MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades NORD/LB Luxembourg S.A. Covered Bond Bank's public-sector covered bonds

Global Credit Research - 11 Aug 2017

London, 11 August 2017 -- Moody's Investors Service has today downgraded to Aa3 from Aa1 on review for downgrade the public-sector covered bonds issued by NORD/LB Luxembourg S.A. Covered Bond Bank (NORD/LB CBB; counterparty risk assessment Baa2(cr)). This rating action concludes the review initiated on 19 April 2017.

RATINGS RATIONALE

Today's rating action follows Moody's downgrade of NORD/LB CBB's counterparty risk assessment to Baa2(cr) from Baa1(cr) on review for downgrade. For further information on the rating action taken by Moody's Financial Institutions Group, please refer to "Moody's downgrades NORD/LB's and its subsidiaries' deposits to Baa2 and senior unsecured ratings to Baa3, outlook negative", published on 30 June 2017.

The expected loss analysis has been the primary driver of today's rating action. Under Moody's rating methodology, an issuer's credit strength is incorporated into Moody's expected loss analysis. Therefore, any downgrade of the issuer's counterparty risk assessment increases the expected loss on the covered bonds. In general, issuers may be able to offset a deterioration in the expected loss analysis by adding further supports to their programmes. However, the issuer does not provide additional overcollateralization (OC) in a "committed" form beyond the 2% required by Luxembourg's covered bond legislation. Moody's gives limited benefit to "uncommitted" OC and the resulting expected loss analysis is consistent with the newly positioned ratings. The rating positioning is in line with Moody's indication at the time the rating review was initiated on 19 April 2017.

Moody's notes that today's rating action has not been prompted by a deterioration in the credit quality of the cover pool assets backing the issuer's covered bonds.

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The CB anchor for the programme is the CR assessment plus one notch. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's may use a CB anchor of CR assessment plus one notch in the European Union or otherwise where an operational resolution regime is particularly likely to ensure continuity of covered bond payments.

--- NORD/LB Luxembourg S.A. Covered Bond Bank's Pubic Sector Covered Bonds ---

The cover pool losses for this programme are 29.8%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 24.0% and collateral risk of 5.8%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 11.5%.

The over-collateralisation in the cover pool is 24.4%, of which NORD/LB CBB provides 2.0% on a "committed" basis. The minimum OC level consistent with a Aa3 rating is 5.0%, of which the issuer should provide 0.0% in a "committed" form (all numbers in nominal value terms). These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on Moody's most recent modelling (based on data as per 31 March 2017).

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's please refer to "Moody's Global Covered Bonds Monitoring Overview", published quarterly.

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor. The covered bonds have a TPI of Probable.

Factors that would lead to an upgrade or downgrade of the ratings:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "Probable" and the issuer's Baa2(cr) counterparty risk assessment, the TPI Leeway for NORD/LB CBB's covered bonds is one notch. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by more than one notch, all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Alexander Zeidler
VP - Senior Credit Officer
Structured Finance Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Juan Pablo Soriano
MD - Structured Finance
Structured Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

MOODY'S INVESTORS SERVICE