FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms LBBW at 'A-'; Outlook Negative

Mon 29 Mar, 2021 - 2:33 PM ET

Fitch Ratings - Frankfurt am Main - 29 Mar 2021: Fitch Ratings has affirmed Landesbank Baden-Wuerttemberg's (LBBW) Long-Term Issuer Default Rating (IDR) at 'A-' with a Negative Outlook and Viability Rating (VR) at 'bbb'.

KEY RATING DRIVERS

IDRS, SUPPORT RATING, AND SENIOR NON-PREFERRED DEBT (SNP) RATINGS

LBBW's Long-Term IDR, Support Rating and SNP debt ratings are driven by Fitch's view of a strong likelihood of support from the bank's owners. Fitch's institutional support assumptions are underpinned by provisions contained in the statutes of the institutional protection fund of Sparkassen-Finanzgruppe (SFG, A+/Negative) and the Landesbanken. Our support considerations are also based on the view that the owners view their investment in LBBW as long-term and strategic. This is underpinned by LBBW's statutory roles, which include supporting the regional economy as well as acting as the central institution for regional savings banks and as house bank for the State of Baden Wuerttemberg.

Feedback

Fitch uses SFG's Long-Term IDR as the anchor rating for determining the bank's support-driven ratings. Fitch believes support would need to be forthcoming from both SFG and the State of Baden Wuerttemberg to avoid triggering state-aid considerations and resolution under the German Recovery and Resolution Act if LBBW fails.

We notch LBBW's Long-Term IDR down twice from SFG's 'A+' to reflect regulatory restrictions to support due to the requirement for state-aid examination under EU competition rules. The two-notch difference also reflects LBBW's strategic, but not key and integral role, for its owners. The Negative Outlook on LBBW's Long-Term IDR mirrors that on SFG.

LBBW's Short-Term IDR is the higher of two possible ratings that map to a 'A-' Long-Term IDR on Fitch's rating scale, because propensity of support by its institutional owners is likely to be more certain in the near term.

VR

LBBW's VR reflects the bank's exposure to cyclical corporates and high single-name concentrations, weak pre-impairment profits and adequate capitalisation. It also reflects our expectation that asset- quality metrics will moderately deteriorate in the aftermath of the pandemic. At the same time, we believe that the risk of significant deterioration of asset quality, capitalisation and profitability has subsided since our last review, leading to the revision of outlooks on these factors to stable from negative. Funding and liquidity are strong and benefit from LBBW's access to savings banks' and the central bank's liquidity.

LBBW's strong regional corporate-banking franchise benefits from Baden Wuerttemberg's large economy. However, this regional focus leads to concentrations on cyclical industries and, to some extent, on large borrowers, in particular in commercial real-estate, retail and consumer goods and automotive, the latter being reduced. Stiff competition in most of LBBW's business lines limits the bank's pricing power and weighs on profitability.

At the beginning of 2021, LBBW announced it expects to achieve EUR100 million of cost savings by 2024 to complement its plan to grow selectively in corporate lending, debt capital markets and asset and wealth management. However, we expect the bank to operate with a fairly high cost/income ratio also in the medium term. Profitability should remain weak in 2021 before improving in 2022 on the back of lower loan impairment charges (LICs) and first visible impact from the bank's cost-saving and revenue-growth plans.

Feedback

The impact of the pandemic on LBBW's asset quality has so far only led to a material increase in Stage 2 loans, driven by collective stage transfers of LBBW's vulnerable portfolios. Large government support programmes and the suspension until end-April 2021 of the legal obligation for illiquid companies, that qualify for state support, to file for bankruptcy have contained the number of corporate insolvencies at a low level until end-2020 and LBBW's Stage 3 loan volume close to its end-2019 level. We expect a rise of Stage 3 loans by end-2021, when support measures are phased out, but LBBW's Stage 3 ratio should remain on average below 2% in the medium term. LBBW's asset quality also benefits from a low exposure to asset classes that are directly affected by the domestic lockdown.

LBBW's transitional common equity Tier 1 (CET1) ratio of 15.1% at end-2020 and its strategic target of 13% solidly exceed regulatory requirements. At the same time, we believe that this buffer is necessary for the bank's business model, which exposes LBBW to potential cyclical performance swings. Moreover, LBBW's organic capital generation remains weak and the bank's leverage is high versus higher-rated peers'. We expect LBBW's capital ratio to decline in the next two years due to growth, regulatory and re-rating driven risk-weighted assets (RWA) inflation and profit distribution.

Reliance on wholesale funding is mitigated by the bank's membership in SFG's institutional protection scheme. The bank's liquidity benefited from capital-market pre-funding in early 2020 and participation in the central bank's tenders.

DERIVATIVE COUNTERPARTY RATING (DCR), DEPOSIT AND SENIOR PREFERRED DEBT RATINGS

LBBW's long-term deposit rating, senior preferred debt rating and DCR are rated one notch above the Long-Term IDR because of the protection provided by resolution buffers to these preferred creditors. LBBW's short-term deposit rating is the lower of the two ratings that map to an 'A' long-term deposit rating. This is because we believe that, despite the owners' very high propensity to provide support to LBBW, we see potential impediments to the prompt flow of funds that are not commensurate with an 'F1+' short-term rating given the lengthy process required to support a Landesbank.

GRANDFATHERED STATE-GUARANTEED SECURITIES

The 'AAA' ratings of LBBW's grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes reflect our view of the creditworthiness of the State of Baden Wuerttemberg, which is closely linked to that of Germany (AAA/Stable), and our expectation that Baden Wuerttemberg will honour its guarantee. Fitch believes that the protection provided by the grandfathered guarantee is similar between senior and subordinated debt instruments because the statutory guarantor's liability (Gewaehrtraegerhaftung) does not differentiate the seniority among liabilities. In our view regulatory and EU state-aid frameworks do not constrain the level of support for grandfathered debt.

NON-GUARANTEED TIER 2 SUBORDINATED DEBT

LBBW's subordinated debt is rated two notches below the VR. This reflects our expectation that the bank will not maintain its buffer of Tier 2 and additional Tier 1 debt at more than 10% of its RWAs.

RATING SENSITIVITIES

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

We would revise the Outlook on LBBW's Long-Term IDR to Stable if the Outlook on SFG's Long-Term IDR is revised to Stable. An upgrade of the IDRs, Support Rating and SNP ratings is contingent on an upgrade of SFG's IDRs or a loosening of European state-support regulation, which we do not expect. We would upgrade the DCR, senior-preferred debt and deposit ratings along with LBBW's IDRs, provided we continue to expect the bank to maintain the buffer of SNP and more junior debt in excess of 10% of RWAs.

An upgrade of LBBW's VR would require a sustainable economic recovery and a limited impact from the pandemic on the bank's asset quality and capitalisation. An upgrade would also be contingent on a structural improvement in LBBW's profitability, with an average operating profit/RWAs of at least 1%, without a material increase in risk appetite. This is unlikely in the short term, until the positive impact from the bank's cost-saving and revenue-growth plan becomes visible.

An upgrade of LBBW's VR would result in an upgrade of the non-guaranteed Tier 2 subordinated notes. The guaranteed notes cannot be upgraded because the ratings are 'AAA', which is the highest level on Fitch's scale.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of SFG's IDRs, a change in the ownership structure or in the owners' strategic commitment to the bank could lead to a downgrade of the IDRs, Support Rating, and SNP ratings. We would downgrade the DCR, senior-preferred debt and deposit ratings along with LBBW's IDRs or if the sum of SNP and more junior debt buffer falls below 10% of RWAs.

We believe that LBBW's VR has sufficient headroom at the current level to absorb moderate deterioration of asset quality and capitalisation. The VR would likely be downgraded if we expect the bank's Stage 3 loans ratio to rise to and remain above 3%, or if the CET1 ratio falls durably below 12.5%. A downgrade of the VR would be accompanied by a downgrade of the non-guaranteed Tier 2 subordinated notes.

The ratings of the grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes are sensitive to changes in Fitch's view of Baden Wuerttemberg's creditworthiness, which is closely linked to that of Germany.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Feedback

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR

ENTITY/DEBT	RATING			PRIOR
Landesbank Baden-Wuerttemberg	LT IDR	A- Rating Outlook Negative	Affirmed	A- Rating Outlook Negative
	ST IDR	F1	Affirmed	F1
	Viability	bbb	Affirmed	bbb
	Support	1	Affirmed	1
	DCR	A(dcr)	Affirmed	A(dcr)
• senior unsecured	LT	AAA	Affirmed	AAA

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Roger Schneider
Director
Primary Rating Analyst
+49 69 768076 242
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Marco Diamantini
Associate Director
Secondary Rating Analyst
+49 69 768076 114

Konstantin Yakimovich
Senior Director
Committee Chairperson
+44 20 3530 1789

Feedback

MEDIA CONTACTS

Adrian Simpson
London
+44 20 3530 1010
adrian.simpson@thefitchgroup.com

Louisa Williams
London
+44 20 3530 2452
louisa.williams@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Landesbank Baden-Wuerttemberg	EU Issued, UK Endorsed

DISCLAIMER

Feedback

READ LESS

COPYRIGHT

Feedback

of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Feedback

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Structured Finance: Covered Bonds   Structured Finance   Banks   Europe   Germany

Feedback