

Fitch Affirms NORD/LB COVERED FINANCE BANK S.A.'s Covered Bonds at 'AAA'/Stable

Ratings Endorsement Policy

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Fitch Ratings-Frankfurt/London-12 February 2014: Fitch Ratings has affirmed NORD/LB COVERED FINANCE BANK S.A.'s (CFB, A/Stable/F1) Lettres de Gage Publiques (LdGPs) at 'AAA' with Stable Outlook following a periodic review of the programme.

Key Rating Drivers

The rating is based on CFB's Long-term Issuer Default Rating (IDR) of 'A', an unchanged Discontinuity Cap (D-Cap) of 3 (moderate high risk) and the over-collateralisation (OC) Fitch takes into account in its analysis. The Stable Outlook on the covered bonds reflects that on CFB's IDR.

In its analysis, Fitch relies on the lowest OC observed over the past 12 months of 27%, in line with its criteria for issuers with a 'F1' Short-term IDR, but takes into account only 22%. This is because in its OC calculation the agency does not give credit to intra-group assets. This level of OC supports a 'AA' rating on a probability of default (PD) basis and allows for a two-notch recovery uplift reflecting outstanding recovery prospects on defaulted covered bonds in a 'AAA' scenario.

The unchanged D-Cap of 3 (moderate high risk) results from what Fitch assesses as moderate high risk for the liquidity gap and systemic risk component, reflecting potential termination payments due to defaulted intra-group counterparties ranking pari passu to payments to LdGP holders. Furthermore, the agency assesses the risk on the privileged derivatives component as moderate, and the risk on the cover pool specific alternative management component as low. The asset segregation and systemic alternative management components are assessed as very low risk.

Credit risk remains the main driver for Fitch's breakeven OC. In its asset analysis the agency calculated a default rate of 19% and a recovery rate of 16% for the cover pool in a 'AAA' stress scenario, resulting in a loss rate of 16%. This represents a decline from 19.9% in the previous analysis. This is due to decreased FX risks with the OC in the USD currency bucket now of a similar magnitude (24%) as the overall OC of the total programme (27%). Apart from remaining open FX positions, the cover pool and covered bond profiles are well matched. Fifty-nine percent of the assets and 60% of the covered bonds pay a floating coupon. The weighted average life of the cover assets is 6.9 years, compares with 6.7 years for the covered bonds.

As of end-September 2013 the LdGPs amounted to EUR3.3bn and were secured by a cover pool of public-sector assets amounting to EUR4.2bn. The cover pool comprised 347 assets, which Fitch assigned to 139 ultimate debtors in its analysis. The cover pool is geographically well diversified with concentrations in Germany (30%) and the U.S. (24%). The largest borrower groups are US subnational entities (24%), German public sector companies (19%) and Canadian regions and cities (5%).

Rating Sensitivities

In terms of sensitivity of the covered bonds' rating, the 'AAA' rating would be vulnerable to downgrade if (i) CFB's IDR is downgraded by one or more notches to 'A-' or lower; (ii) the D-Cap falls by one or more categories to 2 (high risk) or lower; or (iii) the OC that Fitch takes into account in its analysis decreases below Fitch's 'AAA' breakeven OC level.

The Fitch breakeven OC for the covered bond rating will be affected by, among other factors, 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 portfolio and Fitch's analysis will be available in a full rating report, which will be shortly available at www.fitchratings.com.

Fitch may have provided another permissible service to CFB or its related third parties. Details of this service can be found on Fitch's website in the EU regulatory affairs page.

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Additional information is available at www.fitchratings.com.

Applicable criteria, 'Counterparty Criteria for Structured Finance and Covered Bonds ', dated 13 May 2013, 'Covered Bonds Rating Criteria', dated 04 September 2013, 'Asset Analysis Criteria for Covered Bonds of European Public Entities', dated 30 January 2013, and 'Covered Bonds Rating Criteria - Public Sector Liquidity and Refinancing Stress Addendum', dated 07 February 2014 are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Counterparty Criteria for Structured Finance and Covered Bonds
Covered Bonds Rating Criteria
Covered Bonds Rating Criteria – Public Sector Liquidity and Refinancing Stress Addendum
Asset Analysis Criteria for Covered Bonds of European Public Entities

Additional Disclosure

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