

**Rating Action: Moody's assigns Aaa rating to LBBW's Mortgage Covered Bonds**

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**Global Credit Research - 12 Oct 2010**

London, 12 October 2010 -- Moody's Investors Service has assigned a definitive long-term rating of Aaa to the mortgage covered bonds (Hypothekendarlehenbriefe or covered bonds) issued by Landesbank Baden-Württemberg (the issuer or LBBW), which are governed by the German Pfandbrief Act.

**RATINGS RATIONALE**

A covered bond benefits from (i) a promise to pay by the issuer; and (ii) in the event of default of the bank issuing the covered bonds, the economic benefit from a pool of collateral (the cover pool). The ratings of the covered bonds take into account the following factors:

(i) The credit strength of the issuer (rated Aa2/ Prime-1).

(ii) The credit quality of the assets securing the payment obligations of the issuer under the covered bonds. As of 31 March 2010, the assets in LBBW's cover pool amounted to EUR8.6 billion. The majority of the cover assets are residential mortgage loans (58%). The remaining part of the cover pool are commercial mortgages (36%) and so-called further cover pool assets (Weitere Deckungswerte).

(iii) The strength of the German legal framework. There are a number of strengths in the German Pfandbrief legislation, these include inter alia the regulatory requirement for the issuer to maintain 2% over-collateralisation on a stressed present value basis. The issuer is also required to cover potential liquidity gaps over the next 180 days between payments expected to be received under the cover pool assets and the payments due under the outstanding covered bonds.

The current Aaa rating for the covered bonds does not rely on any over-collateralisation over and above the minimum legal requirements set by the Pfandbrief Act. As of 31 March 2010 the total level of over-collateralisation in the cover pool is 96% on a present value basis.

For LBBW's mortgage covered bonds, Moody's has assigned a TPI of "Probable-High".

The Aaa rating assigned to the existing covered bonds is expected to be assigned to all subsequent covered bonds issued by the issuer under this programme and any future rating actions are expected to affect all such covered bonds. Should there be any exceptions to this, Moody's will in each case publish details in a separate press release.

The rating assigned by Moody's addresses the expected loss posed to investors. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.

**KEY RATING ASSUMPTIONS/FACTORS**

Covered bond ratings are determined after applying a two-step process: expected loss analysis and TPI framework analysis.

**EXPECTED LOSS:** Moody's determines a rating based on the expected loss on the bond. The primary model used is Moody's Covered Bond Model (COBOL) which determines expected loss as a function of the issuer's probability of default, measured by the issuer's rating of Aa2, and the stressed losses on the cover pool assets following issuer default.

The Cover Pool Losses for this programme are 17.9%. This is an estimate of the losses Moody's currently models in the event of issuer default. Cover Pool Losses can be split between Market Risk of 12.3% and Collateral Risk of 5.6%. Market Risk measures losses as a result of refinancing risk and risks related to interest rate and currency mismatches (these losses may also include certain legal risks). Collateral Risk measures losses resulting directly from the credit quality of the assets in the cover pool. Collateral Risk is derived from the Collateral Score which for this programme is currently 8.4%.

**TPI FRAMEWORK:** Moody's assigns a "timely payment indicator" (TPI) which indicates the likelihood that timely payment will be made to covered bondholders following issuer default. The effect of the TPI framework is to limit the covered bond rating to a certain number of notches above the issuer's rating.

**SENSITIVITY ANALYSIS**

The robustness of a covered bond rating largely depends on the credit strength of the issuer.

The number of notches by which the issuer's rating may be downgraded before the covered bonds are downgraded under the TPI framework is measured by the TPI Leeway. Based on the current TPI of Probable-High the TPI Leeway for this programme is 4 notches, meaning the issuer rating would need to be downgraded to Baa1 before the covered bonds are downgraded, all other things being equal.

A multiple notch downgrade of the covered bonds might occur in certain limited circumstances. Some examples might be (a) a sovereign downgrade negatively affecting both the issuer's senior unsecured rating and the TPI; (b) a multiple notch downgrade of the issuer; or (c) a material reduction of the value of the cover pool.

For further details on Cover Pool Losses, Collateral Risk, Market Risk, Collateral Score and TPI Leeway across all covered bond programmes rated by Moody's please refer to "Moody's EMEA Covered Bonds Monitoring Overview", published quarterly. These figures are based on the most recent Performance Overview published by Moody's and are subject to change over time.

**RATING METHODOLOGY**

The principal methodology used in rating the issuer's covered bonds is "Moody's Rating Approach to Covered Bonds" published in March 2010. Other methodologies and factors that may have been considered in the rating process can also be found on the Moody's website. In addition,

Moody's publishes a weekly summary of structured finance credit, ratings and methodologies, available to all registered users of our website, at [www.moody's.com/SFQuickCheck](http://www.moody's.com/SFQuickCheck).

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