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CREDIT OPINION
17 April 2023

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	Positive

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 following rating affirmation and change in outlook to positive

Summary

On 24 March 2023, we affirmed NORD/LB Luxembourg S.A. Covered Bond Bank's (NORD/LB CBB) A3 deposit and senior unsecured debt ratings and changed the outlook to positive from stable. The bank's ratings are aligned with those of Norddeutsche Landesbank GZ (NORD/LB, A3 positive/A3 positive, ba3)[1] because of the strong integration of the Luxembourg-based subsidiary with its parent.

NORD/LB CBB deposit and senior unsecured debt ratings reflect the bank's and its parent's ba3 Baseline Credit Assessment (BCA) and the ba1 Adjusted BCA. NORD/LB CBB's deposit and senior unsecured debt ratings further reflect a two-notch uplift for affiliate support based on a high likelihood of cross-sector support from Sparkassen-Finanzgruppe (S-Finanzgruppe, Aa2 stable, a2)[2] through its parent, NORD/LB; three notches of rating uplift from our Advanced Loss Given Failure (LGF) analysis to NORD/LB CBB's parent's liabilities, which incorporates the relative loss severity of a liability class, and a one-notch rating uplift for government support, given its membership in the systemically relevant Sparkassen-Finanzgruppe.

NORD/LB CBB's ba3 BCA is aligned with that of NORD/LB, its parent bank, because NORD/LB CBB is a highly integrated entity. NORD/LB's ba3 BCA reflects the bank's financial resilience after its recapitalisation and loan book clean-up, but also the limited traction in improving its profitability over the past years because of the lack of progress in managing its cost base down, which is not offset by increase in revenue. It impairs the achievability of the bank's 2024 targets and leaves some uncertainty with regard to strategy and value proposition. The significant de-risking of its loan book by exiting the cyclical ship segment and other non-core segments, paired with increased capital buffers since 2019, is an important mitigant to the increased concentration of the corporate loan book. A sustainable improvement in its profitability will remain the key challenge for the bank, particularly amid economic uncertainties.

Credit strengths

- NORD/LB CBB has low-risk assets with sound asset quality, complemented by credit protection granted by NORD/LB.
- After the discontinuation of the new Pfandbrief business, NORD/LB CBB has limited funding needs.
- 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.

Outlook

- The positive outlook on NORD/LB CBB's ratings reflects the positive 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 our publications on NORD/LB.

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 our publications on NORD/LB.

Key indicators

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

	12-21 [2]	12-20 [2]	12-19 [2]	12-18 [2]	12-17 [2]	CAGR/Avg. [3]
Total Assets (EUR Million)	10,048.0	12,063.9	14,809.0	16,522.6	14,634.1	(9.0) [4]
Total Assets (USD Million)	10,813.5	14,760.9	16,623.1	18,887.7	17,572.6	(11.4) [4]
Tangible Common Equity (EUR Million)	623.3	622.4	628.3	631.9	664.3	(1.6) [4]
Tangible Common Equity (USD Million)	706.3	761.5	705.3	722.4	797.7	(3.0) [4]
Problem Loans / Gross Loans (%)	0.7	0.3	0.3	0.1	0.3	0.3 [5]
Tangible Common Equity / Risk Weighted Assets (%)	29.4	23.6	17.6	14.2	15.7	20.1 [6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	7.4	3.4	5.2	1.7	4.2	4.4 [5]
Net Interest Margin (%)	1.0	0.8	0.8	0.7	0.7	0.8 [5]
PPI / Average RWA (%)	-0.7	-0.1	-0.1	-0.1	0.9	(0.0) [6]
Net Income / Tangible Assets (%)	0.0	-0.1	0.0	0.0	0.2	0.0 [5]
Cost / Income Ratio (%)	138.2	107.9	104.8	108.6	58.1	103.5 [5]
Market Funds / Tangible Banking Assets (%)	57.8	63.8	71.4	64.1	66.5	64.7 [5]
Liquid Banking Assets / Tangible Banking Assets (%)	14.0	13.9	16.1	25.7	21.2	18.2 [5]
Gross Loans / Due to Customers (%)	249.4	306.4	378.6	206.2	269.3	282.0 [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 Hanover-based NORD/LB, its 100% owner.

As a part of the parent's transformation programme, NORD/LB CBB discontinued its new business at the beginning of 2022, and will focus on the administrative processes of existing portfolios and cover pools.

As of year-end 2021, NORD/LB CBB reported assets of €10.6 billion and had issued €3.5 billion of *lettres de gage publiques* (2020: €4.1 billion) and €0.3 billion lettres de gage énergies renouvelables (2020: €0.3 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.

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 entity, 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 declining business volume, margin sharing with NORD/LB and the low interest rate environment in 2021

In 2021, NORD/LB CBB reported a lower net loss of €4.1 million, compared with a net loss of €8.8 million in 2020. The loss in 2021 is attributable to declining net interest income, which decreased to €98 million from €113 million in 2020 because of a decrease in loans and a prevailing low interest rate environment. Its commission income of €6.8 million remained broadly stable compared with that in 2020 (€6.9 million). Lower commission fees, which are mainly attributable to the profit-sharing with NORD/LB, helped reduce the overall net loss in 2021.

The bank's moderate profitability reflects its focus on lending to publicly owned companies, declining business volume 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 for specific exposures. The guarantees accounted for €5.5 billion as of year-end 2021 (2020: €6.5 billion), representing around 79% of NORD/LB CBB's gross loans (2020: 82%).

NORD/LB CBB is comfortably capitalised and benefits from low-risk assets and 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) capital ratio of 29.7% as of year-end 2021, compared with 24.4% in 2020. The improvement is driven by a reduction in risk-weighted assets (RWA) by around 20% to €2.1 billion from €2.6 billion in 2020 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 5.7% as of year-end 2021 (2020: 4.8%), which reflects its low-risk assets, underpinned by sizeable exposures to the public sector and financial institutions, accounting for around 32% 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, which was around 20% as of year-end 2021 (2020: 21%).

Limited funding needs after discontinuation of new business

Given that NORD/LB CBB has discontinued its covered bond business and only acts as the administrator of existing portfolios and cover pools, we expect the bank's future funding needs to be rather limited.

Environmental, social and governance (ESG) considerations

Environmental considerations

In line with our general view of 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, banks 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.

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 S-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.

In line with our standard assumptions, we further assume a residual TCE 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 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 S-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 (CRRs) and the Counterparty Risk (CR) 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 to determine 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	Positive
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 GIROZENTRALE	
Outlook	Positive
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 S-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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