MOODY'S INVESTORS SERVICE

CREDIT OPINION

30 July 2021

Update

Rate this Research

RATINGS

Aareal Bank AG

Domicile	Wiesbaden, Germany
Long Term CRR	A3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Withdrawn
Type	Senior Unsecured MTN - Fgn Curr
Outlook	Not Assigned
Long Term Deposit	A3
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Aareal Bank AG

Update to credit analysis

Summary

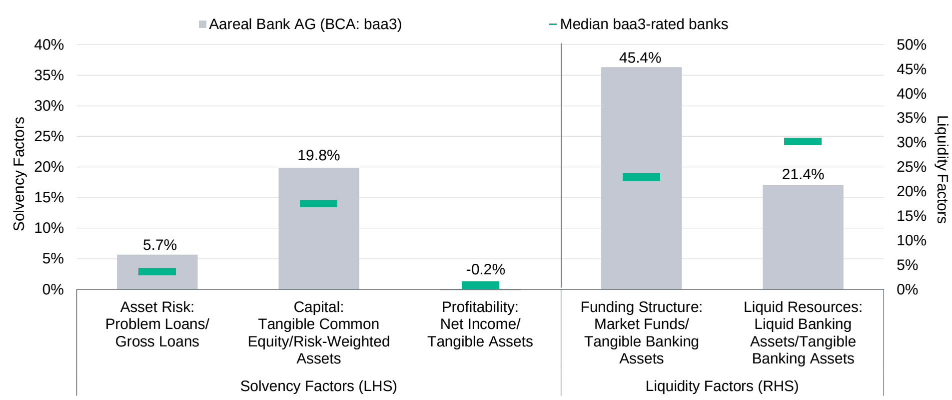
We assign A3(negative) deposit and issuer ratings to Aareal Bank AG (Aareal). We further assign A3/P-2 Counterparty Risk Ratings (CRRs), as well as a baa3 Baseline Credit Assessment (BCA) and Adjusted BCA to the bank.

Aareal's A3 deposit and issuer ratings reflect its baa3 BCA and Adjusted BCA; and the application of our Advanced Loss Given Failure (LGF) analysis to its liabilities, which results in an extremely low loss given failure and three notches of rating uplift. Aareal's ratings do not benefit from government support uplift because of its small size in the context of the German banking sector.

The assigned baa3 BCA reflects Aareal's resilient intrinsic financial strength, even in a difficult operating environment such as the one created by the coronavirus pandemic. The bank's strong capitalization largely mitigates its limited diversification benefits from other businesses and high asset risks, enabling the bank to cope with a deterioration in its asset quality. The BCA also reflects a sound track record of low through-the-cycle credit losses. Aareal's sound liquidity management and funding profile are additional risk mitigants.

Exhibit 1

Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics™

Credit strengths

» Strong and high-quality capitalisation

» Sound liquidity metrics and stable funding from the housing industry sector

» Earnings diversification from real estate software and services business

Credit challenges

» High and concentrated exposures to commercial real estate (CRE) lending, which could exert pressure on the bank's asset quality during a global property downturn

» Significant exposures to hotel and retail CRE portfolios that are severely affected by the pandemic-induced economic downturn

» Above-average nonperforming loans (NPLs)

» Limited diversification benefits from other businesses (monoliners)

Outlook

The negative outlook reflects the downward pressure on the bank's BCA from the deteriorating operating environment as a result of the pandemic.

Factors that could lead to an upgrade

» As indicated by the negative outlook, upward pressure on the ratings is currently unlikely.

» An upgrade of Aareal's ratings could follow an upgrade of its BCA, which would require a substantially more diversified business model, such that it eliminates the existing high concentration risks in its CRE lending.

Factors that could lead to a downgrade

» Aareal's ratings could be downgraded as result of a downgrade of its BCA or if its loss-absorbing liabilities decline significantly and beyond our expectations, thereby resulting in fewer notches of rating uplift from our LGF analysis.

» Downward pressure on Aareal's BCA could develop as a result of a significant deterioration in its asset quality, a significant and sustained drop in its profitability or an overall weakening of the bank's combined liquidity.

Key indicators

Exhibit 2

Aareal Bank AG (Consolidated Financials) [1]

	12-20[2]	12-19[2]	12-18[2]	12-17[2]	12-16[2]	CAGR/Avg.[3]
Total Assets (EUR Billion)	44.4	40.1	41.6	40.8	43.8	0.3[4]
Total Assets (USD Billion)	54.3	45.0	47.6	49.0	46.2	4.1[4]
Tangible Common Equity (EUR Billion)	2.4	2.7	2.7	2.8	2.7	(3.1)[4]
Tangible Common Equity (USD Billion)	2.9	3.0	3.1	3.3	2.9	0.6[4]
Problem Loans / Gross Loans (%)	5.7	3.6	5.8	4.6	4.8	4.9[5]
Tangible Common Equity / Risk Weighted Assets (%)	19.8	24.1	21.0	23.4	18.7	21.4[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	51.8	30.4	47.2	37.0	45.7	42.4[5]
Net Interest Margin (%)	1.2	1.3	1.3	1.4	1.5	1.4[5]
PPI / Average RWA (%)	2.2	2.8	3.0	3.1	2.9	2.8[6]
Net Income / Tangible Assets (%)	-0.2	0.4	0.4	0.5	0.5	0.3[5]
Cost / Income Ratio (%)	68.1	60.6	61.0	59.3	57.8	61.3[5]
Market Funds / Tangible Banking Assets (%)	45.4	40.8	37.9	37.1	39.1	40.0[5]
Liquid Banking Assets / Tangible Banking Assets (%)	21.4	15.7	16.2	20.2	18.5	18.4[5]
Gross Loans / Due to Customers (%)	198.9	208.3	187.7	188.2	227.8	202.2[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Further to the publication of our revised methodology in July 2021, for issuer that have "high-trigger" Additional Tier 1 instruments outstanding, not all ratios included in this report reflect the change in treatment of these instruments.

Profile

Aareal, headquartered in Wiesbaden, Germany, is a CRE lending specialist, active in Europe, North America and, to a limited degree, in Asia. The bank focuses on corporate real estate clients, with no direct retail business either in its lending or funding activities.

Additionally, the group offers consultancy, IT/digital services and transaction banking activities to clients in the housing and commercial property industries. As of year-end 2020, the group's reported total assets amounted to €44.4 billion and it employed around 2,982 people.

Recent developments

The pandemic is causing an unprecedented shock to the global economy. The full extent of the economic downswing will be unclear for some time; the level of uncertainty and strength of the economic recovery will vary across countries.

In Germany, strong government support has stabilised the economy and delayed a weakening of banks' loan book quality. The substantial support that the German government has provided to households and companies in response to the pandemic will allow the supply side of the economy to remain mostly intact and limit any lasting scars from the crisis. Private-sector spending will support the recovery, especially as households have accumulated substantial savings during the crisis. For Germany, we forecast that real GDP will rebound by 3.0% in 2021 after a contraction of 5.0% in 2020. The recovery will be uneven across industries and parts of the banks' corporate loan books will be exposed to high credit risk.

Weighted Macro Profile of Strong+

Because of Aareal's international CRE finance activities, the bank's assigned Strong+ Weighted Macro Profile is reflective of its worldwide activities, primarily focused on the United States of America (Aaa stable), which displays a Very Strong- Macro Profile, as well as other countries with a less benign operating environment, in particular the United Kingdom (Aa3 stable) and Italy (Baa3 stable).

Detailed credit considerations

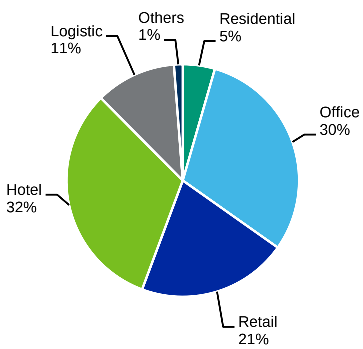
High and concentrated exposures to CRE lending may strain the bank's asset quality because of the pandemic, particularly with risks related to the tourism and nonfood retail sectors

We position Aareal's ba2 Asset Risk score three notches below our baa2 initial score, taking into account the bank's high sector, single-name and single-location concentrations. The bank's €27.2 billion CRE lending book is particularly exposed to high-risk subsectors, which are identified as the most affected by the economic contraction caused by the pandemic, with 32% of its loan book invested in hotel, 21% in retail and 30% in the office sector as of year-end 2020[1].

Exhibit 3

Aareal's CRE portfolio by subsegment

As of year-end 2020

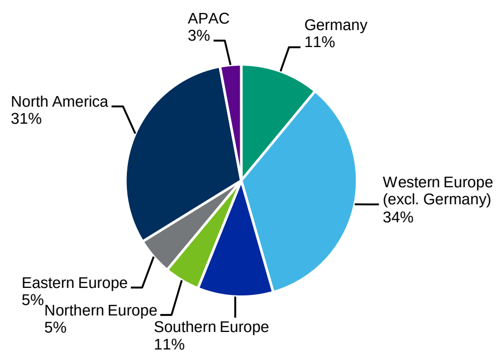


Sources: Company reports and Moody's Investors Service

Exhibit 4

Aareal's CRE portfolio by country

As of year-end 2020



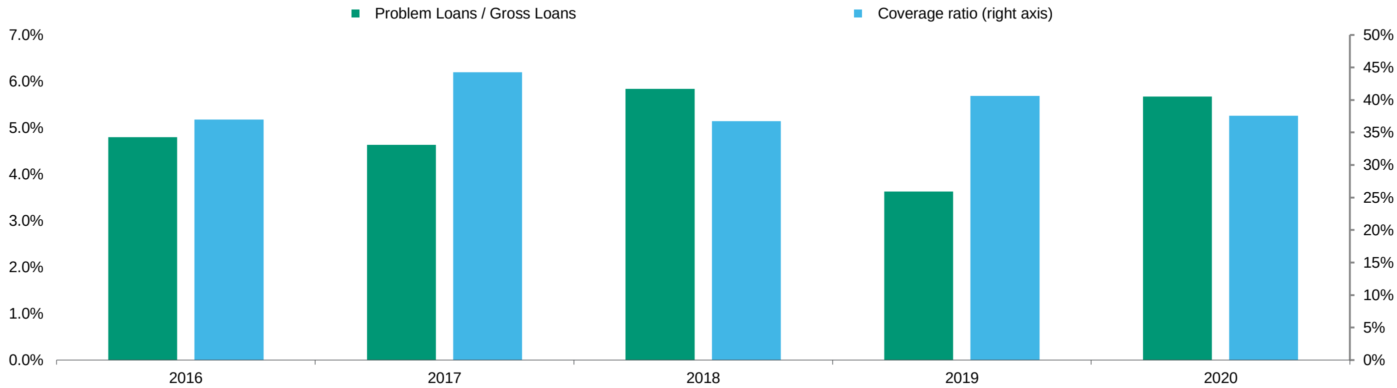
Sources: Company reports and Moody's Investors Service

Consequently, Aareal's sound history of relatively low credit losses will be challenged as nonperforming loans (NPL) are on the rise, despite the bank's efforts to work out the existing NPLs and its diversified portfolio. We currently see less value in regional diversification, as the pandemic has synchronised the decline in economic activity across the globe, producing a significant and simultaneous impact.

Aareal's average loan-to-value ratio of 60% as of year-end 2020 indicates a solid structure of the total CRE lending book and provides a buffer against potential property price decreases, which have started to materialise at least for retail properties. The pressure within the loan book is further reflected in a significant yield-on-debt[2] deterioration in the hotel portfolio, which fell to 3.0% as of year-end 2020 from 9.6% as of year-end 2019, reflecting the decline in income generation by the underlying assets.

The bank's problem loan ratio increased to 5.7% as of year-end 2020 from 3.6% as of year-end 2019 and is high compared with that of its closest domestic peers. Most of the bank's total problem loan exposures stem from its legacy exposures to Italy, followed by increasing NPLs in the UK, reflecting the impact of the pandemic, particularly on the retail sector. Aareal's initiated measures to effectively and significantly reduce the risks resulting from its legacy portfolios led to an improvement in NPLs in late 2019; however, the economic impact of the pandemic did outweigh those efforts.

Exhibit 5
Aareal's problem loan ratio is increasing again



Sources: Company reports and Moody's Investors Service

Strong and high-quality capitalisation is a key risk mitigant

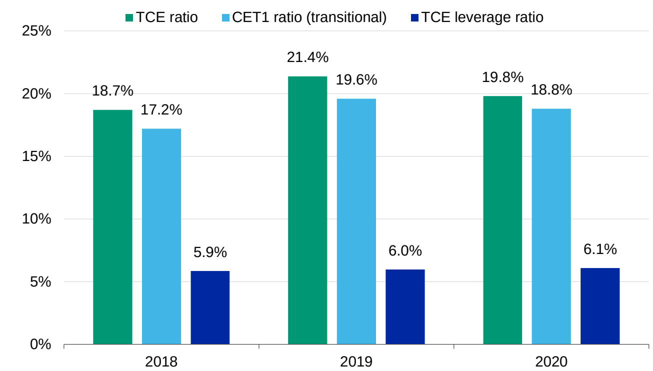
We assign a Capital score of a1 to Aareal, reflecting our expectation that the bank will maintain its strong capitalisation metrics, despite the expected strain from the impact of the pandemic and the upcoming revisions to the Basel framework for measuring credit risks (the so-called constrained internal ratings-based approach). We have captured the expected decline in the bank's capital ratio, in particular our tangible common equity (TCE) ratio, by positioning the bank's Capital score two notches below the aa2 initial score.

Aareal reported a strong TCE ratio of 19.8% and a fully loaded Tier 1 leverage ratio of 6.1% as of 31 December 2020, significantly higher than those of its closest peers. TCE comprises the bank's Common Equity Tier 1 (CET1) capital, but no longer of the €300 million in high-trigger Additional Tier 1 (AT1) instruments after our recent bank's methodology update, which excludes such instruments from TCE and includes them in our Advanced LGF analysis.

Given its good capitalisation, Aareal is able to digest both risk-weighted asset (RWA) increases because of a deterioration in asset quality following the economic downswing in 2020 and early 2021 and a larger increase in regulatory RWA. We expect the bank to be able to maintain and retain a capital ratio of close to 14% despite the aforementioned strain, and taking into account high future dividend payouts, with a communicated medium-term target payout ratio of 70%-80% (thereof 50% base dividend and 20-30% supplementary dividend). For 2020 and 2021, management has already decided to refrain from calling its €300 million high-trigger AT1 instrument and has postponed a decision on the dividend payout because of the economic crisis. Both factors and the bank's sale of its Aareon minority stake supported its capital position in 2020.

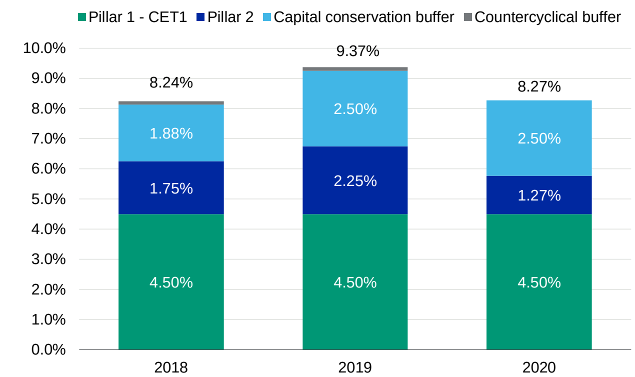
However, Aareal's risk density, that is, the bank's RWA calculated as a percentage of total assets, amounted to only 27.3% as of December 2020. In light of the revisions to the Basel framework and because Aareal calculates its RWA according to the advanced internal ratings-based approach for most of its exposures, we expect its risk density to continue to rise significantly, leading to a significant increase in RWA from the current levels. As of year-end 2020, the bank's CET1 ratio decreased to 18.8% (total capital 28.0%), more than 2x its requirement as outlined in the ECB's Supervisory Review and Evaluation Process of 8.27% for CET1 and its 12.8% total capital requirement.

Exhibit 6
Aareal comfortably exceeds its CET1 requirements



TCE = Tangible Common Equity (Moody's calculation; excludes high-trigger Additional Tier 1 instruments for all periods); CET1 = Common Equity Tier 1 capital.
Source: Company reports and Moody's Investors Service

Exhibit 7
Aareal's CET1 requirements



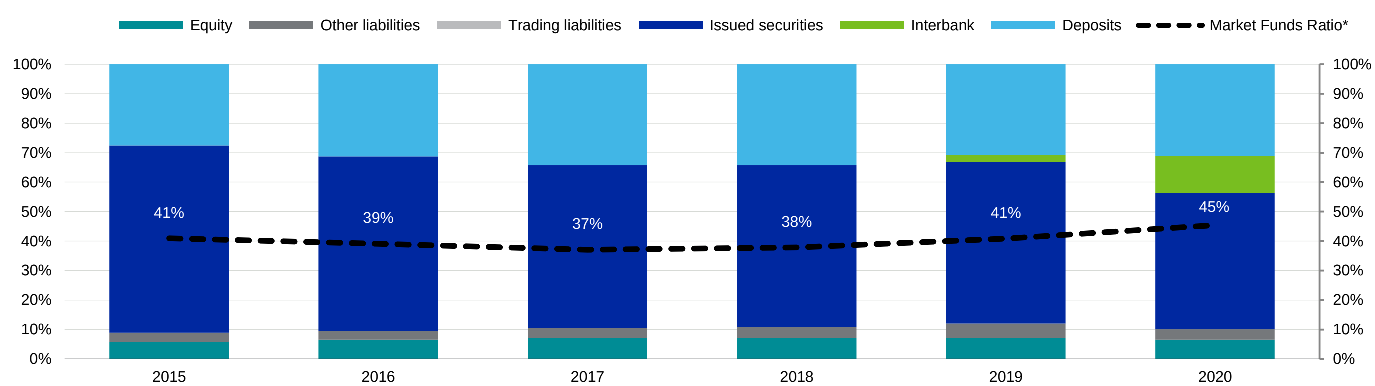
Source: Company reports

Stable funding from the housing industry sector mitigates the bank's remaining wholesale funding dependence

We assign a ba1 Funding Structure score to Aareal, three notches above its initial score, reflecting its favourable term structure, and limited refinancing and interest rate risks. The bank's funding structure comprises less confidence-sensitive covered bonds (Pfandbriefe, €10.7 billion as of year-end 2020), a sizeable amount of corporate and housing industry deposits (€13.7 billion), senior unsecured debt of €2.9 billion, junior senior debt of €4.4 billion and subordinated debt (€0.9 billion). Within its unsecured debt proportion, Aareal is a strong issuer of smaller promissory note loans to the market, benefiting from its strong and proven access to the institutional private placement market. The bank's recourse to nonsensitive TLTRO / central bank funding of €4.3 billion as of year-end 2020 accomplishes its funding profile.

The bank's funding composition is further supported by its three-pillar business model, attracting sizeable and rather sticky housing industry deposits (€10.6 billion as of year-end 2020) because of its IT and banking services, which it provides to the German housing industry. Most of these deposits are either tenant security deposits or operating deposits of the respective housing companies, constituting a reliable and stable source of funding, which is a key credit strength compared with that of the bank's other wholesale-funded CRE lending peers. In addition, Aareal's senior debt and covered bond investor base is diversified, granular and largely driven by a domestic private placement backbone, providing further funding stability.

Exhibit 8
Aareal's funding mix is well diversified



*Market funding ratio = Market funds/tangible banking assets.
Sources: Company reports and Moody's Investors Service

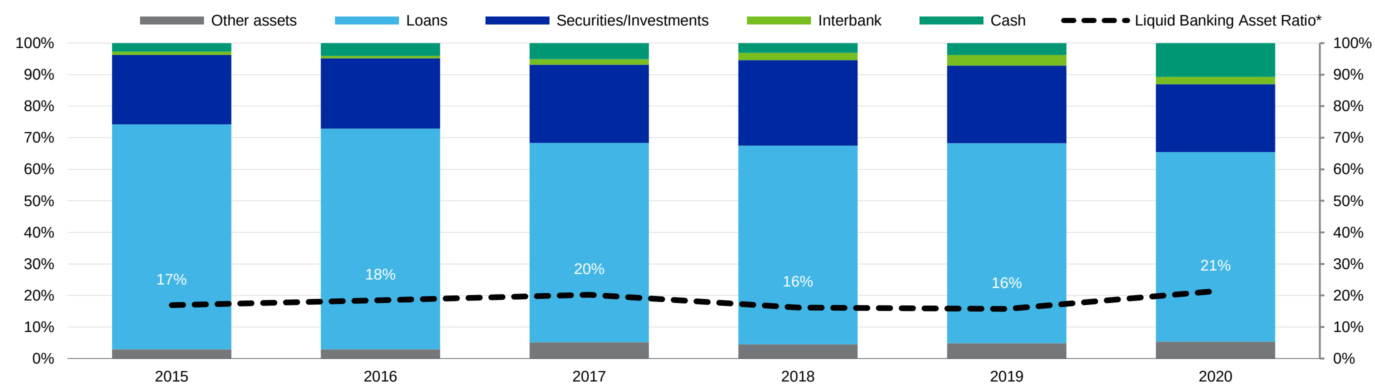
Sound liquidity metrics

We capture Aareal's balanced liquidity profile in its baa2 Liquid Resources score, one notch below its baa1 initial score. The score reflects the bank's cash position and liquid interbank assets (€4.7 billion as of year-end 2020), as well as its high-quality treasury portfolio (€7.2 billion), which mainly consists of public-sector debtors and covered bonds, all of which are investment grade. It further takes into account the bank's more significant encumbrance of liquid assets related to stronger repo activities.

Moreover, additional liquidity could be generated through the issuance of covered bonds. As of September 2020, and based on an outstanding issuance of €10.4 billion, the over-collateralisation in Aareal's mortgage cover pool was 17.5% on an unstressed present value basis. Because the minimum over-collateralisation level, consistent with a Aaa covered bond rating, was 16.0% as of the same date, Aareal has some leeway for using its existing cover pool to generate fresh liquidity through the issuance of covered bonds.

Together with the bank's diversified funding mix, its liquidity reserves constitute a very balanced profile, offering the bank significant flexibility in a more adverse market environment.

Exhibit 9
Aareal's balance-sheet liquidity remains comfortable



*Liquid banking assets ratio = Liquid assets/tangible banking assets.
Sources: Company reports and Moody's Investors Service

Adequate level of risk-weighted profitability

We assign a ba2 Profitability score to Aareal, four notches above the initial score, that is currently strained by the economic downturn. While we expect earnings to remain below the previous years' levels over the next two years, they should improve compared with 2020 to a level that is in line with a ba2 Profitability score (0.25%-0.375% of tangible banking assets).

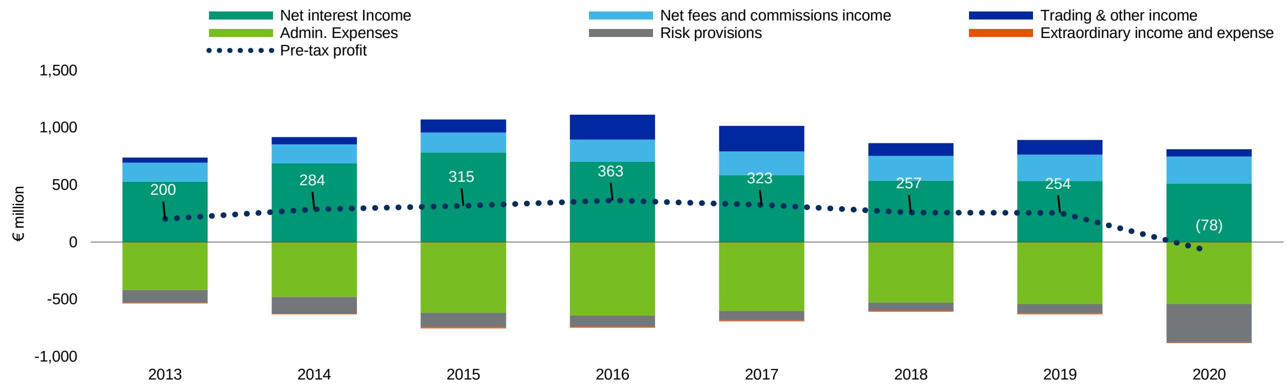
The key drivers for the substantial drop in Aareal's profitability in 2020 were the risk provision of around 125 basis points (annualised), which was a high level considering the bank's secured lending portfolio, but not uncommon for a CRE portfolio in an adverse economic environment. Similar to many of its peers, Aareal booked loan-loss provisions in advance of problem loans materialising, providing the bank with a buffer to deal with a deteriorating economic environment, a factor that should stabilise profitability, at least partially.

Nevertheless, a more increased level of loan-loss provisions and the persistently low interest rate environment will continue to strain Aareal's lending business margins, despite the bank's broader international presence than that of its closest Germany-focused peers, while fee and commission income remains still limited, despite Aareal's efforts to leverage its service and consulting activities under the Aareon brand. The bank's cost-to-income ratio has already been on a slightly rising trend (66.7% as of year-end 2020, up from 59.3% in 2017), and we therefore do not expect Aareal's profitability to recover to the historic 0.375%-0.49% level, in line with a ba1 initial score.

The bank reported a net loss of €69 million for 2020, down from its net income of €163 million in 2019. While net interest income declined somewhat to €512 million, net commission income, largely generated by its service and IT entity Aareon, remained stable at €234 million. Lower administrative expenses of €469 million (down from €488 million) were more than balanced by a lower derecognition gain and significantly higher loan-loss provisions (€344 million, up from €90 million for 2019).

Exhibit 10

Higher provisioning strained earnings for 2020



Sources: Company reports, Moody's Financial Metrics™ and Moody's Investors Service estimates

Qualitative adjustment captures limited business diversification

We reduce the weighted average outcome of Aareal's assigned Financial Profile factor score by one notch to an assigned BCA of baa3. This adjustment reflects Aareal's low revenue and negligible income diversification outside of the commercial mortgage-lending businesses.

Business diversification is an important gauge of a bank's sensitivity to stress in a single business line. It is related to earnings stability in the sense that earnings diversification across distinct and relatively uncorrelated lines of business increases the reliability of a bank's earnings streams and its potential to absorb shocks affecting a business line.

Being a CRE lending specialist, Aareal is exposed to a rather volatile banking business through the cycle. We consider CRE lending highly cyclical and, therefore, a higher-risk sector exposure. The bank's position as a specialist CRE lender benefits its sector-specific risk management know-how, but at the same time, it naturally limits the potential for (earnings) diversification within the bank. Because CRE exposures can cause high losses in times of financial market stress, Aareal's high reliability on CRE-related earnings streams exposes it to unexpected shocks that are likely to hurt its income statement in an adverse scenario. As a result, we classify Aareal as a monoline bank according to our approach for business diversification.

ESG considerations

In line with our general view on the banking sector, Aareal has a low exposure to environmental risks (for further information, see our environmental risk heat map[3]).

For social risks, we also place Aareal in line with our general view for the banking sector, which indicates a moderate exposure. However, Aareal has a high share of lending to sectors such as tourism and nonfood retail that are particularly exposed to the rapid and widening spread of the pandemic given the substantial implications for public health and safety, and a deteriorating global economic outlook creating a severe and extensive credit shock across many sectors, regions and markets (for further information, see our social risk heat map[4]).

Governance is highly relevant for Aareal, as it is to all participants in the banking industry. Governance risks are largely internal rather than externally driven, and, for Aareal, we do not have any particular governance concern[5]. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Loss Given Failure (LGF) analysis

Aareal is subject to the EU Bank Recovery and Resolution Directive, which we consider an operational resolution regime. We, therefore, apply our Advanced LGF analysis, where we consider the risks faced by the different debt and deposit classes across the liability structure should the bank enter resolution.

In line with our standard assumptions, we assume that equity and asset losses are 3% and 8%, respectively, of tangible banking assets in a failure scenario. We also assume a 25% runoff in junior wholesale deposits and a 5% runoff in preferred deposits. Moreover, we assign a 25% probability to junior deposits being preferred to senior unsecured debt. We apply a standard assumption for European banks that 26% of deposits are junior.

For Aareal's deposit and issuer ratings, our LGF analysis indicates an extremely low loss given failure, leading to a three-notch uplift from the bank's baa3 Adjusted BCA.

Government support considerations

We do not assign any rating uplift for Aareal from government support, reflecting our unchanged assumption of a low probability of systemic support in the event of a stress scenario, given the bank's marginal importance to the domestic deposit-taking market and local payment systems.

Counterparty Risk Ratings (CRRs)

Aareal's CRRs are A3/P-2

The bank's CRRs are three notches above the baa3 Adjusted BCA, based on the high buffer against default provided by subordinated instruments to the more senior CRR liabilities.

Counterparty Risk (CR) Assessment

Because the CR Assessment captures the probability of default on certain senior operational obligations, rather than expected loss, we focus purely on subordination and take no account of the volume of the instrument class.

Aareal's CR Assessment is A3(cr)/P-2(cr)

Aareal's CR Assessment is three notches above the bank's baa3 Adjusted BCA, based on the substantial buffer against default provided to the senior counterparty obligations by more junior instruments, such as senior unsecured debt and dated subordinated debt. Because the CR Assessment captures the probability of default on certain senior operational obligations, rather than expected loss, we focus purely on subordination and take no account of the volume of the instrument class.

Methodology and scorecard

Methodology

The principal rating methodology we used in rating Aareal was the Banks Methodology, published in July 2021.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 11

Aareal Bank AG

Macro Factors							
Weighted Macro Profile	**Strong +**	**100%**					
Factor		**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency							
Asset Risk							
Problem Loans / Gross Loans		5.7%	baa2	↔	ba2	Sector concentration	Single name concentration
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)		19.8%	aa2	↔	a1	Risk-weighted capitalisation	Expected trend
Profitability							
Net Income / Tangible Assets		-0.2%	caa1	↔	ba2	Return on assets	Expected trend
Combined Solvency Score			baa2		baa2		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		45.4%	b1	↔	ba1	Term structure	Expected trend
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		21.4%	baa1	↔	baa2	Additional liquidity resources	Stock of liquid assets
Combined Liquidity Score			ba1		baa3		
Financial Profile					baa2		
Qualitative Adjustments					Adjustment		
Business Diversification					-1		
Opacity and Complexity					0		
Corporate Behavior					0		
Total Qualitative Adjustments					-1		
Sovereign or Affiliate constraint					Aaa		
BCA Scorecard-indicated Outcome - Range					baa2 - ba1		
Assigned BCA					baa3		
Affiliate Support notching					0		
Adjusted BCA					baa3		

Balance Sheet	**in-scope (EUR Million)**	**% in-scope**	**at-failure (EUR Million)**	**% at-failure**
Other liabilities	23,798	53.8%	22,084	49.9%
Deposits	10,592	24.0%	12,305	27.8%
Preferred deposits	7,838	17.7%	9,633	21.8%
Junior deposits	2,754	6.2%	2,672	6.0%
Senior unsecured bank debt	2,865	6.5%	2,865	6.5%
Junior senior unsecured bank debt	4,393	9.9%	4,393	9.9%
Dated subordinated bank debt	939	2.1%	939	2.1%
Preference shares (bank)	300	0.7%	300	0.7%
Equity	1,326	3.0%	1,326	3.0%
Total Tangible Banking Assets	44,213	100.0%	44,213	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	28.3%	28.3%	28.3%	28.3%	3	3	3	3	0	a3
Counterparty Risk Assessment	28.3%	28.3%	28.3%	28.3%	3	3	3	3	0	a3 (cr)
Deposits	28.3%	15.7%	28.3%	22.2%	3	3	3	3	0	a3
Senior unsecured bank debt	28.3%	15.7%	22.2%	15.7%	3	3	3	3	0	a3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a3	0	A3	A3
Counterparty Risk Assessment	3	0	a3 (cr)	0	A3(cr)	
Deposits	3	0	a3	0	A3	A3
Senior unsecured bank debt	3	0	a3	0	A3	A3

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 12

Category	Moody's Rating
AAREAL BANK AG	
Outlook	Negative
Counterparty Risk Rating	A3/P-2
Bank Deposits	A3/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating	A3
ST Issuer Rating	P-2

Source: Moody's Investors Service

Endnotes

1 Coronavirus exacerbates difficult operating environment, weighing on credit quality.

2 Yield-on-debt = net operating income of the relevant property/total loan amount (in %).

3 Environmental risks can be defined as environmental hazards encompassing the impacts of air pollution, soil/water pollution, water shortages and natural and human-made hazards (physical risks). Additionally, regulatory or policy risks, like the impact of carbon regulation or other regulatory restrictions, including the related transition risks like policy, legal, technology and market shifts that could impair the evaluation of assets are an important factor. Certain banks could face a higher risk from concentrated lending to individual sectors or operations exposed to the aforementioned risks.

4 Social risk considerations represent a broad spectrum, including customer relations, human capital, demographic and societal trends, health and safety and responsible production. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which are mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are a further social risk. Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services increasing information technology costs, ageing population concerns in several countries affecting demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue bases.

5 Corporate governance is a well-established key driver for banks, and related risks are typically included in our evaluation of the banks' financial profile. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Further factors like specific corporate behaviour, key person risk, insider and related-party risk, strategy and management risk factors and dividend policy may be captured in individual adjustments to the BCA.

REPORT NUMBER 1281640

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