FitchRatings

Banks
Universal Commercial Banks
Germany

Landesbank Baden-Wuerttemberg

Key Rating Drivers

Owners' Support Drives IDRs: Landesbank Baden-Wuerttemberg's (LBBW) Issuer Default Ratings (IDRs) and senior debt ratings are driven by Fitch Ratings' view of a strong likelihood of support from the bank's owners, the state of Baden-Wuerttemberg, the City of Stuttgart and the regional members of Germany's savings banks group, Sparkassen-Finanzgruppe (Sparkassen) (SFG; A+/Negative). The Negative Outlook mirrors that on SFG's Long-Term IDR, which serves as an anchor for LBBW's Long-Term IDR.

Sufficient Headroom in VR: LBBW's Viability Rating (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 Covid-19 pandemic. Still, 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.

Profitability Is a Relative Weakness: At the beginning of 2021, LBBW said 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 in the medium term. We also expect profitability to remain weak in 2021 before improving in 2022 due to lower loan impairment charges (LICs) and the first visible impact from the bank's cost-saving and revenue-growth plans.

Low Impaired Loan Volumes: The impact of the pandemic on LBBW's asset quality has so far only led to a material increase in Stage 2 loans. Large government support has 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 Stage 3 loans to rise in 2021, but LBBW's Stage 3 ratio should remain on average below 2% in the medium term.

Sound Capitalisation and Funding: LBBW's capital ratios solidly exceed regulatory requirements, but we believe that these buffers are necessary for its business model. We expect them to decline over the next two years due to loan growth, risk-weighted asset (RWA) inflation driven by regulation and re-ratings, as well as profit distribution. LBBW's membership in SFG's institutional protection scheme mitigates its reliance on wholesale funding. The bank benefited from capital-market pre-funding in early 2020 and participation in central bank tenders.

Rating Sensitivities

Change in SFG's IDRs: The IDRs and senior debt ratings are primarily sensitive to changes in our assumptions around the propensity or ability of LBBW's owners to provide timely support. This could result from a change to SFG's IDRs, to the owners' strategic commitment to LBBW or to the bank's importance for its home region or for the savings bank sector. We would revise LBBW's Outlook to Stable if the Outlook on SFG's Long-Term IDR is revised to Stable.

Profitability Improvements: 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. 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 common equity Tier 1 (CET1) ratio falls durably below 12.5%.

Ratings

Issuer Ratings	
Long-Term IDR	A-
Short-Term IDR	F1
Derivative Counterparty Rating	A(dcr)
Viability Rating	bbb
Support Rating	1
Sovereign Risk	
Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Fitch Affirms LBBW at 'A-'; Outlook Negative (March 2021)

Global Economic Outlook (March 2021)

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Debt Rating Classes

Rating level	Rating
Long-term deposits	A
Short-term deposits	F1
Long-term senior preferred (SP) debt	A
Short-term SP debt	F1
Senior non-preferred debt (SNP)	A-
State-guaranteed senior unsecured and subordinated debt	AAA
Non-guaranteed Tier 2 subordinated debt	BB+

Source: Fitch Ratings

Deposits and SP Debt

LBBW's long-term deposit rating, SP debt rating and Derivative Counterparty Rating are rated one notch above its 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 support 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 agree on owners' support to Landesbanken.

State Guaranteed Debt

We rate LBBW's grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes 'AAA' to 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 grandfathered guarantee protects senior and subordinated debt instruments similarly because the statutory guarantor's liability (Gewaehrtraegerhaftung) does not differentiate among debt seniorities. In our view, regulatory and EU state-aid frameworks do not constrain 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.

Ratings Navigator

Landesbank Baden-Wuerttemberg

ESG Relevance:

Banks
Ratings Navigator

Navigator Peer Comparison

Peer Group Summary

	Operating Environment	Company Profile	Management & Strategy	Risk Appetite	Asset Quality	Earnings & Profitability	Capitalisation & Leverage	Funding & Liquidity	Viability Rating
Bayerische Landesbank	aa-	bbb	bbb	bbb+	bbb+	bbb-	bbb+	bbb+	bbb
Landesbank Saar	aa-	bb+	bbb-	bbb-	bbb-	bbb-	bb+	bbb	bb+
Norddeutsche Landesbank Girozentrale	aa-	bb	bb	bbb-	bbb-	b+	bbb	bbb-	bb

Source: Fitch Ratings

Institutional Support Assessment

Institutional Support			Value
Parent IDR			A+
Total Adjustments (notches)			-2
Institutional Support:			**A-**
Support Factors (negative)	**Equalised**	**1 Notch**	**2+ Notches**
Parent ability to support and subsidiary ability to use support			
Parent/group regulation			✓
Relative size		✓	
Country risks	✓		
Parent Propensity to Support			
Role in group		✓	
Potential for disposal	✓		
Implication of subsidiary default		✓	
Integration			✓
Size of ownership stake	✓		
Support track record	✓		
Subsidiary performance and prospects		✓	
Branding			✓
Legal commitments			✓
Cross-default clauses			✓

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧	Positive	⇩	Negative
⇳	Evolving	▫	Stable

High Probability of Support from Owners

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 SFG 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 a house bank for the State of Baden Wuerttemberg.

Fitch uses SFG's Long-Term IDR as the anchor rating for determining the bank's support-driven ratings. This is because we believe 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+' IDR to reflect regulatory restrictions to support due to the requirement of 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.

Brief Company Summary

Medium-Sized Commercial Bank with Regional Corporate Focus

LBBW is a publicly-owned wholesale bank that focuses on corporate and asset-based finance in addition to its statutory roles. The size and profit contribution of its retail activities, which are primarily concentrated in Stuttgart and other locations in Baden Wuerttemberg, are moderate.

LBBW's strong regional corporate banking franchise benefits from Baden Wuerttemberg's large economy, which is similar in size to Belgium's. However, this regional focus leads to large concentrations on cyclical industries and, to some extent, on large borrowers, in particular in commercial real estate (CRE), automotive and consumer goods.

The bank's nationwide franchise is weaker. High competition in most of LBBW's business lines limits its pricing power and weighs on profitability. Its modest international franchise is largely concentrated in Western Europe, but the bank supports its corporate customers globally in key international financial centres. LBBW's client-oriented capital market business is a sizeable but volatile revenue source. In 2021, LBBW acquired Bayerische Landesbank's and Hamburg Commercial Bank's interest rate, currency and commodities management business for savings banks' corporate clients. This is not a material addition to LBBW's business volumes or revenues, but we believe this strengthens its role as the main centre of competence and infrastructure provider for capital market activities within SFG.

Cost Savings to Complement Growth Strategy

In the past, LBBW's profit targets relied on acquiring new clients and on increasing margins while maintaining expenses stable. Executing this strategy has become more difficult due to the weakened economic environment, strong competition and likely low-for-long interest rates, prompting a stronger focus on costs. At the beginning of 2021, LBBW announced the reduction of 700 full time equivalents by 2024, following similar steps by several domestic peers pre-crisis. This measure aims at cutting costs by EUR100 million compared with 2019, adding 70bp-80bp to LBBW's pre-tax return on equity. We believe this strategic adjustment underlines the management's commitment to deliver an adequate return to its owners. However, we expect the bank to continue to operate at a relatively high cost/income ratio in the medium term.

LBBW plans to increase and diversify its revenue by gaining market shares in corporate finance, debt capital markets and asset and wealth management, similar to peers. It expects to benefit from its strengthened positioning as a bank for sustainable credit and investments. However, this could be challenged by the competition in these segments from domestic and foreign players.

We view positively LBBW's gradual reduction of its automotive exposure and expansion into sectors where it had been previously less active, such as pharmaceuticals/health care, TMT, electronics and utilities, as this increases diversification.

Summary Financials and Key Ratios

	31 Dec 20 (EURm)	31 Dec 19 (EURm)	31 Dec 18 (EURm)	31 Dec 17 (EURm)
Summary income statement				
Net interest and dividend income	1,771	1,676	1,558	1,587
Net fees and commissions	538	558	513	473
Other operating income	381	467	503	665
Total operating income	2,690	2,701	2,574	2,725
Operating costs	1,861	1,908	1,863	2,077
Pre-impairment operating profit	829	793	711	648
Loan and other impairment charges	545	151	142	92
Operating profit	284	642	569	556
Other non-operating items (net)	-32	-30	-11	-41
Tax	80	168	138	96
Net income	172	444	420	419
Summary balance sheet				
Gross loans	104,481	102,774	98,133	97,502
- Of which impaired	935	968	854	996
Loan loss allowances	1,077	877	849	679
Net loans	103,404	101,897	97,284	96,823
Interbank	58,274	44,409	39,076	38,031
Derivatives	25,369	22,047	18,036	20,309
Other securities and earning assets	70,678	65,037	58,093	56,308
Total earning assets	257,725	233,390	212,489	211,471
Cash and due from banks	13,650	18,331	24,721	22,729
Other assets	5,074	4,909	4,004	3,513
Total assets	**276,449**	**256,630**	**241,214**	**237,713**
Customer deposits	92,101	85,989	78,424	74,090
Interbank and other short-term funding	79,229	68,069	63,881	62,322
Other long-term funding	55,854	46,748	47,002	53,590
Trading liabilities and derivatives	29,508	34,202	32,388	28,162
Total funding	256,692	235,008	221,695	218,164
Other liabilities	4,815	6,614	5,259	5,068
Preference shares and hybrid capital	1,695	1,830	1,081	1,104
Total equity	13,247	13,178	13,179	13,377
Total liabilities and equity	**276,449**	**256,630**	**241,214**	**237,713**
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	0.4	0.8	0.7	0.7
Net interest income/average earning assets	0.7	0.7	0.7	0.7
Non-interest expense/gross revenue	69.3	70.8	73.1	77.1
Net income/average equity	1.3	3.4	3.2	3.2
Asset quality				
Impaired loans ratio	0.9	0.9	0.9	1.0
Growth in gross loans	1.7	4.7	0.7	-1.4
Loan loss allowances/impaired loans	115.2	90.6	99.4	68.2
Loan impairment charges/average gross loans	0.5	0.2	0.2	0.1

Source: Fitch Ratings, Fitch Solutions, LBBW

Summary Financials and Key Ratios

	31 Dec 20	31 Dec 19	31 Dec 18	31 Dec 17
Ratios (annualised as appropriate)				
Capitalisation				
Common equity Tier 1 ratio	15.1	14.6	15.1	15.8
Tangible common equity/tangible assets	4.7	5.0	5.3	5.4
Basel leverage ratio	4.5	4.6	4.7	4.6
Net impaired loans/common equity Tier 1	-1.1	0.8	0.0	2.7
Funding and liquidity				
Loans/customer deposits	113.4	119.5	125.1	131.6
Liquidity coverage ratio	135.4	123.6	114.8	145.8
Customer deposits/funding	39.1	39.7	38.2	37.0

Source: Fitch Ratings, Fitch Solutions, LBBW

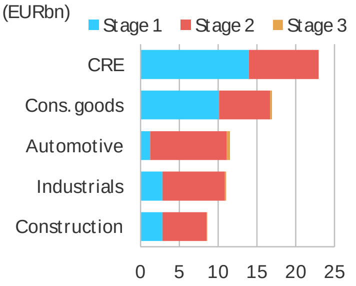
Key Financial Metrics – Latest Developments

Asset Quality to Moderately Deteriorate

The German government put in place, at the beginning of the pandemic, large emergency programmes to support companies and households affected by the crisis. It has also suspended until end-April 2021 the legal obligation for companies that qualify for state support to file for bankruptcy. This has kept the number of corporate insolvencies very low until end-2020 and LBBW's Stage 3 loans volume close to its end-2019 level. We expect a rise in 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. In our view, the risk of a Stage 3 loans ratio durably above 3% has subsided. Thus, we have stabilised our outlook on the bank's asset-quality score.

Stage 2 loans tripled to 36% of gross customer loans at end-2020 from 12% at end-2019, driven by collective stage transfers of LBBW's vulnerable portfolios. This does not indicate heightened risk, in our view, because about 70% of the exposure classified as Stage 2 was internally rated investment-grade at end-2020. LBBW's asset quality also benefits from its fairly low exposure to asset classes that are most severely affected by domestic lockdowns. This also explains the immaterial volume of loans that were granted a moratorium, which was low even compared with the German banking sector. At the same time, LBBW remains exposed to medium-term structural changes, in particular in its EUR10.9 billion net automotive exposure and in its large office portfolio. These are mitigated by the reduction of new business mainly with combustion-engine-specialised suppliers and the adequate collateralisation of mortgage loans.

Largest Sector Exposures
End-2020 IFRS9 gross exposures



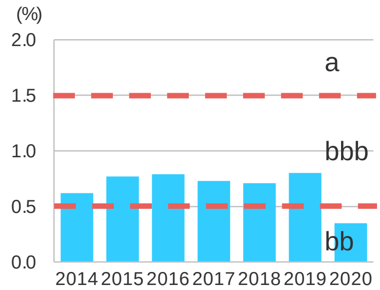
Source: Fitch Ratings, LBBW

Profitability Below Peers

Profitability remains a relative weakness and is of high importance for the VR. From 2017 to 2019, LBBW's operating profit/RWAs has stagnated below 0.7%, which is less than half of the average level achieved by the 20 largest European banks. LBBW's ratio declined to 0.35% in 2020 due to higher LICs and losses in the treasury, which were mitigated by the capital market business's strong results. LICs were driven by EUR276 million provisions for performing loans in anticipation of asset-quality deterioration and EUR160 million loss on a single large exposure. Excluding the latter, LICs amounted to 37bp of gross loans, which is less than those booked by German private sector banks with broadly similar loan books. Fitch expects LICs to remain in the 30bp-45bp range in 2021.

We expect profitability to remain weak in 2021 before improving in 2022 on the back of lower LICs and the first visible impacts from the bank's cost savings and revenue growth plan. Over the medium term, we expect margins to remain low and net interest income growth to result mainly from loan growth.

Modest Profitability
Operating profits/RWAs



Source: Fitch Ratings, LBBW

Dashed lines define indicative ranges and implied scores for Earnings and Profitability for banks operating in an environment scored 'aa-'.

Capitalisation, Funding and Liquidity Are Relative Rating Strengths

LBBW's transitional CET1 ratio of 15.1% at end-2020 and its strategic target of 13% (fully loaded) solidly exceed its regulatory requirements. At the same time, we believe that these buffers are necessary in view of the bank's business model, which exposes the bank to potential cyclical performance swings. Moreover, LBBW's organic capital generation remains weak and its leverage is weaker than higher-rated peers'. We expect LBBW's capital ratio to decline in the next two years due to loan growth, RWA inflation driven by regulation and re-ratings, as well as profit distribution. LBBW will distribute 15% of its combined 2019 and 2020 profits in 1H21 and plans an additional EUR269 million on a conditional basis presumably later in 2021. In the coming years, we expect LBBW to distribute about half of its annual net profit.

LBBW's reliance on wholesale funding is mitigated by its membership in SFG's institutional support scheme, which ensures privileged access to the savings banks' excess liquidity nationwide. The bank also significantly exceeds its minimum requirement for own funds and eligible liabilities of 21.56% of RWAs, thanks to its large stock of legacy SNP debt, as with other large German banks. We expect the ratio to decline gradually as legacy SNP debt matures, but to remain comfortably above required levels. LBBW tapped the markets early in 2020 before the onset of the pandemic and was able to prefund cheaply most of its 2020 planned issuance volume, similar to peers.

LBBW's liquidity portfolios exceed EUR20 billion. They are held for liquidity coverage ratio management and strategic purposes, offering substantial headroom to withstand outflows. In contrast to the 2008 financial crisis, liquidity outflows from corporates during the peak of the pandemic were moderate as increased demand for development loans quickly replaced the drawing of committed credit lines. Outflows from financial institutions were also immaterial.

Environmental, Social and Governance 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

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Credit-Relevant ESG Derivation

Landesbank Baden-Wuerttemberg has 5 ESG potential rating drivers

- Landesbank Baden-Wuerttemberg has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

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.