

Risk Report.

Risk-oriented Management of the Bank as a Whole.

LBBW defines risk management as the use of a comprehensive set of tools to deal with risks within the scope of the risk-bearing capacity, the strategy set out by the Board of Managing Directors and the Group-wide system for risk-oriented management of the Bank as a whole. In particular, these mechanisms include LBBW's organizational structure and processes, risk management and control processes, and internal auditing.

Risk Strategy.

The Board of Managing Directors and the Supervisory Board stipulate the principles of the risk management system by defining risk strategies that are consistent with LBBW's business strategy. Corporate policy and risk strategy guidelines for risk management are specified through risk principles in the Group risk strategy, which applies Group-wide and across all risk categories. The guidelines for risk management represent core principles for balancing opportunities and risks within the LBBW Group and adhere to the basic elements of the EU restructuring. They form the basis for a uniform company-wide understanding of corporate goals in connection with risk management. As a result, they contribute to the creation of a uniform risk culture.

The Board of Managing Directors and all employees feel bound by the risk management guidelines and make their decisions in observance of them. Under materiality principles, the guidelines form the framework for the firm organization of processes and methods of risk management.

In addition, risk policy objectives and auxiliary risk strategy conditions are formulated in the Group risk strategy. Processes, business strategies and earnings targets are also stipulated for the front and back office divisions using a combined top-down/bottom-up process in the specific risk strategies. Specific strategies are approved for all major risk categories (in accordance with the table below).

Risk-bearing Capacity.

A Group-wide compilation of risks across all major risk categories and subsidiaries and the comparison of this with the capital required for economic purposes (aggregate risk cover) are carried out in the calculation of risk-bearing capacity.

The following risk categories are identified:

Risk Categories.

	Risk category	Describes possible ...
Material risks	Credit risks	... losses arising from the default or credit rating deterioration of business partners. ... defaults by state borrowers and payment restrictions. ... losses arising from low proceeds from the liquidation of collateral.
	Market price risks	... losses caused by changes in interest rates, credit spreads, share prices, exchange rates, commodities prices, volatilities.
	Operational risks	... losses arising due to the unsuitability or failure of internal processes and systems, people, or due to external events, including legal risks.
	Liquidity risks	... problems meeting payment obligations in the short term, or not being able to quickly close out larger positions at market value.
	Real estate risks	... losses in value of the Group's real estate holdings.
	Development risks	... losses resulting especially from potential plan variances in the project development business of LBBW Immobilien GmbH.
	Investment risks	... losses in value of Group companies and equity investments to the extent that these are not included in the above risk categories.
	Strategic risks	... losses in value due to strategic decisions.
	Reputation risks	... losses in value due to damage to the Bank's reputation.
	Business performance risks	... losses in value due to less favorable business performance than expected, provided these do not relate to the above risks typical to banks.
	Pension risks	... increases in pension provisions.
	Own credit rating risks	... additional expenses due to increase in funding costs.
	Model risks	... misrepresentations of actual risk.
	Dilution risks	... losses in value due to a lack of legal payment obligations for purchased receivables.
Fund placement risks	... losses in value due to non-placement of equity components in the case of closed-end funds.	

The credit, market price, real estate, development, investment and operational risks are generally quantified as value-at-risk (VaR). The liquidity risks are limited by a defined liquidity risk tolerance and procedural rules. The other risks are quantified via simplified models.

At LBBW, aggregate risk cover (corresponds to risk coverage potential as per MaRisk) denotes the equity restricted according to economic criteria which is available for the coverage of unexpected potential losses. In addition to equity (as per IFRS including revaluation reserves), subordinated capital, P&L result (IFRS) and hidden losses are considered components of aggregate risk cover.

Economic capital is calculated as a uniform risk measure at the highest level. In contrast with the capital stipulated by regulatory bodies, this represents the capital backing required from LBBW's economic point of view, calculated using LBBW's own risk models. LBBW's economic capital is in principle expressed by VaR at a confidence level of 99.95% and with a holding period of 1 year.

The upper risk limit for economic capital represents the upper limit for all material quantifiable risks throughout the Group. This limit reflects LBBW's maximum willingness to take risks and was set well below the total resources available to cover risks in line with the conservative risk policy of LBBW. Economic capital limits for the various risk categories are derived from this, whereby a buffer is provided for other risks that are not directly quantifiable and for risks arising from unforeseeable stress situations.

Stress Tests.

Stress tests are an integral part of LBBW's internal risk management. Stress scenarios are arranged in such a way that extraordinary but plausible events of different levels of severity are considered from economic, regulatory and accounting perspectives. In order to ensure risk-bearing capacity and regulatory capital ratios even in a stress case, basis scenarios have been defined for the various risk categories which are compared with the buffer presented for stress scenarios.

The following scenarios have been implemented and calculated as part of this:

- Macro-economic scenarios, classified by factor, sector and country (e. g. effects of European sovereign crisis)
- Historical scenarios
- Hypothetical scenarios and sensitivities
- Risk category-specific and cross-risk-category scenarios

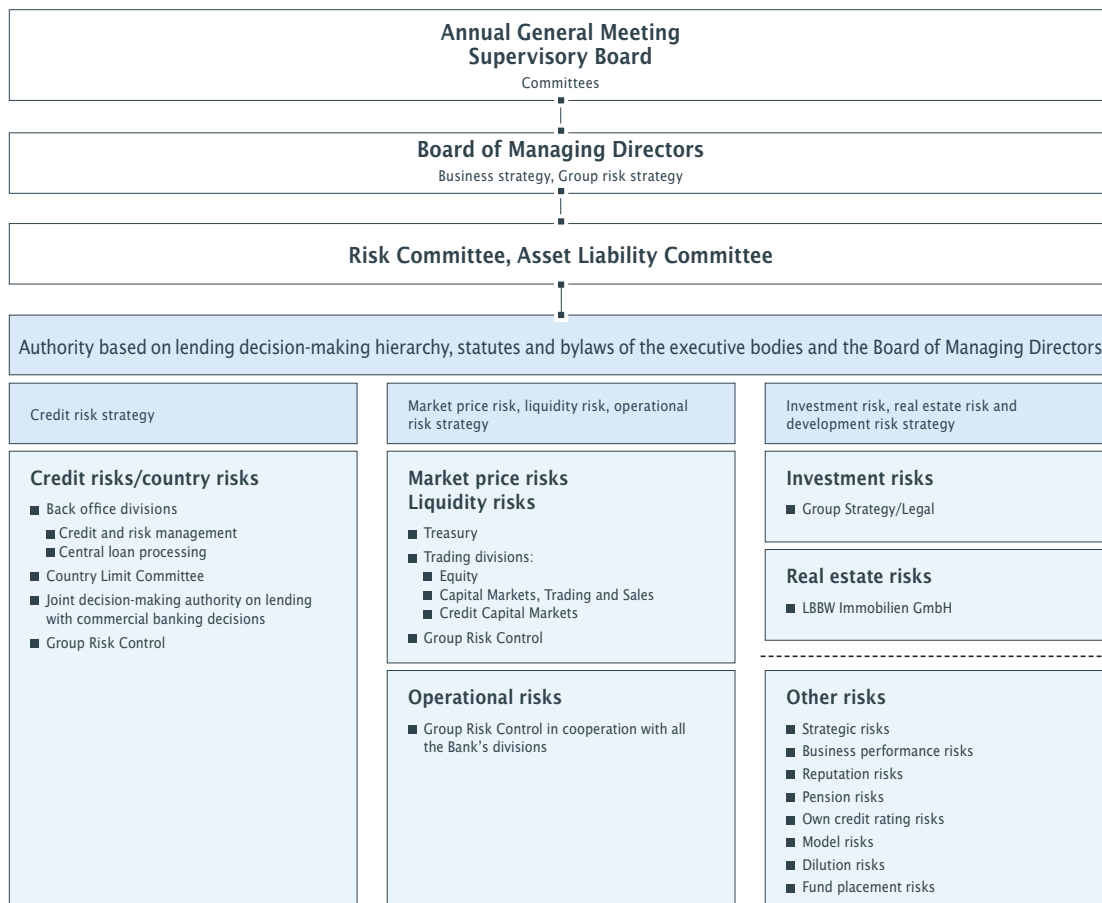
The results showed that risk-bearing capacity was maintained even under stress conditions.

In addition, inverse stress testing is regularly carried out as a complement to the other stress tests. As part of this, it is investigated which scenarios would lead to the existence of the Bank being endangered.

LBBW took part in the stress tests by supervisory authorities in 2010. The results of these showed that in the case of the market factors specified, LBBW would still have good capital resources even in a stress event.

Cross-disciplinary Risk Management Processes.

Risk Management Structure.



At LBBW, transactions can only be entered into within clearly defined limits or competencies. From a yield perspective and due to the associated opportunities for income and growth potential, risks should be taken in a deliberate and controlled manner. The aim of business activities is to achieve the highest possible income for the Bank having weighed up the potential risks. These guidelines form the foundation of LBBW's risk policy and provide a framework for all business activities.

Within the defined framework, risk management decisions are made individually by the departments with portfolio responsibilities on a decentralized basis, maintaining the separation of functions; these decisions are monitored by the central Group Risk Control division. The risk control and risk management system set up for this purpose covers all material risks and the details specific to the risk categories.

Potential concentrations of risk receive particular attention. They are not defined as an independent risk category at LBBW. Concentrations in fact tend to arise as a result of the synchronization of risk positions within one of the risk types specified. They can also be produced as a result of common risk factors or interactions between various risk factors of different risk types. At LBBW, commitments and concentrations which could jeopardize the Bank's existence must be avoided. There is a range

of different monitoring processes and limits (e.g. sector limitations) for the purpose of controlling this strategic requirement.

The Risk Committee comprises the department heads in charge of financial markets, finance/operations and IT, and back office functions, in addition to division managers from the front and back office, risk control and financial controlling, among other areas. As an advisory committee, the Risk Committee prepares decisions for the Board of Managing Directors and supports it in the cross-disciplinary monitoring of LBBW's risk-bearing capacity and of material risks, as well as in complying with regulatory requirements. The monthly overall risk report and other reports prepared as needed on specific issues form the basis for this. Decision-makers are also supported in risk management by an extensive reporting system that is specific to risks and issues.

As of November 2010, the new Asset Liability Committee prepares decisions for the Board of Managing Directors and supports it in ensuring the adequacy of the capital resources, asset/liability control and determining the liquidity and refinancing strategy. The resolution is passed by the Group's Board of Managing Directors. The Committee is coordinated by the Treasury division and comprises the Chairman of the Board of Managing Directors, the department heads in charge of financial markets, finance/operations and IT, and back office functions, in addition to division managers from the front office, risk control, financial controlling and accounting, among other areas.

New Product Process.

New types of products at LBBW are subject to a new product process that ensures that these products are included in LBBW's various systems, such as those of accounting and risk controlling. At LBBW, this generally concerns trading and credit products, with an emphasis on trading products.

Risks from Financial Instruments.

A financial instrument is a contract which, in the case of a company, leads to a financial asset and, in the case of other companies, to a financial liability or equity instrument.

Risk categories classified as significant for financial instruments include credit risk (borrower, counterparty, issuer, country, transfer and collateral risk), market price risk (share price, interest rate, currency and raw materials risk), operational risk (risk of losses due to unsuitability or failure of internal processes and systems, people, or external events), liquidity risk (short-term liquidity risk and refinancing (spread) risk) and investment risk (risk of losses from immaterial subsidiaries and minority interests), as well as other risks.

A holistic approach is taken to the management of risks relevant to LBBW, which is reflected in this Risk Report, particularly in relation to the evaluation of the LBBW Group's risk-bearing capacity. A Group-wide compilation of risks across all major risk categories and subsidiaries (economic capital, generally as value-at-risk) and the comparison of this with the capital required for business purposes (aggregate risk cover) are carried out in the risk-bearing capacity. In addition, the LBBW Group's risk strategies provide the risk framework.

Detailed information on the financial instruments can be found in the Notes to the annual financial statements for this Management Report.

Process-independent Monitoring.

The Internal Auditing division is a process-independent department that monitors all operations and business workflows, risk management and control, and the Internal Control System (ICS) with the aim of safeguarding LBBW's assets and boosting its operating performance. The Internal Auditing division exercises its duties autonomously. The Board of Managing Directors is informed about the results of audits by way of written audit reports discussed with the audited operating units. Internal Auditing also monitors how the audit findings are dealt with.

Implementation of Regulatory Requirements. MaRisk.

LBBW is fully subject to the regulations on the minimum requirements for risk management (MaRisk). On December 15, 2010, the German Federal Financial Supervisory Authority (BaFin) specified and extended the minimum requirements with the third MaRisk amendment.

In particular, the revised version of MaRisk tightens and expands the regulatory requirements for the strategy process, considering the concentration of risk and diversification effects, the risk-bearing capacity concept, management of the Bank as a whole, stress testing and liquidity risk. The new minimum requirements are to be implemented in full by December 31, 2011. At LBBW, extensive work packages were defined for implementation in connection with these issues, some of which have already been processed. Outstanding subjects for implementation will be dealt with by the end of 2011.

SolvV.

As of January 1, 2008, LBBW began using the Internal Ratings-Based Approach (IRBA) to measure capital adequacy for counterparty risks in accordance with the German Solvency Regulation (SolvV), after the most important rating procedures from the point of view of the portfolio were audited and approved by the supervisory authorities. LBBW is aiming to obtain regulatory approval for further rating procedures in subsequent years.

Basel III.

As a result of the far-reaching financial and economic crisis, the G20 states have drawn up an extensive agenda for financial market regulatory reform. The goal of the desired reforms is to make the financial system as a whole more resistant.

As part of this reform, the Basel Committee on Banking Supervision has advised the G20 states on new and expanded regulations (the Basel III framework).

The central plank of the reform is the improvement of the loss-bearing capacity of equity, especially the increase of both the quantity and liability quality of the equity, as well as the extension of risk measurement. In future, banks should hold considerably more equity to cover their risk-weighted assets. This will be operationalized by higher minimum quotas and additional capital buffers.

In addition to new indicators for the supply of liquidity and debt, the Basel Committee on Banking Supervision also devised rules that will reduce the cyclical nature of the equity requirements of Basel II (e.g. by means of an anti-cyclical capital buffer). Furthermore, measures to moderate the systemic relevance of individual banks are under discussion.

These new regulatory developments have implications on business strategy, the strategic direction of the business areas, management metrics and technical reporting capacity. The interdependencies between the new regulatory developments and business strategy demand an integrated approach.

At LBBW, the implementation of Basel III is being supported by an interdisciplinary project team which, as well as quantitative effect analyses, is developing recommendations for action and preparing a Basel III implementation project.

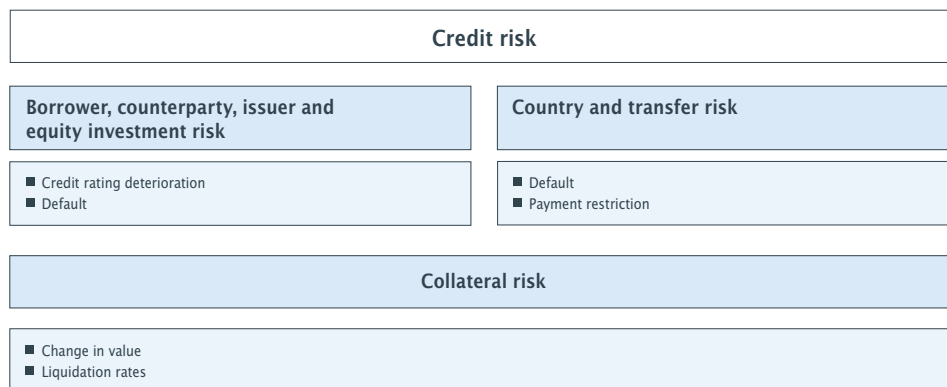
Credit Risks.

At LBBW, credit risks are defined as possible losses that result from:

- Deterioration in the credit ratings of, or defaults by, borrowers, counterparties, issuers or equity investments,
- The impact of cross-border restrictions on payments or
- Changes in the value of collateral.

The credit risk structure follows the illustration below:

Credit Risk Components.



Borrower, Counterparty, Issuer and Equity Investment Risk.

The risk that a contractual partner does not meet his payment obligations or does not meet them in full within the stipulated period and that deteriorations in the credit ratings lead to a decline in value.

Country and Transfer Risk.

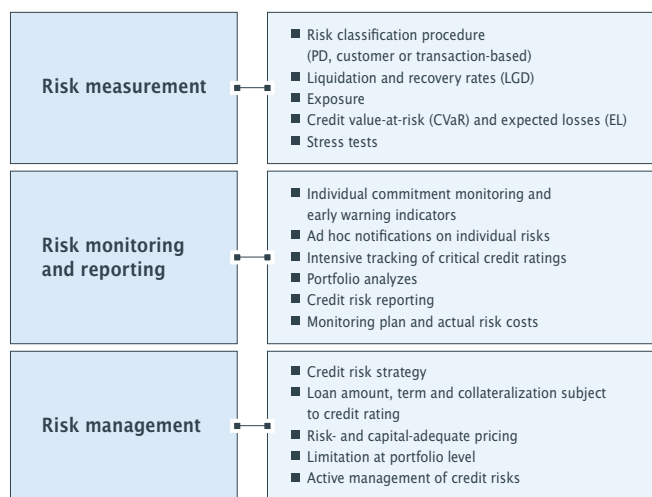
Public budget default (as with borrower/issuer risk) and risk that customers abroad who are both willing and able to meet their payment obligations cannot fulfill them or cannot fulfill them completely due to limitations on payments or other government actions.

Collateral Risk.

The risk that, in the event of liquidation, collateral does not achieve the expected (market) value.

Management for limiting the aforementioned components of credit risk is conducted as an integrated process at LBBW, consisting of the following components:

Credit Risk Management.



Risk Measurement.

In order to measure risk, LBBW uses an extensive range of instruments involving quantitative measuring procedures. These are subject to ongoing quality control and are developed further as and when required.

Risk Classification Procedures.

LBBW uses specific rating procedures for all relevant business fields. These procedures quantify the probability of default for the investments. The counterparty risk is calculated both including and excluding the transfer risk.

The forecast reliability of the rating procedures in use is reviewed regularly and the procedures are refined if necessary. Risk classification procedures are maintained and updated by LBBW on its own initiative or in cooperation with Rating Service Unit GmbH & Co. KG (a subsidiary of the Landesbanken) or S Rating GmbH (a subsidiary of DSGV).

Liquidation and Recovery Rates.

For a risk-adequate valuation of investments, an estimate of the loss given default is required, in addition to the probability of default. To this effect, estimates are calculated for liquidation rates (average proceeds expected from the liquidation of collateral in relation to market value) and for recovery rates (proportion of the proceeds from the unsecured part of a receivable). The estimates are based on empirical values and data recorded by the Bank itself and in cooperation with savings banks and other Landesbanken.

Exposure at Default.

Depending on the type of product, the market factor (interest rate, currency etc.) and the term, a differentiated calculation of potential future exposures is carried out, ensuring adequate application against the line.

Expected Losses and Credit Value-at-risk.

The expected loss, as an indicator that depends on customer creditworthiness, an estimation of the amount of the loss and the expected exposure at the time of default, provides the basis for the level of the standard risk costs. In preliminary costing at the individual transaction level, these are included in the calculation of risk-adequate loan terms. At the portfolio level, this indicator can be used to ensure comparability between different portfolios and to check the plausibility of projected risk costs. In the context of calculating impairment, the concept of the expected loss is also used to calculate flat-rate risk provisions (GLLP and PLLP not impaired), in order to estimate the actual loss (incurred loss) that has not yet been recognized because of delays in information.

At LBBW, unexpected loss or credit value-at-risk (CVaR) represents the potential present value loss of a portfolio above its expected loss. Here, the amount is calculated that will not be exceeded by losses with a given probability (confidence level) within a time horizon of one year. Concentration risks play a particularly important role in this regard. Industry and volume concentrations in the case of individual borrowers increase portfolio risk, while high granularity and diversification reduce this risk. LBBW uses a credit portfolio model based on the modeling of rating migration to calculate this value. The individual borrowers are assigned default and migration probabilities corresponding to their ratings. These are modeled in such a way that correlations between borrowers (particularly based on their allocation to sectors and countries) can be addressed adequately. The credit exposure is subject to mark-to-model valuation; the calculation is based on present value. The credit portfolio model uses a Monte Carlo simulation approach to calculate risk. As for the other risk categories, the CVaR is calculated at a confidence level of 99.95%.

Stress Tests.

In addition to statistical indicators and risk measurement tools, which are ultimately based on historical data, stress scenarios play an important part in risk assessment. These analyze in advance the impact of possible economic volatility and market crises in order to establish whether LBBW's risk-bearing capacity is adequate for these extreme situations. At LBBW, a set of standardized credit risk stress scenarios is calculated and incorporated into the risk-bearing capacity. This is supplemented by special stress scenarios according to current requirements, which analyze changes in LBBW's portfolio with regard to potential developments (e. g. crises in the sector).

Risk Monitoring and Reporting. Individual Transaction Level.

Monitoring of risks at the individual transaction level is ensured through ongoing observation of customers and their environments by the risk analysts in the back office division who are responsible for the transaction.

LBBW's internal processes aim to identify commitments affected by low credit ratings or deterioration in credit ratings at an early stage, on the basis of early warning indicators. This enables the Bank to start a dialogue with customers to initiate timely countermeasures. Depending on the level of risk, problematic commitments are classified as cases requiring intensive tracking, restructuring or liquidation and are dealt with by specialized divisions. LBBW aims to minimize losses through successful restructuring activities, in line with the Bank's own interests and those of customers.

For specific reporting to the decision-makers in charge, an ad hoc reporting process is implemented for significant and extraordinary events. Larger and/or more complicated credit risk exposures are regularly reported to the Board of Managing Directors and the supervisory bodies with well-founded statements about the respective investment strategy and financial development.

Portfolio Level.

Monitoring of counterparty risk at portfolio level takes place in the Group Risk Control division, which, from an organizational point of view, is separate from the front and back office divisions. This division is responsible for ensuring the suitability of rating procedures, measuring credit risk, monitoring counterparty, country and industry limits and drawing up risk reports.

Risks are monitored through limitations at various levels of the portfolio and the Group credit risk is restricted by a limit on the economic capital on the basis of the credit value-at-risk (CVaR).

Compliance with country limits is monitored with a special limit system. Regular reporting to the Board of Managing Directors based on this system was put in place for the »PIIGS« countries in the spotlight in 2010.

The financial institutions portfolio has both an overall limit and limits depending on countries, in addition to the country limit. The exposure of all financial institutions that are not relevant to the system is also limited by means of a further limit for each country.

Industry risks arising from the corporates portfolio are restricted and monitored through the stipulation of industry-specific limits. The limit system is based on a risk-oriented industry key designed specifically for this purpose, which combines industry segments with high dependence of losses along the output chain of companies. For example, mechanical engineering companies whose products are sold predominantly to customers from the automotive industry are assigned to the same sector.

The Risk Committee, which meets on a monthly basis, regularly informs the decision-makers of the risk situation at portfolio level and compliance with the limits described. The credit risk report provides additional detailed information as part of the overall risk report. Reporting on the current risk situation takes place by means of portfolio analyses. If necessary, recommendations for action are made to decision-makers (Group's Board of Managing Directors and supervisory bodies). In addition, the Board of Managing Directors regularly receives portfolio reports from the respective back office divisions with detailed information on the development of risks in various business fields and on critical commitments. Reports on the ongoing development of actual risk costs and deviations from forecast or standard risk costs are also provided on a monthly basis.

Risk Management.

Above all, credit risks are managed through the guidelines of the credit risk strategy, compliance with the economic capital limits with regard to the credit value-at-risk and the monitoring of concentration risks (industries, countries, individual counterparties).

Individual Transaction Level.

Risk management at the level of individual counterparties is the duty of the credit back office divisions. Key elements of individual transaction management are risk-limiting, risk/return-oriented and business segment-specific guidelines as part of LBBW's credit risk strategy. The limitation of risks at individual transaction level is ensured partly by stipulating differentiated minimum levels of creditworthiness for borrowers. In addition, the loan amount and its term and collateral structure are linked to the customer group and the credit rating of the relevant borrower.

From an economic point of view, the question of whether a transaction will produce an adequate profit on a risk-adjusted basis is a key consideration before business is entered into; for this reason, preliminary costing of all transactions is compulsory at LBBW. In addition to the historical interest rate, the components in the calculations are the cost requirement margin (cover for processing costs), the capital range (interest on equity) and the risk range (cover for expected loss). The results of the preliminary costing calculation form the basis of business management at both individual customer and profit center/portfolio level.

Portfolio Level.

In the management of the Group's loan portfolio, the utilization of the limit on the economic capital for credit risks (based on the credit value-at-risk) is monitored particularly closely. On the basis of a traffic light system, measures to cut risk are commenced at an early stage if limits are close to being fully utilized. In addition, the results of the stress tests provide indications of potentially dangerous risk situations.

Country limits are determined by the Board of Managing Directors, based on the proposal of the Country Limit Committee. If the country limit is almost fully utilized, targeted action is taken against the country and transfer risk through the imposition of bans on business. If country credit ratings deteriorate, limits are reduced and/or bans on business issued.

The limitation on the financial institutions portfolio and the corporates and industries portfolio is monitored on an ongoing basis and, if necessary, controlling measures such as the purchase of hedging transactions or a ban on new business will be triggered.

At the level of business fields, risks are limited through adherence to the quantitative guidelines of the credit risk strategy with regard to rating structures, the portfolio quality and risk/return guidelines (e. g. targets for the return on equity). As the strategy is geared towards operating business divisions, clear (sub-) portfolio responsibilities are defined for compliance with guidelines under the credit risk strategy. In addition, the strategy guidelines extend to the product types permitted for each business division.

On December 1, 2009, LBBW set up a new division within the back office department. It is responsible for the management of the credit investment portfolio (CIP). The credit substitute business of LBBW, the former Sachsen LB and the former LRP is bundled within the CIP. The reduction of the CIP will be continued successfully over the years to come as part of the restructuring at LBBW.

Risk Situation.

Preliminary Note.

The following quantitative information on the risk situation is based on the management approach. This means that LBBW's risk situation is reported on the basis of this data, according to which internal risk management and internal reporting to the Board of Managing Directors and the executive bodies is carried out. The internal view of risk differs in some cases from the balance sheet reporting. Key reasons for differences between the figures used for internal management and for external financial reporting are different bases of consolidation and the definition of the loan volume as »exposure« (utilization/fair values plus open external commitments).

In addition to Landesbank Baden-Württemberg, the following subsidiaries relevant in terms of credit risk are included in the basis of consolidation for internal reporting purposes:

- LBBW Luxemburg S.A.
- SüdLeasing Gruppe

LBBW Securities LLC was sold in 2010.

This basis of consolidation is reviewed and adjusted as needed at least annually to reflect current developments.

The differences between the figures used for internal management and for external financial reporting can be quantified as follows for the exposure presented:

EUR million	Carrying amount	Reconciliation			Management approach
		Basis of consolidation	Valuation	Other	
Cash reserve	400	-33	0	-368	0
Receivables	198 526	9 039	-5 756	-6 266	195 543
Investment securities	75 075	-2 276	-6 374	-113	66 312
Non-current assets or disposal groups held for sale	2 203	-1 066	-127	-1	1 008
Hedging derivatives	20 398	-14	35 880	-18 957	37 308
Trading assets (FVO, Hft)	75 128	5 619	29 176	3 954	113 876

Loan Portfolio.

LBBW's loan portfolio, reconciled to the balance sheet categories, is presented in the table below:

Gross Exposure.

EUR million	Dec. 31, 2010	Dec. 31, 2009
Cash reserve	0	20
Receivables	195 543	235 374
whereof loans and advances to banks	66 403	85 910
whereof loans and advances to customers	129 140	149 464
whereof receivables from finance leases	4 074	4 337
Investment securities	66 312	81 095
whereof interest-bearing assets	62 564	75 336
whereof non-interest-bearing assets	3 748	5 759
Non-current assets or disposal groups held for sale	1 008	0
Hedging derivatives	37 308	1 399
Trading assets	113 876	131 875
whereof FVO	5 194	5 650
whereof Hft	108 682	126 224
Loan commitments/other agreements	56 052	61 903
Total	470 099	511 664

Gross exposure decreased against December 31, 2009, by EUR 42 billion to EUR 470 billion. Significant drivers of this development were the intentional reduction in capital market business and targeted exposure reductions in business areas no longer considered part of LBBW's core business.

The different portfolio presentations according to regions, rating levels and industries give an overview of the risk situation of LBBW. In the following tables, the amount reported is the gross exposure or, alternatively, the net exposure. While gross exposure is defined as utilization plus external open loan commitments, net exposure takes into account additional collateral effects.

Regions.

In the regional distribution, business in Germany predominates, with 61 % of gross exposure (December 31, 2009: 59%). This reflects a focus on core markets in private, SME, and large client business, as well as on the function as a central bank to savings banks. 89% of foreign commitments are distributed across Western Europe and North America; therefore, countries with no (eurozone) or very low transfer risks. The overall portfolio share of all investments in the PIIGS countries amounts to less than 5% and will be further reduced in future. Total commitments in Eastern Europe, Latin America, Africa and those with supra-national institutions represent less than 2% of the overall portfolio.

Gross Exposure by Region.

Region	Share
Germany	60.9%
Western Europe (excluding Germany)	25.7%
North America	9.1%
Asia/Pacific	2.4%
Eastern Europe	1.3%
Latin America	0.6%
Africa	0.0%
Supranational	0.0%
Total	100.0%

Credit Risk Reduction.

The illustration of the credit portfolio on the basis of gross exposure does not take into account the reduction of risk by collateral effects. Firstly, the credit risk at single-title level is reduced by means of netting and collateral agreements; secondly, traditional credit collateral such as real estate liens, guarantees, sureties, pledges, assignments and transfers of title of property are used for this purpose. For this reason, net exposure provides a more precise picture of the risk situation and is therefore taken into greater account in internal risk management. Net exposure is derived from gross exposure as follows:

EUR million	
Gross exposure	470 099
Netting/collateral	-41 602
Credit derivatives	-30 865
Classic credit collateral	-51 660
Net exposure	345 972

Traditional credit collateral is shown conservatively, i. e., taking into account different estimates for liquidation and recovery rates from a divestiture perspective.

Portfolio Quality and Industries.

Breaking net exposure down by rating and industry provides information on the scope of LBBW's business activities and the risk situation in the respective industry. The industry classification is based on LBBW's internal risk-oriented industry key.

Net Exposure by Rating and Industry.*

EUR million	AAA- BBB-	BB+ - B+	B - C	Other	Default**	Total
Financial institutions	162 558	5 714	999	1 904	1 474	172 647
Banks	133 980	4 193	384	46	758	139 361
Financial services	28 578	1 521	614	1 858	715	33 286
Companies	55 164	19 563	4 294	1 567	4 463	85 050
Automotive	4 564	3 451	486	64	579	9 144
Construction	3 865	1 961	456	172	538	6 993
Cross-industry services for companies	1 825	625	118	159	260	2 988
Cross-industry manufactured goods	2 142	729	93	72	95	3 130
Commercial real estate	5 713	2 547	788	77	1 501	10 625
Health care	2 079	494	40	131	59	2 803
Foodstuffs trade and other non-cyclical consumer goods	2 142	821	9	11	44	3 027
Transport and logistics	2 863	865	662	141	151	4 683
Insurance	3 463	68	53	22	24	3 629
Utilities	4 821	501	91	48	22	5 482
Other sectors***	21 687	7 501	1 497	670	1 191	32 545
Public sector	78 315	242	1	37	2	78 597
Private individuals	2 832	832	177	5 610	227	9 677
Total	298 868	26 350	5 471	9 118	6 165	345 972
Total in %	86.4%	7.6%	1.6%	2.6%	1.8%	100.0%

* Equivalent external rating classes.

** The Default column shows commitments for which a default event as per § 125 SolvV has occurred, such as 90 days in arrears, improbability of repayment or recognized valuation allowances.

*** Sectors with a share of < 2% of the companies portfolio are summarized under »Other sectors«.

From this rating distribution it can be seen that transactions with customers with good to very good credit ratings (investment grade ratings) account for 86.4% (previous year: 82.2%) of the net exposure. At 1.8% (previous year: 1.6%), commitments for which there has been a default on payment (see Default column) still make up a small part of the overall portfolio. The Other column lists transactions with customers where rating has not been carried out and for which there is no default, e. g. for reasons of risk relevance.

The industry breakdown reveals financial institutions as the largest partial portfolio. Of this, savings banks represent more than half of the net exposure.

The portfolio of corporate customers shows the diversification of industries in place. The Commercial Real Estate and Automotive industries are the most significant corporate sectors; nonetheless, in relation to the overall portfolio, these represent a portfolio share of only 3.1% and 2.6%. From a full-year perspective, the overall portfolio share of the Utilities industry saw an above-average decline from 2.7% to 1.6%. The Renewable Energies industry, newly introduced in 2010, is a major

driver of this development (EUR 2.5 billion net exposure as at December 31, 2010), which largely consists of borrowers formerly allocated to the Utilities sector.

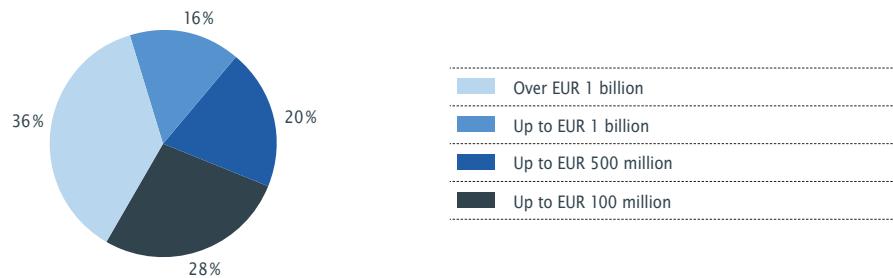
Business with the public sector and private individuals contributes to further portfolio diversification.

Size Classes.

From an annual perspective, the portfolio share of the size class >EUR 1 billion net exposure fell from 39% to 36%. Of this, 42% was exposures to state and savings banks (of which more than two thirds under guarantor's liability) and a further 39% to exposures to public budgets (especially domestic regional authorities). The rest was distributed to banks and companies, almost exclusively with good to very good credit ratings. Further reduction in the share of the size class >EUR 1 billion net exposure to the overall portfolio will be achieved by means of successive disposal of major individual investments.

With shares of 96% and over 90%, those with very good to good credit ratings also dominate the size classes up to EUR 1 billion and up to EUR 500 million net exposure. The size class below EUR 100 million forms a granular portfolio consisting of retail and corporate customers.

Size Class Distribution in Percent (Borrower Units).



Information in Accordance with IFRS 7.36 – 38:

The share of the portfolio accounted for by non-impaired and non-past due commitments amounts to 98.3% of the maximum default risk. The share of commitments for which follow-up negotiations took place was EUR 17 million, which was a distinct decline (2009: EUR 556 million).¹⁾

The non-impaired and non-past due assets are distributed across the balance sheet categories as follows:

Non-impaired and Non-past Due Assets.

EUR million	Gross exposure	Non-impaired and non-past due assets	Gross exposure	Non-impaired and non-past due assets
	Dec. 31, 2010	Dec. 31, 2010	Dec. 31, 2009	Dec. 31, 2009
Cash reserve	0	0	20	20
Receivables	195 543	188 645	235 374	229 088
whereof loans and advances to banks	66 403	65 817	85 910	84 988
whereof loans and advances to customers	129 140	122 827	149 464	144 100
whereof receivables from finance leases	4 074	3 678	4 337	3 945
Investment securities	66 312	65 580	81 095	80 134
whereof interest-bearing assets	62 564	61 832	75 336	74 375
whereof non-interest-bearing assets	3 748	3 748	5 759	5 759
Non-current assets or disposal groups held for sale	1 008	1 008	0	0
Hedging derivatives	37 308	37 308	1 399	1 399
Trading assets	113 876	113 876	131 875	131 875
whereof FVO	5 194	5 194	5 650	5 650
whereof Hft	108 682	108 682	126 224	126 224
Loan commitments/other agreements	56 052	55 734	61 903	61 606
Total	470 099	462 151	511 664	504 121

1) This includes commitments for a period of twelve months from the time at which follow-up negotiations took place.

Past due commitments amount to 0.03% of gross exposure.

Non-impaired and Past Due Assets Dec. 31, 2010.

EUR million	Total gross exposure	< 1 month	> 1 to 3 months	> 3 to 6 months	> 6 to 9 months	> 9 to 12 months	> 12 months
Receivables	132	12	37	3	5	7	67
whereof loans and advances to banks	0	0	0	0	0	0	0
whereof loans and advances to customers	132	12	37	3	5	7	67
whereof receivables from finance leases	24	9	12	0	1	0	2
Investment securities	0	0	0	0	0	0	0
whereof interest-bearing assets	0	0	0	0	0	0	0
whereof non-interest-bearing assets	0	0	0	0	0	0	0
Non-current assets or disposal groups held for sale	0	0	0	0	0	0	0
Hedging derivatives	0	0	0	0	0	0	0
Trading assets	0	0	0	0	0	0	0
whereof FVO	0	0	0	0	0	0	0
whereof Hft	0	0	0	0	0	0	0
Loan commitments/ other agreements	0	0	0	0	0	0	0
Total	132	12	38	3	5	8	67

Non-impaired and Past Due Assets Dec. 31, 2009.

EUR million	Total gross exposure	< 1 month	> 1 to 3 months	> 3 to 6 months	> 6 to 9 months	> 9 to 12 months	> 12 months
Receivables	212	58	44	13	26	7	65
whereof loans and advances to banks	4	0	2	0	2	0	0
whereof loans and advances to customers	209	58	42	13	24	7	65
whereof receivables from finance leases	52	14	10	8	9	4	8
Investment securities	0	0	0	0	0	0	0
whereof interest-bearing assets	0	0	0	0	0	0	0
whereof non-interest-bearing assets	0	0	0	0	0	0	0
Non-current assets or disposal groups held for sale	0	0	0	0	0	0	0
Hedging derivatives	0	0	0	0	0	0	0
Trading assets	0	0	0	0	0	0	0
whereof FVO	0	0	0	0	0	0	0
whereof Hft	0	0	0	0	0	0	0
Loan commitments/ other agreements	3	0	0	3	0	0	1
Total	216	58	44	15	26	7	65

The amount of impaired assets increased year-on-year by EUR 488 million, with the increase due in particular to loans and advances to customers.

Impaired assets.

EUR million	Gross exposure	
	Dec. 31, 2010	Dec. 31, 2009
Receivables	6 767	6 074
whereof loans and advances to banks	586	919
whereof loans and advances to customers	6 181	5 155
whereof receivables from finance leases	372	339
Investment securities	732	960
whereof interest-bearing assets	732	960
whereof non-interest-bearing assets	0	0
Non-current assets or disposal groups held for sale	0	0
Hedging derivatives	0	0
Trading assets	0	0
whereof FVO	0	0
whereof Hft	0	0
Loan commitments/other agreements	317	294
Total	7 816	7 328

Using liquidation value criteria, due and impaired assets contrast with collateral amounting to EUR 1 635 million.

Specific valuation allowances have been recognized for the credit and country risks associated with loans and advances to customers and other banks according to standards uniform throughout the Group. To this end, a test is conducted at each balance sheet date to determine whether objective evidence exists that the value of an individual financial asset or group of financial assets is impaired. Objective evidence of impairment includes, in particular, recognizable financial difficulty of the borrower; a breach of contract (default or past due interest or principal payments); an increased likelihood that the borrower will enter bankruptcy or other financial reorganization; and granting by the lender, for economic or legal reasons relating to the borrower's financial difficulty, of a concession that the lender would not otherwise consider.

To a very limited degree, LBBW assumes assets from collateral received for liquidation (foreclosures totaling EUR 25.1 million, compared with EUR 26.0 million in 2009). This collateral is either purchased directly or acquired in foreclosure sales.

Additional Information on the Portfolio of Securitized Products.

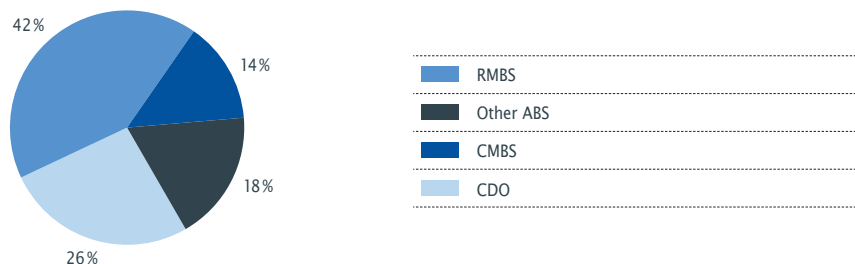
Preliminary Remark on the Risk Shield.

In view of the turbulences in the financial markets, the LBBW Group put in place a risk shield with the state of Baden-Württemberg in the form of a guarantee structure in effect from June 30, 2009. LBBW has been granted a guarantee amounting to a total of EUR 12.7 billion to secure losses on a specified reference portfolio that contains ABS securities and loans, granted by LBBW to the Irish special-purpose entity Sealink Funding Ltd. (Sealink). On December 15, 2009, the European Commission gave its final approval of the risk shield provided by the state of Baden-Württemberg and the capital injection of EUR 5 billion from the owners.

A partial amount of the guarantee amounting to EUR 6.7 billion serves to secure a securitization portfolio (guarantee portfolio) with a currently outstanding nominal volume of EUR 13.4 billion (as of December 31, 2010). LBBW bears the first loss on the guarantee portfolio up to an amount of EUR 1.9 billion, which were already fully included on the balance sheet in the 2009 financial year. Losses beyond this amount will be absorbed by the guarantee. Should further losses occur after the guarantee has been fully utilized, these shall be borne by LBBW.

The remaining EUR 6.0 billion of the guarantee covers loans granted by LBBW to the special-purpose entity Sealink.

Securitization portfolio as at December 31, 2010 – outstanding volume per asset class (EUR 21.0 billion).



As of December 31, 2010, LBBW's securitization portfolio (including guarantee portfolio) amounts to a volume of approximately EUR 21.0 billion^{1) 2)}. Compared with 2009, the securitization portfolio has thus been continually reduced by around EUR 3.5 billion from EUR 24.5 billion (overall effect). The decreased volume is the result of repayments, amortization and sales amounting to EUR 4.1 billion and offsetting currency effects of EUR 0.6 billion.

Overall, LBBW thus continued with the intended restructuring targets, i.e., ongoing risk reduction by means of ordered repayment of the securitization volume and controlled expiry of existing commitments.

1) Whereof CIP securitizations: EUR 20.1 billion.

2) The statements concerning the risk situation are presented below based on the management approach.

The majority of the portfolio volume (approximately 76 %) is distinguished by securitized items categorized as investment grade (rating class AAA to BBB). In this respect, 40 % of the commitment with a volume of EUR 7.3 billion is assessed with the highest rating.

From 2007 onwards, the financial market crisis led to considerable declines in market value in LBBW's securitization portfolio. In retrospect, the average market prices in mid-2010 were a slight improvement on December 31, 2009, and remained stable on average even up to the reporting date.

Rating Reporting.

The allocation to the different rating categories was carried out on the basis of information from external providers. In a conservative approach, the lowest available rating from Moody's, Standard & Poor's or Fitch was applied in each case. Some of these differed markedly from each other. In the case of transactions which had no external rating but had been subject to an internal credit rating evaluation, the internal rating was carried over to the corresponding S&P rating.

Most of the transactions recognized as NR (not rated) were securitization items that had been written down which either had their external rating withdrawn, had no rating even at issue or had their rating withdrawn after restructuring.

Assets not Secured by the Risk Shield Provided by the State.

The nominal securitization volume not covered by the guarantee of the state of Baden-Württemberg decreased in comparison with December 31, 2009, to EUR 7.6 billion. Repayments and amortization totaling EUR 1.6 billion, mostly on RMBS and other ABS, were responsible for the decline in volume. At the same time, however, this was contrasted with moderate currency effects – a volume increase of in foreign-currency denominated securitites – amounting to EUR 63 million. This is a result of the decline in nominal euro exchange rates during the reporting period.

Assets not Secured by the Risk Shield Provided by the State – Non-guarantee Portfolio by Asset-Class and Rating.

Outstanding Volume as of December 31, 2010

EUR million	AAA	AA	A	BBB	BB to B	CCC to C	D	NR	Total	in %
CDO	125	561	193	114	609	202	0	21	1 825	24.2
RMBS	3 068	195	119	109	0	2	0	0	3 494	46.2
CMBS	165	30	61	29	0	0	0	0	285	3.8
Other ABS	630	753	515	0	0	0	0	54	1 952	25.8
Total Investments	3 988 52.8%	1 539 20.4%	888 11.8%	252 3.3%	609 8.1%	203 2.7%	0 0.0%	75 1.0%	7 555 100.0%	100.0

The lowest external rating was generally applied and mapped to S&P's rating scale. Figures may be subject to rounding differences.

As in the previous periods, most of the non-guaranteed portfolio volume of EUR 6.7 billion (88 %) still had a satisfactory rating level at investment grade. The relative share of securities not categorized as investment grade also remained virtually constant (12 %).

Moreover, rating migration took place across various rating classes, particularly from AAA to AA and BBB and as far as BB to B.

Assets Secured by the Risk Shield Provided by the State – Guarantee Portfolio.

The guarantee portfolio had an outstanding nominal volume of EUR 13.4 billion on the reporting date. In comparison to previous year, outstanding ABS investments volume was reduced considerably at EUR 1.9 billion (net effect). Repayments and amortization of EUR 2.4 billion were offset by an increase in the volume of in foreign currencies denominated securities (currency effect) amounting to EUR 0.5 billion.

Assets Secured by the Risk Shield Provided by the State – Guarantee Portfolio by Asset-Class and Rating.

Outstanding Volume as of December 31, 2010 - sub asset class

EUR million	AAA	AA	A	BBB	BB to B	CCC to C	D	NR	Total	in %
CDO	192	965	436	182	705	925	187	110	3 705	27.6
RMBS	1 943	1 233	210	85	137	1 401	244	0	5 253	39.1
CMBS	654	778	682	396	49	96	0	0	2 654	19.7
Other ABS	537	406	179	330	185	79	30	83	1 830	13.6
Total Investments	3 326 24.7%	3 383 25.2%	1 508 11.2%	993 7.4%	1 076 8.0%	2 501 18.6%	461 3.4%	194 1.4%	13 441 100.0%	100.0

The lowest external rating has been applied in each case or the corresponding S&P rating code has been used in line with the internal rating methodology. Figures may be subject to rounding differences.

With a volume of EUR 9.2 billion (approximately 69%), most of the asset-backed securities in the guarantee portfolio maintained a high rating level (investment grade). There are also hedges for 7% of the volume reported with various monoliners.

Guarantee Structure.

Within the closed guarantee structure, LBBW assumes losses from reference assets of up to EUR 1.9 billion. Furthermore, the guarantee of the state of Baden-Württemberg only absorbs losses of EUR 6.7 billion after this first loss has been fully exhausted. The losses exceeding the guarantee would in turn have to be borne by LBBW. The first loss was fully included on the balance sheet by December 31, 2009.

Customer Transactions.

As well as the securitization portfolio illustrated previously, LBBW is also involved in customer transactions segment. This category includes transactions with liquidity line commitments of EUR 2.1 billion. Around EUR 1.0 billion of the overall portfolio is attributable to trade receivables and around EUR 1.1 billion to interest-bearing receivables (primarily leasing receivables).

The receivables are acquired by the purchasing companies Weinberg Funding Ltd. and Weinberg Capital Ltd. LBBW provides liquidity lines of EUR 2.1 billion available for this purpose. The majority of the exposure to trade and interest-bearing receivables is related to SMEs. This customer-driven business is primarily focused on the German market and transactions are exclusively rated internally in investment grade. Funding is provided through LBBW's Asset-Backed Commercial Paper (ABCP) program. As an investment vehicle Weinberg Capital Ltd. also issues these ABCPs. LBBW is planning to expand this customer driven business.

Further details of the LBBW Group's securitization portfolio and customer transactions are covered in the Financial Stability Forum (FSF) report, which is published separately.

Loan Granted by LBBW to the Special-purpose Entity Sealink Funding.

When Sachsen LB was acquired by LBBW in 2008, the structured portfolios Ormond Quay and Sachsen Funding I were excluded from the acquisition. These portfolios with an aggregated nominal outstanding of originally EUR 17.3 billion were transferred to an Irish special purpose vehicle, Sealink Funding Ltd., established in 2008.

The Free State of Saxony has issued a first loss guarantee in the amount of EUR 2.75 billion to cover losses arising from the Sealink portfolio. Losses relating to former Sachsen Funding I assets were covered by LBBW up to an amount of EUR 71.3 million (the »Special First Loss Guarantee«). Since June 30, 2009, defaults exceeding the guarantee provided by the Free State of Saxony up to an amount of EUR 6 billion will be covered by the risk shield of the State of Baden-Württemberg. All other losses beyond this amount would be assumed predominantly by the other Landesbanks involved.

LBBW expects that the guarantee of the Free State of Saxony and the guarantee of the State of Baden-Württemberg will cover all risks arising from the portfolios transferred to Sealink.

Market Price Risks.

LBBW defines market price risks as potential losses resulting from unfavorable changes in market prices. Market price risks are broken down by influencing factors. The following characteristics of market price risks arise from the business activities of LBBW:

Characteristics of Market Price Risks.

Market price risks	Characteristics
Share price risks	<ul style="list-style-type: none"> ■ General and specific price risks ■ Option risks
Interest rate risks	<ul style="list-style-type: none"> ■ General and specific interest rate risks ■ Option risks ■ Credit spread risks
Foreign exchange/ commodities risks	<ul style="list-style-type: none"> ■ Exchange rate risks ■ Commodities risks ■ Option risks

Risk Measurement.

Risk Model.

At LBBW, the value-at-risk (VaR) from market price risks is calculated at a confidence level of 99 % and a holding period of ten days, while a 95 % confidence level and one-day holding period are applied for internal bank management purposes.

This calculation is based on an in-house procedure involving a traditional Monte Carlo simulation. In most cases, the simulation enables LBBW not simply to approximate market-induced value fluctuations, but to measure them fully, even for complex transactions. Historical time series for the preceding 250 days are equally weighted in covariance estimates. LBBW backtests its analyses to ensure the quality of the VaR estimation procedures applied. The LBBW model is also used for other Group companies with material market price risks, enabling Group-wide standardized management based on the value-at-risk risk indicator. The model is used for general interest rate and equity risks to determine the equity requirement for market risks.

At LBBW, market price risks are consistently modeled in the trading book and banking book using the same VaR methodology.

Trading portfolios and the strategic position of the banking book can be affected by potentially detrimental developments in market interest rates.

In the course of the financial market crisis, the credit spread risks have become an important part of LBBW's market price risk. The transactions of the trading book and the banking book that are sensitive to creditworthiness are mapped onto rating- and industry-dependent yield curves. As such, general credit spread risks from bonds and ABS are also measured. In addition, the issuer-specific risk for securities is calculated using the spread (and the spread volatility) of individual counterparties. The credit spread risks from all credit derivatives are determined using a multi-index model. The respective credit spreads of the reference debtor are entered into the risk calculation.

The calculations of VaR and sensitivities are supplemented with separate stress scenarios for the trading book and banking book on a weekly basis. Stress testing is used to examine how the value of the portfolio changes under extreme market conditions. LBBW uses both self-defined (synthetic) and historical market movements with a focus on modeling particular curve movements and spread changes. Synthetic scenarios mainly refer to selected market factor groups (such as interest shifts, equity shifts) on an individual basis or in combination, or stress testing of basis risks (e.g. of different yield curves). Particular attention was devoted in 2010 to the development of macro-economic scenarios in which the further course and potential effects of the European sovereign crisis were analyzed. Historical scenarios have been generated from data analyses of market shocks, with stress tests for the financial crisis having been specifically added to the scenarios in question. All scenarios serve the purpose of modeling extreme events on the financial markets that, as history-based indicators, are not specifically included in VaR, in order to enable LBBW to prepare for the future. The findings are taken into consideration and reported to the relevant decision-makers both on a portfolio basis and with regard to their impact on the Group as a whole and its risk-bearing capacity.

The regulatory requirement to implement a stressed value-at-risk concept and thereby undergo an observation period representing a »period of significant financial stress« resulted from the Basel Committee's revisions to the Basel II market risk framework published in July 2009. Although the implementation and equity requirement obligation were deferred to 2011, LBBW put the concept into practice in 2010 and integrated it in overall bank management and the calculation of risk-bearing capacity.

Further Development of the Risk Model.

If it is not possible to fully integrate the trading products into the model immediately (e. g. after a new product process), a step-by-step approach is taken whereby these products are initially only traded under very strict supervision.

LBBW further developed its internal market risk model in 2010 based on, for example, the dynamics of the capital markets and changed regulatory requirements, such as the implementation of the stressed VaR concept.

For the purpose of regular quality assurance and validation, the adequacy of risk modeling and the risk factors used are reviewed regularly in addition to valuations. If certain markets and risk types become more important in the future, LBBW can flexibly expand the self-developed model.

However, limits have generally been set for the valuation procedure: all types of modeling are simplified compared with reality. LBBW counters such »model risks« by means of further analyses and limitations (e.g. for specific sensitivities or scenario values), as well as valuation discounts, if necessary. An appropriate buffer is also kept available in risk-bearing capacity for model risks.

Risk Management.

Ongoing risk management is handled by the relevant person with portfolio responsibility in the trading units and Treasury division within the scope of the market price risk strategy and the limits set. Limits based on value-at-risk (VaR), stop-loss and sensitivities are set by the Board of Managing Directors. In the case of certain sub-portfolios, this authority is assigned to individual members of the Board of Managing Directors, who then further delegate this authority according to a hierarchical system of responsibilities.

The trading divisions are responsible for managing market price risks in the trading book. The trading divisions are home to the Bank's trading and sales units organized by product responsibility:

The main task assigned to the sales units involves trading transactions with customers, as well as building and maintaining relationships with institutional investors. They do not enter into any risk positions above and beyond these responsibilities.

The trading units are responsible for the Bank's trading, with the market price risks arising from transactions entered into by the sales groups that will not be hedged by Treasury especially assigned to the trading books. The trading units are assigned responsibility for market price risks and earnings.

The transactions of the credit substitute business are bundled in a portfolio (CIP). The transactions are successively being stopped in accordance with the EU plan.

Interest rate risks from new transactions with customers are largely closed out by the Treasury division in near-real time via offsetting transactions.

Management of market price risks in the banking book is the direct responsibility of the Board of Managing Directors.

Hedging transactions outside the trading divisions are generally recognized as micro hedges by Accounting. In this respect, the interest rate risk is hedged almost exclusively. If the hedging transactions are internal, external transactions are recognized together with the underlyings in the fair value hedge accounting portfolio.

Risk Monitoring.

The utilization of limits and compliance with the risk strategy defined in the portfolio characteristics, for example, are monitored by the relevant persons with portfolio responsibilities in Group Risk Control and reported to the Group's Board of Managing Directors. In addition to daily reports, the Board of Managing Directors also receives more detailed monthly reports in the overall risk report about the risk and earnings situation and weekly reports on worst-case results. The additional stressed VaR values are calculated and reported on a monthly basis.

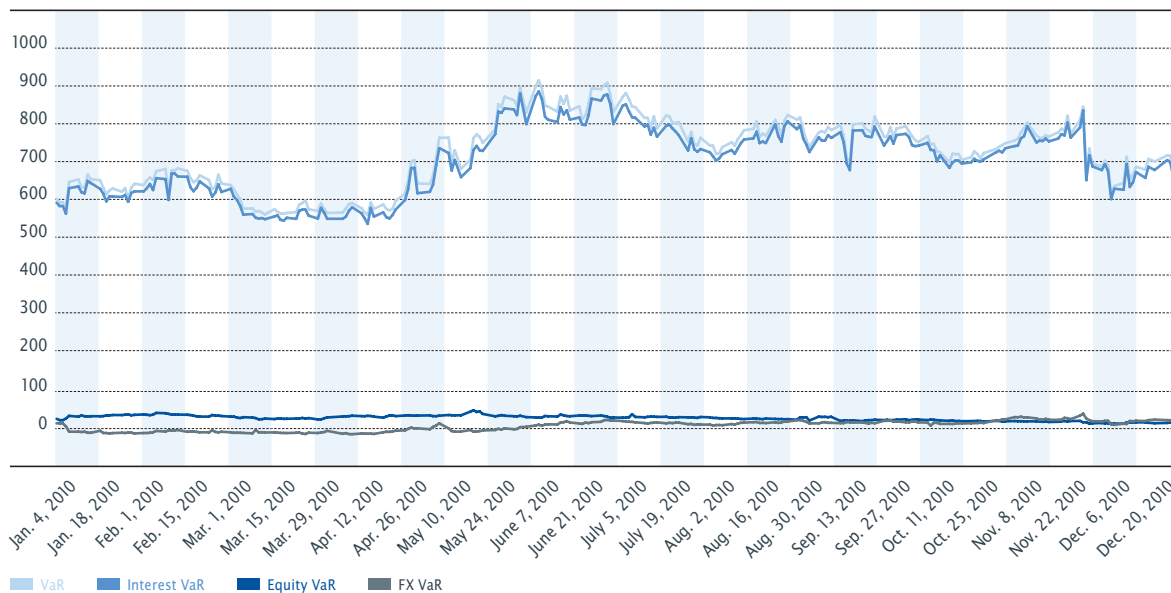
Risk Situation.

Development of Market Price Risks.

The market price risks entered into were fully within LBBW's risk-bearing capacity in 2010. However, in May and June 2010, VaR and stop-loss limits were exceeded up to Bank and Group level as a result of the European sovereign crisis, which was communicated in accordance with the internal escalation process.

The following chart illustrates the LBBW Group's market price risks over the course of the year.

Risk at LBBW Group, EUR million.



The Group's market price risk rose considerably in the first half of the year, as sovereign credit spreads widened distinctly in the wake of the European sovereign crisis. This led to a change in the spread level and an increase in the volatility of the credit spreads. The calming on the markets was reflected over the balanced 250-day average only slowly and with a delay in the volatility and thus the market price risk. Credit spread risks are included in the interest rate risks.

Since December 2010, the credit spread risk of the classic lending business is no longer taken into account in the market price risk. This has led to a noticeable decline in market price risk. The procedure is standard on the market, as the portfolio is particularly subject to credit risks and is considered accordingly in credit risk (CVaR).

The LBBW Group's market price risks are characterized overall by interest rate and credit spread risks. The overall risk is dominated by the items in the banking book. The basis risks in the interest rate range between individual European sovereign and financial curves and the swap curve, as well as the exposure to credit spreads including the risks from fixed-income securities, credit derivatives, and the credit substitute business, play a decisive part here. Equity risks, along with foreign exchange and commodities risks, are less significant for LBBW than interest rate and spread risks. The latter also include risks from precious metals and currency portfolios, which LBBW only holds to a limited degree.

The following table illustrates the composition of VaR (99%/10 days) by risk type at Group level:

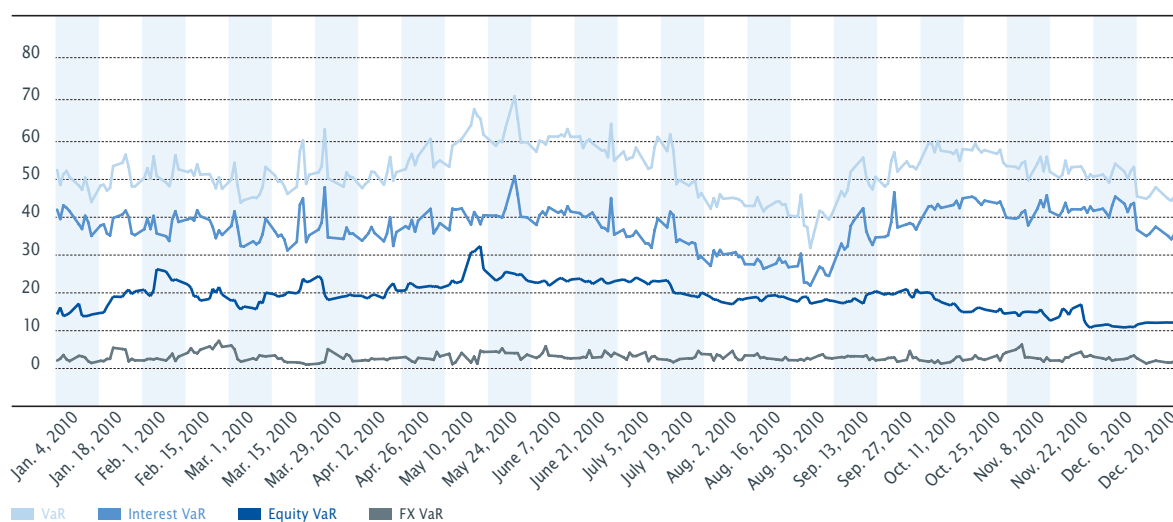
VaR 99 %/10 days

EUR million	Average	Maximum	Minimum	Dec. 30, 2010	Dec. 30, 2009
LBBW Group	731	921	573	724	623
Interest rate risks (incl. credit spread risks)	712	893	550	704	611*
Equity risks	50	71	35	40	23*
Currency risks	30	63	8	45	40*

* Reference values in individual risk categories for 2009 refer to LBBW Bank.

The following graph and table show the composition of market price risks for the trading book positions:

Trading Book Risk, EUR million.



VaR 99 %/10 days

EUR million	Average	Maximum	Minimum	Dec. 30, 2010	Dec. 30, 2009
LBBW trading book	52	71	32	43	62
Interest rate risks	37	51	21	32	53
Equity risks	19	33	11	12	14
Currency risks	3	7	1	3	2

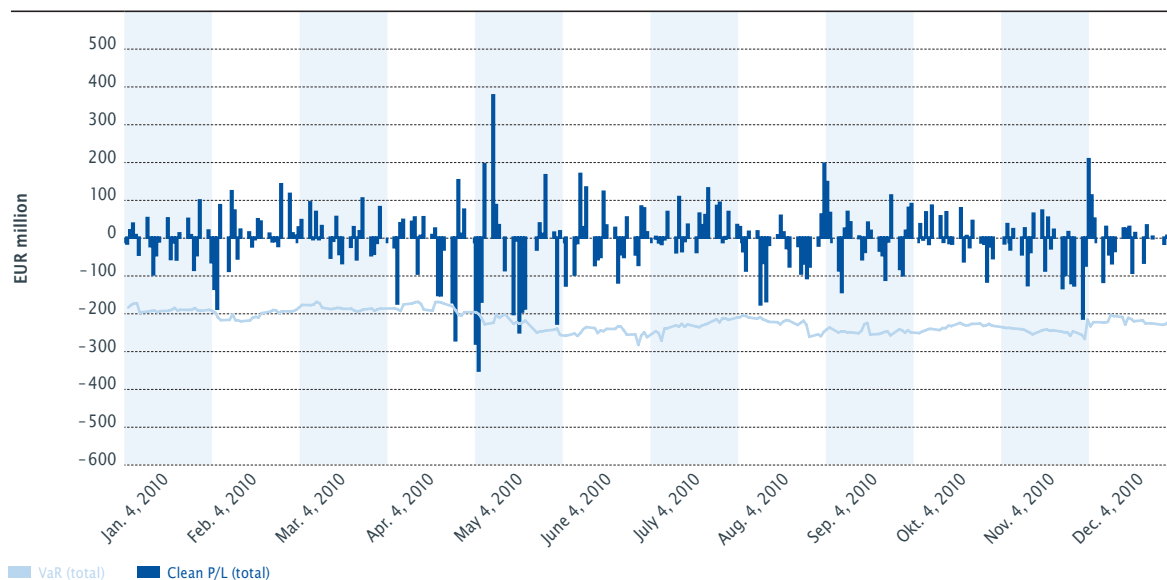
Considering the trading book shows that the European sovereign crisis had less of an effect on the risk values than in the banking book as a result of the lower credit spread exposure.

Backtesting.

The VaR value calculated by the risk model represents a statistical forecast of expected portfolio losses from market price risks over a certain time horizon. In order to verify the suitability of the model, it is necessary to test the quality of forecasts. This process is called backtesting. In concrete terms, this process involves counting the number of times VaR is exceeded by actual portfolio value changes (clean-P/L) called outliers, as the result of changes in market data. As of December 30, 2010 (inclusive), backtesting for the preceding 250 trading days indicated no model outliers for the trading book, but four exceptions for the Group. The exceptions arose from the banking book portfolios following the European sovereign crisis as a result of the widening of the credit spreads of the sovereigns concerned and the spread widening of the EUR financials and government yield curves against the EUR swap curve. However, the trading portfolio, for which capital adequacy for equity risks and general interest rate risks is measured using the internal risk model, did not show any outliers. This means that no additional equity capital needs to be deposited for model outliers for regulatory purposes.

LBBW Group Portfolio Backtesting for the Period January 4, 2010 – December 30, 2010.

VaR parameters: 99% confidence level, 1-day holding period



This graph shows how risk and the fluctuation of the clean-P/L increased during May on account of the European sovereign crisis.

Stress Test.

The effects of simulated stress scenarios increased considerably in 2010. The historical scenarios generated from the data analyses of the financial market crises are the most significant here. In July 2010, there were minor limit excesses for the stress test limit for Group market price risks, yet the overall buffer in the risk-bearing capacity for all stress scenarios was not exceeded at any time. These limit excesses were communicated and monitored in line with the internal escalation process.

Market Liquidity Risks.

Market liquidity risk designates the risk that transactions cannot be closed out, or can only be closed out at a loss, due to inadequate market depth or market disruptions. For example, if a large volume were to be bought or sold quickly, then a corresponding market influence would be anticipated and potentially reduce the expected proceeds. Market liquidity risks are seen as a component of market price risks for trading products (particularly in the case of securities).

LBBW introduced the jump-to-default method for equities and equity derivatives in 2010. This is a scenario calculation in which all positions based on an underlying are remeasured by setting its price to zero. The difference at the current market value represents the utilization that is limited and monitored.

Moreover, the concept of market liquidity risks also relates to potential losses in the sense that the liquidity of market segments can decline, as was the case in 2007 and 2008 with credit spread products and especially securitizations. Since then, the sudden lack of liquidity in what up to that point were very liquid markets has resulted in difficulties in market valuations and the downstream processes in these market segments.

The limited liquidity of products usually leads to a higher volatility and thus to an increase in the market price risk. The market liquidity risk is thus implicitly included in the market price risk calculation to a large extent. However, a sudden lack of liquidity in market segments which are normally very liquid cannot be comparably illustrated using historical models. In this case, assumed scenarios and flat-rate mark-ups must be used. LBBW's risk management also aims to retain a great deal of room to maneuver even in crisis situations, since losses can be avoided if an institution is not forced to sell or close, despite unfavorable market liquidity situation positions.

Liquidity Risks.

LBBW's liquidity risk monitoring and management activities draw a distinction between short-term liquidity risk, which represents the risk of insolvency due to an acute lack of funds, and funding (spread) risk, which describes the adverse effects on income resulting from a possible deterioration of the funding spread.

Risk Measurement.

Short-term liquidity risk in the sense of the availability of sufficient cash at any time cannot be adequately quantified or analyzed on the basis of value-at-risk. It is therefore managed using quantitative standards in the LBBW Group, which have been established by the Board of Managing Directors in accordance with liquidity risk tolerance.

Determining the liquidity risk position involves:

- Preparing liquidity gaps over a time horizon of up to twelve months, both on a daily basis and on at least a weekly basis for the Board of Managing Directors.
- Calculating the potential funding available from central banks on a daily basis.
- Preparing gaps for long durations on a monthly basis in order to analyze funding (spread) risks.
- Preparing investor lists, on the basis of which any changes with regard to the diversification of the investor base can be identified.
- Analyzing the three scenarios »rating downgrade«, »financial market crisis« and »combination« (market crisis at the same time as downgrading of LBBW and competitors) as part of regular stress tests. Ongoing review and, if necessary, adjustment of assumptions and parameters used.

Liquidity risk tolerance is largely defined via a »survival period concept«, i.e., time frames are specified over which the Bank is expected to remain at least solvent, even in the event of severely limited opportunities to borrow on the market, subject to different combinations of assumptions (development paths). In addition, there is a limit system in place for the maximum funding requirements based on maturities from the business portfolio from a three-month and twelve-month perspective.

In order to analyze liquidity risks in the Group, all key subsidiaries and all conduits/SIVs are included in regular reporting in accordance with LBBW guidelines (weekly consolidated cash flow, in further detail in overall risk report on a monthly basis). Liquidity risks from off-balance sheet company constructions are generally analyzed and reported in the same way as on-balance sheet liquidity risks.

Risk Management.

The management of liquidity risks and funding is carried out by the Treasury division taking into consideration the measures stipulated in the liquidity risk tolerance, with the primary objective of ensuring solvency at all times as well as active earnings and risk optimization for existing mismatched maturities as part of funding planning.

The funding strategy of LBBW aims to diversify product and investor groups. In 2010, investments by savings banks and institutional investors within Germany constituted the main sources of medium and long-term funding in addition to retail business.

The setting of internal offsetting prices in line with the market by the Treasury division is a fundamental aspect of management for the assets and liabilities side of LBBW. Offsetting prices are adjusted in line with market conditions on an ongoing basis.

The Money Market Desk is responsible for securing intraday liquidity in trading. Here, planning daily payments and calculating cash requirements up to the end of the day is carried out, while continually taking into account inflows and outflows from payments which only emerge during the course of the day, as well as the central bank function for savings banks.

A detailed emergency plan is in place for securing liquidity in acute crisis situations. The provisions made include those for the formation of a crisis response team bringing in members of the Board of Managing Directors. The emergency plan is reviewed at least once a year and resolved anew by the Board of Managing Directors.

Risk Monitoring.

The regular monitoring of liquidity risks is the responsibility of the Risk Committee of LBBW at management level and Liquidity Risk Control in the Group Risk Control division at operating level. As part of the overall risk report, Liquidity Risk Control reports in detail on all material aspects of liquidity risk, such as liquidity requirements, liquidity reserves and compliance with the specifications on liquidity risk tolerance, including the results of the stress tests carried out.

Risk Situation.

At times there were substantial distortions on the money and capital markets in 2010 as a result of the crisis in Europe. The availability of USD refinancing for European banks was highly restricted at times. In spite of this difficult environment, LBBW has significantly reduced its liquidity risks and was able to procure sufficient refinancing funds on the market at all times in 2010 as well.

The table below illustrates expected inflows and outflows of funds according to contractual maturity. In cases where the disbursement date and/or payment due dates are not clearly spelled out contractually, the worst-case scenario for cash inflows and cash outflows is presented, which means that the capital tie-up on the assets side and thus the actual funding requirements are considerably overstated. In addition, callable liabilities are generally called in on the call date, while the longest possible term is always shown for callable assets, irrespective of who holds the right of cancellation. In the case of loans that are being amortized, it is assumed, above and beyond the requirements of the IFRS standard, that the customer will obtain follow-up financing through LBBW at the amount of the residual debt when the loan agreement matures.

Assets and Liabilities According to Contractually Agreed Payment Dates.

Undiscounted cash flows in accordance with IFRS as at December 31, 2010:

EUR (or EUR equivalent) million		< 1 month	> 1 to 3 months	> 3 to 12 months	> 1 to 5 years	More than 5 years
Principal payments	Inflows of funds	44 549	17 623	42 031	126 658	92 458
	Outflows of funds	-63 770	-20 029	-37 494	-121 769	-42 726
Interest payments	Inflows of funds	970	1 333	5 790	22 335	34 307
	Outflows of funds	-758	-1 137	-4 878	-17 421	-24 617
Balance of payments from interest rate derivatives (net)		-207	2 160	650	-1 849	-1 124
Foreign exchange transactions	Inflows of funds	67 480	61 241	54 842	36 042	20 319
	Outflows of funds	-67 616	-61 273	-54 963	-35 981	-20 917
Advances on current account, claims from interbank accounts, including balances with central banks		5 815				
Savings and demand deposits, securitization from interbank accounts		-33 240				
Irrevocable loan commitments ¹⁾ and guarantees		-28 261				

¹⁾ Basis: For LiqV-relevant loan commitments and guarantees (avals), not including intra-Group commitments as the funding risk associated with these commitments is already reflected in the consolidation of the inflows and outflows of funds and not including undisbursed loans to the extent that these loans are already reflected in the inflows and outflows of funds.

Previous year's figures as at December 31, 2009:

EUR (or EUR equivalent) million		< 1 month	> 1 to 3 months	> 3 to 12 months	> 1 to 5 years	More than 5 years
Principal payments	Inflows of funds	45 360	21 975	54 020	127 754	122 398
	Outflows of funds	-69 243	-29 478	-54 227	-102 132	-84 681
Interest payments	Inflows of funds	1 037	1 612	6 542	27 705	37 489
	Outflows of funds	-889	-2 088	-5 743	-21 805	-21 338
Balance of payments from interest rate derivatives (net)		-647	-1 643	2 472	284	-873
Foreign exchange transactions	Inflows of funds	63 362	51 410	43 888	27 037	10 511
	Outflows of funds	-63 375	-51 296	-43 985	-27 433	-11 317
Advances on current account, claims from interbank accounts, including balances with central banks		8 180				
Savings and demand deposits, securitization from interbank accounts		-29 334				
Irrevocable loan commitments ¹⁾ and guarantees		-28 889				

¹⁾ Basis: For LiqV-relevant loan commitments and guarantees (avals), not including intra-Group commitments as the funding risk associated with these commitments is already reflected in the consolidation of the inflows and outflows of funds and not including undisbursed loans to the extent that these loans are already reflected in the inflows and outflows of funds.

As of December 31, 2010, potential funding available on the same day via central banks (ECB and the Fed), defined at LBBW as the liquidity reserve in the narrower sense, amounted to EUR 32.2 billion at the Group. From 90 days view, free collateral totaling EUR 33.4 billion was available.

The requirements of the liquidity regulation were adhered to at all times in the year under review.

As at December 31, 2010, LBBW Bank's liquidity ratio was 1.45 (2009: 1.52).

The solvency of LBBW Group was also guaranteed at all times from 90 days view, based on severe stress scenarios. The defined stress tests showed at the end of the year that the potential funding available from central banks and on the market exceeded funding requirements, even after the occurrence of the respective scenario.

Results of Economic Stress Scenarios.

According to Risk Controlling, as at December 31, 2010

Results of the economic stress scenarios	Funding requirement in EUR billion	Funding potential (central bank and market) in EUR billion
Rating downgrade	44.7	56.7
Financial market crisis	46.2	66.7
Market crisis with downgrade	46.7	62.7

Risk Management System for Covered Bond (Pfandbrief) Operations.

A multi-tiered limit system is in place for monitoring risks from covered bond (Pfandbrief) operations (§ 27 of the Pfandbriefgesetz [PfandBG – German Covered Bond Act]). Regular stress tests are conducted with regard to NPV (net present value) over collateralization. In the event that the fixed limits are reached, a process for then cutting the risk back down is implemented. As part of internal reporting, the Board of Managing Directors and the Risk Committee are informed quarterly of compliance with the provisions of the Pfandbriefgesetz (German Covered Bond Act) and the utilization of legal and internal limits. The risk management system is reviewed at least annually.

Operational Risks.

LBBW defines operational risks (OpRisk) as the risk of losses arising due to the unsuitability or failure of internal processes and systems, people, or due to external events. This definition also includes legal risks.

Risk Measurement.

The standard approach is used to calculate regulatory capital requirements at LBBW. An OpVaR model was introduced in 2010 for the Bank's risk-bearing capacity. In the context of the current ongoing process of developing methods further, a change to a confidence level of 99.95% is planned for operational value-at-risk.

The model is based on the loss distribution approach. There are separate model forms for frequency and loss distribution for specific business lines. Internal and external losses are included for OpVaR calculation. The model is continuously developed further.

Risk Management and Monitoring.

Ensuring an active risk culture in dealing with operational risks is the prerequisite for monitoring and managing these risks. All employees are encouraged to handle operational risks responsibly.

At LBBW, the management of these risks is mainly the responsibility of the individual divisions and subsidiaries. In this context, the local Operational Risk Managers are very important. They support division management and managing directors in the use of operational risk controlling tools, are contacts for their respective employees regarding operational risks, and are in close contact with LBBW's centralized OpRisk Controlling unit. An independent, centralized organizational unit within the Group Risk Control division is tasked with further developing and implementing the methods and tools used by OpRisk Controlling. To the extent that this is possible and reasonable, the central Group Strategy/Legal division obtains insurance policies to cover potential losses. In 2010 there was an analysis of the OpRisk database against the backdrop of the optimization of the insurance portfolio.

One of the main goals of the operational risk management and control activities is to identify operational risks at an early stage and to reduce or avoid the resulting losses by implementing the appropriate measures. Various tools are used to identify and assess the risk situation. As well as the internal and external incident database, the risk inventory (self-assessment and scenario analysis) and the analysis of risk indicators, the management of OpRisk measures also plays an important role in the management of operational risks.

The centralized OpRisk Controlling unit provides decision-makers with relevant information as part of regular risk reporting. The Risk Committee supports the Board of Managing Directors in exercising its supervisory function. In this forum, incident reports, risk inventory results and risk indicators are discussed, along with measures aimed at promoting a sound and safe risk culture at LBBW and current events.

The OpVaR model introduced in the 2010 fiscal year for the Bank's risk-bearing capacity for internal controlling is integrated into the Group's strategic limit system. The change in method led to an increase in economic capital for operational risks. In addition, redefined economic stress scenarios were introduced that vary the risk parameters of the OpVaR model (frequency or amount of loss in anticipated future loss events). This covers the main business lines and event-type categories.

Together with the local OpRisk managers, extensive segment-specific and general measures were identified and implemented to promote the risk culture in the handling of operational risks. The tracking of these measures will also be a key issue for the whole Group in 2011.

Risk Situation.

As the information presented in the sections below illustrates, LBBW does not expect any operational risks occurring that could jeopardize its existence. Despite the extensive precautionary measures taken, operational risks can never be avoided entirely.

IT Risks.

LBBW takes international IT security standards into consideration on a continual basis and complies with ISO standards 27001, 27002 and 27005. IT risk management for IT/organization is centralized and lies in the Group IT Security Officer's area of responsibility.

Furthermore, the IKON project launched in 2010 introduced an IT control framework to create transparency by complying with internal and external provisions for proper and audit-compliant IT operations. A key element of this was the implementation of a process organization.

LBBW has set up a special IT crisis response team to ensure that its business operations are maintained and that it can function if IT systems fail; in the event of an emergency, this team will coordinate all activities and provide centralized communications capability, with the savings banks in Baden-Württemberg among others, in accordance with defined procedures. The procedure and organizational measures to be taken in the event of a crisis are described in an IT crisis management manual. IT operations have emergency plans in place for operating IT systems in an emergency which are reviewed in regular exercises. In the context of the general business continuity management (BCM) of LBBW, IT emergency plans are regularly compared against the requirements of the business continuity plans of the specialized divisions.

LBBW maintains two independent, geographically separate data centers for production operations. Depending on the critical nature of applications, there are various emergency and backup concepts with corresponding restoration times in line with the requirements of the specialized divisions. Furthermore, there are permanent backup workstations at the alternate location for trading and processing trading transactions that are also reviewed regularly. The fundamental security of data centers is guaranteed by compliance with external and internal provisions for maintenance work and function tests.

At this time, LBBW does not face any unusual IT risks. LBBW has ensured well-organized IT operations for the future by constantly updating and improving its IT environment.

Personnel Risks.

LBBW's success depends materially on the dedication of its employees, and this idea is anchored in LBBW's mission statement: »We as employees drive the success of the Bank, thanks to our expertise, knowledge and commitment.« The objective of comprehensive personnel risk management is to identify negative trends (risk monitoring) and to evaluate measures suitable for preventing or minimizing risk (risk management). The human resources department distinguishes between various types of personnel risk for purposes of risk monitoring and management. The goal is to identify bottleneck, resignation, adjustment and motivation risks early on, and to minimize the resulting costs, such as staff recruitment, termination and staff turnover expenses. These risks are measured

by periodically evaluating and analyzing key human resources indicators, such as turnover rates, absences, or data concerning personnel development measures (particularly management training measures), as well as comparing these indicators across the Group.

In the risk category of »resignation risk«, for example, employees leaving LBBW are surveyed in writing about their reasons for leaving. This provides these employees with another opportunity to express freely their opinion about LBBW as an employer.

A focus here is developing and promoting young employees within the company. In order to counter the risk of a lack of high-performance employees (»bottleneck risk«), employee potential is systematically documented and analyzed. The age structure of LBBW's employees is watched particularly closely due to demographic changes, although this does not require any action in the immediate future.

LBBW has already implemented a series of measures to counter possible personnel risks. These measures range from legal protection for LBBW to ensuring that employees are qualified to do the tasks assigned to them. Among other things, a target group-oriented specialist training program is held annually. In addition, a dedicated department is responsible for education concerning and monitoring of statutory money laundering and compliance regulations.

In the context of the EU restructuring project, more than 1 000 FTEs have either already been downsized or their downsizing has already been contractually agreed for the future. As the downsizing process is controlled and only affects selected function groups, the risk of undesirable resignations by employees is considered low and very manageable.

Legal Risks.

Legal risks comprise economic risks due to omission of and/or non-compliance with the framework of rules established by legal regulations and court rulings. These risks arise from a lack of knowledge of the specific legal situation, insufficient application of the law, or delayed reaction to changes in the general legal framework (including cases where this is unavoidable or the employee is not at fault, or as a consequence of changes in legislation, court rulings or administrative practice, particularly at national and European level). Legal risks are mainly managed by LBBW's Legal departments (as part of the Group Strategy/Legal division). They provide advice on legal matters to the Bank and its German and foreign subsidiaries, branches, and representative offices. In addition, their responsibilities include early identification of legal risks in business units and central divisions in cooperation with the latter, and limiting these in a suitable manner. The National Legal and International Legal departments have themselves developed or examined and approved for use by LBBW's business areas a variety of contract forms and sample contracts in order to minimize legal risks and simplify the business activities of the front office and trading divisions. In relation to this, the Bank is supported by the cooperation of the German Savings Bank Association (DSGV) and the forms developed in the committees there and made available by the Sparkassenverlag publisher. Approved, standardized contract materials are used for derivative transactions wherever possible. If legal questions arise in new areas of business or during the development of new banking products, the Legal departments supervise and actively participate in these processes.

Furthermore, the Legal departments monitor all planned legislation, developments in court rulings, and new standards stipulated by the supervisory authorities in LBBW's key areas of activity in close cooperation with, in particular, the Association of German Public Sector Banks (VOB), the German Savings Bank Association (DSGV) and the Association of German Pfandbrief Banks (VdP).

To the extent that this results in LBBW having to take appropriate action with regard to legal matters or adapt its policies, the Legal departments are instrumental in disseminating information quickly and implementing measures within LBBW. There are currently no legal risks at LBBW that could threaten its existence. The Group Strategy/Legal division also has no reason to believe that such risks will arise at LBBW in the foreseeable future.

Internal Control and Risk Management System with Regard to the Accounting Process.

LBBW defines the internal control and risk management system as a comprehensive system and follows the definitions of Institut der Wirtschaftsprüfer in Deutschland e.V. (the German Institute of Public Auditors in Germany) on the accounting-related internal control system (IDW PS 261 Item 19 f.) and the risk management system (IDW PS 340 Item 4). This includes principles, procedures and measures with the objective of implementing management decisions aimed at

- securing the effectiveness and efficiency of business activities (this also includes the protection of assets, including preventing and detecting asset damage),
- ensuring the regularity and reliability of internal and external accounting and
- ensuring compliance with legal requirements of relevance to the Company within the organization.

The internal control and risk management system for the accounting process helps to provide a true and fair view of the net assets, financial position, and results of operations of LBBW. A key aim is to ensure that all transactions are recorded, processed and documented in full and correctly in accordance with legal regulations and standards, the provisions of the Articles of Association and other guidelines.

The accounting-related internal control and risk management system is an integral component of the internal control and risk management system for the management of the Bank as a whole.

Control Environment.

LBBW is distinguished by a clear organizational, corporate and control and monitoring structure. The Board of Managing Directors takes overall responsibility for proper business organization. All strategic units are included by means of a clearly defined management and reporting organization. The departments involved in the accounting process conform to quantitative and qualitative requirements. The employees tasked with the accounting process are provided with regular, comprehensive training.

Risk Assessment and Control Activities.

The controls are geared towards ensuring that the financial statements are prepared in accordance with German commercial law and ongoing internal and external financial reporting.

When implementing controls, a risk assessment is taken as a basis and the principle of efficiency is observed. Clear regulations are in place regarding the scope of the controls and responsibilities integrated into working processes. In particular, these are the dual control principle, the separation of functions and the assignment of authorities in line with existing decision-making regulations. Control functions are exercised in the respective specialist department. The control targets defined at LBBW in their entirety indicate the identified risks.

The preparation of the financial statements by the Accounting/Reporting/Tax division is predominantly carried out on a decentralized basis at LBBW in conjunction with the specialized divisions. Detailed timetables and workflows are in place for all monthly, quarterly and annual financial statements, which are monitored and automatically managed centrally. Responsibilities in all areas of the accounting process are clearly assigned. The relevant activities in terms of risk are distributed across several organizational units within the organization of business processes. The dual-control principle is applied across the board for all processes relevant to accounting, the assignment of authorities complied with and the separation of functions taken into account.

The IT systems employed at LBBW predominantly use standard software. Portfolio management front-end systems (sub-ledgers), the SAP general ledger system and a central data warehouse (FDB = financial database) are used for the preparation of financial statements. The FDB contains all data necessary for preparing the financial statements. The specialized divisions record, process and post transactions relevant to accounting, which are mapped by the system, in the appropriate IT systems. From here, the transactions and master data are then transferred into the FDB. Data from the front-end systems and FDB are automatically posted in the SAP general ledger, where the balance sheet and income statement are prepared.

Extensive ICS reconciliation steps take place at the interfaces between the sub-ledgers, the FDB and the SAP general ledger, where the completeness and accuracy of the data is checked and documented on a monthly basis as part of standardized reconciliation operations. As regards the annual and semi-annual financial statements, the control processes are also discussed by the relevant system administrators in Accounting in separate quality assurance meetings. Any inconsistencies that may arise are rectified by carrying out these ICS reconciliation steps. Measures to be taken to eliminate future errors are also established on the basis of this.

Financial instruments measured at fair value at LBBW are measured either on the basis of quoted prices for active markets (stock exchanges, brokers, price service agencies etc.) or on the basis of standard, recognized measurement methods using publicly available input data (e.g. yield curves, volatilities, spreads). In cases in which not all the input parameters can be observed directly on the market, fair values are calculated using realistic assumptions based on market conditions. The prices used for accounting purposes are checked independently of trading and validated by a separate organizational unit, »Independent price verification«, in the Risk Controlling division.

Information and Communication.

The risk principles of LBBW, the organizational structure and procedures and the processes of the accounting-related internal control and risk management system are set out in manuals and guidelines (e.g. accounting guidelines, operating procedures, specialist concepts etc.), which are regularly adjusted to current external and internal developments and published on the LBBW intranet.

The »Basic Accounting Issues« department identifies and analyzes all legal changes which have an impact on the accounting process. It informs the specialized divisions affected and ensures that these are implemented promptly and in accordance with their respective specialization. New types of products are examined in detail in the New Product Process as regards how they should be treated in accordance with the German Commercial Code. The regulation of structures and embedded derivatives is also carried out here for each product type. This regulation is stored in a database system (FinNexus) developed in house. In the case of new types of products, the correct mapping, analysis and recognition of transaction types is also checked in a test phase.

Financial reports created in connection with accounting and sent to external parties or readers are checked for consistency by an internal records office before being sent.

Furthermore, the Board of Managing Directors has passed regulations that state that it must be informed immediately if doubts arise in individual divisions as to proper business organization (»ad hoc reporting requirement«). This also applies to accounting. If information is also significant in terms of risk aspects, the Board of Managing Directors must also forward this to the Risk Committee of the Supervisory Board.

Monitoring.

The effectiveness and suitability of the accounting-based internal controlling system and the risk management system are regularly monitored. This ensures that potential improvements are identified and processes are adjusted accordingly where required.

One form of monitoring takes place in the preparation of the annual financial statements (and half-year financial statements). Bilateral and multilateral coordination talks are held at regular intervals between the employees involved in the preparation of the financial statements to discuss and analyze any problems that arise. Adequate measures are derived and incorporated into ongoing processes.

Both the Audit Committee of the Supervisory Board and Group Auditing serve as senior monitoring bodies. Group Auditing is responsible for process-independent monitoring of operations and as such is an instrument of the Board of Managing Directors. The Audit Committee, as a committee of the Supervisory Board, deals with the analysis and preparation of audit findings and informs the Supervisory Board of these activities.

Investment Risks.

LBBW invests in other companies or assigns functions to subsidiaries if this appears to be a logical choice after consideration of strategic aims or returns.

Here, equity investments are managed by the relevant specialized and operating divisions of LBBW based on the division of tasks.

Early identification of business and risk developments at LBBW's subsidiaries and equity investments is particularly important for investment controlling purposes. To this end, regular coordination meetings are held at the corresponding management levels of LBBW and the subsidiary/equity investment, particularly in the case of companies that are material in terms of risk policy. In addition, these companies' results and planning are constantly monitored by the Group Strategy/Legal division. This unit also produces extensive reporting on this issue for the Board of Managing Directors and governing bodies.

The companies in LBBW's equity investment portfolio are assigned to one of two categories in terms of risk:

Material subsidiaries, i.e., companies in which LBBW is the majority shareholder and whose risk potential (in the main risk categories of credit risk, market price risk, liquidity risk, operational risk, real estate risk and development risk) is deemed to be material from the Group's perspective.

Non-material subsidiaries and equity investments, i.e., companies in which LBBW is the majority shareholder and whose risk potential is deemed to be immaterial from the Group's perspective, or minority equity investments, i.e., companies in which LBBW as the minority shareholder does not have the direct influence possible in the case of majority interests.

As much as possible, material subsidiaries are treated in line with the transparency principle. In accordance with the transparency principle, risks identified as material at the respective companies are measured according to LBBW's principles and parameters and included at the level of LBBW in an aggregation or Group assessment.

In the case of the non-material subsidiaries and minority interests, the risk potential is quantified based on the interest held and included as a whole in LBBW's risk management system. This calculation is made using a ratings-based credit VaR approach which is prepared by Group Risk Control and serves as the basis for recognition in the risk-bearing capacity.

LBBW pursues a selective equity investment policy. As a rule, a comprehensive risk analysis (of legal, financial and other risks) is performed in the form of due diligence, generally in conjunction with LBBW's specialized divisions, before equity investments are acquired. Of particular importance here are factors such as ensuring that inappropriate concentrations of risk do not arise in the investment portfolio.

LBBW aims to use transaction agreements to contractually hedge risks as much as possible, such as through option agreements or earn-out clauses. In addition, the buying process includes valuation of equity investments taking into account capital market-oriented risk premiums.

Enterprise values for LBBW's equity investments are calculated in accordance with the guidelines issued by the Institut der Wirtschaftsprüfer (IDW – the German Institute of Auditors) at least once a year as part of preparatory work for the annual financial statements. For the half-year report, a plausibility check of the book values is performed using calculations pro-rated for the period.

Besides the risk of a potential decline in value as the result of defaults, there is also a risk that LBBW will receive an insufficient return or no return at all on its investments. However, this risk corresponds to the above-mentioned general carrying amount or market value risk due to the focus on capitalized income value in the valuation of equity investments.

In addition, liability risks also arise from the profit and loss transfer agreements signed with some subsidiaries and from the responsibility for fulfilling the maintenance obligation (Anstaltslast) and guarantor's liability (Gewährträgerhaftung) for equity investments in public-sector banks. Furthermore, LBBW has signed letters of comfort with various investees.

There is a central risk to LBBW in terms of its investments in the event of a partial or full loss in value of one or more of its major strategic investments. LBBW's investment portfolio has a strong financial focus. A disturbance in this market segment can therefore lead to significant losses from investments.

Management and monitoring systems ensure that LBBW is continually informed about the situation in its investees. Moreover, the subsidiaries and major equity investments follow a conservative risk policy synchronized with LBBW to the extent that LBBW can influence such policies.

LBBW is making good progress in reducing its investment portfolio to meet the requirements of the EU restructuring plan. The investments in Sachsen DV Betriebs- und Servicegesellschaft mbH and quirin bank AG were already disposed of in 2009. During 2010, disposals included LBBW Securities LLC, LRI Invest S.A. and the retail banking business of LBBW Luxembourg S.A. Furthermore, all assets of Lassarus Handels GmbH were disposed of in preparation for liquidation. Further investments are to be sold successively until 2013 as part of the restructuring.

Reputation Risks, Business Performance Risks and Strategic Risks.

Reputation risk is the risk of a loss or foregone profit due to (impending) damage to/deterioration of the Bank's reputation in the eyes of owners, employees, business partners or the wider public.

Reputation risk is not a component of operational risk. However, reputation risks can be caused by an incident of loss resulting from operational risk or other risk categories becoming public knowledge.

As regards reputation risks, a distinction is made between transaction-based and non-transaction-based management. In non-transaction-based management, Group Communication/Marketing is responsible in particular for ensuring controlled public and press relations via stringent and centralized issue management. In addition with the sustainability policy, the standard for all areas of business with regard to this is established in the Administration unit as part of the sustainability policy. Reputation risks are accounted for in risk-bearing capacity with a buffer amount.

The transaction-based analysis of new transactions with regard to reputation risks is carried out on a decentralized basis by the front office, particularly within the context of the New Product Process and the credit application process.

Business performance risk is the risk of unexpected falls in earnings and negative plan variances not caused by other defined risk categories.

Business performance risk can be caused by various factors, including changes in customer behavior or changes to the economic environment that are not of a legal nature. The front office is responsible for introducing individual measures as part of ongoing operating activities aimed at managing risks associated with business activities. Financial Controlling carries out a central comparison of planning and actual business development.

Strategic risk is the risk of adverse business development as a result of fundamental decisions made concerning business policy. For example, strategic risks may arise when entering into new markets, but equally when failing to build up new areas for achieving potential success.

The monitoring of the implementation of and adherence to the business strategy decided on by the Board of Managing Directors and the division-specific plans in line with this, as well as the implementation of strategic decisions made by the committees, is carried out by the relevant divisions together with Financial Controlling.

Real Estate Risks.

Real estate risks are defined as potential negative changes in the value of LBBW's own real estate holdings due to deterioration of the general real estate market or deterioration in the particular attributes of an individual property (vacancies, changes in options for use of the property, damage etc.). This does not include development risks from residential and commercial project development business, which form a separate risk category, or risks from service business. The latter are taken into consideration in the LBBW Group as part of business performance risk.

The LBBW Group's real estate portfolio is managed by the subsidiary LBBW Immobilien GmbH.

LBBW uses a VaR model to measure real estate risk. The central Group Risk Control division calculates VaR indicators for real estate risks quarterly and incorporates these into the Group's analysis of risk-bearing capacity. The input data in this model are the volatilities and correlations derived from market data histories assigned to the portfolio values.

The operating subsidiaries of LBBW Immobilien are also controlled using special real estate-specific indicators such as rent increases, vacancy rates, and amounts in arrears. The Group's own properties are monitored and analyzed for risks in the course of quarterly portfolio valuation using a fair value approach. The goal is to identify at an early stage and analyze any adverse factors occurring as part of or relating to LBBW's activities. Active risk management contributes to ensuring a tolerable portfolio that provides a balanced ratio of opportunities to risks.

The implementation of the resolution of the EU Commission on the disposal of the residential property holdings of LBBW Immobilien by no later than 2012, which will also entail the transfer of the employees responsible for the assets for sale, will mark a significant change in the portfolio and structure of investment property. This process is reducing the options for diversification by types of use. However, diversification is still possible within commercial use, particularly for office and retail use, and by size classes. Macro location-specific diversification is also reduced as the remainder of the commercial portfolio is predominantly located at the Stuttgart location. However, this is distinguished by a stable market with relatively low rent fluctuations overall. The properties of LBBW Immobilien are also primarily excellently situated with low rental risk and are leased to tenants of good credit standing. The credit rating of potential tenants is examined carefully when letting new properties and attempts are always made to conclude as long a lease agreement as possible. Overall, macro location-specific risks are therefore considered manageable.

The remaining commercial properties in LBBW's portfolio are reviewed using a comprehensive set of real estate-relevant criteria such as the cost/income ratio, risk aspects, the Group's strategy for use/growth of the site, the site's potential for development, portfolio diversification or usage by LBBW-branches, and appropriate solutions are found on a case-by-case basis.

The client of the owner-occupied real estate business is the LBBW Group. Most of the properties are used for office or bank purposes. The restructuring plan requires a reduction of space at all central locations of the Bank. This is largely being achieved by concentrating on properties owned by the Bank and by avoiding rented space as much as possible. As a result, this is not expected to have a significant influence on the holdings the Bank uses itself or real estate risk.

Development Risks.

Development risks are defined as the bundle of risks that typically arise when implementing commercial and residential project developments and in residential real estate trading. LBBW Immobilien does not trade in commercial real estate. The risks in this field mainly lie in the areas of letting and selling as well as in the deviations that could emerge between what is planned as feasible under building law and the planned construction costs and schedules and the actual realization of these plans. The following additional risks in particular also apply if project developments are implemented in partner projects: credit risk on the part of partners, change in strategy and possibly pressure to force decisions from the company. The emergence of these risks can also result in the forecast return not being generated, the invested capital not being recovered in full – or not at all in extreme cases – or the need for further equity injections.

Development risks were classified as a material independent risk category for the LBBW Group for the first time in 2010. The risk and business strategy in the Development division was fundamentally revised as part of the review of the project portfolio in 2009/2010. This led to a reorientation of the segment and a regional focus on the core markets of Baden-Württemberg and Rhineland-Palatinate. LBBW Immobilien acts as an investor in commercial and residential real estate on these markets. The wrapping up of projects lying outside these target markets is a high priority.

In fiscal 2010, LBBW Immobilien developed a risk model to measure development risks that was validated with the assistance of a major auditing firm. Development risk is calculated quarterly by the Controlling division of LBBW Immobilien. The central Group Risk Control division includes this in the LBBW Group's analysis of risk-bearing capacity. The model is based on a risk driver tree that identifies risks and shows the ranges in which these can fluctuate even before a construction project begins. From this, mark-ups and mark-downs on future costs and income are derived that are applied to the real case calculation. A normal and extreme risk are calculated on the basis of different fluctuation ranges of risk factors.

Summary of the Risk Situation.

Measures have been implemented in the LBBW Group as part of appropriate risk management to limit or minimize all material risks. Sufficient capital is available to cover all risks.

In the first quarter of 2010, the risk-bearing capacity situation had gradually improved on account of a reduction in risks as against the end of 2009. However, stress on risk cover built up in the second quarter of 2010 on account of the debt crisis in Europe. Following an interim recovery, negative effects on risk cover were again observed in the fourth quarter of 2010 when the crisis in Europe intensified. However, risks began to diminish again towards the end of the year, particularly in customer loans business. As of December 1, 2010, a methodological adjustment was implemented in market price risk in the reconciliation from the operative to strategic economic capital level, which resulted in a significant rise in economic capital while the risk situation remained unchanged.

Overall, risk-bearing capacity was assured at all times throughout the year and as of December 31, 2010, with conservative buffer amounts. As at December 31, 2010, utilization of aggregate risk cover through material risks quantified as economic capital was at 57%. Taking into account the buffer for other risks that are not explicitly quantified, this utilization rose to 61%.

LBBW Group

EUR million	December 31, 2010			December 31, 2009		
	Limit***	Absolute	Utilization	Limit***	Absolute	Utilization
Aggregate risk cover		21 025	57%		21 734	57%
Economic capital tie-up	14 300	11 903	83%	15 700	12 479	79%
Diversification effects		1 493			1 003	
Credit risk		6 556			8 929	
Market price risk		5 010			3 359	
Investment risk		360			391	
Operational risk*		742			437	
Development risk**		345				
Real estate risk		383			366	

* 2010 OpVaR value, comparative figure end of 2009 – standard regulatory approach.

** New major risk category, included in risk-bearing capacity from Q4 2010.

*** The individual risk categories are limited via economic capital limits.