Rating Action: Moody's changes direction of long-term ratings' review for NORD/LB to a review for upgrade, confirms short-term ratings

14 Feb 2019

Rating review for upgrade extends to rated subsidiaries; hybrid securities' review direction remains uncertain

Frankfurt am Main, February 14, 2019 -- Moody's Investors Service (Moody's) has today changed the direction of the ongoing rating review for Norddeutsche Landesbank GZ (NORD/LB) and its rated subsidiaries' long term ratings and rating inputs to review for upgrade from review direction uncertain. In addition, Moody's has confirmed the P-2 short-term ratings of NORD/LB and its rated subsidiaries, as applicable. Moody's review with direction uncertain on the Caa1(hyb) ratings of the hybrid instruments issued through the funding vehicles Fuerstenberg Capital Erste GmbH and Fuerstenberg Capital II GmbH remains ongoing.

The rating actions follow an ad-hoc announcement of NORD/LB on 2 February 2019, stating the decisions of its owners to focus on a capital strengthening and a realignment of the bank jointly with Sparkassen-Finanzgruppe (S-Group, corporate family rating Aa2 stable) and not to proceed with an alternative option of a joint bid received by two private financial investors for the time being.

Moody's expects to conclude the review, initiated on 18 December 2018, in the course of second or third quarter 2019, depending on the bank's progress in executing measures and obtaining the necessary regulatory and stakeholder approvals.

Moody's Aa1 backed ratings for instruments that benefit from the grandfathering of statutory guarantees remained unaffected by today's rating action.

For a list of all affected ratings, please refer to the end of this press release.

RATINGS RATIONALE

- RATIONALE FOR THE CHANGE IN DIRECTION TO REVIEW FOR UPGRADE FROM REVIEW DIRECTION UNCERTAIN FOR THE LONG-TERM RATINGS

Moody's decision to change the direction of the ongoing review to review for upgrade of NORD/LB's long term ratings reflects the elimination of the downside risk, that a targeted capital injection could be either delayed or even derailed. Moreover, the proposed measures entail significant financial benefits for NORD/LB.

S-Group's decision on 31 January 2019, to support NORD/LB via a EUR1.2 billion capital commitment will be complemented by a capital injection of the state of Lower Saxony to the amount of EUR1.5 billion and unspecified further capital-strengthening measures, all targeted to be in compliance with European state-aid rules. The targeted realignment of NORD/LB will also include the sale of EUR 2.7 billion in mostly nonperforming loans.

Moody's said that the positive effects of the decision for a "sector solution" for the bank include not only the financial benefits but also promises long-term ownership by the sector and the resulting continued membership of NORD/LB in the mutual support mechanism of Germany's largest institutional protection scheme. Both are strong positive factors for NORD/LB's ratings.

While the use of funds from the Savings Bank Group Institutional Protection Scheme and from its public sector shareholder will require a favourable decision from the anti-trust department of the EU Commission (DG Comp) before the transaction can proceed, Moody's believes that, ultimately, an agreement with DG Comp will be found that is in keeping with Europe's anti-trust legislation. The rating agency believes that NORD/LB can emerge as a viable franchise, once restructured, which is also reflected by bids from private equity investors for a stake in the bank.

- THE REVIEW FOR UPGRADE OF NORD/LB'S LONG-TERM RATINGS WILL PRIMARILY FOCUS ON THE BCA
The review for upgrade of NORD/LB's long-term ratings will primarily focus on the upgrade potential of the Baseline Credit Assessment (BCA). This particularly concerns the magnitude of the combined positive effects of the announced measures. During the review period, Moody's will develop an understanding to what extent the joint effort of NORD/LB's new owners can also restore NORD/LB's profit generation and capital retention capacity amidst a significantly reduced business volume. This will include whether a protracted weakness of profit -- and therefore of the bank's franchise - could (partly) offset the positive measures under way.

**- RATIONALE FOR CONFIRMING THE SHORT-TERM RATINGS OF NORD/LB GROUP AT P-2**

The confirmation of the short-term ratings at P-2 reflects Moody's expectation that potential improvement in the bank's BCA is unlikely to result in upgrades of the short-term ratings.

**- EXTENSION OF THE REVIEW DIRECTION UNCERTAIN OF NORD/LB'S HYBRID RATINGS**

Moody's decision to continue the review with direction uncertain on the Caa1(hyb) ratings on NORD/LB's non-cumulative preference shares reflects the continued high uncertainty of the expected losses of these instruments.

The rating agency said that, on the one hand, announcements of the two issuing vehicles that followed NORD/LB announcement on 2 February clarified that investors in the non-cumulative preference shares will have to suffer a coupon loss and principal write-down. On the other hand, Moody's said that several important aspects still remain opaque, including 1) to what extent NORD/LB may report further (local GAAP) losses during 2019-20; 2) whether management plans to implement measures which limit the eventual loss that investors face, and 3) the risk from NORD/LB's possible decision to call these instruments for reasons relating to their regulatory or tax treatment during the time of their impairment.

During the review period, Moody's assessment will focus on these aspects whereby the expected time horizon for the principal write-down will be a key driver.

**- WHAT COULD CHANGE THE RATINGS - UP / - DOWN**

Upside for NORD/LB's and its rated subsidiaries' ratings during the review period will materially depend on an upgrade of the banks' BCA and Adjusted BCA. The result of Moody's Advanced Loss Given Failure analysis already yields the best possible outcome for NORD/LB's ratings, and bears no further upside for deposits and senior unsecured debt.

A BCA upgrade will likely be prompted as and when 1) the bank and its (new) owners successfully execute the measures that have been agreed upon, specifically the recapitalisation and the selling of all nonperforming loans relating to ship finance, and 2) the most important regulatory approval have been obtained, in particular that of the EU's anti-trust authorities.

Moody's may downgrade NORD/LB's and its rated subsidiaries' ratings if NORD/LB's BCA and Adjusted BCA are downgraded.

Downside for NORD/LB's BCA would arise if the planned de-risking and recapitalisation measures were to face major obstacles from one or several authorities which need to approve the transactions. Specifically, failure to obtain DG Comp's approval could lead to NORD/LB's unwinding, with adverse implications for the bank's BCA.

The impact of a BCA downgrade on the long-term and short-term ratings could be reduced or even offset by Moody's re-assessment of affiliate support, e.g. if higher support assumptions were justified by credible support measures undertaken by Sparkassen-Finanzgruppe, specifically in an unwinding scenario.

**LIST OF AFFECTED RATINGS**

Issuer: Norddeutsche Landesbank GZ

- Placed on Review for Upgrade:
  - Long-term Counterparty Risk Ratings, currently Baa2
  - Long-term Bank Deposits, currently Baa2 Rating under Review
  - Long-term Counterparty Risk Assessment, currently Baa2(cr)
....Long-term Issuer Rating, currently Baa2 Rating under Review
...Baseline Credit Assessment, currently b2
...Adjusted Baseline Credit Assessment, currently ba3
...Senior Unsecured Regular Bond/Debenture, currently Baa2 Rating under Review
...Senior Unsecured Medium-Term Note Program, currently (P)Baa2
...Junior Senior Unsecured Regular Bond/Debenture, currently Ba1
...Junior Senior Unsecured Medium-Term Note Program, currently (P)Ba1
...Subordinate Regular Bond/Debenture, currently B1
...Subordinate Medium-Term Note Program, currently (P)B1

..Confirmations:
....Short-term Counterparty Risk Ratings, confirmed at P-2
....Short-term Bank Deposits, confirmed at P-2
....Short-term Counterparty Risk Assessment, confirmed at P-2(cr)
....Commercial Paper, confirmed at P-2
....Other Short Term, confirmed at (P)P-2

..Outlook remains unchanged at Rating under Review
Issuer: Bremer Landesbank Kreditanstalt Oldenburg GZ

..Placed on Review for Upgrade:
....Junior Senior Unsecured Regular Bond/Debenture, currently Ba1

..Outlook remains unchanged at Rating under Review
Issuer: Deutsche Hypothekenbank (Actien-Gesellschaft)

..Placed on Review for Upgrade:
....Long-term Counterparty Risk Ratings, currently Baa2
....Long-term Bank Deposits, currently Baa2 Rating under Review
....Long-term Counterparty Risk Assessment, currently Baa2(cr)
....Long-term Issuer Ratings, currently Baa2 Rating under Review
....Baseline Credit Assessment, currently b2
....Adjusted Baseline Credit Assessment, currently ba3
....Senior Unsecured Regular Bond/Debenture, currently Baa2 Rating under Review
....Senior Unsecured Medium-Term Note Program, currently (P)Baa2
....Junior Senior Unsecured Regular Bond/Debenture, currently Ba1
....Subordinate Regular Bond/Debenture, currently B1
....Subordinate Medium-Term Note Program, currently (P)B1
..Confirmations:
....Short-term Counterparty Risk Ratings, confirmed at P-2
....Short-term Bank Deposits, confirmed at P-2
....Short-term Counterparty Risk Assessment, confirmed at P-2(cr)
....Short-term Issuer Ratings, confirmed at P-2
....Other Short Term, confirmed at (P)P-2
..Outlook remains unchanged at Rating under Review
Issuer: NORD/LB Luxembourg S.A. Covered Bond Bank
..Placed on Review for Upgrade:
....Long-term Counterparty Risk Ratings, currently Baa2
....Long-term Bank Deposits, currently Baa2 Rating under Review
....Long-term Counterparty Risk Assessment, currently Baa2(cr)
....Long-term Issuer Ratings, currently Baa2 Rating under Review
....Baseline Credit Assessment, currently b2
....Adjusted Baseline Credit Assessment, currently ba3
....Senior Unsecured Medium-Term Note Program, currently (P)Baa2
..Confirmations:
....Short-term Counterparty Risk Ratings, confirmed at P-2
....Short-term Bank Deposits, confirmed at P-2
....Short-term Counterparty Risk Assessment, confirmed at P-2(cr)
....Short-term Issuer Ratings, confirmed at P-2(cr)
..Outlook remains unchanged at Rating under Review
Issuer: Fuerstenberg Capital Erste GmbH
..Review direction uncertain extended:
....Preferred Stock Non-cumulative, currently Caa1(hyb)
..Outlook remains unchanged at Rating under Review
Issuer: Fuerstenberg Capital II GmbH
..Review direction uncertain extended:
....Preferred Stock Non-cumulative, currently Caa1(hyb)
..Outlook remains unchanged at Rating under Review
Issuer: Norddeutsche Landesbank GZ, New York Branch
..Placed on Review for Upgrade:
....Long-term Counterparty Risk Ratings, currently Baa2
....Long-term Counterparty Risk Assessment, currently Baa2(cr)
Confirmations:

....Short-term Counterparty Risk Ratings, confirmed at P-2
....Short-term Counterparty Risk Assessment, confirmed at P-2(cr)
....Commercial Paper, confirmed at P-2

Outlook remains unchanged at Rating under Review

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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