



## Fitch Places NORD/LB's VR and IDR on RWN

Fitch Ratings-Frankfurt/London-07 December 2018: Fitch Ratings has placed Norddeutsche Landesbank Girozentrale's (NORD/LB) 'A-' Long-Term Issuer Default Rating (IDR), 'F1' Short-Term IDR, 'bb' Viability Rating (VR) and '1' Support Rating (SR) on Rating Watch Negative (RWN). The bank's non-guaranteed debt and deposit ratings have also been placed on RWN. A full list of rating actions is at the end of this rating action commentary.

The placement of the support-driven ratings on RWN follows NORD/LB's announcement that it has received four offers from investors to buy minority stakes in the bank and reflects Fitch's view that the IDRs and SR would be downgraded if a minority ownership by private-sector investors weakens the long-term commitment and propensity of NORD/LB's public-sector owners to support the bank. NORD/LB has invited private sector investors to participate in the bank's capital as part of efforts to strengthen its capitalisation and reduce its large non-performing shipping loan portfolio.

The RWN on the VR reflects our view that the capital strengthening measures and a planned reduction of the non-performing shipping portfolio will expose the bank to significant execution risk. NORD/LB has announced plans to reduce its non-performing shipping financing portfolio by a large share, which will trigger further valuation losses and could weaken its capital ratios. A downgrade of the VR could result from a failure to execute the capital strengthening and non-performing loan book reduction in the near term, as this could compromise the sustainability of the bank's business model and ultimately increase the probability of regulatory actions. This could also weaken the current owners' ability to support, which is reflected in the RWN on the support-driven ratings.

### KEY RATING DRIVERS

**IDRS, SUPPORT, SENIOR DEBT, DERIVATIVE COUNTERPARTY (DCR) AND DEPOSIT RATINGS**  
NORD/LB's IDRs, senior debt ratings, DCR, Deposit Ratings and SR are driven by institutional support from its owners: the 'AAA'/Stable rated German federal states of Lower Saxony and Saxony-Anhalt, which together hold a 64.7% stake in the bank, 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 uses the lowest rating of NORD/LB's parents, SFG's Long-Term IDR, as anchor and starting point for determining the bank's support-driven ratings because in Fitch's view, support from SFG would help avoid triggering state aid considerations and resolution under the German Recovery and Resolution Act (Sanierungs- und Abwicklungsgesetz) if NORD/LB fails.

Lower Saxony has signaled its willingness, and in Fitch's opinion has the financial means to support NORD/LB. To minimise the risk of state aid considerations by the European Commission, NORD/LB's owners have invited private-sector investors to bid for a minority stake in the bank and had received four offers by 28 November 2018. The bank expects to finalise concrete plans for its recapitalisation measures in early 2019. This could either involve one of the offers already received, or other options, which Fitch believes could include a solution within the German public banking sector.

NORD/LB's Short-Term IDR is the higher of two possible levels that map to a 'A-' Long-Term IDR on Fitch's rating scale, reflecting the bank's continued strong links to SFG and privileged access to SFG's ample excess liquidity and funding resources.

NORD/LB's senior unsecured and senior preferred debt ratings, DCR and Deposit Ratings are equalised with its IDRs. We believe the bank's buffer of junior and non-preferred senior unsecured debt does not afford any obvious incremental probability of default benefit over and above the multi-notch support benefit already factored into its IDRs.

## VR

NORD/LB's VR reflects the bank's large exposure to non-performing ship lending, which burdens its asset quality, earnings and capitalisation, and limits its managerial and strategic flexibility. NORD/LB will need its current owners to approve the change of its legal form into a limited company that is necessary to allow external investors to acquire a minority stake.

The peak of the shipping sector's crisis triggered NORD/LB's record pre-tax loss of EUR1.86 billion at end-2016. Given the sector's overriding impact on NORD/LB's business model, this has put its ratings under pressure. The bank has since worked on improving its asset quality, but its planned reduction of the non-performing shipping portfolio would trigger large haircuts and a capital shortfall.

NORD/LB's shrinking and lower-yielding asset base, margin pressure from low interest rates and intense competition, and upfront restructuring costs also burden its profitability. Cost-cutting measures are unlikely to benefit the group in the near term, given the lengthy processes and associated up-front charges. We expect credit impairment charges to further erode a large share of the bank's pre-provision income, albeit less than in 2016. Consequently, we expect the bank's cost-income ratio to remain above management's target of 50% over the next years.

Weak, volatile internal capital generation prospects and rising capital requirements limit NORD/LB's flexibility to manage its capital. Its fully-loaded CET1 ratio recovered to 11.8% at end-3Q18 from a trough of 9.9% at end-2016, driven by a sizeable cut in risk-weighted assets, but its tight leverage ratio of 3.5% offers only a limited buffer above regulatory requirements.

Funding remains a relative rating strength. NORD/LB enjoys a privileged placement capacity with the savings banks and typically taps capital markets only for regular issuance of benchmark secured debt issues. However, in our view, its funding costs and access to SFG's liquidity are sensitive to a deterioration of its credit profile. Liquidity is adequate, as reflected by a liquidity coverage ratio of 168% at end-3Q18 and a liquid securities portfolio of EUR34 billion, of which 83% are eligible for central bank refinancing.

## NON-GUARANTEED SUBORDINATED DEBT

The rating of NORD/LB's non-guaranteed Tier 2 subordinated notes is notched once from the VR to reflect our assessment of the notes' relative loss severity. The RWN reflects the RWN on the VR.

## GRANDFATHERED STATE-GUARANTEED SECURITIES

The ratings of NORD/LB's grandfathered state-guaranteed notes are equalised with the Long-Term IDRs of their guarantors, Lower Saxony and Saxony-Anhalt. This reflects our opinion that both states' ability and propensity to honour their guarantees are very strong.

## NORD/LB LUXEMBOURG S.A. COVERED BOND BANK'S (NORD/LB CBB)

NORD/LB CBB's IDRs and senior debt ratings are equalised with those of its parent NORD/LB, and the RWN mirrors that on the parent. The equalisation of the ratings reflects NORD/LB's declaration of backing and strong propensity to support given NORD/LB CBB's strategic role within the group, which is to fund NORD/LB's core businesses by issuing covered bonds based on Luxembourg's Lettres de Gage legislation.

## RATING SENSITIVITIES

### IDRS, SR, DCR, SENIOR DEBT AND DEPOSIT RATINGS

NORD/LB's support-driven ratings are sensitive to changes in our assumptions around the propensity

or ability of its owners to provide timely support. We expect to resolve the RWN upon completion of the recapitalisation and asset clean-up, which we expect in 1H19, or earlier if we believe the planned remedial actions have become significantly less likely.

We could affirm the support-driven ratings and remove them from RWN upon completion of the recapitalisation and asset clean-up, if we conclude that this sustainably strengthens the bank's business model. An affirmation would be contingent on the public-sector owners' commitment to their long-term investment, notably by maintaining the bank's focus on its statutory roles, which include supporting the regional economy, the central clearing for the regional savings banks, and being the regional states' main bank. NORD/LB's continued membership in the public-sector banks' institutional protection scheme would also underpin the owners' commitment, in our view.

We would downgrade NORD/LB's support-driven ratings and VR if we believe that the owners cannot sustainably strengthen its business model. We would downgrade the Long-Term IDR to 'BBB-' if we conclude that a weakened business model makes the authorities more likely to enforce an orderly wind-down of the bank under its public-sector owners' sponsorship, which would still imply a high likelihood that senior creditors would be protected. We could also downgrade the support-driven ratings, possibly to the level of the VR, if we believe that a minority stake by private investors could eventually pave the way for a full privatisation of the bank.

The DCR, senior unsecured debt rating and Deposit Ratings are primarily sensitive to changes in the bank's IDRs.

#### VR

NORD/LB's VR is primarily sensitive to material execution risk that we may identify in its recapitalisation plan and to its capital ratios falling close to or below its regulatory requirements (following the planned reduction of non-performing shipping loans or oversized loan impairments).

An upgrade of the VR is unlikely in the short term as it would require a significant structural improvement of the bank's balance sheet, strengthening of its regulatory capital ratios well beyond our expectations and a lasting recovery of the shipping sector.

#### SUBORDINATED DEBT

The rating of the non-guaranteed Tier 2 subordinated notes is primarily sensitive to the same considerations that might affect the bank's VR.

#### GRANDFATHERED STATE-GUARANTEED SECURITIES

The ratings of NORD/LB's grandfathered state-guaranteed marked-linked securities and Tier 2 notes are sensitive to changes in Fitch's view of the guarantors' creditworthiness.

#### NORD/LB CBB

NORD/LB CBB's IDRs, SR and senior unsecured debt rating are primarily sensitive to changes in NORD/LB's Long-Term IDR and to a reassessment of NORD/LB's propensity to support.

The rating actions are as follows:

Norddeutsche Landesbank Girozentrale

Long-Term IDR: 'A-', placed on RWN

Short-Term IDR: 'F1', placed on RWN

Support Rating: '1', placed on RWN

Viability Rating: 'bb', placed on RWN

Derivative Counterparty Rating: 'A-(dcr), placed on RWN

Deposit Ratings: 'A-/F1', placed on RWN

Senior unsecured debt rating: 'A-', placed on RWN

Senior preferred debt and issuance programme ratings: 'A-/F1', placed on RWN

Commercial paper programme ratings: 'F1', placed on RWN  
Non-guaranteed Tier 2 subordinated debt ( DE000NLB8K69): 'BB-', placed on RWN  
Grandfathered state-guaranteed senior and Tier 2 subordinated notes: affirmed at 'AAA'

NORD/LB Luxembourg S.A. Covered Bond Bank  
Long-Term IDR: 'A-', placed on RWN  
Short-Term IDR: 'F1', placed on RWN  
Senior unsecured debt rating: 'A-', placed on RWN  
Support Rating: '1', placed on RWN

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Summary of Financial Statement Adjustments - Fitch reclassified loans reported by the bank as "assets held for sale" to "loans".

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Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

**Applicable Criteria**

Bank Rating Criteria (pub. 12 Oct 2018) (<https://www.fitchratings.com/site/re/10044408>)

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