MOODY'S
INVESTORS SERVICE

Rating Action: Moody's changes the direction of ratings review for NORD/LB Luxembourg S.A. - Public-Sector Covered Bonds to review for upgrade from review direction uncertain

18 Feb 2019

London, 18 February 2019 -- Moody's Investors Service ("Moody's") has today changed the direction of the ongoing Aa3 rating review for the covered bonds issued by NORD/LB Luxembourg S.A. Covered Bond Bank (the issuer, NORD/LB CBB; deposits Baa2 on review for upgrade; adjusted baseline credit assessment ba3 on review for upgrade; counterparty risk assessment Baa2(cr) on review for upgrade). The direction of the covered bond rating review is now for an upgrade, from previously review with direction uncertain.

RATINGS RATIONALE

Today's rating action is prompted by the change in direction for the review of the ratings assigned to the issuer. For further details, please see "Moody's changes direction of long-term ratings' review for NORD/LB to a review for upgrade, confirms short-term ratings" (https://www.moodys.com/research/Moodys-changes-direction-of-long-term-ratings-review-for-NORDLB--PR_394987), published 14 February 2019.

The Covered Bonds have been placed on review for upgrade because the issuer's counterparty risk ("CR") assessment has been placed on review for upgrade. We expect to conclude the rating review once the review of the CR assessment is finalised. During the review, Moody's will also consider the adequacy of the level of over-collateralisation ("OC") for higher ratings, including OC in "committed" form, that is expected for the programme.

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 of 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 of the cover pool assets following a CB anchor event.

The CB anchor for all programmes 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.

The cover pool losses for this programme are 25.4%. 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 19.1% and collateral risk of 6.3%. 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 12.6%.

The over-collateralisation in the cover pool is 25.2%, of which the issuer provides 2.0% on a "committed" basis. Under Moody's Cobol model, given the issuer's Baa2(cr) CR assessment, the minimum OC level consistent with the Aa3 covered bond rating is 6.5%, of which 0.0% needs to be in "committed" form to be given full value. If the issuer's CR assessment is upgraded one notch to Baa1(cr), the minimum OC level consistent with a Aa2 covered bond rating is 11.0%, of which 0.0% needs to be in "committed" form to be given full value. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on the Performance Overview report based on data as per 30 September 2018, published on 28 January 2019, and Moody's most recent modelling.

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" and "Covered Bonds - Global Sector Update", 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.

For NORD/LB Luxembourg S.A. - Public-Sector Covered Bonds, Moody's has assigned 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) CR assessment, the TPI Leeway for the covered bonds is 1 notch. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by 2 notches 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 February 2019. 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.

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