

Fitch Affirms NORD/LB COVERED FINANCE BANK's Public Sector Lettres de Gage at 'AAA' Ratings Endorsement Policy
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Fitch Ratings-London-20 December 2012: Fitch Ratings has affirmed NORD/LB COVERED FINANCE BANK's ('A/Stable/F1') public sector Lettres de Gage at 'AAA'; Outlook Stable following a periodic review of the programme.

The rating is based on NORD/LB COVERED FINANCE BANK's Long-term Issuer Default Rating (IDR) of 'A', the Discontinuity Cap (D-Cap) of 4 (moderate risk) and the overcollateralisation (OC) level.

The breakeven OC of 17.4% limits the programme to a 'AA' rating on a probability of default (PD) basis and supports a 'AAA' rating considering recoveries given default. Given the issuer's 'F1' Short-term IDR, the OC level the agency takes into account is the lowest OC in the last 12 months (14.1%). The issuer has informed the agency that it intends to increase the OC to the level sufficient to support the 'AAA' rating by end of January 2013. Fitch will monitor this programme based on the lowest level of OC of the preceding 12 months, with the 12 months period starting from end of January 2013.

As of end September 2012, the covered bonds amounted to EUR3.57bn and were backed by a cover pool of EUR4.26bn, which led to a nominal OC of 19.2%. In its credit analysis and the OC calculation the agency did not give credit to the intra-group assets, which account for about 4% of the cover pool. Therefore, the current OC Fitch takes into account is 14.1%.

In terms of sensitivity of the covered bonds' rating, the 'AAA' rating would be vulnerable to downgrade if any of the following occurred: (i) the IDR was downgraded by two or more notches to 'BBB+' or lower; or (ii) the D-Cap fell by two or more categories to 2 (moderate high risk) or lower; or (iii) the OC that Fitch considers in its analysis dropped below Fitch's 'AAA' breakeven level of 17.4%.

The D-Cap of 4 (moderate risk) results from a moderate risk assessment for the liquidity gap and privileged derivatives components. The asset segregation and systemic alternative management components have been assessed as very low risk, while the risk assessment for the cover pool-specific alternative management is low.

The public sector nature of the cover pool primarily supports the low discontinuity risk assessments due to the greater degree of expected liquidity and ease of management of public sector assets (74% of which are publicly-traded bonds) compared with mortgage loans.

The main contributors to the 'AAA' breakeven OC are the credit risk of the cover pool (rating default rate of 17.9% and rating loss rate of 11.7% in a 'AAA' stress scenario) and the open currency positions. The cover pool contains currency and interest rate swaps mitigating the currency and interest rate mismatches. However, post swaps the remaining open currency positions drive the OC, while the interest rate stress has minimal impact on the OC. The weighted-average life of the assets and liabilities are 7.5 and 7.25 years, respectively.

The Fitch breakeven OC for the covered bond rating will be affected by, amongst 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.

On 10 October 2012, Fitch published an exposure draft to propose changes in its analysis of portfolios of public sector entities (Exposure Draft: Asset Analysis Criteria for Covered Bonds and CDOs of European Public Entities, available on www.fitchratings.com). NORD/LB COVERED FINANCE BANK's Lettres de Gage could be affected by the changes, if they are implemented as proposed. Fitch will review the programme once the new criteria report is published.

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Additional information is available at www.fitchratings.com. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Covered Bonds Rating Criteria', dated 10 September 2012, 'Covered Bonds Counterparty Criteria', dated 25 July 2012, 'Covered Bonds Rating Criteria - Public Sector Liquidity and Spread Assumption Addendum', dated 27 November 2012, are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Covered Bonds Rating Criteria - Amended

Covered Bonds Counterparty Criteria

Covered Bonds Rating Criteria - Public Sector Liquidity & Spread Assumption Addendum

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