



Fitch Maintains NORD/LB Luxembourg S.A. Covered Bond Bank's LdGPs on Rating Watch Negative

Fitch Ratings-Milan/London-21 January 2019: Fitch Ratings has maintained NORD/LB Luxembourg S.A. Covered Bond Bank's (NORD/LB CBB, A-/RWN/F1/RWN) 'AAA' public sector covered bonds (Lettres de Gages Publiques, LdGPs) on Rating Watch Negative (RWN). The rating action follows the periodic review of the programme.

Fitch originally placed the LdGPs on RWN on 11 December 2018 (see 'Fitch Places NORD/LB Luxembourg S.A. Covered Bond Bank's LdGPs on Rating Watch Negative' available at www.fitchratings.com) after the agency placed NORD/LB CBB's Issuer Default Rating (IDR) on RWN (see 'Fitch Places NORD/LB's VR and IDR on RWN' dated 07 December 2018 on www.fitchratings.com).

Fitch will resolve the RWN on NORD/LB CBB's LdGPs following the resolution of the RWN on the bank's IDR.

KEY RATING DRIVERS

The RWN on NORD/LB CBB's LdGPs rating reflects that on the bank's IDR. The covered bonds' rating now has a two-notch (as opposed to one before) buffer against a downgrade of the IDR: the 'AAA' covered bonds' rating would only be downgraded if NORD/LB CBB's IDR is downgraded by more than two notches.

The larger cushion against an IDR downgrade is derived from Fitch increasing the Payment Continuity Uplift (PCU) assigned to the programme to five notches (from four); this reflects the introduction of the 180-day liquidity rule in the Luxembourgian covered bonds law. In the past Fitch used to rely 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.

The LdGPs are rated 'AAA', six notches above the bank's Long-Term IDR of 'A-'. This is based on an IDR uplift of one notch, a PCU of five notches and a recovery uplift of two notches. The overcollateralisation (OC) of 23.8% (the lowest level of OC over the past 12 months, as of March 2018) that Fitch relies upon in its analysis provides more protection than the revised 'AAA' breakeven OC of 15.5%.

Fitch has increased the breakeven OC to 15.5% from 14.5%. It remains driven by the credit loss of 15.5% (up from 14.7%). The increase reflects the increased share of public private partnerships (PPP; 19.1%) and of government-related entities (GRE; 33.9%) with a significant reduction of exposures towards sovereign or municipalities (32.5% from 43.5%), as of September 2018. Rating assumptions for GREs were provided by Fitch's Public Finance team based on the approach outlined in Government-Related Entities Rating Criteria.

Exposure to countries rated in the 'Acat' or below has declined to 2.4% (from 6%); China is now included in the cover pool (0.6%) and United Arab Emirates (UAE) now represents 2.3% of the total assets. Fitch continues to apply a 0% recovery rate for UAE exposures, reflecting uncertainty about governmental support should the obligor default. Additionally UAE's legal environment limits recovery

prospects.

The share of PPP loans, eligible as cover assets under Luxembourgian law, has increased to about 19% of the cover pool from about 17% as of end-2017. Fitch assumes superior recoveries (45% in AAA scenario) for these assets.

The cover pool continues to remain internationally diversified with concentrations in Germany (44.7%), UK (16.5%) and the US (14.3%); the high share of German assets results in the programme's rating being credit-linked to Germany (AAA/Stable/F1+).

RATING SENSITIVITIES

All else being equal, the 'AAA' rating of the covered bonds issued by NORD/LB CBB would be vulnerable to a downgrade if any of the following occurs: (i) NORD/LB CBB's IDR is downgraded to 'BBB-' or below; (ii) the German sovereign is downgraded to 'AA+' or below; (iii) the combined number of notches represented by the IDR uplift and payment continuity uplift is reduced to three notches or lower; or (iv) the relied-upon OC drops below Fitch's AAA' breakeven OC of 15.5%.

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+' /RWN.

The Fitch breakeven OC for the LdGPs 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 issuance. Therefore the breakeven OC to maintain the covered bond rating cannot be assumed to remain stable over time.

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Additional information is available on www.fitchratings.com

Applicable Criteria

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

CLOs and Corporate CDOs Rating Criteria (pub. 19 Jul 2018)

(<https://www.fitchratings.com/site/re/10038306>)

Covered Bonds Rating Criteria (pub. 11 Jan 2019) (<https://www.fitchratings.com/site/re/10059083>)

Covered Bonds and CDOs Public Entities' Asset Analysis Criteria (pub. 09 Nov 2018)

(<https://www.fitchratings.com/site/re/10049366>)

Fitch's Interest Rate Stress Assumptions for Structured Finance and Covered Bonds - Excel File

(pub. 02 Feb 2018) (<https://www.fitchratings.com/site/re/10018863>)

Fitch's Foreign-Currency Stress Assumptions for Residual Foreign-Exchange Exposures in Covered Bonds and Structured Finance – Excel File (pub. 30 Oct 2017)

(<https://www.fitchratings.com/site/re/10008156>)

Government-Related Entities Rating Criteria (pub. 25 Oct 2018)

(<https://www.fitchratings.com/site/re/10047173>)

Structured Finance and Covered Bonds Counterparty Rating Criteria (pub. 01 Aug 2018)

(<https://www.fitchratings.com/site/re/10039504>)

Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum (pub. 01 Aug 2018) (<https://www.fitchratings.com/site/re/10039505>)

Structured Finance and Covered Bonds Country Risk Rating Criteria (pub. 23 Oct 2018)

(<https://www.fitchratings.com/site/re/10047041>)

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub. 02 Feb 2018)

(<https://www.fitchratings.com/site/re/10018549>)

U.S. Public Finance State Revolving Fund and Municipal Finance Pool Program Rating Criteria (pub. 27 Sep 2018) (<https://www.fitchratings.com/site/re/10045104>)

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