

03 Jan 2020 | Affirmation

# Fitch Affirms NORD/LB's IDR at 'A-'; off RWN; Outlook Stable

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Fitch Ratings-Frankfurt am Main-03 January 2020:

Fitch Ratings has affirmed Norddeutsche Landesbank Girozentrale's (NORD/LB) 'A-' Long-Term Issuer Default Rating (IDR) and removed it from Rating Watch Negative (RWN). The RWN was initially assigned on 7 December 2018. Fitch has also upgraded NORD/LB's Viability Rating (VR) to 'bb+' from 'f'.

A full list of rating actions is detailed below.

NORD/LB Luxembourg S.A. Covered Bond Bank; Long Term Issuer Default Rating; Affirmed; A-; RO:Sta

; Short Term Issuer Default Rating; Affirmed; F1; RW: Off

; Support Rating; Affirmed; 1; RW: Off

----Senior preferred; Long Term Rating; Affirmed; A-; RW: Off

Norddeutsche Landesbank Girozentrale; Long Term Issuer Default Rating; Affirmed; A-; RO:Sta

; Short Term Issuer Default Rating; Affirmed; F1; RW: Off

; Viability Rating; Upgrade; bb+; RW: Off

; Support Rating; Affirmed; 1; RW: Off

; Derivative Counterparty Rating; Affirmed; A-(dcr); RW: Off

----senior unsecured; Long Term Rating; Affirmed; AAA

----subordinated; Long Term Rating; Affirmed; AAA

----senior unsecured; Long Term Rating; Affirmed; A-; RW: Off

----long-term deposits; Long Term Rating; Affirmed; A-; RW: Off

----Senior preferred; Long Term Rating; Affirmed; A-; RW: Off

----subordinated; Long Term Rating; Upgrade; BB; RW: Off

----short-term deposits; Short Term Rating; Affirmed; F1; RW: Off

----Senior preferred; Short Term Rating; Affirmed; F1; RW: Off

## Key Rating Drivers

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

The affirmation of NORD/LB's support-driven ratings and their removal from RWN reflects the successful recapitalisation of NORD/LB through a capital injection by its owners on 23 December, following the approval by the European Commission (EC) on 5 December, parliamentary approval by the related state governments in Lower Saxony and Sachsen-Anhalt and clearance of the transaction by the regulatory and supervisory authorities. The EC concluded that NORD/LB's support measures, based on a detailed business plan covering the period 2019-2024, are compliant with the EC's state-aid rules.

NORD/LB's IDRs, senior debt ratings, DCR, Deposit Ratings and Support Rating (SR) are driven by institutional support from the bank's owners.

The recapitalisation of NORD/LB by its public-sector owners underlines their commitment to their long-term investment in the bank, in our view. The capital increase consisted of a cash injection of EUR2,835 million, comprising EUR1,500 million from Lower Saxony, EUR198 million by Saxony-Anhalt and a combined EUR1,135 million from the savings bank organisations. In addition Lower Saxony provided a guarantee primarily for part of NORD/LB's maritime and aircraft portfolios and took over two of the bank's investments (lottery Toto Lotto and porcelain manufacturer Fürstenberg), providing a capital relief of around EUR800 million. NORD/LB's recapitalisation changed the bank's stakeholder structure by adding two investment vehicles of the savings banks institutional protection fund.

The combined share of the savings banks group (the savings banks associations of Lower Saxony, Saxony-Anhalt and Mecklenburg-Western Pomerania, and the two investment vehicles) rose to 40% (from 35.4%) while the German federal states of Lower Saxony and Saxony-Anhalt (both AAA/Stable), together hold a 59.9% stake in the bank; Lower Saxony remains the bank's majority shareholder.

NORD/LB's statutory role is also being preserved. It includes supporting the regional economy in Lower Saxony and Sachsen-Anhalt, and being the regional states' main bank. At the same time, NORD/LB maintains its membership in Sparkassen-Finanzgruppe's (SFG, A+/Stable) institutional mutual support scheme (IPS) and acts as the central clearing institution for the regional savings banks in all three federal states.

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 again in the future.

NORD/LB's Short-Term IDR is the higher of two possible ratings that map to an 'A-' Long-Term IDR on Fitch's rating scale, because propensity of support by its institutional owners is likely more

certain in the near term and the bank shares strong links with SFG and has 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 the bank's IDRs. We believe the bank's buffer of junior and senior non-preferred debt does not afford any obvious incremental probability of default benefit over and above the multi-notch support benefit already factored into the IDRs.

VR

NORD/LB's viability was restored following the capital injection by the bank's owners, which has raised the bank's Common Equity Tier 1 (CET1) ratio to around 14% at end-2019, comfortably in compliance with regulatory requirements. The bank's capital position is a relative rating strength and has a high influence on the 'bb+' VR, helping to offset factors we consider as relative rating weaknesses, notably a business model whose stability is unproven, strategic execution and profitability.

The VR reflects the transformation of NORD/LB's business model into a regionally-focused wholesale bank with a balance sheet size below EUR100 billion, a niche international franchise, a moderate risk profile and significantly improved asset quality and capitalisation. NORD/LB's margins should also benefit from a reduction of funding costs. However, we expect the bank to be profitable in 2021 at the earliest and medium-term profitability will rely heavily on a successful execution of the cost-reduction and revenue-generation measures outlined in its business plan. We also believe that a deteriorating economic environment in Germany will significantly challenge NORD/LB's net return-on-equity target of 7% in 2024.

NORD/LB's asset quality further improved following the wind-down of the bank's shipping portfolio to EUR6.1 billion end-3Q19 (of which EUR 3.7 billion was non-performing). Its reported non-performing loan (NPL) ratio of 2.4% at end-3Q19 is approaching its strategic target of below 2% and NORD/LB plans to exit shipping by end-2021 and sell most non-performing shipping assets prior to it. This would also bring the bank's NPL ratio closer in line with German peers'.

We expect NORD/LB's profitability to remain weak in the medium term, as the deleveraging and restructuring could weaken the bank's franchise and client loyalty amid highly competitive markets. During its restructuring, the bank will also have to cope with lasting pressure on interest rates and a likely upward normalisation of loan impairment charges, especially in the corporate and commercial real estate segments. As a result, we expect NORD/LB's financial performance to remain highly volatile in the foreseeable future. Over the longer term, we expect NORD/LB's pricing power to remain weak in the bank's main business lines.

In the medium term capitalisation will benefit from Lower Saxony reinvesting the guarantee payments it receives from NORD/LB into the bank's CET1, which could mitigate potential negative rating migrations or lower-than-expected profits. NORD/LB plans to resume partial dividend payments in 2022, subject to the level of its capitalisation.

Some pressure on unsecured funding seen in 2019 is expected to ease in 2020 as NORD/LB resumes its regular strategic funding plan and we expect funding costs to decline over time. NORD/LB is able to gather funding from the savings banks and typically accesses capital markets mostly for regular issuance of benchmark covered bonds. We believe access to funding from SFG will remain strong as NORD/LB remains a member of SFG's IPS.

#### NON-GUARANTEED SUBORDINATED DEBT

NORD/LB's non-guaranteed Tier 2 subordinated bond (DE000NLB8K69) rating is now notched down once from the VR (one notch to reflect below-average recovery prospects in the event of a default). The previously applied second notch to reflect the potential for incremental non-performance risk in the event of a state-aid ruling that requires burden-sharing is no longer required in the short-term in our view following the state aid-free recapitalisation.

#### 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 (NORD/LB CBB)

NORD/LB CBB's IDRs and senior debt ratings are at the same level as those of parent NORD/LB. We believe that NORD/LB CBB is an integral and important part of its parent funding franchise whose default would constitute a huge reputational risk to its parent, despite decreasing issuance volume in Luxembourg's lettres des gages market, NORD/LB CBB primary business focus. NORD/LB has also issued a declaration of backing NORD/LB CBB, which helps drive our assessment of the bank's institutional support.

#### 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 the bank's owners to provide timely support. The provided capital injection

has moderately reduced the ability of SFG to support its members, but the IPS's statutes ensure a mechanism to restore the scheme's reserves on a reasonably timely basis through increased member banks' contributions.

The ratings would nevertheless likely be downgraded if failed execution of the business plan threatens NORD/LB's viability again, in which case an orderly wind-down under sponsorship of the owners could become more likely. We believe support from SFG's IPS would qualify as an alternative private-sector measure, capable of preventing resolution under German Law.

The revised state treaty allows the bank's ownership to be opened up to private investors and represents a medium-term exit option for Sachsen-Anhalt. Private-sector ownership contradicts the statute of the IPS, which requires its members to be public-law institutions. We could downgrade the support-driven ratings if we believe that a private investor could take a significant share in the bank or base NORD/LB's IDR on the bank's standalone credit profile if we conclude that institutional support would not be forthcoming.

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 execution of the bank's business plan agreed with the EC to restore profitability while maintaining asset quality and capitalisation metrics broadly in line with peers'. We could upgrade the VR upon delivery on the cost-cutting plan and a track record of positive earnings generation, which we do not expect in the next two years.

A disruption to its business plan, weak execution capacity, primarily an inability to accomplish the envisaged balance-sheet reduction and cost savings as well as high impairment charges, would put pressure on NORD/LB's VR.

#### NON-GUARANTEED SUBORDINATED DEBT

The rating of the non-guaranteed Tier 2 subordinated notes is primarily sensitive to the level of NORD/LB's VR and changes in our assumptions on the level of losses that might be imposed on Tier 2 debtholders in a default.

On 15 November 2019 Fitch published an Exposure Draft of its Bank Rating Criteria, which included proposals to alter the notching of certain debt securities. If the final Bank Rating Criteria are in line with the Exposure Draft, NORD/LB's non-guaranteed Tier 2 subordinated debt ratings could be downgraded by one notch to 'BB-'.

## 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 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 subsidiary.

### ESG Considerations

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

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### **Applicable Criteria**

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

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

### **Additional Disclosures**

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