

FITCH AFFIRMS NORD/LB COVERED FINANCE BANK S.A.'S COVERED BONDS AT 'AAA'/STABLE

Fitch Ratings-Frankfurt/London-13 February 2015: Fitch Ratings has affirmed NORD/LB COVERED FINANCE BANK S.A.'s (CFB, A/Negative/F1) Lettres de Gage Publiques (LdGPs) at 'AAA'. The Outlook is Stable.

KEY RATING DRIVERS

The rating is based on CFB's Long-term Issuer Default Rating (IDR) of 'A', an unchanged IDR uplift of 1, an unchanged Discontinuity Cap (D-Cap) of 3 (moderate high risk) and the 21% over-collateralisation (OC) that Fitch takes into account, which provides more protection than the 15% 'AAA' breakeven OC.

The main constituent of the breakeven OC remains the credit loss component of 18.5% in line with last year's analysis. The 'AAA' credit loss represents the impact on the breakeven OC from the 19% stressed default rate and the 17% stressed recovery rate for the public sector cover assets.

The asset disposal loss component of 2.6% further contributes to the 'AAA' breakeven OC. This relatively low component results from well-matched asset and liability maturity 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.

The cash flow valuation component is -0.6% on the 'AAA' breakeven OC driven by the excess margins the programme realises. The issuer uses swap contracts to mitigate open currency and interest rate positions. The breakeven OC considers whether timely payments are met in a 'AA' scenario and tests for recoveries of at least 91% in a 'AAA' scenario.

As of 31 December 2014, CFB's EUR3.194bn outstanding LdGP were secured by a cover pool of EUR4.048bn. The cover pool comprised 287 (last analysis: 347) assets, which Fitch assigned to 130 (last analysis: 139) ultimate debtors in its analysis. Compared with 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 consider there is increased credit risk from this pool change.

In its analysis, Fitch relies on the lowest OC observed over the past 12 months which was 24.5%. However, Fitch only takes only 21% OC into account because the agency does not give credit to intra-group assets.

The unchanged IDR uplift of 1 reflects the covered bonds exemption from bail-in and Fitch's judgement of 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 Fitch's 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.

The Outlook is Stable despite the Negative Outlook on CFB's IDR, reflecting Fitch's favourable view on the position of covered bonds under the proposed EU Bank Recovery and Resolution Directive (BRRD). Fitch expects the IDR uplift of 1 to offset potential negative rating action on the IDR resulting from a weakening of state support.

CFB's cover pool contains 24.5% of US municipal exposure. The assumptions used for these assets have been agreed with Fitch's US public finance group. The default assumptions are based on public

ratings or, where not available, on floor assumptions. In line with Fitch's 'State Revolving Fund and Leveraged Municipal Loan Pool Criteria', we used a floor assumption of 'BB' for standard assets. For non-standard assets we applied an assumption of 'B'.

Fitch believes that the default risk for municipal assets conditional on the default of the corresponding sovereign is significantly higher than the default risk indicated by the respective rating. To reflect this, for the US municipal assets, Fitch has associated the higher municipal conditional default risk with a default probability assumption of 40%. This assumption is lower than the 80% used for European municipalities taking into account the more federal framework in the US. The recovery rate assumptions for the US municipal assets range from 15% to 70% in a 'AAA' scenario, depending on the type of bond.

Fitch tested for adverse interest rate and currency movements in its cash flow analysis. For residual interest rate risk, Fitch applied its published interest rate stresses. The remaining small open foreign currency positions in five different currencies were stressed ranging from 1.4 to 3 times the current exchange spot rate in a 'AAA' scenario. These tested scenarios are not intended to conform to exact probabilities of occurrence and are not trying to represent explicit forecasts but rather show vulnerability of the covered bond programme to changes in foreign currency exchange rates.

RATING SENSITIVITIES

The 'AAA' LdGP rating would be vulnerable to downgrade if any of the following occurs: (i) the IDR is downgraded by two or more notches to 'BBB+' or below; or (ii) the number of notches represented by the D-Cap is reduced to 2 or lower; or (iii) the OC that Fitch considers in its analysis decreases below Fitch's 'AAA' breakeven level of 15.0%.

Since the covered bond rating can sustain a one-notch downgrade of CFB's IDR to its ultimate parent Norddeutsche Landesbank Girozentrale's Support Rating Floor of 'A', the Outlook on the LdGP is Stable despite the Negative Outlook on CFB's IDR.

Fitch does not expect that the announced euro Benchmark issue planned to be issued later in February 2015 will lead to significant changes in the breakeven OC.

If the OC that Fitch considers in its analysis drops to the legal requirement of 2%, it would not be sufficient to allow for timely payment of the covered bonds following an issuer default. As a result, the covered bond rating would likely be downgraded to 'AA-', because this level of OC would limit the covered bond rating to two-notches above the 'A' IDR as adjusted by the IDR uplift.

The Fitch breakeven OC for the LdGP's rating will be affected, amongst others, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuance. Therefore the breakeven OC to maintain the covered bond rating cannot be assumed to remain stable over time.

More details on the cover pool and Fitch's analysis will be available in a credit update report, which will shortly be available at www.fitchratings.com.

Contact:

Primary Analyst

Vessela Krmnicek, CFA

Director

+49 69 768 076 298

Fitch Deutschland GmbH

Taunusanlage 17

D-60325 Frankfurt am Main

Secondary Analyst
Jan Seemann, CFA
Director
+49 69 768 076 112

Committee Chairperson
Susanne Matern, CFA
Senior Director
+49 69 768 076 237

Media Relations: Christian Giesen, Frankfurt am Main, Tel: +49 69 768076 232, Email: christian.giesen@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable criteria, 'Covered Bonds Rating Criteria', dated 08 August 2014, 'Asset Analysis Criteria for Covered Bonds of European Public Entities', dated 30 January 2013, 'Covered Bonds Rating Criteria - Public Sector Liquidity and Refinancing Stress Addendum', dated 29 January 2015, 'Counterparty Criteria for Structured Finance and Covered Bonds', dated 14 May 2014, 'Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum', dated 14 May 2014, 'State Revolving Fund and Leveraged Municipal Loan Pool Criteria', dated 22 October 2014, 'Criteria for Interest Rate Stresses in Structured Finance Transactions and Covered Bonds', dated 19 December 2014 are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Covered Bonds Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=753052

Asset Analysis Criteria for Covered Bonds of European Public Entities

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=699609

Covered Bonds Rating Criteria - Public Sector Liquidity and Refinancing Stress Addendum

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=860409

Counterparty Criteria for Structured Finance and Covered Bonds

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=744158

Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=744175

State Revolving Fund and Leveraged Municipal Loan Pool Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=792908

Criteria for Interest Rate Stresses in Structured Finance Transactions and Covered Bonds

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=838868

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

