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

Fitch Ratings - Frankfurt am Main - 07 Mar 2023: 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'. A full list of rating actions is detailed below.

Key Rating Drivers

Owners' Support Drives IDRs: NORD/LB's Long-Term IDR is driven by its Shareholder Support Rating (SSR), which reflects a strong likelihood of support from the bank's owners, Germany's savings banks group Sparkassen-Finanzgruppe (Sparkassen) (SFG; A+/Stable) and the federal states of Lower Saxony and Saxony-Anhalt (both AAA/Stable).

Fitch uses SFG's Long-Term IDR as the anchor rating for determining NORD/LB's support-driven ratings, as we believe support would need to be forthcoming from both SFG and its federal states owners to avoid triggering state-aid considerations and resolution under the German Recovery and Resolution Act if NORD/LB fails. The Stable Outlook on NORD/LB's Long-Term IDR reflects that of SFG.

Fitch believes the federal states of Lower Saxony and Saxony-Anhalt will participate in support measures for the bank but NORD/LB's SSR does not factor in support from the federal states as it is based on the lowest of the owners' ratings, ie that of SFG.

We notch NORD/LB's SSR down twice from SFG's 'A+' to reflect regulatory restrictions on support, due to the requirement for state-aid examination under EU competition rules. The two-notch difference also reflects NORD/LB's strategic, but not key and integral, role for its owners.

Execution Risk, Weak Profitability: The VR reflects the bank's ongoing restructuring, satisfactory asset-quality, adequate capitalisation and access to savings banks' excess liquidity. NORD/LB's VR is two notches below the implied 'bbb-' rating due to the bank's weak profitability, which we score at 'bb-'.

Business Model Transformation Continues: The bank's restructuring is progressing satisfactorily on headcount reduction and the wind-down of its shipping loan portfolios is on track. However, profitability remains weak and a large portion of the planned cost reduction and revenue generation measures is subject to execution risk.

Improved Asset Quality: The bank's risk appetite is in line with Landesbanken peers' and limited by its owners' close scrutiny. NORD/LB's business model entails high single borrower concentrations, but asset quality has been resilient through the pandemic and the bank's impaired loan ratio further improved at end-3Q22. Rising interest rates and high energy prices will likely lead to an increase of

German corporate defaults in 2023 and 2024, but we expect only moderate deterioration of NORD/LB's asset-quality metrics.

Profitability to Gradually Increase: We estimate NORD/LB's operating profit in 2022 to have fallen below 2021's level. We expect operating profit to improve in the next two years, driven by higher net interest margins, lower fees paid on guarantees and progress in cost reduction. We also expect precautionary loan loss allowances to offset a large portion of credit losses. We believe that the probability of incurring large operational losses during the restructuring has decreased.

At the same time, pre-tax profit could be burdened by revaluation reversals on guarantees in the next two years, which Fitch views as non-operating.

Adequate Capitalisation: NORD/LB's common equity Tier 1 (CET1) capital ratio declined to 14.6% at end-3Q22 from 15.4% at end-2021, driven mainly by loan growth, but remains well above its regulatory requirement of 8.7%. This provides a comfortable buffer to absorb larger unexpected credit losses. The bank benefited from capital reinjections from Lower Saxony during its restructuring, but its weak organic capital generation, in combination with expected regulatory and business-driven risk weighted assets (RWA) inflation, constrains our assessment.

IPS Membership Underpins Funding: NORD/LB's predominantly wholesale funding benefits from its membership in SFG's Institutional Protection Scheme (IPS). The bank's liquidity profile is sound.

Rating Sensitivities

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

A downgrade of SFG's IDRs, or an adverse change in the ownership structure or in SFG's strategic commitment to the bank 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.

We could downgrade the VR on a material deviation from NORD/LB's business plan, in particular weak execution on the bank's cost-cutting programme or inability to generate sufficient and 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 would require an upgrade of SFG's ratings. We could upgrade the VR if we believe NORD/LB will remain profitable on a sustained basis and if its CET1 ratio remains above 13%, while maintaining asset-quality metrics broadly in line with peers'.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

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 to 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.

NORD/LB's senior non-preferred debt is rated in line with its Long-Term IDR. The Derivative Counterparty Rating (DCR), long-term senior preferred 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 two possible 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 given the lengthy process required to support a Landesbank, which are not commensurate with an 'F1+' short-term rating.

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

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.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

A change in NORD/LB's short-term ratings would require a change in NORD/LB's Long-Term IDR of more than one notch.

NORD/LB's DCR, senior non-preferred and long-term senior preferred debt and deposit ratings are sensitive to a change in the bank's Long-Term IDR. We could also downgrade these ratings if we expect the sum of junior and senior non-preferred debt to decrease, in particular, if the buffer is likely to fall and remain sustainably below 10% of its RWAs.

NORD/LB's non-guaranteed Tier 2 subordinated bond rating is sensitive to a change in the VR.

We would downgrade the ratings of NORD/LB's grandfathered state-guaranteed senior and Tier 2 notes if Lower Saxony and Saxony-Anhalt's ratings are downgraded.

VR ADJUSTMENTS

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

The asset quality score of 'bbb' is below the 'a' implied category score due to the following adjustment reason: concentrations (negative).

The earnings and profitability score of 'bb-' is above the 'b' implied category score due to the following adjustment reason: historical and future metrics (positive).

The capitalisation and leverage score of 'bbb' is below the 'a' implied category 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 ratings are driven by potential support from SFG.

NORD/LB's grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes are linked to Fitch's assessment of Lower Saxony and Saxony-Anhalt 's creditworthiness and, by extension, to Germany's ratings.

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
	DCR	A(dcr)	Affirmed	A(dcr)
	Shareholder Support	a-	Affirmed	a-
	• subordinated	AAA	Affirmed	AAA
	• Senior non- preferred LT	A-	Affirmed	A-

ENTITY/DEBT	RATING	RECOVERY	PRIOR
• 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 \(pub.07 Sep 2022\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

[Solicitation Status](#)

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Norddeutsche Landesbank Girozentrale EU Issued, UK Endorsed

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