



## RATING ACTION COMMENTARY

# Fitch Revises NORD/LB's Outlook to Negative, Affirms IDR at 'A-'

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Fitch Ratings - Frankfurt am Main - 06 Apr 2020: Fitch Ratings has revised the Outlooks on the Long-Term Issuer Default Ratings (IDRs) of Norddeutsche Landesbank Girozentrale (NORD/LB) and of its subsidiary NORD/LB Luxembourg S.A. Covered Bond Bank (NORD/LB CBB) to Negative from Stable and affirmed the IDR at 'A-'. It also downgraded NORD/LB's Viability Rating (VR) to 'bb' from 'bb+' due to the coronavirus disruption.

The revision of the Outlooks follows the revision of Sparkassen-Finanzgruppe's (SFG, A+/Negative) Outlook (see 'Fitch takes Rating Action on 6 German Banks' dated 27 March 2020) as NORD/LB's IDR is driven by institutional support from SFG and NORD/LB CBB's IDR is driven by institutional support from NORD/LB.

A full list of rating actions is at the end of this Rating Action Commentary.

## RATING ACTIONS

ENTITY/DEBT	RATING
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ENTITY/DEBT	RATING		
NORD/LB Luxembourg S.A. Covered Bond Bank	LT IDR	A-	Affirmed
	ST IDR	F1	Affirmed
	Support	1	Affirmed
● Senior preferred	LT	A-	Under Criteria Observation
Norddeutsche	LT IDR	A-	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

## KEY RATING DRIVERS

Unless noted below, the key rating drivers for NORD/LB and NORD/LB CBB are those outlined in our Rating Action Commentary published in January 2020 (Fitch Affirms NORD/LB's IDR at 'A-'; off RWN; Outlook Stable).

### LONG-TERM IDR

NORD/LB's Long-Term IDR is driven by institutional support from the bank's owners. Fitch's institutional support assumptions are underpinned by provisions contained in the statutes of the institutional protection fund of the SFG and the Landesbanken. The recapitalisation of NORD/LB by its public-sector owners in December 2019 underlines their commitment to their long-term investment in the bank, in our view. This is underpinned by NORD/LB's focus on the bank's statutory roles, which include supporting the regional economy as well as acting as the central institution for the regional savings banks and as house bank for its federal states owners.

Fitch uses SFG's Long-Term IDR as the anchor rating for determining the bank's support-driven ratings. Fitch believes support would need to be forthcoming from SFG along with the bank's federal states owners to avoid triggering state-aid considerations and resolution under the German Recovery and Resolution Act if NORD/LB fails again.

We notch down NORD/LB's Long-Term IDR twice from SFG's 'A+', to reflect regulatory restrictions to support due to the requirement for state aid

examination under the EU competition rules despite the short-term exception communicated by the European Commission in March 2020 that allows for state aid to compensate for losses that are directly related to the coronavirus outbreak, which we expect to be only temporary. The two-notch difference in the ratings also reflects NORD/LB's strategic but not key and integral role for their respective owners and its weak past performance.

## VR

Fitch has downgraded NORD/LB's VR because we believe that economic disruption in Germany could result in very high execution risk for the bank's deleveraging and restructuring plan. We believe that NORD/LB faces substantially weaker profitability and asset-quality prospects compared with when we last reviewed the bank in January. In particular, a protracted crisis could significantly challenge the plan's revenue targets and lead to much-higher-than-expected loan impairment charges. At the same time, we believe that NORD/LB's capitalisation could absorb a moderate, but not a severe shock at the current rating level.

## SUBORDINATED DEBT

We downgraded NORD/LB's non-guaranteed Tier 2 debt by two notches. The downgrade reflects the downgrade of the VR and the switch to a baseline notching of two notches for loss severity from the bank's VR under Fitch's new Bank Rating Criteria, from one notch under the previous criteria. The widened notching reflects our expectation that the bank will not maintain buffers of Tier 2 and additional Tier 1 debt exceeding 10% of its respective risk-weighted assets.

## NORD/LB CBB

NORD/LB CBB's IDRs and senior debt ratings are at the same level as those of its 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 gage 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.

NORD/LB's and NORD/LB CBB's preferred ratings, which were placed under criteria observation (see "Fitch Places German and Austrian Banks Under Criteria Observation" published on 04 March 2020) following the publication of the updated Bank Rating Criteria, are maintained under criteria observation and

will be reviewed and resolved as soon as practical and in any case within six months.

## **RATING SENSITIVITIES**

Unless noted below, the rating sensitivities for NORD/LB and NORD/LB CBB outlined in our Rating Action Commentary published in January 2020 (Fitch Affirms NORD/LB's IDR at 'A-'; off RWN; Outlook Stable) continue to apply.

### **LONG-TERM IDR**

The Long-Term IDR is primarily sensitive to changes in our assumptions around the propensity or ability of NORD/LB's owners to provide timely support. This could result from a change to SFG's IDRs, to the owners' strategic commitment to NORD/LB, or to the bank's importance for its home region or for the savings bank sector.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of SFG's IDRs or a loosening of European state support regulation, which we do not expect, could lead to an upgrade of the above ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of SFG's IDRs, a change in the ownership structure or a change in the owners' strategic commitment to the bank could lead to a downgrade of the above ratings. A weaker VR could compromise the propensity of NORD/LB's owners to support the bank, which would negatively affect NORD/LB's IDRs.

### **VR**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of NORD/LB's VR would require the economic shock from the pandemic to be short, followed by a swift recovery, resulting in a limited impact on the bank's restructuring plan, and a structural improvement in NORD/LB's profitability, which in our view is unlikely in the next two years.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

NORD/LB has headroom to emerge from the crisis with its VR intact, but this outcome will depend on the ultimate depth and duration of the coronavirus shock to the domestic economy. The VR would likely be downgraded if the economic and financial market disruption arising from the coronavirus outbreak reaches a level that places sustained pressure on asset quality or earnings that ultimately make the bank's business model less sustainable. The failure to manage the bank's turnaround would also likely result in a downgrade of the VR.

## SUBORDINATED DEBT

The rating of the non-guaranteed Tier 2 subordinated notes is primarily sensitive to the level of NORD/LB's VR.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of NORD/LB's VR or a buffer of Tier 1 and Tier 2 debt sustainably exceeding 10% of risk-weighted assets.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of NORD/LB's VR.

## 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.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of NORD/LB's Long-Term IDR.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of NORD/LB's Long-Term IDR or a reduction of the subsidiary's strategic importance to the parent.

Particularly a termination of NORD/LB's declaration of backing for the bank, which we think is unlikely in the short term, could lead to a downgrade of NORD/LB CBB's IDR.

## **BEST/WORST CASE RATING SCENARIO**

Ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings <https://www.fitchratings.com/site/re/10111579>.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## **PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS**

NORD/LB's IDRs are driven by institutional support from SFG. NORD/LB's CBB IDRs are driven by institutional support from NORD/LB.

## **ESG CONSIDERATIONS**

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

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## APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)

## ADDITIONAL DISCLOSURES

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NORD/LB Luxembourg S.A. Covered Bond Bank	EU Issued
Norddeutsche Landesbank Girozentrale	EU Issued

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