MOODY'S
INVESTORS SERVICE

Announcement: Moody's downgrades LBBW's BFSR to D+; outlook stable (Germany)

Global Credit Research - 25 Aug 2011

Long-term ratings remain on review for downgrade

Frankfurt am Main, August 25, 2011 -- Moody's Investors Service has today downgraded the standalone bank financial strength rating (BFSR) of Landesbank Baden-Wuerttemberg (LBBW) to D+ from C-, now mapping to Baa3 on the long-term rating scale from Baa2 previously. Concurrently, Moody's has changed the outlook on the BFSR to stable from negative.

The downgrade was driven by several considerations, including (i) a higher-than-expected vulnerability to market movements, caused by the group's sizeable -- albeit decreasing -- bond and CDS investments; and (ii) the resulting low visibility of the time LBBW requires to regain financial and strategic independence from earlier support measures. The outlook change to stable principally reflects LBBW's satisfactory capital levels and Moody's expectation that LBBW will continue to improve its relative risk position through further downsizing over the next two years.

At the same time, LBBW's Aa2 senior unsecured debt and deposit ratings and its Baa1 senior subordinated debt rating remain on review for downgrade. The ongoing review of these ratings focuses on the support assumptions that are factored into the long-term ratings of LBBW in the context of the weakening support environment in Germany, and will also take into consideration the lower D+ BFSR.

Today's rating announcement, however, does not materially change Moody's earlier guidance that, upon conclusion of the ongoing rating review, LBBW's Aa2 long-term debt and deposit ratings will likely be subject to a downgrade by more than one notch, although a downgrade by more than two notches is unlikely. Please refer to the press release "Moody's reviews ratings of German Landesbanken" dated 1 July 2011. The review, which concerns 12 German public-sector banks, will be concluded within the next few weeks.

The following ratings are unaffected by today's rating action: (i) the Prime-1 short-term rating; (ii) the Caa1(hyb) ratings for certain upper-tier-2 hybrid instruments; and (iii) the Aaa rating for debt that falls under the former grandfathering rules.

RATINGS RATIONALE

RELATIVELY WEAK AND VOLATILE EARNINGS POWER WEIGHS ON LBBW'S STANDALONE RATING

"Although LBBW is making progress in reducing its market and credit risk, its large fixed-income portfolios continue to cause repeated set-backs in its efforts towards recovering earlier levels of risk-adjusted profitability", says Katharina Barten, Senior Credit Officer and lead analyst for LBBW at Moody's Frankfurt office. "The resulting high volatility of earnings implies that there is still low visibility as to when LBBW will be able to generate sufficient earnings to relieve itself of the financial burden associated with the various support facilities that the group continues to rely on for appropriate economic and regulatory capitalisation," Ms. Barten explains.

According to the rating agency, LBBW's relatively high vulnerability to strong market movements was not fully factored into the previous C-standalone financial strength rating that had carried a negative outlook since mid-2009.

Moody's notes that, with a net profit of EUR 376 million for the six months to June 2011, LBBW has finally reversed an extended period of substantial losses (under IFRS). However, expected group earnings for the next two to three years will likely be sufficient to meet only (i) the additional financial burden from previous support measures; (ii) the new bank levy in Germany; and (iii) the replenishment of -- and deferred coupon payments for -- its hybrid securities. As a result, LBBW's internal capital generation will likely remain weak for several years.

STABLE OUTLOOK IMPLIES EXPECTATION OF LIMITED RISK

The stable outlook on the D+ BFSR is underpinned by LBBW's satisfactory capital levels, which combined with the protection offered by portfolio guarantees for most of LBBW's ABS investments, mitigate the less reliable loss-absorption capacity of the income statement. Additionally, the stable outlook reflects Moody's expectation that LBBW will, over the next two years, continue to improve its relative risk position through further downsizing, with positive implications for LBBW's resilience to shocks.

CORRECTION OF HYBRID INSTRUMENT LABELLING

LBBW's issued upper Tier 2 instruments, i.e. profit participation rights ("Genussscheine") are rated Caa1(hyb). These ratings are not affected by today's rating action.

However, Moody's has attached the "hyb" indicator to the rated hybrid instruments listed below. Due to an internal administrative error, the hybrid indicator (hyb) inadvertently was not included in the rating in accordance with our Rating Symbols and Definitions published in May 2011. In addition, Moody's has relabelled these securities as "junior subordinated"; they were initially mislabelled as "subordinated" due to an internal administrative error.

The three instruments that are affected by today's correction are as follows:

EUR250 million 6.50% Genussschein due 31 December 2011 (ISIN: DE0008065095)

EUR100 million 6.60% Genussschein due 31 December 2011 (ISIN: DE0002978657)

EUR 20 million 6.65% Genussschein due 31 December 2011 (ISIN: DE0002978673)

PREVIOUS RATING ACTIONS AND PRINCIPAL METHODOLOGIES

Please see ratings tab on the issuer/entity page on Moodys.com for the last rating action and the rating history.

The principal methodologies used were "Bank Financial Strength Ratings: Global Methodology" published in February 2007, and "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology", published in March 2007.

Domiciled in Stuttgart, Germany, LBBW had total assets of EUR355 billion as of 30 June 2011, and reported a net profit of EUR 376 million for the six months to June.

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