MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns definitive Aa1 rating to NORD/LB Luxembourg S.A. Covered Bond Bank's public sector covered bonds

Global Credit Research - 03 Jan 2017

EUR 3,628 million of notes affected

London, 03 January 2017 -- Moody's Investors Service has today assigned a definitive Aa1 long-term rating to the public-sector covered bonds issued by NORD/LB Luxembourg S.A. Covered Bond Bank (the issuer, NORD/LB CBB, issuer rating Baa1; adjusted baseline credit assessment ba1; counterparty risk (CR) assessment A3(cr)). The covered bonds are governed by the Luxembourg covered bond legislation.

RATINGS RATIONALE

A covered bond benefits from (1) the issuer's promise to pay interest and principal on the bonds; and (2) following a CB anchor event, the economic benefit of a collateral pool (the cover pool). The ratings therefore reflect the following factors:

(1) The credit strength of NORD/LB CBB (issuer rating Baa1 with negative outlook; adjusted baseline credit assessment ba1; CR assessment A3(cr)) and a CB anchor of CR assessment plus 1 notch.

(2) Following a CB anchor event the value of the cover pool. The stressed level of losses on the cover pool assets following a CB anchor event (cover pool losses) for this transaction is 30.4%.

Moody's considered the following factors in its analysis of the cover pool's value:

a) The credit quality of the assets backing the covered bonds. The public-sector covered bonds ("lettres de gage publiques") are backed primarily by claims against public sector entities, claims guaranteed by such entities or claims financing public undertakings in Europe and the United States of America. The collateral score for the cover pool is 9.7%.

b) The legal framework. Notable aspects of the Luxembourg covered bond legislation (articles 12-1 to 12-12 of the law of 5 April 1993 on the financial sector, as amended) include that (i) the issuer is a regulated and supervised bank; (ii) a cover pool monitor (Approved Statutory Auditor) monitors the operations of the cover pool; (iii) the nominal and net present value of the assets is required to always exceed the amount of outstanding covered bond liabilities by at least 2% (over-collateralisation, OC). In addition, the assets' interest income must at all times be sufficient to cover the interest due on the outstanding bonds.

c) The exposure to market risk, which is 18.3% for this cover pool.

d) The over-collateralisation (OC) in the cover pool is 23.3% on a net present value basis, of which the issuer provides 2.0% on a "committed" basis (see Key Rating Assumptions/Factors, below).

The TPI assigned to this transaction is Probable. Moody's TPI framework does not constrain the rating.

The total nominal value of the assets included in the cover pool is approximately EUR 4,046 million, comprising 300 loan/debt exposures financing public entities, public undertakings and infrastructure investments. 42% of the pool's debtors are located in Germany and 24% in the United States of America. The largest individual exposure is with 3% of the pool to the Republic of Poland (A2, negative).

The rating that Moody's has assigned addresses the expected loss posed to investors. Moody's ratings address only the credit risks associated with the transaction. Moody's did not address other non-credit risks, but these may have a significant effect on yield to investors.

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss of the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The CB anchor for this programme is CR assessment plus one notch. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's may use a CB anchor of CR assessment plus one notch in the European Union or otherwise where an operational resolution regime is particularly likely to ensure continuity of covered bond payments.

The cover pool losses for this programme are 30.4%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 18.3% and collateral risk of 12.1%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is 9.7%.

The over-collateralisation in the cover pool is 23.3% on a net present value basis, of which the issuer provides 2.0% on a "committed" basis. The minimum OC level consistent with the Aa1 rating is 16.0%, of which the issuer should provide 2.0% in a "committed" form (numbers in net present value terms). These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's please refer to "Moody's Global Covered Bonds Monitoring Overview", published quarterly. All numbers in this section are based on Moody's most recent modelling (based on data, as of 31 March 2016).

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

FACTORS THAT WOULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "Probable", the TPI Leeway for this programme is 2 notches. This implies that Moody's might downgrade the covered bonds because of a TPI cap, if it lowers the CB anchor by 3 notches all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain limited circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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