MOODY'S
INVESTORS SERVICE

Rating Action: Moody's places on review NORD/LB Luxembourg S.A. Covered Bond Bank's Public Sector Covered Bonds

Global Credit Research - 19 Apr 2017

London, 19 April 2017 -- Moody's Investors Service has placed on review for downgrade the Aa1 ratings assigned to the covered bonds issued by NORD/LB Luxembourg S.A. Covered Bond Bank (the issuer, NORD/LB CBB; counterparty risk assessment Baa1(cr), on review for downgrade).

RATINGS RATIONALE

Today's rating action is prompted by the downgrade and review of the ratings assigned to the issuer. For further details, please see "Moody's downgrades NORD/LB CBB's deposits to Baa1 and senior unsecured ratings to Baa2 and places ratings on review for further downgrade", published on 18 April 2017 (http://www.moodys.com/viewresearchdoc.aspx?docid=PR_364803).

The covered bonds have been placed on review for downgrade because the issuer's counterparty risk (CR) assessment remains on review for further downgrade. Based on the current modelling, if the issuer's CR assessment stays at Baa1(cr), the covered bonds are expected to maintain their Aa1 rating. If the issuer's CR assessment falls below Baa1(cr), the Aa1 rating currently assigned to the covered bonds will not be achievable unless over-collateralisation (OC) is provided in a "committed" form. In addition, if the CR assessment is downgraded below Baa2(cr), the rating assigned to the covered bonds will be constrained under Moody's TPI framework.

Moody's notes that today's rating action has not been prompted by a deterioration in the credit quality of the cover pool assets backing the issuer's covered bonds.

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 of the cover pool assets following a CB anchor event.

The CB anchor for all programmes 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 currently 9.7%.

The over-collateralisation in the cover pool is 25.0%, of which the issuer provides 2.0% on a "committed" basis. Given the issuer's Baa1(cr) CR assessment, the minimum OC level consistent with the Aa1 covered bond rating is 19.5%, of which the issuer should provide 0.0% in a "committed" form (numbers in nominal value terms). These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

With a Baa2(cr) CR assessment, the minimum OC level consistent with the Aa1 covered bond rating is 22.0%, of which the issuer should provide 17.0% in a "committed" form (numbers in nominal value terms). If the issuer does not provide additional OC in a "committed" form, the maximum expected loss rating is Aa3. With a

Baa2(cr) CR assessment, the minimum OC level consistent with the Aa3 covered bond rating is 6.0%, of which the issuer should provide 0.0% in a "committed" form (numbers in nominal value terms).

All numbers in this section are based on the Press Release "Moody's assigns definitive Aa1 rating to Nord/LB Luxembourg S.A. Covered Bond Bank's public sector covered bonds", published on 3 January 2017 and Moody's most recent modelling.

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.

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.

Moody's has assigned a TPI of Probable.

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" and the issuer's Baa1(cr) CR assessment, the TPI Leeway for the covered bonds is 1 notch. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by 2 notches all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain 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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Alexander Zeidler
VP - Senior Credit Officer
Structured Finance Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Juan Pablo Soriano
MD - Structured Finance
Structured Finance Group
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

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