

# The LBBW Group's Business Performance.

## Results of Net Assets, Financial Position and Operations. Results of Operations.

	Jan. 1, 2010 - Dec. 31, 2010	Jan. 1, 2009 - Dec. 31, 2009	Change from 2009 to 2010	
	EUR million	EUR million	EUR million	in %
1. Net interest income	2 163	2 778	- 615	- 22.1
2. Allowance for losses on loans and advances	- 471	- 1 527	1 056	- 69.2
3. Net fee and commission income <sup>1)</sup>	630	814	- 184	- 22.6
4. Net trading income/loss <sup>2)</sup>	- 629	748	- 1 377	-
5. Other operating income <sup>3)</sup>	163	- 217	380	-
<b>6. Total operating income (after allowance for losses on loans and advances)</b>	<b>1 856</b>	<b>2 596</b>	<b>- 740</b>	<b>- 28.5</b>
7. Administrative expenses	- 1 764	- 1 909	145	- 7.6
8. Net loss from investment securities	22	- 733	755	-
9. Net income/loss from investments accounted for using the equity method and from profit/loss transfer agreements	- 58	- 124	66	- 53.2
<b>10. Operating result</b>	<b>56</b>	<b>- 170</b>	<b>226</b>	<b>-</b>
11. Impairment of goodwill	0	- 519	519	- 100.0
12. Restructuring expenses	- 67	- 368	301	- 81.8
13. Guarantee commission for Baden-Württemberg	- 306	- 157	- 149	94.9
<b>14. Consolidated profit before tax</b>	<b>- 317</b>	<b>- 1 214</b>	<b>897</b>	<b>- 73.9</b>
15. Taxes on income	- 30	- 268	238	- 88.8
<b>16. Consolidated loss for the period</b>	<b>- 347</b>	<b>- 1 482</b>	<b>1 135</b>	<b>- 76.6</b>

1) For reasons of transparency, net fee and commission income is shown without guarantee commission for the state of Baden-Württemberg.

2) In addition to net trading income/loss, this item also includes net income/loss from financial instruments designated at fair value and the net income/loss from hedging transactions.

3) In addition to other operating income/expenses, this item also includes net income from investment property.

## LBBW Group Shaped by Market Environment and Restructuring.

The varying development of the banking industry and the financial markets formed the framework for the LBBW Group's economic performance last financial year. Operating activities were spurred on by Germany's economic recovery in particular. Progress in the customer business in LBBW's core markets was especially pleasing. Alongside widening margins in the corporate customer business, positive effects came from a decline in risk provisions in particular. Negative factors were the turbulence on bond and foreign exchange markets brought about by the debt crisis suffered by countries on the European periphery. On the whole, negative valuation effects on net trading income/loss could thus be neither avoided nor offset. The rigorous pursuit and implementation of the restructuring measures agreed with the EU also created special conditions. The measures introduced in this respect have already begun to show their first successes, with expenses for administration and business activities affected by the restructuring having been reduced. Of particular note here is the credit investment portfolio (CIP), which was reduced even further than planned.

The LBBW Group reported a net loss for the year of EUR -347 million. This represented a year-on-year improvement of EUR 1 135 million, or 77%. The situation in operating earnings was eased primarily by the improved risk provision situation in the lending business (EUR + 1 056 million), the increased result from financial assets (EUR + 755 million) and decreased administrative expenses (EUR + 145 million). Earnings were particularly diminished by reduced net interest income (EUR -615 million) and the negative effects from volatile earnings components in connection with the changes from the sovereign problem in net trading income/loss (EUR - 1 377 million). The previous year, a positive result was still expected here, not least because of the recovery on the capital markets. Furthermore, the commission payments, relating to the whole year for the first time in 2010, for the risk shield agreed with the state of Baden-Württemberg (EUR - 306 million) and further expenses (EUR -67 million) for the restructuring of the LBBW Group led to negative impacts on consolidated earnings.

## Real Economy Provides Palpable Easing.

At EUR 2 163 million, **net interest income** remained one of the cornerstones of earnings. Net interest income was lower year-on-year, largely as a result of two effects. The first of these was the fact that the easing of the previous year from the payments not yet made for silent partners' contributions and profit participation rights was no longer felt. The second was the ongoing reduction in total assets and risk assets in connection with the EU restructuring leading to a decline in interest income and expenses. Given these conditions, net interest income was almost at the pre-crisis level. The reliable contributions from widening margins in the corporate customer business and perceptible easing in connection with liquidity procurement supported development. There was an overall decline of -22%, or EUR -615 million.

At EUR – 471 million, **allowances for losses on loans and advances** were significantly below the previous year's value. One major reason for this very positive development (previous year: EUR – 1 527 million) was the economic recovery. The upward trend in the real economy demonstrated in 2010 meant that the Group reported distinct easing in the risk situation in the customer business – especially in the corporate customer area. By contrast, the property sector in the anglo-saxon economic area had a negative effect.

In the year under review, **net fee and commission income** did not continue on from the previous year, marked as it was by individual transactions, as fees for individual transactions (arrangement fees) were not recognized to the same extent. Earnings from the brokerage business declined as a result (EUR – 102 million) and increased expenses in connection with the securities and custody business (EUR – 57 million) led to a decline in this income item. At EUR 630 million, the Group posted an overall drop of EUR – 184 million (23%). In order to improve transparency, the guarantee fee for the risk shield was recognized separately as guarantee commission for the state of Baden-Württemberg for the first time in 2009.

## Fluctuations in Credit-sensitive Financial Products.

**Net trading income/loss** evinced considerable negative effects from the market movements associated with the European debt crisis and the resulting sovereign problem among states on the European periphery. These led to year-on-year deterioration of EUR – 1 377 million to EUR – 629 million. Particular effects were felt here from what in some cases was considerable spread widening in all credit classes, which had a negative impact on the measurement parameters of credit-sensitive financial products and sovereign risks. This led to significant total measurement losses of approximately EUR – 700 million on the reporting date, mainly in CIP credit derivatives. Income from interest rate and equity transactions showed contrasting positive development. The changes to the measurement of LBBW's own credit rating had a particularly positive effect on net income/loss from financial instruments designated at fair value.

At EUR 163 million, **other operating income** was far above the previous year's result of EUR – 217 million, which was subject to negative non-recurring effects. In addition to the lapse of these non-recurring effects from the write-down of the development business in 2009 and market-related reversals in the subsidiary LBBW Immobilien GmbH, profits from the initial consolidation of former subsidiaries were achieved. Income from investment property also contributed to the positive development, with an increase of EUR 20 million (25%) to EUR 101 million.

## Restructuring Yields First Results.

**Administrative expenses** were reduced at the end of the year and in comparison with the previous year by EUR +145 million (–8%) to EUR –1 764 million. This fall can be attributed to reductions in staff costs (EUR +43 million) and operating expenses (EUR +66 million) and lower write-downs (EUR +36 million) in connection with the ongoing restructuring. The major reduction was due in particular to a reduced workforce, savings on special payments and a drop in lease fees, consulting and expert fees in the LBBW Group.

**Net income from investment securities** improved significantly year-on-year by EUR +755 million to EUR 22 million. Reasons for the change included the start of consistent implementation of the EU requirements and the associated earnings from the disposal of non-consolidated equity investments. In addition, the current market situation and the effectiveness of the risk shield led to reversals of impairment losses and compensation of the impairment volume with securities and bonds classified as AfS and LaR. The reimbursement rights resulting from the risk shield totaled EUR 117 million. There was no payment obligation for the state of Baden-Württemberg as at December 31, 2010.

**Net income/loss from investments accounted for using the equity method and from profit/loss transfer agreements** posted year-on-year improvement of EUR 66 million or –53% to EUR –58 million. This development was largely the result of the valuation haircuts and loss absorption already recognized the previous year.

## Restructuring at LBBW Group Negatively Impacts Earnings.

There were no measurement losses on **goodwill** in the financial year. On the other hand, there were numerous **restructuring expenses** from the ongoing process at the LBBW Group. This situation negatively impacted earnings by EUR –67 million (previous year: EUR –368 million). LBBW also incurred expenses of EUR –306 million from the **guarantee commission** to be transferred in connection with the risk shield provided to the state of Baden-Württemberg. In comparison with the previous year, expenses were reported in full for the entire financial year for the first time. For reasons of transparency, guarantee commission was reported in a separate income item.

Despite the good operating customer business, the Group posted negative **consolidated profit before tax** of EUR –317 million at the end of 2010, owing in particular to the high measurement losses associated with the European debt crisis. Taking due **income taxes** of EUR –30 million into account, largely resulting from prior-period effects, LBBW reported a **consolidated loss** of EUR –347 million as at December 31, 2010.

## Net Assets and Financial Position.

Assets	Dec. 31, 2010	Dec. 31, 2009	Change from 2009 to 2010	
	EUR million	EUR million	EUR million	in %
1. Cash reserve	400	1 878	-1 478	-78.7
2. Loans and advances to banks	66 217	88 087	-21 870	-24.8
3. Loans and advances to customers	132 309	149 633	-17 324	-11.6
4. Loan loss provision	-3 717	-3 904	187	-4.8
5. Positive fair values from derivative hedging instruments	20 399	2 799	17 600	>100
6. Trading assets	68 786	66 997	1 789	2.7
7. Financial assets designated at fair value	6 342	7 562	-1 220	-16.1
8. Non-current financial assets	75 075	91 028	-15 953	-17.5
9. Investments accounted for using the equity method	322	309	13	4.2
10. Portfolio hedge adjustment attributable to assets	287	196	91	46.4
11. Non-current assets or disposal groups held for sale	2 203	692	1 511	>100
12. Intangible assets	604	628	-24	-3.8
13. Investment property	1 725	1 761	-36	-2.0
14. Property and equipment	721	854	-133	-15.6
15. Current income tax assets	277	700	-423	-60.4
16. Deferred income tax assets	1 148	1 109	39	3.5
17. Other assets	1 315	1 365	-50	-3.7
<b>Total assets</b>	<b>374 413</b>	<b>411 694</b>	<b>-37 281</b>	<b>-9.1</b>

Equity and liabilities	Dec. 31, 2010	Dec. 31, 2009	Change from 2009 to 2010	
	EUR million	EUR million <sup>1)</sup>	EUR million	in %
1. Liabilities due to banks	79 328	127 536	-48 208	-37.8
2. Amounts due to customers	87 931	105 212	-17 281	-16.4
3. Securitized liabilities	81 692	100 068	-18 376	-18.4
4. Negative fair values from derivative hedging instruments	19 763	3 807	15 956	> 100
5. Trading liabilities	68 246	36 694	31 552	86.0
6. Financial liabilities designated at fair value	9 794	12 371	-2 577	-20.8
7. Portfolio hedge adjustment attributable to liabilities	584	522	62	11.9
8. Provisions	2 427	2 374	53	2.2
9. Liabilities from disposal groups held for sale	2 225	678	1 547	> 100
10. Current income tax liabilities	301	312	-11	-3.5
11. Deferred income tax liabilities	228	314	-86	-27.4
12. Other liabilities	783	624	159	25.5
13. Subordinated capital	11 151	10 657	494	4.6
14. Equity	9 960	10 525	-565	-5.4
Share capital	2 584	2 584	0	0.0
Capital reserves	6 910	6 910	0	0.0
Retained earnings	1 392	2 941	-1 549	-52.7
Cumulative net income recognized directly in equity	-590	-439	-151	34.4
Net retained loss	-347	-1 483	1 136	-76.7
Minority interests	11	12	-1	-8.3
<b>Total liabilities</b>	<b>374 413</b>	<b>411 694</b>	<b>-37 281</b>	<b>-9.1</b>
Guarantee and surety obligations	6 934	6 677	257	3.8
Irrevocable loan commitments	21 457	21 479	-22	-0.1
<b>Business volume</b>	<b>402 804</b>	<b>439 850</b>	<b>-37 046</b>	<b>-8.4</b>

1) After taking into account adjustments in accordance with IAS 8.

## Consolidated Total Assets Further Reduced.

As part of the EU restructuring, it has been agreed that the Group's balance sheet volume is to be successively reduced. In comparison with the previous year, both the business and consolidated balance sheet volume have fallen considerably. The business volume has declined by approximately -8%, or EUR -37.0 billion, to EUR 402.8 billion. Total assets dropped by roughly -9%, or EUR -37.3 billion, to EUR 374.4 billion. This can be attributed especially to asset portfolio reduction in the credit investment portfolio (CIP), which had been significantly reduced further as at December 31, 2010, by approximately EUR 20 billion to a nominal value of around EUR 54 billion. As the previous year, the utilization of maturities and targeted disposals reduced the portfolio. In addition, a decline in inter-bank transactions led to reduced receivables and liabilities due to banks. There were also major changes to loans and advances to other banks and customers and deposits from other banks and customers, as well as trading assets and liabilities from the different way of reporting new business from money market transactions in place since the beginning of the year. These were to be reported in the trading portfolio as of 2010.

## Lending.

**Loans and advances to banks** decreased by -25% or EUR -21.9 billion to EUR 66.2 billion against the end of the previous year. This drop was largely due to a reduction in borrower's note loans (EUR -5.8 billion) and the different way of reporting receivables from money market transactions (EUR -12.7 billion).

At the same time, **loans and advances to customers** were reduced. These fell by approximately -12% or EUR -17.3 billion to EUR 132.3 billion. Major contributors to this development were the decline in other loans (approximately EUR -4.4 billion) and, since the beginning of the year, the changes to the reporting of customer-induced money market transactions in the trading portfolio (approximately EUR -6.8 billion).

The **positive fair values from derivative hedging instruments** changed by EUR 17.6 billion to EUR 20.4 billion. The increase is largely due to the addition of hedging derivatives in the fair value hedge accounting portfolio and a rise in fair values.

**Trading assets** moved only slightly year-on-year by EUR 1.8 billion (approximately 3%) to EUR 68.8 billion. Alongside the increase from the different way of reporting bank/customer-induced money market transactions (EUR +26.3 billion), this item especially recorded a disposal of bonds and other fixed-income securities in the trading portfolio (EUR -12.7 billion) and a market-related decline in positive fair values from trading derivatives (EUR -11.5 billion).

The fall in **financial assets** should be viewed in the context of the reduction in the CIP in particular. The portfolio of bonds and debentures (EUR -14.5 billion) and non-consolidated equity investments largely decreased. Overall, financial assets declined by EUR -15.9 billion (approximately -18%) to EUR 75.1 billion.

## Funding.

LBBW continued its aim of achieving a balanced funding structure last financial year. For this reason, funding was based primarily on three pillars that were used in varying degrees depending on the performance of the money and capital markets. In accordance with this approach, the funding volume comprised liabilities due to banks and customers and securitized liabilities.

**Liabilities due to banks** showed a distinct decline in 2010, falling EUR - 48.2 billion (- 38%) to EUR 79.3 billion. Major drivers of the reduction were the different way of reporting money market transactions, the new business of which has been recorded in the trading portfolio as of the beginning of the year (EUR - 33.9 billion). In addition, the drop in securities repurchase agreements (EUR - 11.9 billion) and other liabilities due to banks (approximately EUR - 10.6 billion) led to a reduction in the item. By contrast, the improvement in the schuldschein portfolio (EUR + 10.7 billion) had a compensatory effect.

The principal pillar of funding came in the form of **liabilities due to customers**. With a change of - 16%, or EUR - 17.3 billion, the volume fell to EUR 87.9 billion. Alongside a decline in public-sector registered covered bonds issued (EUR - 3.5 billion), the reduction in this item was also driven by the reporting of new business of customer-induced money market transactions in the trading portfolio in use since the beginning of the year (EUR - 13.7 billion).

The third major source of funding, **securitized liabilities**, also posted distinct reduction of around - 18%, or EUR - 18.4 billion, to EUR 81.7 billion. Reflected in this was the lower funding requirement resulting from the decline in financial assets connected with the intended reduction in total assets. The portfolio was reduced primarily by means of repayments and the utilization of maturities of public-sector covered bonds and other bonds (EUR - 14.7 billion).

LBBW issued mortgage-backed covered bonds and public-sector covered bonds on the capital market, in addition to unsecured bonds. The target groups for issues placed directly in 2010 were primarily savings banks, private customers, insurance companies and pension and investment funds. In addition, bonds were issued with other banks and on the international capital markets. In June 2010, LBBW issued a EUR 1 billion public-sector covered bond, with great success. This transaction underlined the role of LBBW as an important issuer of covered bonds in Germany. A short time later, in mid-July 2010, LBBW successfully reopened the Reg S USD market with a three-year USD 500 million public-sector covered bond issue. This issue won LBBW many new investors. In 2010, LBBW was able to fulfill its refinancing requirements without any restrictions.

Despite the difficult market environment, LBBW was not dependent on state-guaranteed issues at any time. LBBW's good refinancing situation was strengthened by its integration in the savings bank association and in customer business.

The **negative fair values from derivative hedging instruments** changed by EUR 15.9 billion to EUR 19.8 billion. The increase is largely due to the addition of hedging derivatives in the fair value hedge accounting portfolio and a rise in fair values.

The portfolio of **trading assets** grew considerably as business progressed. In this respect, the Group reported an increase of EUR 31.6 billion (86%) to EUR 68.2 billion. As on the assets side, this rise was linked with the changes to the reporting of new business in money market transactions in the trading portfolio since the beginning of the year. As a result, the item grew by approximately EUR 40.4 billion year-on-year. The negative fair values from trading derivatives had a reducing effect (EUR - 8.7 billion).

In the case of the **financial liabilities designated at fair value** balance sheet item, the reduction in securitized liabilities was primarily responsible for a fall of around -21%, or EUR -2.6 billion, to EUR 9.8 billion. This reduction is also linked with the reduced funding volume in the Group.

## Equity.

**Equity** amounted to approximately EUR 10 billion as at December 31, 2010. In comparison with the end of 2009, this represented a change of around EUR -0.6 billion (-5%). Equity was reduced by the decline in revenue reserves from the calculation of the accumulated loss for 2009 (approximately EUR -1.5 billion). The year-on-year reduction in accumulated losses was approximately EUR 1.1 billion, to EUR 0.3 billion.