17 DEC 2020

Fitch Affirms NORD/LB at 'A-' Negative, Withdraws NORD/LB CBB (Lux)

Fitch Ratings - Frankfurt am Main - 17 Dec 2020: Fitch Ratings has affirmed Norddeutsche Landesbank Girozentrale's (NORD/LB) Long-Term Issuer Default Rating (IDR) at 'A-' with a Negative Outlook and Viability Rating (VR) at 'bb'.

A full list of rating actions is provided below.

The ratings of NORD/LB Luxembourg S.A. Covered Bond Bank (NORD/LB CBB) have been affirmed and subsequently withdrawn for commercial reasons. Fitch will no longer provide ratings or analytical coverage for this entity.

Key Rating Drivers

IDRs

NORD/LB's Long-Term IDR is driven by institutional support from the bank's owners. Fitch's institutional support assumptions are underpinned by provisions contained in the statutes of the institutional protection fund of Sparkassen-Finanzgruppe (SFG) and the Landesbanken. The recapitalisation of NORD/LB by its public-sector owners in December 2019 underlines their commitment to their long-term investment in the bank, in our view. This is underpinned by the focus of NORD/LB on its statutory roles, which include supporting the regional economy as well as acting as the central institution for regional savings banks and as house bank for its federal state owners.

Fitch uses SFG's Long-Term IDR as the anchor rating for determining the bank's support-driven ratings. Fitch believes support would need to be forthcoming from SFG along with the bank's federal state owners to avoid triggering state-aid considerations and resolution under the German Recovery and Resolution Act if NORD/LB fails again. We notch down NORD/LB's Long-Term IDR twice from SFG's 'A+', to reflect regulatory restrictions on support due to the requirement for state-aid examination under EU competition rules. The two-notch difference in the ratings also reflects the strategic but not key and integral role of NORD/LB for its respective owners and its weak past performance.

The Negative Outlook on NORD/LB's IDR mirrors that of SFG and reflects our view that risks remain skewed to the downside in the medium term, especially if targeted measures to contain virus hotspots have limited success, resulting in more frequent lockdowns and stretching health systems until late in 1H21, or setbacks in efficacy or distribution of vaccines delay confidence boost from a medical solution. This could result in a second round of job losses and GDP decline, though less severe than in 1H20, prompting a negative wealth and confidence shock. This would lead to a prolonged period of below-trend economic activity, putting pressure on SFG's asset quality and earnings.

NORD/LB's Short-Term IDR is the higher of two possible levels that map to an 'A-' Long-Term IDR on Fitch's rating scale, because propensity of support by its institutional owners is likely more certain in the near term and the bank shares strong links to SFG and privileged access to SFG's ample liquidity and funding resources.

DERIVATIVE COUNTERPARTY RATING (DCR), SENIOR PREFERRED (SP) DEBT AND DEPOSIT RATINGS

NORD/LB's DCR, long-term SP debt and long-term deposit ratings are one notch above the bank's IDR, to reflect the protection that could accrue to them from junior resolution debt buffers. NORD/LB's short-term SP debt and deposit ratings are the lower of the two ratings that map to an 'A' long-term SP and deposit rating because our assessment of NORD/LB's funding and liquidity score is not sufficiently high to achieve a higher short-term rating.

VR

NORD/LB's 'bb' VR reflects the bank's poor profitability, which we expect to come under further pressure from weakening asset quality due to the coronavirus pandemic. The challenging operating environment also threatens the execution of NORD/LB's restructuring plan and the stability of the bank's targeted business model. The bank's adequate capitalisation and funding are rating strengths and should support the VR in the 'bb' range through the crisis, in our view.

Business transformation at NORD/LB is progressing satisfactorily in terms of balance-sheet and headcount reduction, the wind-down of its remaining shipping exposure and the implementation of measures to achieve its targeted medium-term cost and revenue benefits. However, the 2020 recession in Germany will weigh on the success of the bank's transformation plan, despite Fitch's expectation of a recovery in 2021. Remaining downside risks could significantly undermine NORD/LB's efforts to restore profitability.

We expect NORD/LB to report a financial loss in 2020, driven by high loan impairment charges (LICs), guarantee payments and restructuring costs. LICs reached EUR275 million in 9M20; the majority of which were driven by model adjustments and loan migrations to Stage 2. Performance prospects for 2021 are skewed to the downside as we expect LICs to remain high due to loan migrations to Stage 3. We expect NORD/LB to remain loss-making in 2021.

NORD/LB's Stage 3 loans ratio improved to 2.7% at end-1H20. The non-performing shipping exposure, which the bank plans to exit by end-2021, declined to EUR1.5 billion end-3Q20 from EUR2.5 billion at end-2019. However, asset quality in the non-guaranteed aviation portfolio (EUR 1.9 billion end-3Q20) has deteriorated rapidly and is likely to result in material Stage 3 inflows which, in addition to an expected surge in corporate defaults, is likely to endanger the bank's strategic target of an NPL ratio of below 2%.

NORD/LB's CET1 ratio of 14.1% at end-3Q20 (14.5% end-2019) was reasonably steady in light of the reported loss and moderately higher risk-weighted assets (RWAs). We expect pressure on its capitalisation to intensify over the next quarters. At the same time, Lower Saxony will reinvest EUR137 million (34bp of RWA at end-3Q20) of received guarantee payments into NORD/LB's equity, in line with contractual provisions in 2020. Additional planned reinvestments of outstanding guarantee payments of about EUR200 million until 2024 should partially mitigate the impact on capitalisation from NORD/LB's expected credit losses.

NORD/LB is majority wholesale-funded, with reasonable costs and low refinancing volumes due to its shrinking balance sheet. It benefits from its strong owners and membership in SFG's institutional protection scheme (IPS), which gives savings banks a 0% risk weighting for their exposures to NORD/LB and ensures sufficient demand from savings banks for NORD/LB's debt. The bank decided to discontinue the covered bond business conducted by its subsidiary NORD/LB Luxembourg S.A. Covered Bond Bank from 2022 and will likely issue in 2021 only private placed debt. We believe the overall impact on the bank's funding capacity and costs will be fairly minor.

NON-GUARANTEED SUBORDINATED DEBT

NORD/LB's non-guaranteed Tier 2 subordinated bond rating is notched twice from the bank's VR to reflect loss severity in line with Fitch's baseline approach. The notching reflects our expectation that the bank will not maintain buffers of Tier 2 and additional Tier 1 debt exceeding 10% of its respective RWAs.

GRANDFATHERED STATE-GUARANTEED SECURITIES

The ratings of NORD/LB's grandfathered state-guaranteed senior and Tier 2 notes are equalised with the Long-Term IDRs of their guarantors, Lower Saxony and Saxony-Anhalt. This reflects our opinion that both states' ability and propensity to honour their guarantees are very strong.

NORD/LB LUXEMBOURG S.A. COVERED BOND BANK (NORD/LB CBB)

NORD/LB CBB's IDRs and SP debt ratings have been affirmed at 'A-'/'F1'and 'A' respectively, the same level as NORD/LB, to primarily reflect the declaration of backing for the entity.

RATING SENSITIVITIES

IDRS, SR, SENIOR NON-PREFERRED DEBT

NORD/LB's support-driven ratings are sensitive to changes in our assumptions around the propensity or ability of the bank's owners to provide timely support.

Factors that could, individually or collectively, lead to positive rating action/upgrade

An upgrade of SFG's IDRs or a loosening of European state support regulation, which we do not expect, could lead to an upgrade of the ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of SFG's IDRs, a change in the owners' strategic commitment to the bank or a change in the ownership structure could lead to a downgrade of the ratings. The state treaty allows the bank's ownership to be opened up to private investors and represents a medium-term exit option for Sachsen-Anhalt. Private-sector ownership contradicts the statues of the IPS, which requires its members to be public law institutions. We could downgrade the support-driven ratings if we believe that a private investor could take a significant share in the bank or base NORD/LB's Long-Term IDR on the bank's standalone rating if we conclude that institutional support would not be forthcoming.

The ratings could also be downgraded if failed execution of the business plan would threaten NORD/LB's viability, in which case an orderly wind-down under sponsorship of the owners is likely. We believe support from SFG's IPS would qualify as an alternative private-sector measure, capable of preventing resolution under German Law.

DCR, DEPOSIT RATINGS, SP DEBT

The DCR, deposit ratings and SP debt ratings are primarily sensitive to changes in the bank's IDRs.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of NORD/LB's IDR.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The ratings would be downgraded if NORD/LB's IDR is downgraded or if we expect NORD/LB to include SP debt in its resolution buffer and if the sum of SNP and junior debt buffers falls below 10% of RWA.

VR

Factors that could, individually or collectively, lead to positive rating action/upgrade:

We could upgrade the VR if NORD/LB delivers two consecutive profitable years and its CET1 ratio remains above 13%, while maintaining asset-quality metrics broadly in line with peers'.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

We could downgrade the VR upon a material deviation from NORD/LB's business plan, in particular weak execution on the bank's cost-cutting programme or inability to generate adequately priced new business. We could also downgrade the ratings if we expect NORD/LB's CET1 ratio to fall below 12% for a sustained period or if specific coverage of Stage 3 loans deteriorates materially.

NON-GUARANTEED SUBORDINATED DEBT

The ratings of the non-guaranteed Tier 2 subordinated notes are primarily sensitive to changes in the bank's VR, from which they are notched.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade in NORD/LB's VR or a buffer of Tier 1 and Tier 2 debt sustainably exceeding 10% of RWAs.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of NORD/LB's VR.

GRANDFATHERED STATE-GUARANTEED SECURITIES

The ratings of NORD/LB's grandfathered state-guaranteed senior and Tier 2 notes are sensitive to changes in Fitch's view of the guarantors' creditworthiness, which is closely linked to that of Germany.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The ratings are 'AAA', which is the highest level on Fitch's scale, and therefore cannot be upgraded.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of the IDRs of NORD/LB federal owners would lead to a downgrade of the bank's ratings.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance for NORD/LB and NORD/LB CBB is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Following the withdrawal of ratings for NORD/LB CBB Fitch will no longer be providing the associated

ESG Relevance Scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
NORD/LB Luxembourg S.A. Covered Bond Bank	LT IDR	A-	Affirmed		A-
	LT IDR	WD	Withdrawn		A-
	ST IDR	F1	Affirmed		F1
	ST IDR	WD	Withdrawn		F1

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	Support	1	Affirmed		1
	Support	WD	Withdrawn		1
• Senior preferred	LT	WD	Withdrawn		A
• Senior preferred	LT	A	Affirmed		A
Norddeutsche Landesbank Girozentrale	LT IDR	A-	Affirmed		A-
	ST IDR	F1	Affirmed		F1
	Viability	bb	Affirmed		bb
	Support	1	Affirmed		1
	DCR	A(dcr)	Affirmed		A(dcr)
• senior unsecured	LT	AAA	Affirmed		AAA
• subordinated	LT	AAA	Affirmed		AAA
• Senior non-preferred	LT	A-	Affirmed		A-

ENTITY/DEBT		RATING		RECOVERY	PRIOR
• subordinated	LT	B+	Affirmed		B+
• long-term deposits	LT	A	Affirmed		A
• Senior preferred	LT	A	Affirmed		A
• short-term deposits	ST	F1	Affirmed		F1
• Senior preferred	ST	F1	Affirmed		F1

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

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