

# NORD/LB COVERED FINANCE BANK S.A.

Public Sector Lettres de Gage

Update

## Rating/Outlook

Lettres de Gage Publiques AAA/Stable

## Key Data December 2014

Asset type	Public Sector
Cover assets (EURbn)	4.1
Lettres de Gage (EURbn)	3.2
Weighted-average life assets (years)	7.0
Weighted-average life liabilities (years)	7.1

## Rating Rationale

Issuer Default Rating (IDR)	A/Negative
D-Cap	3 (Moderate High risk)
Covered bond rating	AAA/Stable
Tested rating on a PD basis	AA
'AAA' Breakeven OC (%)	15.0
Legal Minimum OC (%)	2.0
Min OC past 12 months (%)*	21.0

PD – probability of default

\* adjusted for Group internal exposure

## D-Cap Assessment

Asset segregation	Very low
Liquidity gap and systemic risk	Moderate
	High
Systemic alternative management	Very low
Cover pool-specific alternative management	Low
Privileged Derivatives	Moderate
Overall Assessment	3 (Moderate High)

## Related Research

[Fitch Affirms NORD/LB Covered Finance Bank SA's IDRs on Merger Announcement \(October 2014\)](#)

[Fitch Affirms NORD/LB COVERED FINANCE BANK S.A.'s Covered Bonds at 'AAA'/Stable \(February 2015\)](#)

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## Key Rating Drivers

**Cushion Against IDR Downgrade:** The 'AAA' rating would be vulnerable to downgrade if any of the following occurs: (i) the issuer's IDR is downgraded by 2 or more notches to 'BBB+' or below; or (ii) the Discontinuity Cap (D-Cap, which reflects payment interruption risk) is reduced from 3 (moderate high) to 2 or lower; or (iii) the overcollateralisation (OC) that Fitch takes into account in its analysis decreases below Fitch's 'AAA' breakeven level of 15.0%.

**Stable Outlook Unchanged:** The Outlook is Stable despite the Negative Outlook on the issuer's IDR, reflecting Fitch's view that the IDR uplift of 1 would offset potential negative rating actions on the IDR resulting from a weakening of state support.

**IDR Uplift of 1:** The unchanged IDR uplift of 1 reflects the covered bonds' exemption from bail-in and the degree of protection in the event of a bank's resolution that would be available to prevent the source of covered bonds payments switching from the issuer to the cover pool. It is derived from our estimate of the institution's long-term non-retail placed senior unsecured debt exceeding 5% of total adjusted assets on the latest available financial information.

**D-Cap Unchanged:** The D-Cap of '3' is unchanged from Fitch's previous review.

## Programme Highlights

**Credit Loss Drives Breakeven OC:** The main constituent of the breakeven OC remains the stable credit loss component of 18.5% relating to a 'AAA' stress scenario. Compared to last year's analysis the pool shows higher single obligor concentrations. As this is driven by a higher exposure to the German sovereign and its federal states, Fitch does not see an increased credit risk from this pool change.

**Well Matched ALM Profile:** The asset disposal loss component of 2.6% further contributes to the 'AAA' breakeven OC. This relative low component results from well matched asset and liability maturity (ALM) profiles. In addition, some of the liabilities feature embedded call options, which enhance the ability to manage existing mismatches and were taken into account in the modelling.

**Ample Excess Margin:** The cash flow valuation component reduces the 'AAA' breakeven OC by 0.6% driven by the excess margins the programme realises.

**Market Mismatches Hedged:** The issuer's covered bond programme exhibits open interest and foreign currency positions. These positions are mitigated by hedging agreements in line with Fitch's Counterparty Criteria. Transaction documents provide for remedial options in the event of a downgrade below the eligible rating level.

**Stable Composition:** The cover pool composition has been stable over the past 12 months, with the main exposures to US municipalities (24.5%) and public private partnerships (21.8%). For the US assets, dedicated assumptions have been derived as detailed in the rating action commentary for the issuer's Lettres de Gage dated 13 February 2015.

**Breakeven OC Commitment:** Fitch relied in its analysis on the lowest OC observed in the past 12 months of 21% (adjusted for group internal exposure). The issuer announced to commit to at least 22% OC starting from March 2015 which does not have a negative impact as the commitment comprises a sufficient buffer to the required breakeven OC of 15%.

Figure 1  
**Cover Pool Characteristics: Dec 2014**

Interest type after swaps (%)	Assets	Liabilities
Fixed rate	33	45
Floating rate	67	55

Denomination after swaps (%)	Assets	Liabilities
EUR	64.7	58.8
USD	29.3	32.9
CHF	2.9	5.2
JPY	2.7	3.1
GBP	0.3	0.0
NOK	0.1	0.0

Source: Fitch/CFB

Figure 2  
**Geographical Distribution: Dec 2014**

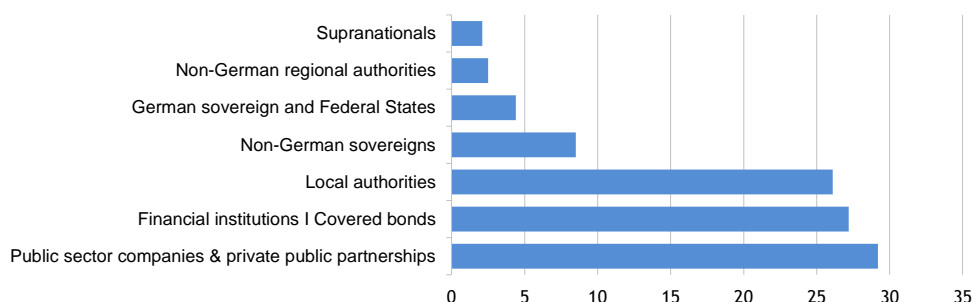
Total current balance (EURbn)	4.1
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Cover assets by country (%)	
Germany	35.1
United States	24.5
Luxembourg	6.7
Canada	5.8
Poland	4.2
France	4.0
Netherlands	3.4
Italy	3.2
Spain	2.3
Austria	2.3
South Korea	2.3
Supranational	2.1
Ireland	1.9
United Kingdom	1.2
Czech Republic	0.7
Japan	0.4

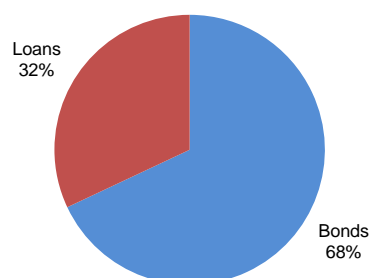
Source: CFB/Fitch

Figure 3  
**Debtor Group Distribution**



Source: Fitch/CFB

Figure 4  
**Asset Type Distribution (as % of total cover assets)**



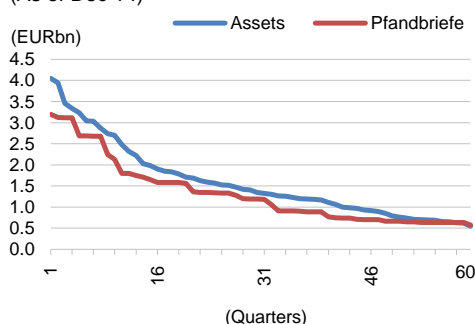
Source: CFB/Fitch

Figure 5  
**Fitch Default Model Output (%)**

Rating level	'AAA'	'AA+'	'AA'
Rating default rate (%)	18.7	16.0	14.7
Rating recovery rate (%)	16.6	20.7	20.5
Rating loss rate (%)	15.6	12.7	11.7

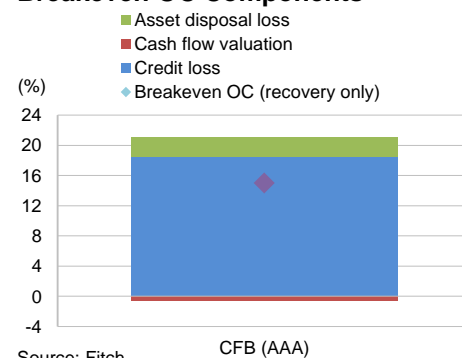
Source: Fitch

Figure 6  
**Amortisation Profile (As of Dec 14)**



Source: Fitch/CFB

Figure 7  
**Breakeven OC Components**



Source: Fitch

## Related Criteria

[Covered Bond Rating Criteria \(August 2014\)](#)

[Criteria for Interest Rate Stresses in Structured Finance Transactions and Covered Bonds \(December 2014\)](#)

[Counterparty Criteria for Structured Finance and Covered Bonds \(May 2014\)](#)

[Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum \(May 2014\)](#)

[Asset Analysis Criteria for Covered Bonds and CDOs of European Public Entities \(February 2015\)](#)

[Covered Bonds Rating Criteria – Public Sector Liquidity and Refinancing Stress Addendum \(January 2015\)](#)

[State Revolving Fund and Leveraged Municipal Loan Pool Criteria \(October 2014\)](#)

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