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CREDIT OPINION
7 August 2020

Update

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RATINGS

NORD/LB Luxembourg S.A. Covered Bond Bank

Domicile	Luxembourg, Luxembourg
Long Term CRR	A3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	(P)A3
Type	Senior Unsecured MTN - Dom Curr
Outlook	Not Assigned
Long Term Deposit	A3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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NORD/LB Luxembourg S.A. Covered Bond Bank

Update to credit analysis

Summary

We assign A3(stable)/P-2 deposit and senior unsecured debt rating to NORD/LB Luxembourg S.A. Covered Bond Bank (NORD/LB CBB). We further assign a Baseline Credit Assessment (BCA) of ba3 and an Adjusted BCA of ba1 to NORD/LB CBB. The bank's ratings are aligned with those of Norddeutsche Landesbank GZ (NORD/LB, A3 stable/A3 stable, ba3)[1] because of the strong integration of the Luxembourg-based bank with its parent.

NORD/LB CBB's ratings reflect (1) the bank's ba3 BCA; (2) its ba1 Adjusted BCA, which incorporates two notches of uplift from affiliate support provided by Sparkassen-Finanzgruppe (Aa2 negative, a2)[2] through its parent, NORD/LB; (3) the result of our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution and provides three notches of rating uplift to the bank's deposit and senior unsecured ratings; and (4) our assumption of a moderate probability of support from the Government of Germany (Aaa stable), which results in a one-notch rating uplift.

NORD/LB CBB's ba3 BCA is aligned with NORD/LB, its parent bank, because we consider NORD/LB CBB a highly integrated and harmonised subsidiary.

Credit strengths

» Low-risk assets with sound asset quality, complemented by credit protection granted by NORD/LB

» Cost-efficient covered bond funding franchise (*lettres de gage publiques* and *lettres de gage énergies renouvelables*)

» In resolution, NORD/LB CBB's senior unsecured creditors face only an extremely low loss given failure because they would benefit from the loss-absorbing buffers available at NORD/LB group level, reflecting NORD/LB's large volume of outstanding junior senior debt and subordinated instruments

Credit challenges

» Close integration with NORD/LB limits NORD/LB CBB's standalone banking franchise and aligns the ratings with those of its parent bank.

» Moderate profitability reflects margin sharing with NORD/LB.

» Funding strongly relies on capital markets, mitigated by the issuance of covered bonds (*lettres de gage publiques* and *lettres de gage énergies renouvelables*) and sizeable intragroup funding from NORD/LB.

Outlook

The stable outlook on NORD/LB CBB's ratings mirrors the stable outlook on NORD/LB's ratings.

Factors that could lead to an upgrade

» Upward rating pressure on NORD/LB CBB's issuer, senior unsecured debt and deposit ratings would be subject to a rating upgrade for NORD/LB.

» For further details, please refer to NORD/LB's credit opinion.

Factors that could lead to a downgrade

» Downward rating pressure on NORD/LB CBB's issuer, senior unsecured debt and deposit ratings would be subject to a rating downgrade for NORD/LB.

» For further details, please refer to NORD/LB's credit opinion.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 1

NORD/LB Luxembourg S.A. Covered Bond Bank (Consolidated Financials) [1]

	12-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (EUR Million)	14,821.3	16,522.6	14,634.1	15,134.3	15,047.7	(0.4)[4]
Total Assets (USD Million)	16,636.9	18,887.7	17,572.6	15,962.9	16,346.2	0.4[4]
Tangible Common Equity (EUR Million)	647.0	631.9	664.3	667.2	671.3	(0.9)[4]
Tangible Common Equity (USD Million)	726.3	722.4	797.7	703.7	729.2	(0.1)[4]
Problem Loans / Gross Loans (%)	0.3	0.1	0.3	0.8	2.1	0.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	18.1	14.2	15.7	15.8	16.2	16.0[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	5.0	1.7	4.2	9.1	19.8	8.0[5]
Net Interest Margin (%)	0.8	0.7	0.7	0.6	0.6	0.7[5]
PPI / Average RWA (%)	0.6	-0.1	0.9	0.9	1.0	0.7[6]
Net Income / Tangible Assets (%)	0.1	0.0	0.2	0.2	0.2	0.1[5]
Cost / Income Ratio (%)	67.8	108.6	58.1	52.6	53.5	68.1[5]
Market Funds / Tangible Banking Assets (%)	71.2	64.1	66.5	66.2	66.8	67.0[5]
Liquid Banking Assets / Tangible Banking Assets (%)	16.1	25.7	21.2	33.6	39.8	27.3[5]
Gross Loans / Due to Customers (%)	378.6	206.2	269.3	241.5	210.1	261.2[5]

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel III - fully loaded or transitional phase-in; IFRS. [3]May include rounding differences because of the scale of reported amounts. [4]Compound annual growth rate (%) based on the periods for the latest accounting regime. [5]Simple average of periods for the latest accounting regime. [6]Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Profile

NORD/LB Luxembourg S.A. Covered Bond Bank (NORD/LB CBB) is a specialised issuer of covered bonds (*lettres de gage publiques* and *lettres de gage énergies renouvelables*) that contributes to the diversified funding structure and funding sources of the Hanover-based NORD/LB, its 100% owner. This issuance tool allows the NORD/LB group to increase the scope of assets eligible for refinancing through covered bonds by transferring specific assets eligible for cover pool inclusion under Luxembourg's covered bond framework to the Luxembourg-based subsidiary.

At the end of 2019, NORD/LB CBB reported assets of €15.6 billion and had issued €4.36 billion of *lettres de gage publiques* (1Q2020: €3.86 billion). On 21 January 2020 NORD/LB CBB issued its first green bond (*lettres de gage énergies renouvelables*) with a nominal value of €300 million.

NORD/LB CBB's business model as a specialised issuer of lettres de gage may be challenged by the targeted harmonisation of the legal framework for covered bonds in the European Union (EU).

NORD/LB has pledged to support its subsidiary based on a letter of comfort (*Patronatserklärung*). For more information, please see NORD/LB's Issuer Profile.

Recent developments

The coronavirus will cause unprecedented shock to the global economy. The full extent of the economic downswing will be unclear for some time; however, G-20 economies will contract in 2020. We presently expect the G-20 advanced economies as a group to contract by 6.4% in 2020 and the euro area by 8.5%, followed by a gradual recovery in 2021. In Europe, the coronavirus outbreak adds to late-cycle risks for European banks. The recession in 2020 will weigh on banks' asset quality and profitability. We expect fiscal policy measures, as already announced by a variety of euro-area governments, to mitigate the economic contraction caused by the outbreak.

In the current coronavirus-induced recession and its aftermath, capital levels will be a key differentiator of credit profiles among banks. Generally, banks are facing a sharp deterioration in asset quality and reductions in profitability from already low levels, while central banks are providing extraordinary levels of liquidity and governments have strong incentives to support banking systems to foster an eventual recovery. Thus, when comparing a bank to its peers, the level of capital with which it entered this recession and its ability to retain capital throughout the next several years take on particular importance.

The European Central Bank (ECB) announced a series of measures to help European Union (EU) economies weather the widening effects of the coronavirus pandemic, temporarily increasing banks' liquidity provisions, as well as lowering regulatory capital and liquidity requirements. As part of these temporary measures, the ECB increased its targeted long-term refinancing operations (TLTRO III) under more favourable terms as well as its financial asset purchase program, while refraining from lowering the ultralow interest rates further. The temporary suspension of buffer requirements for regulatory capital and the liquidity coverage ratio (LCR) gives banks greater flexibility and additional leeway to absorb the economic impacts, such as asset-quality declines. Overall, the package aims to help the banks continue to finance corporates and small and medium-sized businesses suffering from the effects of the coronavirus outbreak. We believe that the ECB's measures will provide a limited relief for banks and their borrowers, and that it will require meaningful fiscal policy measures by the European Union and its member states to avert higher default rates in banks' lending books.

Germany launched a large stimulus package and the government's support is crucial for corporate borrowers in industries immediately hurt by the coronavirus outbreak like airlines, tourism, retail and the shipping sector, as well as smaller companies experiencing weak liquidity and high leverage. The scale of the support package is unprecedented and is far larger than the support provided during the financial crisis. At the same time, the government made it easier to access its short-work scheme ("Kurzarbeit") and extended it to a broader pool of workers, which will limit the spike in unemployment and the fall in domestic consumption. The measures, which are adapted according to the evolution of the economic effects of the pandemic, add to Germany's already expansionary fiscal policy stance as well as to automatic stabilizers that support household incomes when unemployment increases.

On 23 December 2019, NORD/LB announced the successful completion of the combined capital strengthening of €3.6 billion from its public-sector owners. The support package included fresh capital of €2.835 billion, of which €1.7 billion was injected by Lower Saxony and Saxony-Anhalt. The rest was provided by the German Savings Banks Association, which injected a combined €1.1 billion. In addition, Lower Saxony provides risk shields on certain assets, relieving capital by an equivalent to around €800 million.

Detailed credit considerations

Tight integration with NORD/LB means that the ratings of NORD/LB CBB move in tandem with those of its parent bank

NORD/LB CBB's credit profile is closely linked with that of NORD/LB. Considering that the subsidiary and the parent share the same name, its role as a specialised financier within the group and its high proportion of intragroup liabilities, we consider NORD/LB CBB a highly integrated and harmonised subsidiary, with a limited proprietary banking franchise. Our assessment implies a high correlation of risk between the Luxembourg-based bank and its parent.

NORD/LB CBB's close integration with NORD/LB limits the significance of a standalone analysis, based on the subsidiary's financials. Although NORD/LB CBB holds an insignificant amount of high-risk assets and is comfortably capitalised, our assessment of NORD/LB's credit strengths and challenges drives NORD/LB CBB's BCA and ratings. This view is further supported by NORD/LB CBB's exemption from large lending limits with regard to intragroup exposures, based on a waiver from the Luxembourg regulator.

Moderate profitability reflects lending to the public sector and margin sharing with NORD/LB

NORD/LB CBB has consistently made positive contributions to NORD/LB's consolidated income. For the period 2014 to 2019, NORD/LB CBB showed an average annual net income compared with assets of around 0.2% (2019: 0.12%, 2018: 0.01%).

The bank's moderate profitability reflects its focus on lending to publicly-owned companies and margin sharing (*Verrechnungspreismodell*) with its parent bank, NORD/LB. This margin sharing is included in NORD/LB CBB's net fee and commission income, which also includes fees paid for the credit protection provided by its parent bank on selected exposures. The guarantees accounted for €5.6 billion as of year-end 2019 (2018: €4.9 billion), representing around 56% of NORD/LB CBB's gross loans (2018: 53%).

In 2019, NORD/LB CBB reported net income to €18.5 million, compared with a net income of €1.1 million in 2018. The better result was driven by 1) lower negative marks on the fair value of financial assets, including the impact from hedge accounting, triggering a net loss of €0.4 million for 2019, compared with a net loss of €26.7 million in 2018 which was driven by unfavourable changes in credit spreads; 2) higher net interest income which increased to €120.9 million from €113.9 million, driven by increases in loans; 3) declining operating expenses of €30.5 million compared with €38.4 million in 2018, reflecting the groupwide restructuring efforts. In addition, NORD/LB CBB benefit from the reversals of credit provisions, at €2.5 million, compared with €5.5 million in the previous year. These positives were balanced by 1) higher net fee and commission expenses, rising to €53.1 million, compared with €41.2 million; and 2) higher tax expenses of €6.0 million compared with tax income of €0.1 million in 2018.

NORD/LB CBB is comfortably capitalised and benefits from low-risk assets as well as risk transfers to its parent bank

NORD/LB CBB is comfortably capitalised in the context of its low-risk credit profile which benefits from exposures to the public sector, financial institutions, and credit guarantees provided by NORD/LB. Our view is underpinned by the bank's Commone Equity Tier 1 (CET1) ratio of 18.1% as of year-end 2019, compared with 13.8% in 2018. The improvement is driven by a 5% increase of CET1 capital to €647 million and around 20% lower risk-weighted assets of €3.6 billion because the bank has reduced or let mature financial securities.

Our assessment is balanced by NORD/LB CBB's low regulatory leverage ratio[3] of 3.8% at the end of 2019 (2018: 3.2%; 2017: 3.8%), which reflects its low-risk assets, underpinned by sizeable exposures to the public sector and financial institutions, accounting for around 41% of total, and credit risk transfers to NORD/LB through individually guaranteed loan exposures. These allow the bank to operate with a low risk-weighted assets (RWA) density of around 23% at the end of 2019 (2018: 26%).

Funding relies on capital markets, mitigated by its covered bond franchise and access to parent funding

NORD/LB CBB sources most of its funding through debt issuance and intragroup borrowings. However, we do not expect this setup to result in undue liquidity risks different from that of NORD/LB, given the high integration of the subsidiary in the parent's treasury management. Our assessment also takes into account NORD/LB CBB's standalone access to funding via public covered bonds (*lettres de gage publiques*) and green bonds (*lettres de gage énergies renouvelables*).

At the end of 2019, around €4.4 billion or 28% of assets were funding via covered bonds (2018: 24%). On 21 January 2020, NORD/LB CBB issued its first green bond with a nominal value of €300 million at favourable funding conditions.

In addition, NORD/LB provides medium- and long-term senior unsecured funding to its Luxembourg-based subsidiary, with initial maturities greater than two years. As of end-2019, NORD/LB provided funding, equivalent to around 34% of NORD/LB CBB's assets, compared with 30% in 2018. NORD/LB's significant contribution to the subsidiary's funding needs underscores the importance of the group's funding support to NORD/LB CBB's funding structure.

Environmental, social and governance (ESG) considerations

Environmental considerations

NORD/LB CBB's exposure to Environmental risks is low, consistent with our general assessment for the global banking sector.[4] See our Environmental risk heatmaps for further information.

Social considerations

Overall, we consider banks to face moderate social risks.[5] See our Social risk heat maps for further information.

Corporate governance considerations

Governance[6] is highly relevant for NORD/LB CBB, as it is to all institutions in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit a bank's credit profile. Governance risks are largely internal rather than externally driven. Corporate governance remains a key credit consideration and requires ongoing monitoring. For NORD/LB, and thus NORD/LB CBB, we do not have any particular governance concern. However, we apply a negative adjustment to NORD/LB's ba2 Financial Profile score to reflect the high execution risks under its transformation plan until 2024.

Support and structural considerations

Affiliate support

We align NORD/LB CBB's Adjusted BCA with the ba1 Adjusted BCA of NORD/LB. This assessment results in two notches of rating uplift stemming from affiliate support for NORD/LB CBB.

NORD/LB CBB's Adjusted BCA incorporates the high likelihood of support available to NORD/LB from the cross-sector support mechanism of Sparkassen-Finanzgruppe, from which we expect the Luxembourg-based subsidiary to benefit equally. NORD/LB has pledged to support its subsidiary based on a letter of comfort (*Patronatserklärung*).

Loss Given Failure (LGF) analysis

NORD/LB CBB is subject to the EU Bank Recovery and Resolution Directive, which we consider an operational resolution regime. We expect NORD/LB CBB to be included in the resolution perimeter of its parent, NORD/LB, and therefore apply our LGF analysis of NORD/LB, which takes into consideration the risks faced by the different debt and deposit classes across the liability structure at failure at the group level.

Furthermore, in our LGF analysis for NORD/LB group, we assume residual tangible common equity of 3%, post-failure losses of 8% of tangible banking assets, a 25% runoff in junior wholesale deposits and a 5% runoff in preferred deposits for NORD/LB. These are in line with our standard assumptions.

» For deposits, our LGF analysis indicates an extremely low loss given failure, leading to a three-notch uplift from the bank's ba1 Adjusted BCA.

» For the senior unsecured debt and issuer ratings, our LGF analysis also indicates an extremely low loss given failure, leading to a three-notch uplift from the bank's ba1 Adjusted BCA.

Government support considerations

As a result of the close integration of the Luxembourg-based bank into NORD/LB, we expect any potential support from the German government, which would be made available through Sparkassen-Finanzgruppe, to be available to both NORD/LB and NORD/LB CBB. Therefore, we include one notch for government support from Germany to the long-term deposit and issuer ratings, as well as the Counterparty Risk Ratings and the Counterparty Risk Assessment of NORD/LB CBB.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

NORD/LB CBB's CRRs are positioned at A3/P-2

The CRRs, before government support, are positioned three notches above the Adjusted BCA of ba1, reflecting the extremely low loss given failure from the high volume of instruments that are subordinated to CRR liabilities. NORD/LB CBB's CRRs benefit from one notch of rating uplift based on government support, in line with our support assumptions on deposits and senior unsecured debt.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

NORD/LB CBB's CR Assessment is positioned at A3(cr)/P-2(cr)

The CR Assessment, before government support, is positioned three notches above the Adjusted BCA of ba3 based on the buffer against default provided to the senior obligations represented by the CR Assessment by more subordinated instruments, including junior deposits and senior unsecured debt, within the context of the group liability structure of NORD/LB.

NORD/LB CBB's CR Assessment benefits from one notch of rating uplift based on government support, in line with our support assumptions on deposits and senior unsecured debt.

Methodology and scorecard

Methodology used

The principal methodology used in rating NORD/LB CBB was Banks Methodology, published in November 2019.

About Moody's Bank Scorecard

We do not apply the Bank Scorecard for the positioning of NORD/LB CBB's BCA, given the alignment of the bank's BCA with that of NORD/LB.

Ratings

Exhibit 2

Category	Moody's Rating
NORD/LB LUXEMBOURG S.A. COVERED BOND BANK	
Outlook	Stable
Counterparty Risk Rating	A3/P-2
Bank Deposits	A3/P-2
Baseline Credit Assessment	ba3
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating	A3
Senior Unsecured MTN -Dom Curr	(P)A3
ST Issuer Rating	P-2
PARENT: NORDDEUTSCHE LANDESBANK GZ	
Outlook	Stable
Counterparty Risk Rating	A3/P-2
Bank Deposits	A3/P-2
Baseline Credit Assessment	ba3
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating	A3
Senior Unsecured -Dom Curr	A3
Junior Senior Unsecured	Baa2
Junior Senior Unsecured MTN -Dom Curr	(P)Baa2
Subordinate	Ba2
Commercial Paper	P-2
Other Short Term -Dom Curr	(P)P-2

Source: Moody's Investors Service

Endnotes

1 The rating shown is NORD/LB's deposit rating and outlook, its senior unsecured debt rating and outlook, and its BCA.

2 The ratings shown are Sparkassen-Finanzgruppe's Corporate Family Rating and outlook, and its BCA.

3 The regulatory leverage ratio compared Tier 1 capital to exposure at default.

4 Environmental risks can be defined as environmental hazards encompassing the impacts of air pollution, soil/water pollution, water shortages and natural and man-made hazards (physical risks). Additionally, regulatory or policy risks, like the impact of carbon regulation or other regulatory restrictions, including the related transition risks like policy, legal, technology and market shifts, that could impair the evaluation of assets are an important factor. In our Environmental risk heat map, we scored 84 sectors according to their overall exposure to environmental risks.

5 The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage due to product mis-selling or other types of misconduct is a further social risk. Social trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services increasing information technology cost, aging population concerns in several countries impacting demand for financial services or socially driven policy agendas that may translate into regulation that affects banks' revenue base.

6 Corporate governance is a well-established key driver for banks and related risks are typically included in our evaluation of the banks' financial profile. Further factors like specific corporate behaviour, key person risk, insider and related-party risk, strategy and management risk factors and dividend policy may be captured in individual adjustments to the BCA, if deemed applicable. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. When credit quality deteriorates due to poor governance, such as break-down in controls resulting in financial misconduct, it can take a long time to recover. Governance risks are also largely internal rather than externally driven.

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REPORT NUMBER 1236072

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