

DBRS Morningstar Confirms NORD/LB's Issuer Ratings at A (high)/R-1 (middle), Stable Trend

BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) confirmed the ratings for Norddeutsche Landesbank Girozentrale (NORD/LB or the Bank), including the Long-Term Issuer Rating at A (high), the Senior Non-Preferred Debt Rating at 'A', and the Short-Term Issuer Rating at R-1 (middle). The trend on all ratings remains Stable. The ratings and the trend are all in line with the broader Sparkassen-Finanzgruppe (SFG). NORD/LB's Intrinsic Assessment (IA) remains at BBB (low) and its Support Assessment remains unchanged at SA1. For a complete list of ratings, please see the table at the end of this press release.

KEY RATING CONSIDERATIONS

The confirmation of NORD/LB's ratings reflects its membership of the SFG and the Institutional Protection Scheme (IPS) of the SFG. Each member of the IPS, including NORD/LB, is generally rated at the floor level, which is currently A (high) with a Stable trend.

The IA continues to take into account NORD/LB's established franchise as a commercial bank in the region of Northern Germany, its role as a central institution and clearing bank for the savings banks in this region, as well as a global footprint in its specialty finance business. Following a period of a mandated de-leveraging as part of the Bank's restructuring programme, the Bank has started growing again with new business increasing across all segments, underscoring that the franchise has remained intact. As the wind-down of the shipping portfolio has been largely completed, asset quality metrics have improved significantly. The IA is further supported by the Bank's solid liquidity position which benefits from its membership of the SFG and its established covered bond franchise. Since its recapitalisation in 2019 the Bank has maintained substantial capital cushions above regulatory minimum requirements. The Bank's main challenges remain its limited earnings power and the ambitious restructuring programme, which, while on track in terms of cost reduction, continues to be subject to execution risk, especially given the weakening economic environment. We continue to monitor the Bank's progress towards sustainable revenue generation, cost reductions, and the build-out of new IT systems.

RATING DRIVERS

NORD/LB's Issuer Ratings benefit from the SFG's IPS. An upgrade of SFG's ratings would lead to an upgrade of NORD/LB's ratings. The IA would be upgraded, if the Bank is successful in restoring sustainable profitability, while maintaining healthy asset quality and capital metrics.

NORD/LB's Issuer Ratings benefit from the SFG's IPS. A downgrade of SFG's ratings would lead to downgrade of NORD/LB's ratings. The IA would be downgraded, should the Bank fail to achieve a sustainable business model over the medium term. Any developments that would lead to a material deterioration in the Bank's liquidity or capital situation would also lead to a downgrade of the IA.

RATING RATIONALE

Franchise Combined Building Block (BB) Assessment: Good / Moderate

With total assets of EUR 120 billion as of end-Q3 2022, NORD/LB ranks among the top ten banks in Germany by assets and is the fourth largest of 5 Landesbanken. NORD/LB has a predominantly corporate and commercial banking franchise in Northern Germany, complemented by a savings bank segment and revenues from more global business lines. NORD/LB also performs central banking and clearing functions for the savings bank associations of Lower Saxony, Mecklenburg-Western Pomerania and Saxony Anhalt. NORD/LB is currently executing a large-scale restructuring programme (“NORD/LB 2024”). Parts of the programme such as the exit from the shipping business, and a reduction in total assets to about EUR 110 billion by end-2024, down from EUR 145 billion in 2019 are nearing completion. Other areas such as cost reductions and a complete overhaul of the Bank’s IT systems are still in the implementation phase and subject to significant execution risk at a time when the macroeconomic environment is posing new risks.

Earnings Combined Building Block (BB) Assessment: Weak / Very Weak

Despite NORD/LB’s wide and diverse wholesale banking franchise, earnings generation ability has been only moderate. DBRS Morningstar notes that earnings volatility from the operating segments has improved following the wind-down of the shipping portfolio. However, large fluctuations in positions accounted at fair value as well as certain items related to the Bank’s restructuring programme have an outsized impact on the P&L. The underlying performance is gradually improving, but still modest. In DBRS Morningstar’s view, NORD/LB’s earning generation ability remains under pressure while the Bank is executing its restructuring programme. Although higher interest rates and the decline in guarantee fees that the Bank has been paying are supportive of revenues, we expect cost pressure from inflation and higher credit costs to materialise over the medium-term.

Risk Combined Building Block (BB) Assessment: Moderate / Weak

DBRS Morningstar notes that NORD/LB has significantly improved its credit risk profile in recent years through divestments of risky assets and various portfolio guarantees. As a result, the Bank’s reported NPL ratio has reached a low 0.7% at end-September 2022 from 1.2% at end-2021. The NPL ratio as calculated by DBRS Morningstar was 1.3% at end-H1 2022, the latest available data. Exposure to shipping, which caused significant credit losses in the past, has now been virtually eliminated. However, the Bank has exposure to aircraft finance not subject to guarantees of EUR 1.76 billion, a sector adversely affected by the COVID-19 pandemic that has yet to fully recover. Given its wholesale banking franchise, the Bank continues to maintain sizeable exposures to cyclical sectors that include more lumpy exposures. Due to multiple challenges ahead such as higher energy costs, inflation, and interest rates weighing on the economy, credit risk is likely to increase going forward. The Bank still carries a management overlay of EUR 351 million as part of its loan loss reserves, however, we also note that the Bank has currently limited earnings capacity to absorb higher credit costs. We continue to see elevated operational risks associated with the restructuring and the overhaul of the Bank’s IT systems.

Funding and Liquidity Combined Building Block (BB) Assessment: Good / Moderate

NORD/LB’s liquidity and funding profile is satisfactory. The funding profile which predominantly consists of wholesale funding and corporate deposits is balanced by access to stable Pfandbrief funding, established wholesale funding relationships within the Sparkassen-Finanzgruppe, and healthy liquidity buffers above minimum requirements. As of end-Q3 2022 the liquidity coverage ratio (LCR) stood at 172.4%, and the Bank reported a net stable funding ratio (NSFR) of 125.6%, both ratios were well above the 100% requirement.

NORD/LB's Q3 2022 CET 1 ratio was 14.6%, implying a cushion of almost 500 basis points above the current SREP requirement of 8.68%. In DBRS Morningstar's view NORD/LB's sound capital cushion is partly offset by the fact that the Bank's capital generation capacity is still constrained and the ability to raise external capital is very limited. We also note that the capital cushion is needed given the risk related to the execution of the Bank's ambitious restructuring programme and the current macroeconomic uncertainty. The CET1 ratio declined to 14.6% at end-Q3 2022 from 15.4% at year-end 2021, as risk weighted assets increased to EUR 38.7 billion from EUR 37.5 billion due to new business growth. However, this ratio does not yet include the benefit from other comprehensive income of EUR 367 million for 9M 2022, which is subject to regulatory approval that is expected in Q1 2023.

Further details on the Scorecard Indicators and Building Block Assessments can be found at <https://www.dbrsmorningstar.com/research/406041>.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Governance (G) Factors:

The subfactor 'corporate governance' is relevant to the rating of NORD/LB but does not affect the overall rating or trend assigned to the bank. There are no known material ethics or other corporate governance violations. However, the governance structure resulting from predominantly State ownership may have contributed to inadequate risk controls in the past at various Landesbanken in the past and is an area DBRS Morningstar closely monitors. The ownership mix and the parliamentary process involved in decision making, have also made it difficult at times to swiftly react to challenges. In 2020, the ECB requested better pre-emptive risk controls within the IPS and more transparent processes in case of a recapitalisation, which was addressed in 2021.

There were no Environmental or Social factors that had a significant or relevant effect on the credit analysis.

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>. (May 17, 2022)

Notes:

All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations <https://www.dbrsmorningstar.com/research/398692/global-methodology-for-rating-banks-and-banking-organisations> (June 23, 2022). In addition DBRS Morningstar uses the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings, <https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings> (May 17, 2022) in its consideration of ESG factors.

The sources of information used for this rating include Morningstar Inc. and Company Documents, NORD/LB 9M 2022 Presentation, NORD/LB H1 2022 Interim Report, NORD/LB 2017-2021 Annual Reports. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: <https://www.fca.org.uk/firms/credit-rating-agencies>.

The sensitivity analysis of the relevant key rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/406046>.

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Initial Rating Date: June 11, 2018

Last Rating Date: December 3, 2021

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For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

Ratings

NORD/LB Luxembourg S.A. Covered Bond Bank

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
02-Dec-22	Long-Term Issuer Rating	Confirmed	A (high)	Stb	EU U
02-Dec-22	Short-Term Issuer Rating	Confirmed	R-1 (middle)	Stb	EU U
02-Dec-22	Short-Term Debt	Confirmed	R-1 (middle)	Stb	EU U
02-Dec-22	Short-Term Deposits	Confirmed	R-1 (middle)	Stb	EU U
02-Dec-22	Long-Term Deposits	Confirmed	A (high)	Stb	EU U
02-Dec-22	Long-Term Senior Debt	Confirmed	A (high)	Stb	EU U

Norddeutsche Landesbank Girozentrale

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
02-Dec-22	Long-Term Issuer Rating	Confirmed	A (high)	Stb	EU U
02-Dec-22	Short-Term Issuer Rating	Confirmed	R-1 (middle)	Stb	EU U
02-Dec-22	Long-Term Deposits	Confirmed	A (high)	Stb	EU U
02-Dec-22	Senior Non-Preferred Debt	Confirmed	A	Stb	EU U
02-Dec-22	Short-Term Debt	Confirmed	R-1 (middle)	Stb	EU U
02-Dec-22	Short-Term Deposits	Confirmed	R-1 (middle)	Stb	EU U
02-Dec-22	Subordinated Debt	Confirmed	A (low)	Stb	EU U
02-Dec-22	Long-Term Senior Debt	Confirmed	A (high)	Stb	EU U

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