

NORD/LB Luxembourg S.A. Covered Bond Bank (/gws/en/esp/issr/89812661)**Fitch Affirms NORD/LB Luxembourg S.A. Covered Bond Bank's Lettres de Gages Publiques at 'AAA'**

Fitch Ratings-Frankfurt/London-08 February 2017: Fitch Ratings has affirmed NORD/LB Luxembourg S.A. Covered Bond Bank's (NORD/LB CBB, A-/Stable/F1) Lettres de Gage Publiques (LdGPs) at 'AAA' with a Stable Outlook, following a periodic review of the programme.

KEY RATING DRIVERS

The rating is based on NORD/LB CBB's Long-Term Issuer Default Rating (IDR) of 'A-', an unchanged IDR uplift of one notch, an unchanged payment continuity uplift (PCU) of four notches and the 24.6% over-collateralisation (OC) that Fitch takes into account, which provides more protection than the 14% 'AAA' breakeven OC. The Stable Outlook mirrors that on NORD/LB CBB's Long-Term IDR.

NORD/LB CBB's breakeven OC has decreased to 14.0% from 17.5% as reported in our rating action commentary dated 5 December 2016. This is mainly driven by the decreased credit loss of 10.0%, the main constituent of the breakeven OC. Fitch continues to credit link the programme's rating to the Federal Republic of Germany (AAA/Stable/F1+) given the high share of German assets as of 30 September 2016 (44.5%) and its steady growth over the past four years. A higher share of the assets credit-linked to German sovereign and the individual rating assessments for loans to public private partnerships (PPP) are the main drivers of the improved weighted average credit quality of NORD/LB CBB's end of September 2016 cover pool compared with that reported as of end-2015. The decreased credit loss component reflects these positive developments.

The programme has very limited maturity mismatches. The asset disposal loss component of 1.6% reflects the only minimal need for the forced asset sales to ensure timely payment on outstanding LdGPs and a marginal negative carry from excess cash holdings in the modelled high prepayments scenario. Similar to the previous analysis, Fitch has taken into account the flexibility provided by callable LdGPs to manage maturity mismatches when modelling the cash flows. However, the cash flow valuation component has slightly increased to 2.4% due to a higher share of fixed liabilities and, consequently, a lower excess spread generated by the programme under the modelled low interest rates stress.

We derived our rating assumptions for unguaranteed loans to the public sector entities (PSE; about 24% of the NORD/LB CBB's cover pool) in line with the criteria report 'Rating of Public-Sector Entities - Outside the United States' dated 22 February 2016 at www.fitchratings.com. Under this approach, in the absence of a public rating, the rating assumption for the respective PSE is credit-linked to the rating of the largest public sector shareholder and the assumption can be equalised or notched down by up to three notches depending on the aggregate share of public ownership. We applied conservative rating assumptions for PSEs with fragmented ownership structure.

US municipal exposure accounts for about 21% of NORD/LB CBB's cover pool. The default assumptions are based on assets' or bond insurers' public ratings or where not available, on rating assumptions. In line with Fitch's 'State Revolving Fund and Leveraged Municipal Loan Pool Criteria' dated 20 October 2016, we used a rating assumption of 'BB' for 1.9% of the cover pool. Fitch applied individual recovery rate assumptions for the US municipal assets ranging from 15% to 70% in a 'AAA' scenario, depending on the type of bond.

The share of PPP loans, eligible as cover assets under Luxembourgian law, has increased to about 13% of NORD/LB CBB's cover pool from about 6% as of end-2015. For the first time, Fitch performed an individual credit analysis for all PPP loans based on additional information provided by the issuer, in contrast to the conservative 'CCC' assumption we applied previously. Fitch assumed superior recoveries (45% in 'AAA' scenario) for these assets. This is slightly lower for most exposures represented in this sub-portfolio than respective municipal recoveries applied previously, but this assumption only partially offsets the otherwise positive impact of individual credit assessments on asset modelling results.

IDR Uplift

Luxembourg LdGPs are eligible for a maximum IDR uplift of two notches given their exemption from bail-in in a resolution scenario, Fitch's assessment that resolution of the issuer will not result in the direct enforcement of recourse against the cover pool and the low risk of undercollateralisation at the point of resolution (see Fitch's Jurisdictional Analysis of the Risk of Undercollateralisation of Covered Bonds - Excel file).

However, Fitch has assigned NORD/LB CBB's public sector programme an one-notch IDR uplift as the bank's IDR is support-driven and also because the bank does not have a Viability Rating (VR). This reflects the bank's close integration with parent Norddeutsche Landesbank Girozentrale (A-/Stable/F1).

PCU

Fitch has assigned NORD/LB CBB's LdGPs a PCU of four notches based on the voluntary inclusion of liquid assets in the cover pool matching the maximum negative cumulated balance of cash flows for the next 180 days. This is one notch less than the five notches generally assigned for a six-month protection for a public sector programme, given that the commitment is voluntary as opposed to a mandatory legal obligation.

Recovery Uplift

NORD/LB CBB LdGP's public sector programme benefits from a two-notch recovery uplift, as the overcollateralisation (OC) Fitch takes into account compensates for credit losses modelled in a stress scenario corresponding to the level of the covered bond rating, and has not identified any material downside risk to recovery expectations.

VARIATIONS FROM CRITERIA

Fitch applied a variation from 'Counterparty Criteria for Structured Finance and Covered Bonds - Derivatives Addendum' published on 8 July 2016. Although the collateral formula is different to the calculation as per Fitch's criteria we have not made any adjustment as the calculated amounts meet the expectation outlined in Fitch's counterparty criteria. Accordingly there is no rating impact from this variation.

RATING SENSITIVITIES

The LdGP's 'AAA' 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 combined number of notches represented by the IDR uplift and PCU is reduced to three notches or lower; or (iii) the OC that Fitch considers in its analysis decreases below Fitch's 'AAA' breakeven level of 14.0%. If the OC that Fitch considers in its analysis drops to the legal minimum requirement of 2%, the rating would likely be downgraded to 'A+'.

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

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Applicable Criteria

Asset Analysis Criteria for Covered Bonds and CDOs of Public Entities (pub. 05 Jan 2017)

(<https://www.fitchratings.com/site/re/892367>)

Counterparty Criteria for Structured Finance and Covered Bonds (pub. 01 Sep 2016)

(<https://www.fitchratings.com/site/re/886006>)

Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum (pub. 18 Jul 2016)

(<https://www.fitchratings.com/site/re/884964>)

Covered Bonds Rating Criteria (pub. 26 Oct 2016) (<https://www.fitchratings.com/site/re/888874>)

Criteria for Country Risk in Global Structured Finance and Covered Bonds (pub. 26 Sep 2016)

(<https://www.fitchratings.com/site/re/881269>)

Criteria for Interest Rate Stresses in Structured Finance Transactions and Covered Bonds (pub. 26 Oct 2016)

(<https://www.fitchratings.com/site/re/888492>)

Fitch's Cover Assets Refinancing Spread Level (RSL) Assumptions - Excel file (pub. 20 Jan 2017)

(<https://www.fitchratings.com/site/re/893377>)

Fitch's Interest Rate Stress Assumptions for Structured Finance and Covered Bonds - Excel File (pub. 17 May 2016)

(<https://www.fitchratings.com/site/re/880522>)

Fitch's Foreign-Currency Stress Assumptions for Residual Foreign-Exchange Exposures in Covered Bonds and Structured Finance – Excel File (pub. 26 Oct 2016) (<https://www.fitchratings.com/site/re/888865>)

Global Bank Rating Criteria (pub. 25 Nov 2016) (<https://www.fitchratings.com/site/re/891051>)

Rating of Public-Sector Entities – Outside the United States (pub. 22 Feb 2016) (<https://www.fitchratings.com/site/re/877128>)

State Revolving Fund and Leveraged Municipal Loan Pool Criteria (pub. 20 Oct 2016)

(<https://www.fitchratings.com/site/re/888966>)

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Dodd-Frank Rating Information Disclosure Form

(https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1018706&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJzZXNzaW9uS2V5IjoiQUJFU01aSVFHNBQVUIYN1IiUWVZCUkpQWUhSSE8wQjdUMjNYUvdGSClslmV4cCI6MTQ4NzE1NTA2NSwidXNlcklkIjoyNTY4MTQ5fQ.99YVqCHZYEss0uJqxwa9YV2zjlecn94nQghJVdtQyH4)

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