

FITCH AFFIRMS NORD/LB'S IDR AT 'A-'; OUTLOOK STABLE

Fitch Ratings-Frankfurt/London-12 May 2016: Fitch Ratings has affirmed Norddeutsche Landesbank Girozentrale's (NORD/LB) and NORD/LB Luxembourg S.A. Covered Bond Bank's (NORD/LB CBB) Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook, Short-Term IDR at 'F1' and Support Rating at '1'. At the same time, Fitch affirmed NORD/LB's Viability Rating (VR) at 'bb+'.

NORD/LB's IDRs and Support Rating are driven by institutional support from the bank's owners. A full list of rating actions is available at the end of this rating action commentary.

KEY RATING DRIVERS

IDRS, SR AND SENIOR DEBT

NORD/LB's IDR, SR and senior debt rating reflect Fitch's view of a very strong likelihood of combined support from its owners, the States of Lower Saxony and Saxony-Anhalt, the regional savings banks, and ultimately Sparkassen-Finanzgruppe (Sparkassen) (SFG, A+/Stable). Support assumptions are underpinned by provisions contained in the statutes of SFG and the Landesbanken institutional protection fund.

Fitch's institutional support considerations are based on the view that the owners of NORD/LB consider their investment in NORD/LB long-term and strategic. The owners' strong support propensity is underpinned by the focus of NORD/LB on its statutory roles, which include supporting the regional economy, acting as the central bank for regional savings banks and as the federal states' house bank.

In Fitch's view support would need to be forthcoming from SFG as well as the States of Lower Saxony and Saxony-Anhalt to avoid triggering state aid considerations and resolution under the German Sanierungs und Abwicklungsgesetz (SAG), if NORD/LB fails. Our assessment of the creditworthiness of Lower Saxony and Saxony-Anhalt is underpinned by the stability of Germany's solidarity and financial equalisation system, which links the creditworthiness of the states to that of Germany (AAA/Stable). The support ability of SFG, as expressed by its 'A+' IDR, while very strong, is weaker than that of the federal states. Fitch uses the lower of the parents' ratings, the Long-Term IDR of SFG, as anchor and starting point for determining NORD/LB's support-driven ratings.

We notch down NORD/LB's Long-Term IDR twice from SFG's 'A+'. The notching reflects NORD/LB's role for its owners, which we consider strategic, but not key and integral, as well as uncertainties over potential legal and regulatory barriers related to state aid considerations and provisions of German resolution legislation.

The Stable Outlook reflects stable support assumptions and the Stable Outlook on SFG's Long-Term IDR.

The ratings of senior unsecured obligations are in line with NORD/LB's IDR. NORD/LB's 'F1' Short-Term IDR is at the higher of the two Short-Term IDRs that map to an 'A-' Long-Term IDR on Fitch's rating scale. This reflects NORD/LB's strong links to the affiliated savings banks, which have ample liquidity and funding resources.

VR

NORD/LB's VR primarily reflects our expectation that the group's asset quality will remain burdened by the large shipping exposure held at the bank and its subsidiary Bremer Landesbank

Kreditanstalt Oldenburg-Girozentrale (Bremer/LB, A-/Negative/bb). The weak outlook for the shipping sector has reduced the bank's resilience to adverse market movements and limits the bank's managerial flexibility. Fitch considers that NORD/LB is more diversified than its northern German Landesbanken peers, and firmer performance in the bank's businesses outside ship finance should help mitigate the impact of the weakness in that sector on asset quality, performance and capital.

NORD/LB's operating profit has improved steadily but continues to be weighed down by significant loan impairment charges (LICs) for exposures to the shipping sector, which we expect to continue in the near term. Diversity of income streams, low LICs in other segments and positive effects in the bank's more volatile trading, fair-valued instruments and hedge accounting resulted in a firm 2015 pre-tax profit.

Revenue generation is mainly driven by net interest income, in line with the bank's lending-driven business, which we expect will come under pressure, primarily because a further decline in funding costs from the current low level is unlikely.

Continued efforts to reduce risk-weighted assets (RWAs) and sound 2015 earnings allowed NORD/LB to strengthen its fully-loaded CET1 ratio to 12.16% (2014: 8.41%), which compares well with Landesbanken peers. NORD/LB's regulatory CET1 capital includes a EUR0.96bn shortfall deduction to cover unreserved expected losses primarily in its shipping portfolio, which provides a capital buffer against further increases in LICs.

In Fitch's view, the primary risk to NORD/LB's capitalisation is further deterioration in asset quality as unreserved impaired loans were equal to a high 70% of Fitch Core Capital (FCC) at end-2015. Capitalisation is also sensitive to movements in the euro/US dollar exchange rate as a fairly high share of the group's exposure, especially to shipping, is US dollar-denominated.

NORD/LB's wholesale-driven funding is robust, due to access to the liquidity of local savings banks and also to other institutional investors. We expect funding needs to remain moderate given that balance sheet amounts are, until end-2016, constrained by the conditions of the 2011/12 recapitalisation approved by the European Commission.

STATE-GUARANTEED/GRANDFATHERED SECURITIES

The 'AAA' ratings of the state-guaranteed/grandfathered senior and subordinated debt and market-linked securities reflect the credit strength of the guarantors, the German Laender.

SUBSIDIARY

NORD/LB CBB's IDR and senior debt rating are equalised with NORD/LB's, reflecting our expectation that the bank would be supported by its parent given its role within the group. This expectation is underpinned by a declaration of backing (Patronatserklaerung) from the parent. NORD/LB CBB operates as a special bank (covered bond bank) with the task of generating additional covered refinancing for the core business of the NORD/LB group by issuing covered bonds in accordance with Luxembourg law (Lettres des Gage). Fitch does not assign a VR to NORD/LB CBB given its strong integration with NORD/LB and the lack of a sufficiently strong standalone franchise.

The 'F1' Short-Term IDR of NORD/LB CBB is at the higher of the two Short-Term IDRs that map to an 'A-' Long-Term IDR on our rating scale. This is because NORD/LB CBB is embedded in the global liquidity policy of NORD/LB which itself has access to the ample liquidity of SFG and their strong funding and liquidity links to the Landesbanken.

RATING SENSITIVITIES

IDRS, SR AND SENIOR DEBT

The IDRs, SR and senior unsecured debt ratings are sensitive to changes in assumptions around the propensity or ability of NORD/LB's owners to provide timely support. This may be indicated by a change to SFG's IDRs. The IDRs are also sensitive to changes to the owners' strategic commitment to NORD/LB and to the importance of NORD/LB for its respective home region or for the savings banks sector.

A change to our assessment of the risks of triggering a resolution process ahead of support for a Landesbank could also affect the SRs, IDRs and senior unsecured debt ratings.

VR

NORD/LB's VRs is most sensitive to changes in the bank's asset quality and capitalisation.

A material and lasting recovery of the shipping sector or a substantial reduction in the bank's exposure to the sector would be positive for the VR, as this would ease the burden on profitability, lower NPL ratios and facilitate internal capital generation.

NORD/LB's VR could come under pressure if deterioration of the shipping sector further weakens the bank's earnings and capitalisation. Negative pressure could also arise if commercial real estate lending deteriorates to an extent that earnings from that sector no longer offsets the weakness from the shipping portfolio.

STATE-GUARANTEED/GRANDFATHERED SECURITIES

NORD/LB's state-guaranteed/grandfathered senior debt ratings and subordinated guaranteed notes are sensitive to changes in Fitch's view of the creditworthiness of the guarantors.

SUBSIDIARY

A rating action on NORD/LB CBB would most likely be driven by similar rating action on NORD/LB. NORD/LB CBB's ratings are also sensitive to a change in Fitch's view of the propensity of support from NORD/LB.

The rating actions are as follows:

Norddeutsche Landesbank Girozentrale

Long-Term IDR: affirmed at 'A-'; Outlook Stable

Short-Term IDR affirmed at 'F1'

Support Rating affirmed at '1'

Viability Rating: affirmed at 'bb+'

State-guaranteed/grandfathered senior and subordinated debt affirmed at 'AAA'

Long- and Short-term senior debt, including programme ratings: affirmed at 'A-' and at 'F1'

NORD/LB CBB

Long-Term IDR: affirmed at 'A-'; Outlook Stable

Short-Term IDR affirmed at 'F1'

Support Rating affirmed at '1'

Senior debt: affirmed at 'A-'

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Applicable Criteria
Global Bank Rating Criteria (pub. 20 Mar 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501

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