FITCH REVISES NORD/LB AND BREMERLB'S OUTLOOK TO NEGATIVE; AFFIRMS IDRS AT 'A-'

Fitch Ratings-Frankfurt/London-28 March 2017: Fitch Ratings has revised the Outlooks on Norddeutsche Landesbank Girozentrale (NORD/LB) and its fully-owned subsidiary Bremer Landesbank Kreditanstalt Oldenburg Girozentrale (BremerLB) to Negative from Stable and affirmed their Long-Term Issuer Default Ratings (IDRs) at 'A-'. Fitch has also downgraded NORD/LB's Viability Rating (VR) to 'bb' from 'bb+' and BremerLB's VR to 'b+' from 'bb' and subsequently withdrawn BremerLB's VR. A full list of rating actions is at the end of this rating action commentary.

The rating actions follow BremerLB's profit warning on 9 March 2017 announcing a loss of about EUR1.4 billion in 2016, which is significantly higher than the high nine-digit range previously expected by management.

The downgrade of BremerLB's VR reflects our view that the bank's prospects for ongoing unsupported viability have weakened. In 2016, considerable loan impairment charges relating to its sizeable shipping portfolio depleted its small capital base, making a capital injection from NORD/LB necessary.

Under the control agreement (Beherrschungsvertrag) between NORD/LB and BremerLB effective since 1 January 2017, NORD/LB's instructions are now contractually binding for BremerLB's management. We believe that this prevents a meaningful analysis of BremerLB as a standalone entity. Consequently, we have subsequently withdrawn BremerLB's VR because of the expected reorganisation under its new ownership.

The downgrade of NORD/LB's VR reflects our view that the targeted reduction of its shipping exposure and its envisaged return to profitability in 2017 has become less likely in light of its decreased financial flexibility and the severe crisis in the shipping market. This affects NORD/LB's own large shipping portfolio as well as BremerLB's.

We have revised the Outlook on NORD/LB and BremerLB's Long-Term IDRs to Negative from Stable as we believe that the likelihood of extraordinary solvency support from NORD/LB's owners could weaken if the bank's creditworthiness, as expressed by its VR, and the sustainability of its business model, deteriorate further over the next one to two years.

KEY RATING DRIVERS

IDRS, SUPPORT RATINGS (SR) AND SENIOR DEBT RATING

NORD/LB's IDRs and Support Rating are driven by the strong institutional support from its owners, the 'AAA'/Stable rated German regional states of Lower Saxony and Saxony-Anhalt (combined 64.7% share), the savings banks associations of Lower Saxony, Saxony-Anhalt and Mecklenburg-Western Pomerania and ultimately the German savings banks group, Sparkassen Finanzgruppe (SFG, A+/Stable).

Fitch's institutional support considerations are based on the view that NORD/LB's owners consider their investment in NORD/LB long-term and strategic. The owners' strong support propensity is underpinned by NORD/LB's focus on its statutory roles, which include supporting the regional economy as well as acting as the regional savings banks' central clearing institution and the regional states' house bank.

Fitch uses the lower rating of NORD/LB's parents, SFG's Long-Term IDR, as anchor and starting point for determining support-driven ratings. In Fitch's view, support would need to be forthcoming from SFG as well as the states of Lower Saxony and Saxony-Anhalt to avoid triggering state aid considerations and resolution under the German Recovery and Resolution Act (Sanierungs- und Abwicklungsgesetz, SAG) if NORD/LB fails. Our assessment of Lower Saxony and Saxony-Anhalt's creditworthiness is underpinned by the stability of Germany's solidarity and financial equalisation system, which links the regional states' creditworthiness to that of Germany (AAA/Stable). SFG's ability to support, as expressed by its Long-Term IDR of 'A+' is very strong but weaker than that of the regional states.

We notch down NORD/LB's Long-Term IDR twice from SFG's 'A+'. The notching reflects NORD/LB's role for its owners, which we consider strategic, but not key and integral, as well as uncertainties over potential legal and regulatory barriers related to state aid considerations and provisions of German resolution legislation.

BremerLB's IDRs, SR and senior debt ratings are driven by the strong institutional support available from NORD/LB, as demonstrated by a capital injection completed by NORD/LB to restore BremerLB's depleted capital. Our view of institutional support from NORD/LB is also underpinned by NORD/LB's declaration of backing (Patronatserklaerung) for BremerLB.

Despite their wholesale-driven funding mixes, NORD/LB and BremerLB have Short-Term IDRs of 'F1', which is at the higher of two Short-Term IDRs that map to a 'A-' Long-Term IDR on Fitch's rating scale. Through their role as central clearing institutions for the savings banks in their respective regions, both banks have strong links to SFG and privileged access to SFG's ample excess liquidity and funding resources. BremerLB additionally benefits from ordinary funding and liquidity support from NORD/LB. Both banks' liquidity is adequate but not strong, as reflected by LCR ratios in excess of regulatory requirements.

The ratings of both banks' senior unsecured obligations are equalised with their IDRs.

VR

The one-notch downgrade of NORD/LB's VR reflects our view that a continued deterioration in asset quality, which triggered a large loss in 2016, is threatening the long-term sustainability of the bank's business model, limiting managerial flexibility and burdening its financial profile. In November 2016, NORD/LB expected an annual loss of over EUR1 billion for 2016 driven by loan impairment charges. We now expect a substantially higher loss following BremerLB's profit warning.

NORD/LB's targeted shipping exposure reduction (to EUR12 billion-EUR14 billion exposure at default by end-2018 from EUR17 billion at end-9M16) will likely trigger further losses. This will render a return to profitability in 2017, as envisaged by NORD/LB's management, more difficult, in our view, even though better earnings diversification at NORD/LB than BremerLB should mitigate the downside risk.

We understand that the vast majority of the impairment charges incurred by both banks in 2016 relates to their exposure to the poorly performing shipping sector, which resulted in a continued deterioration in asset quality and triggered an increase in reserve coverage. We expect the additional losses to have eroded NORD/LB's fully-loaded CET1 ratio from the 12.2% reported at end-9M16. The one-year expected loss calculated on the bank's loan book exceeded its stock of loan loss allowances by EUR353 million at end-9M16. This shortfall was already deducted from the bank's regulatory CET1 ratio, providing some loss absorption buffer. However, we expect this buffer to have been largely consumed by additional impairment charges in 4Q16.

The two-notch downgrade of BremerLB's VR reflects our assessment that the bank's standalone business model is highly unlikely to be viable without NORD/LB's support as its overexposure to the shipping sector is insufficiently mitigated by unrelated income sources. BremerLB's small capital base relative to its unreserved NPLs suggests that its regulatory capital ratios have been depleted to a level that required a capital injection from NORD/LB. We expect BremerLB's capitalisation to remain weak even after the capital increase.

SUBSIDIARIES
The IDRs and senior debt ratings of NORD/LB Luxembourg S.A. Covered Bond Bank's (NORD/LB CBB) are equalised with those of its parent NORD/LB, reflecting NORD/LB's strong propensity to provide support given NORD/LB CBB's strategic role within the group. This expectation is underpinned by a declaration of backing from NORD/LB. Operating as a specialised covered bond issuer, NORD/LB CBB's role is to fund NORD/LB's core businesses by issuing covered bonds in accordance with Luxembourg law (Lettres de Gage).

DERIVATIVE COUNTERPARTY RATINGS (DCRS), DEPOSIT RATINGS
We have affirmed NORD/LB and BremerLB's DCRs and Deposit Ratings at the level of their respective IDRs. We believe that their respective buffers of junior and vanilla senior debt do not afford any obvious incremental probability of default benefit over and above the multi-notch support benefit already factored into the IDRs.

SUBORDINATED DEBT
NORD/LB's Tier 2 subordinated note DE000NLB8K69 is notched once from the bank's VR to reflect our assessment of the instrument's respective non-performance and relative loss severity risk profile.

GRANDFATHERED STATE-GUARANTEED SECURITIES
The ratings of NORD/LB's grandfathered state-guaranteed senior and Tier 2 notes are equalised with the Long-Term IDR of the federal guarantors. This reflects our opinion that the respective federal states ability and propensity to honour their guarantees are very strong.

RATING SENSITIVITIES
IDRS, SR AND SENIOR DEBT
NORD/LB's IDRs, SRs and senior unsecured debt ratings are sensitive to changes in our assumptions around the propensity or ability of its owners to provide timely support. This could result from a change to SFG's IDRs or changes to the owners' strategic commitment to NORD/LB.

The strategic commitment could weaken if NORD/LB's credit profile deteriorates to an extent that would ultimately put the sustainability of its business model at risk. This could be indicated by a further downgrade of NORD/LB's VR, in which case we could apply a wider notching to NORD/LB and BremerLB's IDRs and senior unsecured debt ratings from SFG's anchor rating.

BremerLB's IDRs, SR and senior unsecured debt ratings are sensitive to changes in our assumptions around the propensity or ability of NORD/LB to support it, and as such predominantly to the same sensitivities as NORD/LB. They could come under pressure if the bank's track record remains weak despite planned restructuring measures or if we believed NORD/LB's propensity to support its subsidiary weakened because it concluded that BremerLB's weak profile would durably impair its own credit quality.

A change to our assessment of the risks of triggering a resolution process ahead of support for a Landesbank more generally could also affect both banks' IDRs, SRs and senior unsecured debt ratings.

VR

NORD/LB's VR is primarily sensitive to changes in capitalisation, asset quality and profitability. Capitalisation is primarily sensitive to continued weak earnings, as the cost of integrating BremerLB will compound NORD/LB's vulnerability to further asset quality deterioration in the shipping sector. Capitalisation also remains sensitive to movements in the euro/US dollar exchange rate as a fairly high share of the shipping exposure is US dollar-denominated. Upside potential for the VR is limited as we view a material and lasting recovery of the shipping sector as unlikely in the foreseeable future.

NORDLB's plan to lower its exposure to the shipping sector is ambitious and bears high execution risk, in our view, particularly if market demand for structured transactions based on shipping assets diminishes. Forced sales of ships may also require additional risk provisions, which could impair NORD/LB's target to return to profitability in 2017. The negative pressure could also be compounded if deterioration in commercial real estate or corporate lending triggers unexpectedly high loan loss provisions.

GRANDFATHERED STATE-GUARANTEED SECURITIES
The ratings of NORD/LB's grandfathered state-guaranteed senior and Tier 2 notes are sensitive to changes in Fitch's view of the creditworthiness of the guarantors.

DCRS AND DEPOSIT RATINGS
The DCRs and Deposit Ratings of NORD/LB and BremerLB are primarily sensitive to changes in their respective IDRs.

SUBORDINATED DEBT
The rating of NORD/LB's Tier 2 subordinated note DE000NLB8K69 is broadly sensitive to the same considerations that might affect the bank's VR.

SUBSIDIARIES
Rating actions on NORD/LB CBB's IDRs and senior unsecured debt ratings would most likely mirror similar actions on NORD/LB's IDRs. NORD/LB CBB's IDRs, SR and senior unsecured debt ratings are also sensitive to changes in our view of NORD/LB's propensity to support.

The rating actions are as follows:

Norddeutsche Landesbank Girozentrale
Long-Term IDR: affirmed at 'A-'; Outlook revised to Negative from Stable
Short-Term IDR: affirmed at 'F1'
Support Rating: affirmed at '1'
Viability Rating: downgraded to 'bb' from 'bb+'
Derivative Counterparty Rating: affirmed at 'A-'(dcr)
Deposit Ratings: affirmed at 'A-'/'F1'
Senior debt and programme ratings: affirmed at 'A-'/ 'F1'
Subordinated debt: new rating assigned at 'BB-' (ISIN: DE000NLB8K69)
Grandfathered state-guaranteed senior and Tier 2 subordinated debt ratings: affirmed at 'AAA'

Bremer Landesbank Kreditanstalt Oldenburg Girozentrale
Long-Term IDR: affirmed at 'A-'; Outlook revised to Negative from Stable
Short-Term IDR: affirmed at 'F1'
Support Rating: affirmed at '1'
Viability Rating: downgraded to 'b+' from 'bb' and withdrawn
Derivative Counterparty Rating: affirmed at 'A-'(dcr)
Deposit Ratings: affirmed at 'A-'/'F1'
Senior debt ratings: affirmed at 'A-'/'F1'

NORD/LB Luxembourg S.A. Covered Bond Bank
Long-Term IDR: affirmed at 'A-'; Outlook revised to Negative from Stable
Short-Term IDR: affirmed at 'F1'
Support Rating: affirmed at '1'
Senior debt rating: affirmed at 'A-'

Contact:
Primary Analyst
Roger Schneider
Director
+49 69 768076 242
Fitch Deutschland GmbH
Neue Mainzer Strasse 46-50
D-60325 Frankfurt am Main

Secondary Analyst
Ioana Sima
Associate Director
+44 20 3530 1736

Committee Chairperson
Patrick Rioual
Senior Director
+49 69 76 80 76 123

Media Relations: Elaine Bailey, London, Tel: +44 203 530 1153, Email: elaine.bailey@fitchratings.com.

Additional information is available on www.fitchratings.com

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