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CREDIT OPINION
2 September 2021

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

NORD/LB Luxembourg S.A. Covered Bond Bank's (NORD/LB CBB) deposit and senior unsecured debt ratings are A3 (stable)/P-2. The bank's Baseline Credit Assessment (BCA) is ba3 and the Adjusted BCA is ba1. 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 subsidiary with its parent.

NORD/LB CBB's deposit and senior unsecured debt ratings reflect the bank's ba3 BCA; a two-notch uplift from affiliate support provided by Sparkassen-Finanzgruppe (S-Finanzgruppe, Aa2 negative, a2)[2] through its parent, NORD/LB; the application of our Advanced Loss Given Failure (LGF) analysis to NORD/LB CBB's liabilities, which results in an extremely low loss given failure and three notches of rating uplift; and a one-notch rating uplift for government support, because of NORD/LB CBB's parent's membership in systemically relevant S-Finanzgruppe.

NORD/LB CBB's ba3 BCA is aligned with that of NORD/LB, its parent bank, because we consider NORD/LB CBB a highly integrated entity. NORD/LB's ba3 BCA reflects the group's sound solvency after a capital injection in 2019 and improving asset quality after the exit from shipping finance and the implementation of resizing activities in accordance with its medium-term plan; the BCA remains constrained by the execution risks associated with this transition plan and challenges that the bank faces in restoring its profitability.

Credit strengths

» NORD/LB CBB has low-risk assets with sound asset quality, complemented by credit protection granted by NORD/LB.

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

» Discontinuation of the new Pfandbrief business from 2022 onwards

» Moderate profitability, which reflects margin sharing with NORD/LB

» Strong reliance on capital markets for funding, mitigated by 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 of 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 of NORD/LB.

» For further details, please refer to NORD/LB's Credit Opinion.

Key indicators

Exhibit 1

NORD/LB Luxembourg S.A. Covered Bond Bank [1]

	12-20[2]	12-19[2]	12-18[2]	12-17[2]	12-16[2]	CAGR/Avg.[3]
Total Assets (EUR Million)	12,063.9	14,821.3	16,522.6	14,634.1	15,134.3	(5.5)[4]
Total Assets (USD Million)	14,760.9	16,636.9	18,887.7	17,572.6	15,962.9	(1.9)[4]
Tangible Common Equity (EUR Million)	622.4	647.0	631.9	664.3	667.2	(1.7)[4]
Tangible Common Equity (USD Million)	761.5	726.3	722.4	797.7	703.7	2.0[4]
Problem Loans / Gross Loans (%)	0.3	0.3	0.1	0.3	0.8	0.4[5]
Tangible Common Equity / Risk Weighted Assets (%)	23.6	18.1	14.2	15.7	15.8	17.5[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	3.4	5.0	1.7	4.2	9.1	4.7[5]
Net Interest Margin (%)	0.8	0.8	0.7	0.7	0.6	0.7[5]
PPI / Average RWA (%)	-0.1	0.6	-0.1	0.9	0.9	0.4[6]
Net Income / Tangible Assets (%)	-0.1	0.1	0.0	0.2	0.2	0.1[5]
Cost / Income Ratio (%)	107.9	67.8	108.6	58.1	52.6	79.0[5]
Market Funds / Tangible Banking Assets (%)	63.8	71.2	64.1	66.5	66.2	66.4[5]
Liquid Banking Assets / Tangible Banking Assets (%)	13.9	16.1	25.7	21.2	33.6	22.1[5]
Gross Loans / Due to Customers (%)	306.4	378.6	206.2	269.3	241.5	280.4[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 contribute 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. From 2022 onwards, the bank will discontinue the new Covered Bond business, and focus on the administrative processes of existing portfolios and cover pools.

As of year-end 2020, NORD/LB CBB reported assets of €12.7 billion and had issued €4.13 billion of *lettres de gage publiques* (2019: €4.4 billion).

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 parent of NORD/LB CBB announced in November 2020 that from 2022 onwards, NORD/LB will discontinue the Covered Bond business actively operated by NORD/LB CBB. The discontinuation includes new issuance activities via the Lettres de Gage products and limits the transfer on new lending business eligible for the respective cover pools. The remaining cover pools will be actively managed and the assets required to manage the cover pool will come from the bank's management portfolios.

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, margin sharing with NORD/LB and a low interest rate environment

In 2020, NORD/LB CBB reported a net loss of -€8.8 million, compared with a net loss of -€0.2 million in 2019. The loss in 2020 was driven by lower net interest income, which decreased to €112.6 million from €120.9 million in 2019 because of a decrease in loans and a persistently low interest rate environment. Furthermore, the loss in 2020 was driven by the deterioration in commission income to €7 million from €12 million in 2019, while total commission expenses, which are mainly attributable to the profit-sharing with NORD/LB, increased slightly. Loan loss provisions related mainly to exposures affected by the coronavirus pandemic resulted in a negative valuation allowance of additional €4.5 million.

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 select exposures. The guarantees accounted for €6.5 billion as of year-end 2020 (2019: €5.6 billion), representing around 82% of NORD/LB CBB's gross loans (2019: 56%).

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 Common Equity Tier 1 (CET1) ratio of 24.4% as of year-end 2020, compared with 18.1% in 2019. The improvement is driven by a reduction in risk-weighted assets (RWA) by around 26% to €2.6 billion from €3.6 billion in 2019 because the bank has reduced its financial securities or has let them mature.

Our assessment is balanced by NORD/LB CBB's low regulatory leverage ratio[3] of 4.8% as of year-end 2020 (2019: 3.9%), 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 exposures allow the bank to operate with a low RWA density of around 21% as of year-end 2020 (2019: 23%).

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 from NORD/LB. 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 least until 2022. Thereafter, we expect the bank's funding needs to be rather limited.

Environmental, social and governance (ESG) considerations

Environmental considerations

In line with our general view on the banking sector, NORD/LB CBB's exposure to environmental risks is low[4] (see our Environmental risk heat map for further information).

Social considerations

Overall, we consider banks to face moderate social risks[5](see our Social risk heat map 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. 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 26% 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 a one-notch uplift 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)

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

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

Counterparty Risk (CR) Assessment

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

The CR Assessment, before government support, is 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 the Banks Methodology, published in July 2021.

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 ratings shown are 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 compares Tier 1 capital to exposure at default.

4 Environmental risks can be defined as environmental hazards encompassing the impact of air pollution, soil/water pollution, water shortages, and natural and human-made hazards (physical risks). Additionally, regulatory or policy risks, such as the impact of carbon regulation or other regulatory restrictions, including the related transition risks like policy, legal, technology and market shifts, which could impair the evaluation of assets, are an important factor.

5 Social risk considerations represent a broad spectrum, including customer relations, human capital, demographic and societal trends, health and safety, and responsible production. 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 are mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are further social risks. Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services increasing information technology costs, ageing population concerns in several countries affecting demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue bases.

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 such as specific corporate behaviour, key-person risk, insider and related-party risk, strategy and management risk, 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 as a result of poor governance, such as a

breakdown 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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