual reduction of the NCOU-liabilities and a moderate improvement of fee income as a result of a new pricing model for servicing current accounts.

Similar to most of its peers, the vulnerability of PB's performance to the prevailing low interest rates is compounded by a reluctance to pass on negative rates to retail depositors. In 2016, we expect this to contribute to a material decline of its performance. A prolonged period of low or negative interest rates will put earnings under increasing pressure as the bank continues to reprice its assets. On the other hand, an end to the prolonged low-rate environment may weaken PB's interest earnings as bank's liabilities are likely to reprice more rapidly than its generally long-term, fixed-rate loans. However, this could be partly offset by the margins on PB's sticky overnight deposits, as well as, to a lesser extent, on the savings and term deposits.

While the retail banking sector as a whole is suffering from low interest rates, we believe that PB has less scope to mitigate their impact than its larger competitors, which benefit from better pricing power, or smaller, leaner peers focusing on higher-yielding asset classes.

PB enjoys strong brand recognition as the largest centrally managed retail bank in Germany operating a dense nationwide branch network, including own branches and postal agencies. However, its market penetration and pricing power are moderate by international comparison. They also trail those of the much larger (albeit unconsolidated) savings and cooperative banking groups, which dominate the otherwise fragmented and highly competitive German banking sector.

PB's risk-adjusted capitalisation has improved materially in recent years and is now adequate in light of the bank's solid and granular loan book. The run-off of the NCOU's high-yielding liabilities should improve the bank's internal capital generation and drive further deleveraging, which we expect to result in a significant reduction of securities and interbank exposures. However, this process is gradual and will take several years to bring material capital benefit.

PB's solid asset quality reflects the bank's focus on German retail banking, especially residential mortgage lending, which has historically been robust and resilient. Its non-performing loans are low and loan concentration is moderate.

Its significantly reduced investment securities portfolio is now dominated by German and western European sovereign and bank bonds (mostly covered bonds), the vast majority of which are investment-grade. Its largest securities investments, notably its still large Italian sovereign exposure, are, however, fairly concentrated. Fitch understands from management that PB intends to reduce this exposure significantly in the next few years.

PB's strong funding and liquidity are underpinned by a stable and granular retail deposit base. Other funding sources (e.g. covered bonds) are well-diversified and mostly stable, with limited sensitivity to market sentiment. Its reliance on unsecured wholesale funding is moderate.

KEY RATING DRIVERS - SUPPORT RATING
The SR reflects our view that, in light of the severe reputational damage that a default of PB would represent for DB, the probability of support from DB will remain high as long as it is PB's majority owner.

The SR does not reflect the control and profit and loss transfer agreement in place between PB and DB via DB Finanz-Holding GmbH as we expect the agreement to be terminated upon PB's deconsolidation at the latest. We maintain the SR on RWN to reflect the expectation that the probability of external support being available to PB after its divestment by DB in the form of an IPO will be low.

KEY RATING DRIVERS - HYBRID SECURITIES
The legacy hybrid capital securities issued by Deutsche Postbank Funding Trust I-IV and subject to phasing-out under capital requirements regulation are notched twice for non-performance risk and twice for loss severity from DB's VR. This reflects our expectation that DB's support for PB would extend to its hybrid instruments until the deconsolidation is completed.

Absent a sale to a higher-rated bank that in our opinion would support PB's hybrid instruments, the hybrids will be notched down from PB's VR after the divestment by DB. In view of this we have revised the rating watch on the hybrid instruments to Negative from Evolving. We expect to resolve the watch after the divestment is finalised, which is likely to take more than six months.

KEY RATING DRIVERS - PB's LEGACY UNSECURED GUARANTEED DEBT RATINGS ISSUED BY DSL
The rating of the guaranteed debt originally issued by the former DSL (which was later merged with PB) reflects our view that Germany (AAA/Stable) has a strong incentive to ensure timely payments under its grandfathered deficiency guarantee for these notes. The notes are rated two notches below Germany's IDR as we believe that uncertainty around timeliness of payment is limited given Germany's high reputational risk if holders of these notes incur losses.

RATING SENSITIVITIES - VR, IDRS AND SENIOR DEBT
PB's IDRs and senior debt ratings are primarily sensitive to changes to the bank's VR. They could be upgraded in the event of the sale of PB to an entity that has the ability and propensity to support PB at a higher level than PB's VR. However, we do not consider this scenario to be particularly likely.

PB's IDRs and senior debt ratings could be downgraded in the event of a downgrade of PB's VR. However, should that occur while DB remains PB's majority shareholder, the extent of any IDR downgrade would be limited by Fitch's assessment of the likelihood of potential support from DB.

An upgrade of PB's VR would require significantly and sustainably improved profitability or capitalisation while maintaining resilient asset quality through the cycle. A downgrade could arise from an unexpected severe deterioration of Germany's operating environment including a recession, lower property prices and a sharp increase in unemployment, which would trigger high loan impairments.

Rising competitive pressure in German retail, corporate and CRE banking could also put pressure on the VR by delaying the improvement of PB's performance, as would a prolonged period of unfavourable interest rate development. The VR is also sensitive to a material shift in PB's strategic objectives, including those that might result from ownership change.

RATING SENSITIVITIES - SUPPORT RATING
The SR is sensitive to DB's progress in selling PB. In case of an IPO, we expect to resolve the RWN by downgrading the SR to '5' and assign a Rating Support Floor of 'No Floor'. In case of an institutional sale, the SR would depend on our assessment of the buyer's ability and propensity to provide support.

RATING SENSITIVITIES - PB's LEGACY UNSECURED GUARANTEED DEBT ISSUED BY DSL
The ratings of the legacy guaranteed debt are sensitive to a downgrade of Germany's rating or to a change in Fitch's assessment of the likelihood that Germany will honour the guarantee in a timely manner.

RATING SENSITIVITIES - HYBRID SECURITIES
The hybrid securities (Deutsche Postbank Funding Trust) are primarily sensitive to DB's VR as well as the progress in the process of PB's deconsolidation.

The rating actions are as follows:

Deutsche Postbank AG
Long-term IDR: affirmed at 'BBB+'; Outlook Stable
Short-term IDR: affirmed at 'F2'; off RWE
Support Rating: '2'; remain on RWN
Senior debt and debt issuance programme ratings: affirmed at 'BBB+'/'F2'; off RWE
Senior unsecured guaranteed bonds issued by former DSL Bank:: affirmed at 'AA'

Deutsche Postbank Funding Trust I-IV: 'BB+'; Rating Watch revised to Negative from Evolving

Contact:
Primary Analyst
Patrick Rioual
Director
+49 69 76 80 76 123
Fitch Deutschland GmbH
Neue Mainzer Strasse 46-50
60311 Frankfurt am Main

Secondary Analyst
Lola Yusupova
Associate Director
+49 69 768076 114

Committee Chairperson
Gordon Scott
Managing Director
+44 20 3530 1075

Media Relations: Christian Giesen, Frankfurt am Main, Tel: +49 69 768076 232, Email: christian.giesen@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Global Bank Rating Criteria (pub. 15 Jul 2016) (https://www.fitchratings.com/site/re/884135)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1010846)
Solicitation Status (https://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=1010846)
Endorsement Policy (https://www.fitchratings.com/jsp/creditdesk/PolicyRegulation.faces?context=2&detail=31)

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (https://www.fitchratings.com/regulatory) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.