

## **FITCH AFFIRMS NORD/LB, BREMERLB & HSH'S IDRS, NEGATIVE OUTLOOKS; DOWNGRADES BREMERLB'S VR TO 'BB+'**

Fitch Ratings-Frankfurt/London-21 July 2014: Fitch Ratings has affirmed Norddeutsche Landesbank Girozentrale's (NORD/LB), Bremer Landesbank Kreditanstalt Oldenburg - Girozentrale's (BremerLB) and NORD/LB Covered Finance Bank's (NORD/LB CFB) Long-term Issuer Default Ratings (IDRs) at 'A' with Negative Outlooks and HSH Nordbank AG's (HSH) Long-term IDR at 'A-' with Negative Outlook. The affirmations follow a peer review of the northern German Landesbanken.

At the same time, Fitch has downgraded Bremer LB's Viability Rating (VR) to 'bb+' from 'bbb-' to reflect further prolonging of the crisis in the shipping industry and the bank's material exposure to this sector in terms of both asset quality and earnings. NORD/LB's VR has been affirmed at 'bbb-' and HSH's 'b' VR has been maintained on Rating Watch Evolving (RWE). A full list of rating actions is at the end of this rating action commentary.

### **KEY RATING DRIVERS AND SENSITIVITIES - IDRS, SUPPORT RATINGS, SUPPORT RATING FLOORS AND SENIOR DEBT RATINGS**

The IDRs of the three northern German Landesbanken are at their Support Rating Floors (SRFs) and, therefore, along with unsecured senior debt are driven by the same factors that drive the banks' Support Ratings and SRFs. These factors include in particular the banks' systemic importance to their respective regions and, in the case of NORD/LB to Germany as a whole, as a result of their important roles for the respective states and the state economies. State ownership is also an important ratings factor. BremerLB's majority ownership by NORD/LB alongside the minority stake from the state of Bremen boosts its SRF and IDR slightly. HSH's SRF and Long-term IDR are notched down by one notch to reflect the State of Schleswig Holstein's intention to sell its stake once the market environment allows, although Fitch views this as unlikely to happen before 2017, as well as minority private sector participation in the bank.

The sensitivities for the banks' support-driven ratings, reflected in the Negative Outlooks on their Long-term IDRs, relate to recent developments within the regulatory and legal framework, particularly emanating from the EU authorities with regard to bank support, bail-ins, centralised regulatory oversight and resolution. The EU's Bank Recovery and Resolution Directive (BRRD) is being implemented into German legislation, targeted for completion by the end of this year. In addition, we expect progress towards the Single Resolution Mechanism (SRM) for eurozone banks during the coming year. In Fitch's view, these two developments will present obstacles to German federal states making capital injections into the Landesbanken if these banks are insolvent, despite continued extremely strong willingness by the states to do so.

The BRRD requires 'bail in' of creditors by 2016 before an insolvent bank can be recapitalised with state funds. A functioning SRM and progress on making banks 'resolvable' without jeopardising the wider financial system are areas of focus for eurozone policymakers. Once these are operational they will become an overriding rating factor for the SRFs, as the likelihood of banks' senior creditors receiving full state support if ever required, despite their systemic importance, will diminish substantially, unless mitigating factors arise in the meantime. Fitch, therefore, expects SRFs for all German commercially operating banks to be revised to 'No Floor' likely in late 2014 or in 1H15. A downward revision of the SRFs would likely result in downgrades of the three northern German Landesbanken. Fitch expects the downgrades of each of the three banks to be contained to one or

two notches, despite their lower VRs, because institutional support considerations will likely keep their IDRs at a higher level.

#### KEY RATING DRIVERS - VRs

Asset quality is a key rating driver for all three Landesbanken's VRs. They have all suffered to varying degrees from further asset quality deterioration, primarily driven by their exposure to the shipping industry which remains in crisis, especially in certain sectors, notably containers and tankers. On a relative basis NORD/LB's group exposure to the shipping sector, including consolidation of BremerLB, is the lowest with about 8% of its total exposure at default, compared with 17% at BremerLB and 22% at HSH. The consequent rise in loan impairment charges has significantly affected financial profiles. NORD/LB and BremerLB are still reporting pre-tax profits, but HSH made a sizeable loss in 2013 as its operating earnings are additionally burdened by high payments for its asset guarantees.

Fitch believes that NORD/LB is still the best positioned among the three banks to absorb further pressure from its shipping loan book. It has a more diversified stream of income sources and robust performance in its core business which supports its investment grade VR. BremerLB on the contrary has fewer ways to balance the impact of the shipping crisis on asset quality and earnings, which has driven the downgrade of its VR by one notch. This is due to its smaller balance sheet and moderate growth opportunities in its selected businesses despite its reasonably conservative management and business profile.

HSH's relatively low VR is based on the uncertainties around its business model, which in Fitch's view still needs to demonstrate its long-term viability, especially proof that new business originated in recent years has a materially better risk return profile through the economic cycle. The VR reflects low legacy asset quality and significantly higher exposure to the most risky parts of ship financing compared with its peers. Fitch recognises gradual improvements made during the past five years, specifically the reduction of legacy assets while maintaining its regional franchise and funding access. However, prolonged above-market loan growth in core business could be a negative VR driver although HSH's new business in 2014 shows better average ratings than its existing portfolio.

The RWE on HSH's VR reflects the provisional basis of the European Commission's 21 June 2013 approval of restoration of the original EUR10bn guarantee from the States of Hamburg and Schleswig Holstein. The Commission is still investigating whether the measure is in line with EU state aid rules. In Fitch's view, the final decision is vital for HSH's viability and therefore the agency's ability to resolve the RWE. Fitch expects a decision to be reached in 4Q14 at the earliest.

Fitch believes that the capitalisation of NORD/LB and Bremer LB is modest compared with European peers and the two large Southern German Landesbanken and provides a smaller buffer against adverse market developments. However, the agency does not expect that either Landesbank will require unmanageable additional amounts of capital following the European Banking Authority's stress tests.

HSH's capitalisation is comparably stronger despite its higher risk profile as long as the state asset guarantees are approved.

The VRs of all three northern Landesbanken also reflect their regional franchises and high degree of co-operation with the local savings banks. All three banks are dependent on wholesale funding, which is mitigated by moderate capital market funding needs due to their declining balance sheets and a track record of good and diversified market access. Fitch believes that the replacement of grandfathered bonds that expire to 2015 is manageable, even if it comes at a marginally higher cost.

#### RATING SENSITIVITIES - VRs

NORD/LB's and BremerLB's VRs are most sensitive to further evolution of their asset quality. This primarily includes shipping but also developments in other cyclical industries like commercial real

estate. A deepening of the shipping crisis would endanger already weak profitability and put pressure on moderate capitalisation levels compared with European peers. On the other hand, a sooner than expected recovery in the shipping industry would support the banks' financial profile and enforce the targeted business alignment process.

HSH's VR depends on the final approval of the guarantee, which currently supports its capitalisation level, as it ring-fences out its otherwise substantial risk. If approval is not extended or if additional terms and conditions are imposed, there would be downside risk for HSH's VR, while full approval would be a positive VR driver. HSH's financial profile would benefit most from an end to the shipping crisis, which would likely be positive for its VR. However, more substantial upside potential on its VR requires HSH to make significant structural progress in its targeted client-oriented business model, which Fitch does not expect in the short term.

#### SUSBIDIARY AND AFFILIATED COMPANY - KEY RATING DRIVERS AND RATING SENSITIVITIES

The affirmation of NORD/LB CFB's IDR is based on the extremely high likelihood of support from Norddeutsche Landesbank Luxembourg S.A. and NORD/LB, the bank's direct and ultimate owner, respectively. Fitch considers NORD/LB CFB as core to NORD/LB's business, a view supported by a declaration of backing (Patronatserklaerungen) for NORD/LB CFB from both entities. Fitch currently does not assign a VR to NORD/LB CFB as a result of the strong degree of integration into NORD/LB group.

Given the high degree of integration between the two banks, any rating action on NORD/LB CFB would most likely be caused by rating action on NORD/LB. NORD/LB CFB's ratings are also sensitive to a change in Fitch's view of the propensity of support from NORD/LB.

#### KEY RATING DRIVERS AND SENSITIVITIES- SUBORDINATED DEBT AND GUARANTEED DEBT RATINGS

NORD/LB's, BremerLB's and HSH's state-guaranteed/grandfathered senior and subordinated obligations have all been affirmed at 'AAA' as Fitch believes such debt would not be subject to burden-sharing. HSH's state guaranteed/grandfathered market-linked securities have been affirmed at 'AAAemr'. The ratings are sensitive to any change in Fitch's view of the creditworthiness of the German federal states, underpinned by the stability of the German solidarity system linking its creditworthiness to that of the Federal Republic of Germany (AAA/Stable) or to any indication that the grandfathered guarantees would not be honoured by the respective federal states.

The rating actions are as follows:

##### NORD/LB

Long-term IDR affirmed at 'A'; Outlook Negative

Short-term IDR affirmed at 'F1'

Viability Rating: affirmed at 'bbb-'

Support Rating Floor affirmed at 'A'

Support Rating affirmed at '1'

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

Senior debt affirmed at 'A'/F1'

##### NORD/LB CFB

Long-term IDR affirmed at 'A'; Outlook Negative

Short-term IDR affirmed at 'F1'

Support Rating affirmed at '1'

##### BremerLB

Long-term IDR affirmed at 'A'; Outlook Negative

Short-term IDR affirmed at 'F1'

Viability Rating: downgraded to 'bb+' from 'bbb-'  
Support Rating Floor affirmed at 'A'  
Support Rating affirmed at '1'  
State-guaranteed/grandfathered senior obligations affirmed at 'AAA'  
Senior Debt affirmed at 'A'/F1'

#### HSH

Long-term IDR: affirmed at 'A-', Outlook Negative  
Short-term IDR: affirmed at 'F1'  
Viability Rating: 'b', maintained on RWE  
Support Rating: affirmed at '1'  
Support Rating Floor 'A-' affirmed at 'A-'  
Senior debt: affirmed at 'A-' / 'F1'  
Subordinated debt 'B-' maintained on RWE  
State-guaranteed/grandfathered senior and subordinated obligations: affirmed at 'AAA'  
State-guaranteed/grandfathered market-linked securities: affirmed at 'AAAemr'

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Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 31 January 2014 and 'Assessing and Rating Bank Subordinated and Hybrid Securities', dated 31 January 2014 are available at [www.fitchratings.com](http://www.fitchratings.com).

#### Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=732397](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=732397)

Assessing and Rating Bank Subordinated and Hybrid Securities Criteria

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