

## **FITCH DOWNGRADES DUESSELDORFER HYPOTHEKENBANK AG'S PUBLIC SECTOR PFANDBRIEFE TO 'AA-'; OFF RWN**

Fitch Ratings-Frankfurt/London-25 October 2011: Fitch Ratings has downgraded Duesseldorfer Hypothekenbank AG's (DUS, 'BBB-/Stable/F3') public sector Pfandbriefe to 'AA-' from 'AAA' and removed them from Rating Watch Negative (RWN). The downgrade concludes Fitch's review of the credit risk of the cover pool and the cash flow mismatches between the assets and the liabilities of the programme.

The downgrade was mainly driven by increased loss expectations on the cover pool assets due to the continuing downward trend in some sovereign ratings and a negative migration in the creditworthiness of the exposure to German municipalities. As a result, the 13.2% overcollateralisation (OC) which the issuer publicly commits to maintain is no longer sufficient to prevent a default of the covered bonds in a 'AA' scenario and to provide outstanding recoveries in a 'AAA' stress scenario.

In the agency's updated default and cash flow analysis, this level of OC allows the cover pool to withstand 'A+' stresses and still repay the covered bonds in time. It further enables stressed recoveries from the cover pool, given a default of the covered bonds, to exceed 51% in a 'AA-' scenario, allowing a one-notch uplift from the covered bonds rating on a probability of default (PD) basis. In Fitch's analysis, the level of OC supporting a 'AA-' rating for DUS's public sector Pfandbriefe stands at 12.8%. The supporting OC level for a given rating will be affected, among others, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuances.

The covered bond rating is based on DUS's Long-term Issuer Default Rating (IDR) of 'BBB-' and an unchanged Discontinuity Factor (D-Factor) of 6.1%. This combination continues to enable the Pfandbriefe to be rated up to 'AA' on a PD basis, and up to 'AAA' when factoring in recoveries given default, provided that the OC taken into account by Fitch would be sufficient to sustain the respective stress scenario. All else being equal, the rating of DUS's public sector Pfandbriefe could be maintained at 'AA-' if the issuer is rated at least 'BB'. The rating of the covered bonds is also dependent on Germany's 'AAA' rating, as around 43% of the cover pool is directly exposed to or guaranteed by the German sovereign and federal states.

The portfolio's exposure to non-'AAA' countries represents around 27% of the portfolio. Fitch has stress-tested the default of one non-'AAA' sovereign (9.5%) and a significant increase in the default rate of the exposures located in that country, combined with a low stressed recovery rate on these defaulted assets to simulate the potential impact that a sovereign default could have on the public-sector entities located within that country. In a 'AA'-default scenario, Fitch has calculated an expected credit loss of 8.5% on the cover pool.

As of end-June 2011, DUS's outstanding public sector Pfandbriefe of EUR6.15bn were secured by a cover pool worth EUR7.03bn, resulting in nominal OC of around 14.3%. As per end-June 2011, the residual weighted average life of the cover assets was seven years, compared to eight years for the covered bonds. As almost all assets (98%) and all of the covered bonds (97%) are EUR-denominated, there is only a minor currency mismatch resulting from the remaining CHF positions on the asset and liability side. The programme has a notable open interest rate position, as around 21% of the assets are floating rate compared to only 9% of the Pfandbriefe. Fitch has taken these mismatches into account in modelling the expected cash flows by applying appropriate stresses. The existing market risks are not mitigated by privileged derivatives.

More details on the portfolio and Fitch's analysis will be available in a credit update, which will shortly be available at [www.fitchratings.com](http://www.fitchratings.com).

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Additional information is available on [www.fitchratings.com](http://www.fitchratings.com).

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Covered Bonds Rating Criteria', dated 12 August 2011, 'Covered Bonds Counterparty Criteria', dated 14 March 2011, are available on [www.fitchratings.com](http://www.fitchratings.com).

Applicable Criteria and Related Research:

Covered Bonds Rating Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=648551](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648551)

Covered Bonds Counterparty Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=606185](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=606185)

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