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Fitch Affirms NORD/LB at 'A-'; Stable Outlook

Fitch Ratings - Frankfurt am Main - 03 Dec 2021: Fitch Ratings has affirmed Norddeutsche Landesbank Girozentrale's (NORD/LB) Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook and its Viability Rating (VR) at 'bb'.

Fitch has withdrawn the bank's Support Rating following the update of the agency's Bank Rating Criteria on 12 November 2021 as it is no longer considered by Fitch to be relevant to the agency's coverage. In line with the updated criteria, we have assigned NORD/LB a Shareholder Support Rating (SSR) of 'a-'.

A full list of rating actions is at the end of this rating action commentary.

Key Rating Drivers

IDRs, SSR AND SENIOR NON-PREFERRED DEBT

NORD/LB's IDRs and senior non-preferred (SNP) debt rating are driven by its SSR, which reflects a strong likelihood of support from the bank's owners, the German federal states of Lower Saxony and Saxony-Anhalt (both AAA/Stable) as well as Sparkassen-Finanzgruppe (SFG, A+/Stable/F1+), the German savings banks group.

Fitch's support assumptions are underpinned by NORD/LB's focus on its statutory roles, which include supporting the regional economy as well as acting as the central institution for regional savings banks and as house bank for its federal state owners as well as provisions contained in the statutes of the institutional protection scheme (IPS) of SFG and the Landesbanken.

Fitch uses the lowest rating of NORD/LB's parents, SFG's Long-Term IDR, as the anchor rating for determining the bank's SSR because we believe support from SFG would help 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 SSR and Long-Term IDR twice from that of SFG to reflect regulatory restrictions to support due to the requirement for state aid examination under the EU competition rules. The two-notch difference also reflects NORD/LB's strategic but not integral role for its owners and its weak past performance. The Stable Outlook on NORD/LB's Long-Term IDR mirrors that on SFG.

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, because propensity of support by its institutional owners is likely more certain in the near term and the bank shares strong links to SFG and privileged access to SFG's ample liquidity and funding resources.

DERIVATIVE COUNTERPARTY RATING, DEPOSIT AND SENIOR PREFERRED DEBT RATINGS

NORD/LB's derivative counterparty rating (DCR), long-term senior preferred (SP) debt and long-term deposit ratings are one notch above its Long-Term IDR, to reflect the protection that could accrue to them from junior resolution debt buffers. NORD/LB's short-term senior debt and deposit rating are the lower of the two ratings that map to a long-term rating of 'A'. This is because we believe that, despite the owners' very high propensity to provide support to NORD/LB, we see potential impediments to the prompt flow of funds that are not commensurate with an 'F1+' short-term rating given the lengthy process required to support a Landesbank.

VR

We rate NORD/LB's VR below its implied level of 'bbb-' because of the bank's poor earnings and profitability, which represents the weakest link in our rating assessment. Business transformation has progressed satisfactorily in terms of balance-sheet and headcount reduction, the wind-down of its remaining shipping exposure and the implementation of measures to achieve its targeted medium-term cost benefits. However, execution risk in NORD/LB's restructuring plan remains high, which drives our assessment of the bank's business profile at 'bb', below its implied 'bbb' score. The bank's adequate capitalisation and funding are rating strengths.

We upgraded the risk profile and the asset quality scores to 'bbb'. The bank's risk appetite is in line with Landesbanken peers and constrained by intensive screening from its owners. Like peers, NORD/LB's asset quality was resilient throughout the pandemic. Downside risks remain in the not-guaranteed portion of the bank's aviation portfolio, which accounts for about a quarter of common equity Tier 1 (CET1).

We expect NORD/LB to post a small pre-tax profit in 2021, after three consecutive losses, driven by reversals of risk provisions in its shipping portfolio and gains in the valuation of the guarantee on the aviation portfolio. NORD/LB's operating profit, which includes restructuring expenses and is adjusted for the valuations of the guarantees and silent participations, is likely to remain weak next year. This is because we expect net interest income to remain low due to the smaller balance sheet and risk costs to start normalising. This will be mitigated by lower fees paid on the portfolio guarantees. At the same time, we believe the bank will not incur any material operational loss over the restructuring period and therefore revised the trend on profitability to positive from stable.

NORD/LB's capitalisation benefits from capital injections from Lower Saxony but the bank's weak organic capital generation and higher expected risk-weighted assets (RWAs) constrain our assessment. The CET1 ratio improved to 15.8% at end-3Q21, in line with large Landesbanken. It provides a comfortable buffer to absorb also larger unexpected credit losses, which drives the revision of the trend on capitalisation to stable from negative.

We have upgraded NORD/LB's funding and liquidity score following a flow of unsecured bond issuances in 2020 and 1H21 at spreads comparable with peers', which in our view confirms the restoration of NORD/LB's wholesale funding franchise. The score also benefits from low refinancing volumes due to the declining balance sheet and NORD/LB's strong owners and its membership in SFG's

institutional protection scheme, which ensures sufficient demand from savings banks for NORD/LB's debt. Liquidity is sound.

NON-GUARANTEED SUBORDINATED DEBT

NORD/LB's non-guaranteed Tier 2 subordinated bond rating is notched twice from its VR to reflect loss severity in line with Fitch's baseline approach.

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.

Rating Sensitivities

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

A downgrade of SFG's IDRs, a change in the owners' strategic commitment to the bank or a change in the ownership structure could lead to a downgrade of the ratings. The ratings could also be downgraded if failed execution of the business plan threatens NORD/LB's viability, in which case an orderly wind-down under sponsorship of the owners is likely. We believe support from SFG's IPS would qualify as an alternative private-sector measure, capable of preventing resolution under German Law.

A downgrade of NORD/LB's IDRs would trigger a downgrade of the DCR, SP debt and deposit ratings. We could also downgrade these ratings if we expect the sum of junior and SNP debt to decrease, in particular, if the buffer is likely to fall and remain sustainably below 10% of its RWAs.

We could downgrade the VR upon a material deviation from NORD/LB's business plan, in particular weak execution on the bank's cost-cutting programme or inability to generate adequately priced new business. We could also downgrade the ratings if we expect NORD/LB's CET1 ratio to fall below 12%.

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

An upgrade of NORD/LB's IDRs and senior debt ratings would require an upgrade of SFG's ratings. An upgrade of NORD/LB's IDRs would trigger an upgrade of the DCR, SP debt and deposit ratings if the bank maintains a buffer of junior and SNP debt above 10% of its RWAs.

We could upgrade the VR if we believe NORD/LB will remain profitable on a sustainable basis and its CET1 ratio remains above 13%, while maintaining asset-quality metrics broadly in line with peers'.

VR ADJUSTMENTS

The business profile score of 'bb' has been assigned below the 'bbb' category implied score due to the following adjustment reason: business model (negative).

The capitalisation and leverage score of 'bbb' has been assigned below the 'a' category implied score due to the following adjustment reason: internal capital generation and growth (negative).

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond 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, visit <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 Sparkassen FinanzGruppe's IDRs.

ESG Considerations

Unless otherwise disclosed in this section, 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 the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Norddeutsche Landesbank Girozentrale	LT IDR	A- ●	Affirmed	A- ●
	ST IDR	F1	Affirmed	F1
	Viability	bb	Affirmed	bb
	Support	WD	Withdrawn	1
	DCR	A(dcr)	Affirmed	A(dcr)
	Shareholder Support	a-	New Rating	
• subordinated		AAA	Affirmed	AAA
• Senior non-	LT	A-	Affirmed	A-

ENTITY/DEBT	RATING	RECOVERY	PRIOR
preferred			
• subordinated	B+	Affirmed	B+
• long-term deposits LT	A	Affirmed	A
• Senior preferred LT	A	Affirmed	A
• short-term deposits ST	F1	Affirmed	F1
• Senior preferred ST	F1	Affirmed	F1

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◊	◆
STABLE	⊙	

Applicable Criteria

[Bank Rating Criteria \(pub.12 Nov 2021\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

Solicitation Status

Endorsement Status

Norddeutsche Landesbank Girozentrale EU Issued, UK Endorsed

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