

RATING ACTION COMMENTARY

Fitch Upgrades NORD/LB's IDR to 'A+'/Stable; Affirms Viability Rating at 'bb+'

Mon 08 Jul, 2024 - 10:20 ET

Fitch Ratings - Frankfurt am Main - 08 Jul 2024: Fitch Ratings has upgraded Nordeutsche Landesbank Girozentrale's (NORD/LB) Long-Term Issuer Default Rating (IDR) to 'A+' from 'A-' and Shareholder Support Rating (SSR) to 'a+' from 'a-'. The Outlook on the Long-Term IDR is Stable. Fitch has affirmed NORD/LB's Viability Rating (VR) at 'bb+'. The bank's Short-Term IDR and debt and deposit ratings were also upgraded. A full list of rating actions is below.

The upgrade of the IDRs and SSR reflects our view that the likelihood of support for NORD/LB from its owners has increased as a result of the recent reform of the institutional protection scheme (IPS) for the German savings bank sector. We believe the revised IPS statutes significantly increase the probability of timely support for NORD/LB, and the creation of an additional fund improves the IPS's ability to support a larger number of members requiring capital support at the same time, in a reasonable downside scenario.

KEY RATING DRIVERS

Support Drives IDRs: NORD/LB's IDRs and SSR are aligned with the IDRs of Sparkassen-Finanzgruppe (Sparkassen) (SFG, A+/ Stable/F1+), the German savings bank network. This reflects Fitch's view that there is a very high probability that SFG, which owns almost 36% of NORD/LB, would provide support if needed. Fitch believes that the revised statutes of SFG's IPS, which include clear rules for addressing weaknesses as member banks, including the Landesbanken, have resulted in an increased propensity for SFG to provide timely support. The Stable Outlook on NORD/LB's Long-Term IDR mirrors that on SFG.

We believe support would also be available from its other owners, the states of Lower Saxony and Saxony-Anhalt, which own almost 58% and 6.25%, respectively. Fitch uses SFG's Long-Term IDR as the anchor rating because support would need to be forthcoming from SFG and the states of Lower Saxony and Saxony-Anhalt to avoid

triggering state-aid considerations and resolution under the German Recovery and Resolution Act if NORD/LB fails.

NORD/LB's 'F1+' Short-Term IDR is the higher of two ratings mapping to its Long-Term IDR and is equalised with SFG's Short-Term IDR to reflect our view that propensity to support is more certain in the short-term.

Wholesale-Oriented Business Profile: The VR reflects NORD/LB's largely wholesale-driven business profile and only modest profitability compared with domestic peers. The transformation programme is almost completed, and Fitch expects the bank to build a record of sustainable profitable business generation. The bank also has good asset quality, adequate capitalisation and access to savings banks' excess liquidity. NORD/LB's VR is one notch below the implied 'bbb-' VR due to its only recently stabilising business profile and franchise, which has a high impact on our view of its credit profile.

Concentration Constrains Risk Profile: The bank's risk appetite is in line with Landesbanken peers and limited by its owners' close scrutiny. NORD/LB's focus on wholesale banking leads to sector concentrations, in particular in commercial real estate. The latter benefits from conservative underwriting standards and good collateralisation.

Resilient Asset Quality: We expect NORD/LB's impaired loans ratio to deteriorate slightly in 2024 as a result of the continued challenging economic conditions, high interest rates, and inflation, but for it to remain below 2% in the medium term. Risk concentrations, including to the energy sector and commercial real estate, constrain our asset-quality assessment.

Stabilising Profitability: We expect NORD/LB's operating profit to remain at above 0.3% of risk-weighted assets (RWAs), a modest level, in the next two years. In the coming quarters, profitability could temporarily fall below this level as a challenging operating environment in Germany could weaken loan demand and lead to higher loan impairment charges. Intense competition in most business segments structurally limits NORD/LB's pricing power and weighs on its profitability.

Adequate Capitalisation: We expect NORD/LB's common equity Tier 1 (CET1) ratio, which was 16% at end-March 2024, to remain above 15% in the medium term. This is comfortably above its regulatory requirement of 9.6%.

IPS Membership Underpins Funding: NORD/LB's predominantly wholesale funding benefits from its membership in SFG's IPS. The recent issuances of senior preferred and

Tier 2 debt helped the bank to re-establish its funding franchise. The liquidity profile is sound.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A downgrade of SFG's IDRs would likely lead to a downgrade of NORD/LB's IDRs and SSR.

The VR would likely be downgraded if we expect the bank's impaired loans ratio to rise to and remain above 3%, if the CET1 ratio falls durably below 12% or if NORD/LB becomes loss-making on a sustained basis without clear recovery prospects.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of SFG's IDRs would likely lead to an upgrade of NORD/LB's IDRs.

An upgrade of the VR would require evidence that the bank further strengthens its business profile, reflected in the generation of sufficient and adequately priced new business without relaxing its risk standards post-restructuring.

An upgrade would also require asset quality to remain resilient and to be broadly in line with peers over the next one or two years, and be contingent on NORD/LB maintaining a CET1 ratio above 13.5% and its operating profit/RWAs rising towards 0.5%.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

NORD/LB's Derivative Counterparty Rating (DCR), long-term deposit rating and senior preferred debt ratings have been upgraded to 'AA-' from 'A' and are one notch above its Long-Term IDR. This reflects the protection of preferred creditors arising from the bank's large resolution buffers, including senior non-preferred and more junior debt. For the same reason, the senior non-preferred debt rating is in line with the bank's Long-Term IDR.

NORD/LB's short-term deposit rating and short-term senior preferred debt rating is the only short-term rating mapping to the long-term deposit rating and the long-term senior preferred debt rating.

The 'AAA' ratings of NORD/LB's grandfathered state-guaranteed subordinated notes reflect our view of the creditworthiness of the state of Lower Saxony and the state of

Saxony-Anhalt, which is closely linked to that of Germany (AAA/Stable), and our expectation that the federal states will honour the guarantee.

The rating of NORD/LB's non-guaranteed Tier 2 subordinated debt has been upgraded to 'A-' from 'BB-' and is now notched twice from NORD/LB's Long-Term IDR to reflect poor recoveries in case of non-performance. Fitch now uses NORD/LB's Long-Term IDR rather than its VR as the anchor rating because we expect shareholder support from SFG to be extended to the bank's Tier 2 instruments under the revised statutes, which we believe has reduced the likelihood of regulatory resolution measures at NORD/LB.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

The DCR, deposit, senior preferred and non-preferred debt ratings are sensitive to changes to its IDRs. We could also downgrade these ratings if we expect its junior and senior preferred debt buffer to fall below 10% of its RWAs on a sustained basis.

NORD/LB's subordinated debt is primarily sensitive to changes in SFG's IDR. The subordinated debt could also be downgraded if Fitch no longer believes that shareholder support would be extended to subordinated creditors, or that such support is moderately less likely for subordinated creditors than for senior creditors.

Adverse changes in Fitch's view of Lower Saxony's or Saxony-Anhalt's creditworthiness, which is closely linked to that of Germany, would lead to a downgrade of NORD/LB's grandfathered state-guaranteed subordinated debt rating.

VR ADJUSTMENTS

The business profile score of 'bb+' is below the 'bbb' implied category score due to the following adjustment reason: business model (negative).

The asset quality score of 'bbb' is below the 'a' implied category score due to the following adjustment reason: concentrations (negative).

The capitalisation and leverage score of 'bbb' is below the 'a' implied category score due to the following adjustment reason: internal capital generation and growth (negative).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

NORD/LB's ratings are driven by potential support from SFG.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Norddeutsche Landesbank Girozentrale	LT IDR	A+ Rating Outlook Stable		A- Rating Outlook Stable
	Upgrade			
	ST IDR	F1+	Upgrade	F1
	Viability	bb+	Affirmed	bb+
	DCR	AA-(dcr)	Upgrade	A(dcr)
	Shareholder Support	a+	Upgrade	a-
subordinated	LT	AAA	Affirmed	AAA
subordinated	LT	A-	Upgrade	BB-
Senior non- preferred	LT	A+	Upgrade	A-

long-term deposits	LT	AA-	Upgrade	A
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Senior preferred	LT	AA-	Upgrade	A
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[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 15 Mar 2024\) \(including rating assumption sensitivity\)](#)

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