

Rating Action: Moody's reviews NORD/LB Luxembourg S.A. - Public-Sector Covered Bonds, direction uncertain

19 Dec 2018

London, 19 December 2018 -- Moody's Investors Service ("Moody's") has placed on review with direction uncertain the Aa3 ratings assigned to the covered bonds issued by NORD/LB Luxembourg S.A. Covered Bond Bank (the issuer, NORD/LB CBB; deposits Baa2 on review direction uncertain; adjusted baseline credit assessment ba3 on review direction uncertain; counterparty risk assessment Baa2(cr) on review with direction uncertain).

RATINGS RATIONALE

Today's rating action is prompted by the review of the ratings assigned to the issuer. For further details, please see "Moody's places long-term ratings of NORD/LB on review with direction uncertain" (http://www.moody's.com/viewresearchdoc.aspx?docid=PR_392759), published on 18 December 2018.

The covered bonds have been placed on review with direction uncertain because the issuer's counterparty risk (CR) assessment has been put on review with direction uncertain. Based on the current modelling, if the issuer's CR assessment stays at Baa2(cr), the covered bonds are expected to maintain their Aa3 rating. If the issuer's CR assessment is upgraded, Moody's would incorporate the issuer's proposals related to the level of OC they intend to maintain in the future. If the CR assessment is downgraded below Baa3(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 27.1%. 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 20.6% and collateral risk of 6.5%. 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 13.1%.

The over-collateralisation in the cover pool is 26.4%, of which the issuer provides 2.0% on a "committed" basis. Under Moody's Cobol model, given the issuer's Baa2(cr) CR assessment, the minimum OC level consistent with the Aa3 covered bond rating is 7.5%, of which 0.0% needs to be in "committed" form to be given full value. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the Performance Overview report based on data as per 30 June 2018, published on 1 November 2018, 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" and "Covered Bonds - Global Sector Update", 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.

For NORD/LB Luxembourg S.A. - Public-Sector Covered Bonds, 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 Baa2(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 November 2018. Please see the Rating Methodologies page on www.moody.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.

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