

12 Aug 2019 | Rating Watch

Fitch Maintains NORD/LB's 'A-' IDR on RWN

Fitch Ratings-Frankfurt am Main-12 August 2019:

Fitch Ratings has maintained Norddeutsche Landesbank Girozentrale's (NORD/LB) 'A-' Long-Term Issuer Default Rating (IDR) on Rating Watch Negative (RWN) and affirmed its Viability Rating (VR) at 'f'. Fitch has also maintained the ratings of NORD/LB's 100 % subsidiary, NORD/LB Luxembourg S.A. Covered Bond Bank on RWN.

Key Rating Drivers

IDRS, SUPPORT RATING (SR), SENIOR DEBT, DERIVATIVE COUNTERPARTY RATING (DCR) AND DEPOSIT RATINGS

Fitch placed NORD/LB's Long- and Short-Term IDRs, SR, DCR, deposit ratings and related debt instrument ratings on RWN on 7 December 2018 following NORD/LB's announcement of capital strengthening measures. Fitch maintained the RWN on 22 February 2019 following the announcement of a large loss for 2018 and regulatory capital ratios that are in breach of its Pillar 1 and Pillar 2R requirements at end-2018.

The resolution of the RWN is contingent on a recapitalisation of the bank by its owners. This has been contractually agreed upon. The owners plan to strengthen the capital ratios through a cash capital injection of EUR2.835 billion, which the federal states of Lower Saxony and Saxony-Anhalt will participate together with a total of EUR1.7 billion. EUR1.135 billion of the cash capital supply will be made available by the German Savings Bank Association (DSGV) and the publicly owned savings banks through two vehicles, which will increase the number of NORD/LB's stakeholders to seven from five. The State of Lower Saxony will also carry out additional capital-relieving measures of up to EUR800 million, leading to a total capitalisation effect of up to EUR3.635 billion.

However, the bank's recapitalisation has not been executed to date, because the transaction is subject to the European Commission's (EC) approval with respect to state aid considerations. We have maintained the RWN as it is approaching Fitch's six-month review period and the EC has not yet announced its decision.

NORD/LB has presented a revised business model to the EC for an assessment of compatibility with state aid rules. Under the proposal, NORD/LB will be transformed into a regionally oriented,

re-dimensional commercial bank without a material exposure to shipping by 2024. The bank targets a balance sheet of about EUR95 billion (end-1Q19: EUR148.2 billion), a common equity Tier 1 (CET1) ratio of around 14 %, a problem loan ratio below 2.0% and a cost-income ratio below 50%. The new operating model targets a pre-tax return on CET1 capital of above 8% from 2024.

NORD/LB's IDRs, senior debt ratings, DCR, Deposit Ratings and SR are driven by institutional support from its owners, the German federal states of Lower Saxony and Saxony-Anhalt (both AAA/Stable), 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 under EU law and resolution under the German Recovery and Resolution Act if NORD/LB fails.

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 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

The affirmation of NORD/LB's VR at 'f' reflects the pending extraordinary support in the form of a contribution of capital by its owners to address its material capital shortfall. At end-1Q19 NORD/LB reported a CET1 ratio of 6.7 %, which is still below its combined Pillar 1 and Pillar 2 CET1 requirement of 7%, and a leverage ratio of 2.1%. Fitch estimates that if the expected recapitalisation is executed as planned, the bank's CET1 would improve to around 14% at end-2019. The VR also reflects the expected deep restructuring of the bank, which could affect its franchise and is subject to significant execution risk. The VR also takes into account weak expected profitability in coming years. NORD/LB's asset quality is expected to improve following the planned wind-down of its non-performing shipping portfolio to below EUR3 billion at end-2019. Funding is a relative strength despite challenges, given the bank's ability to source funding from the savings banks and through issuance of covered bonds.

NON-GUARANTEED SUBORDINATED DEBT

The maintained RWN on NORD/LB's non-guaranteed Tier 2 subordinated bond (DE000NLB8K69) reflects further risks for subordinated bondholders in the event the recapitalisation does not proceed as outlined.

NORD/LB's non-guaranteed Tier 2 subordinated bond (DE000NLB8K69) rating is notched down twice from what Fitch reasonably believes to be the level for NORD/LB's VR post-re-capitalisation, 'bb' (one notch to reflect below average recovery prospects in the event of a default and a second notch to reflect the potential for incremental non-performance risk, for example in the event of a state aid ruling that requires burden sharing).

GRANDFATHERED STATE-GUARANTEED SECURITIES

The ratings of NORD/LB's grandfathered state-guaranteed senior and Tier 2 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 preferred debt ratings are equalised with those of its parent NORD/LB, and the maintained RWN mirrors that on the parent. The equalisation primarily reflects NORD/LB's declaration of backing.

Rating Sensitivities

IDRS, SR, SENIOR DEBT AND DEPOSIT RATINGS AND DCR

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, or earlier if we believe the planned remedial actions have become significantly less likely.

We could affirm the IDRs and remove them from RWN upon completion of the planned recapitalisation under its current owners and reduction of a large share of the bank's shipping NPLs, if we conclude that this sustainably stabilises the bank's business model and results in a VR no lower than 'bb'. 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, central clearing for the regional savings banks, and being the regional states' main bank.

We could downgrade NORD/LB's IDR upon completion of the recapitalisation under its public

sponsors if state aid considerations are triggered and we believe eventual limitations imposed by the EC will significantly weaken the bank's business model, which would result in a lower VR.

We would likely 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.

We could downgrade the support-driven ratings if NORD/LB reverts to a private-sector recapitalisation and if we believe that sale of a minority stake to private investors could pave the way for a full privatisation.

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

VR

NORD/LB's VR is primarily sensitive to the completion of the recapitalisation measures to restore the bank's capital ratios above the regulatory minimum. If the measures are successful, we would upgrade the VR to reflect stronger capitalisation and asset quality, but also Fitch's expectation that earnings will remain weak in the coming years as the bank will undergo a material transformation under a new business plan.

NON-GUARANTEED SUBORDINATED DEBT

The rating of the non-guaranteed Tier 2 subordinated notes is primarily sensitive to changes in our assumptions on the level of losses that might be imposed on Tier 2 debtholders in a default scenario, and to the level of NORD/LB's VR post-recapitalisation. The rating would be downgraded if we believe that a distressed debt exchange or burden sharing, which we currently do not expect, has become more likely.

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 guarantors' creditworthiness.

NORD/LB CBB

NORD/LB CBB's IDRs, SR and senior preferred 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. We could also apply a wider notching if we conclude that the strategic role of NORD/LB CBB will be less relevant for NORD/LB in the future or if developments at NORD/LB threaten the viability of NORD/

LB CBB, given its level of integration, services and dependencies in areas such as liquidity management and refinancing.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

Criteria Variation

Fitch has varied its criteria in respect of the rating of NORD/LB's non-guaranteed Tier 2 subordinated bond (DE000NLB8K69). Under Fitch's criteria, for banks whose IDRs are driven by expectations of institutional support, Fitch notches subordinated debt ratings down from the VR where Fitch has concerns over the potential for institutional support extending to subordinated debtholders. This is the case with NORD/LB, given its partial state-ownership and potential state aid and limitations driven by the Bank Recovery and Resolution Directive.

Fitch's criteria allows for a bank's IDR and senior debt ratings to be above the VR at very low rating levels, where we consider a bank to have failed under our criteria, but consider default risk on senior debt to be lower than failure risk. However, Fitch's criteria have not explicitly contemplated the same principle being applicable to subordinated debt.

In the case of NORD/LB, we consider the default risk on its subordinated debt to be lower than the risk implied by this level of VR because of a recapitalisation plan that is credible, but still carries more risk for subordinated bondholders than senior bondholders. Hence, we have varied our criteria and notched down NORD/LB's subordinated debt from what we consider to be a plausible post-recapitalisation VR for NORD/LB of 'bb' (one notch for loss severity and a second notch for incremental non-performance risk).

Norddeutsche Landesbank Girozentrale; Long Term Issuer Default Rating; Rating Watch Maintained; A-; RW: Neg
; Short Term Issuer Default Rating; Rating Watch Maintained; F1; RW: Neg
; Viability Rating; Affirmed; f

; Support Rating; Rating Watch Maintained; 1; RW: Neg
; Derivative Counterparty Rating; Rating Watch Maintained; A-(dcr); RW: Neg
----senior unsecured; Long Term Rating; Affirmed; AAA
----subordinated; Long Term Rating; Affirmed; AAA
----senior unsecured; Long Term Rating; Rating Watch Maintained; A-; RW: Neg
----long-term deposits; Long Term Rating; Rating Watch Maintained; A-; RW: Neg
----Senior preferred; Long Term Rating; Rating Watch Maintained; A-; RW: Neg
----subordinated; Long Term Rating; Rating Watch Maintained; B+; RW: Neg
----short-term deposits; Short Term Rating; Rating Watch Maintained; F1; RW: Neg
----Senior preferred; Short Term Rating; Rating Watch Maintained; F1; RW: Neg
NORD/LB Luxembourg S.A. Covered Bond Bank; Long Term Issuer Default Rating; Rating Watch
Maintained; A-; RW: Neg
; Short Term Issuer Default Rating; Rating Watch Maintained; F1; RW: Neg
; Support Rating; Rating Watch Maintained; 1; RW: Neg
----Senior preferred; Long Term Rating; Rating Watch Maintained; A-; RW: Neg

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Additional information is available on www.fitchratings.com

Applicable Criteria

[Bank Rating Criteria \(pub. 12 Oct 2018\)](#)

[Short-Term Ratings Criteria \(pub. 02 May 2019\)](#)

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