FitchRatings

Banks
Universal Commercial Banks
Germany

Landesbank Baden-Wuerttemberg

Update

Ratings

Foreign Currency

Long-Term IDR	A-
Short-Term IDR	F1
Derivative Counterparty Rating	A(dcr)
Viability Rating	bbb
Shareholder Support Rating	a-

Sovereign Risk (Germany)

Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA

Outlooks

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

Applicable Criteria

Bank Rating Criteria (September 2022)

Related Research

Sparkassen-Finanzgruppe (Sparkassen) – Update (December 2021)

Fitch Affirms LBBW at 'A-'; Outlook Stable (March 2022)

Landesbank Baden-Wuerttemberg (March 2022)

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Key Rating Drivers

Landesbank Baden-Wuerttemberg's (LBBW) Long-Term Issuer Default Rating (IDR) is driven by its Shareholder Support Rating (SSR), which reflects a very high likelihood of support from the bank's owners, the regional members of Germany's savings banks group Sparkassen-Finanzgruppe (Sparkassen) (SFG; A+/Stable), the State of Baden-Wuerttemberg and the City of Stuttgart.

LBBW's Viability Rating (VR) is one notch below the implied 'bbb+', due to the bank's subdued average profitability. The VR also reflects the bank's exposure to cyclical corporate sectors, strong asset-quality metrics and adequate capitalisation. LBBW's acquisition of Berlin Hyp AG is neutral to Fitch Ratings' assessment of its standalone credit strength.

Owners' Support Highly Likely: Fitch's support assumptions are underpinned by LBBW's focus on its statutory roles, and by the statutes of the institutional protection scheme (IPS) of SFG and the Landesbanken. We use SFG's Long-Term IDR as the anchor for LBBW's support-driven ratings, because we believe support would need to come from both SFG and Baden Wuerttemberg to avoid triggering state-aid considerations and resolution if LBBW fails.

We notch LBBW's SSR down twice from SFG's 'A+' to reflect the regulatory restrictions on support, due to the EU's state-aid examination requirement. The two notches also reflect LBBW's strategic, but not key or integral, role, for its owners. The Short-Term IDR is the higher of two options that map to its 'A-' Long-Term IDR, because LBBW has privileged access to SFG's ample liquidity and funding, and its owners' propensity to support is more certain in the near term.

High Sector Concentrations: 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 on the commercial real estate (CRE) and automotive sectors, although the bank is reducing its exposure to the latter. Stiff competition in most of LBBW's business lines limits the bank's pricing power and is likely to continue to weigh on its profitability.

Low Impaired Loans: LBBW's exposure to cyclical industries is higher than that of its Landesbanken peers, and its asset quality is sensitive to the ongoing global supply chain disruptions, input price shocks and structural changes. We expect its loan impairment charges (LICs) and Stage 3 loans to rise only moderately in 2023 from their exceptionally low level at end-1H22 because of large precautionary provisions buffers. However, its four-year average Stage 3 ratio should remain below 2% in the coming years, which is a rating strength.

Moderate Average Profitability: LBBW's operating profit/risk-weighted assets (RWAs) ratio improved in 2021 and 1H22, benefitting from strong business growth and low LICs. We expect improving net interest rate margins to compensate for regulatory RWAs inflation. However, it will be more difficult for the bank to execute on its growth strategy in the deteriorating economic environment.

Adequate Capitalisation: We expect LBBW's common equity Tier 1 (CET1) ratio to remain comfortably above its 13% target at end-2022. We view this level as adequate but not strong in light of LBBW's business model that exposes the bank to potential cyclical performance swings. Stronger profit retention will be key to offset higher RWAs from the bank's growth strategy and the phasing-in of the Basel output floor from 2025.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A downgrade of SFG's IDRs, or a change in LBBW's ownership or in its owners' strategic commitment to the bank, could lead to a downgrade of LBBW's IDRs and SSR. LBBW's VR has sufficient headroom at the current level to absorb a moderate deterioration of its 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%.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of LBBW's IDRs and SSR would require an upgrade of SFG's ratings. An upgrade of the bank's VR would require a limited impact from the economic fallout of the Ukraine–Russia conflict on the bank's asset quality and capitalisation. An upgrade would also be contingent on a sustainable improvement in LBBW's profitability, with an average operating profit/RWAs ratio close to 1%, without a material increase in risk appetite.

Other Debt and Issuer Ratings

Rating level	Rating
Deposits	A/F1
Senior Preferred	A/F1
Senior Non-Preferred	A-
State-Guaranteed Senior Unsecured	AAA
Tier 2 Subordinated	BB+
State-Guaranteed Tier 2 Subordinated	AAA

Source: Fitch Ratings

LBBW's long-term deposit rating, senior preferred debt rating and Derivative Counterparty Rating (DCR) are one notch above the bank's Long-Term IDR because of the protection provided to preferred creditors by its resolution buffers. Its senior non-preferred (SNP) debt rating is in line with its Long-Term IDR for the same reason.

LBBW's short-term senior preferred and deposit ratings are the lower of the two options that map to the respective 'A' long-term ratings. This is because, despite the owners' very high support propensity, the lengthy process required to support a Landesbank could impede the prompt flow of funds that we would expect for a 'F1+' short-term rating.

The 'AAA' of LBBW's grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes reflect our view of the creditworthiness of the guarantor, Baden Wuerttemberg, which is closely linked to that of Germany (AAA/Stable). We believe the grandfathered guarantee similarly protects senior and subordinated debt because the statutory guarantor's liability (Gewaehrtraegerhaftung) does not differentiate among seniorities. In our view, regulatory and EU state-aid frameworks do not constrain the level of support for grandfathered debt.

LBBW's non-guaranteed Tier 2 subordinated debt is rated two notches below the VR to reflect loss severity that is in line with Fitch's baseline approach.

Significant Changes from Last Review

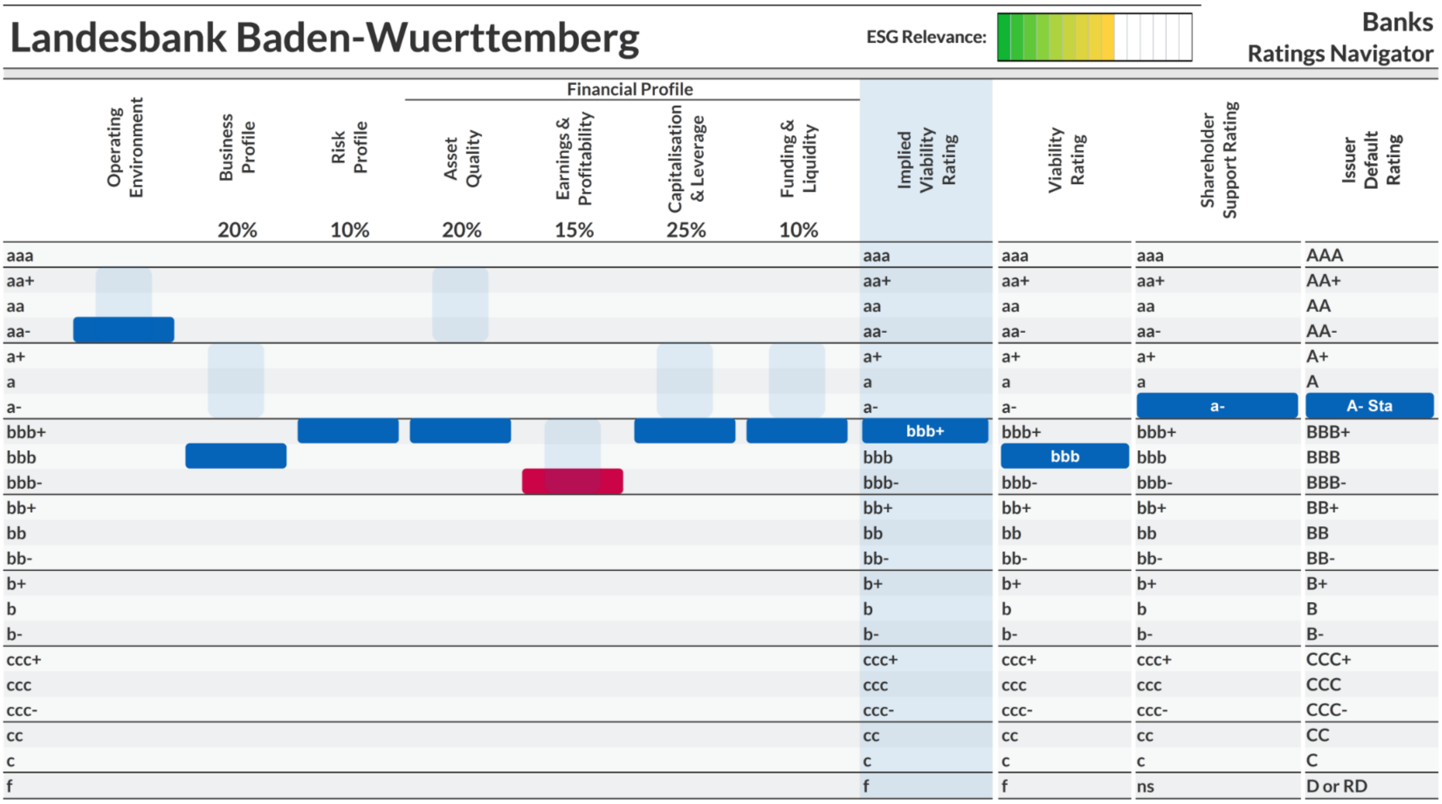
In 1H22 LBBW's pre-tax income increased by 11% (yoy) primarily due to stable revenues and moderate LICs, supported by positive fair-value swings of trading assets, mainly interest-rate derivatives. LBBW continued to strengthen its stock of loan loss allowances, and the reported LICs in 1H22 were mainly driven by model-adjustments, referring to performing Stage 1 and 2 loans rather than actual defaults. LBBW's asset quality remained resilient, as reflected in a sound impaired loans ratio at of 0.9% at end-1H22, which puts the bank in a good position to manage the expected weakening of the domestic economy from 2H22.

Fitch expects that LBBW will continue to operate at a relatively high cost-to-income ratio (CIR) above LBBW's own 60% target due to inflationary pressures, combined with investments in the bank's focus areas and higher levies. The latter increased in 1H22 by EUR51 million (yoy) and LBBW's cost base in total by EUR82 million (8% yoy) resulting in a CIR of about 66%. In 2022, LBBW's CIR will benefit from the integration of Berlin Hyp given its lean cost base; however, considering Berlin Hyp's overall small size compared with LBBW, Fitch estimates the positive impact will be only up to 2pp.

LBBW revised its 2022 pre-tax profit guidance upwards to above EUR1 billion. According to LBBW, extraordinary effects from the first-time consolidation of Berlin Hyp (not further specified) will support LBBW's revenues. Fitch believes that this accounting uplift is likely to reverse in the medium term.

The group's CET1 ratio decline to a still sound 13.9% at end-1H22 was primarily due to inflating RWAs resulting from loan growth.

Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

The business profile score of 'bbb' has been assigned below the 'a' category implied score, due to the following adjustment reason: business model (negative).

The asset quality score of 'bbb+' has been assigned below the 'aa' category implied score, due to the following adjustment reason: concentrations (negative).

The capitalisation and leverage score of 'bbb+' has been assigned below the 'a' category implied score, due to the following adjustment reason: internal capital generation and growth (negative).

The funding and liquidity score of 'bbb+' has been assigned below the 'a' category implied score, due to the following adjustment reason: deposit structure (negative).

Financials

Financial Statements

	30 Jun 22		31 Dec 21	31 Dec 20	31 Dec 19
	(USDm)	(EURm)	(EURm)	(EURm)	(EURm)
Summary income statement					
Net interest and dividend income	1,079	1,039	2,031	1,771	1,676
Net fees and commissions	334	322	598	538	558
Other operating income	308	297	372	381	467
Total operating income	1,722	1,658	3,001	2,690	2,701
Operating costs	1,126	1,084	1,928	1,861	1,908
Pre-impairment operating profit	596	574	1,073	829	793
Loan and other impairment charges	87	84	240	545	151
Operating profit	509	490	833	284	642
Other non-operating items (net)	-15	-14	-16	-32	-30
Tax	167	161	399	80	168
Net income	327	315	418	172	444
Summary balance sheet					
Assets					
Gross loans	117,320	112,949	112,644	104,481	102,774
- Of which impaired	1,080	1,040	1,002	935	968
Loan loss allowances	1,413	1,360	1,288	1,077	877
Net loans	115,908	111,589	111,356	103,404	101,897
Interbank	48,000	46,212	39,640	58,274	44,409
Derivatives	20,042	19,295	19,073	25,369	22,047
Other securities and earning assets	79,149	76,200	70,678	70,678	65,037
Total earning assets	263,099	253,296	240,747	257,725	233,390
Cash and due from banks	72,203	69,513	36,871	13,650	18,331
Other assets	6,879	6,623	4,726	5,074	4,909
Total assets	342,182	329,432	282,344	276,449	256,630
Liabilities					
Customer deposits	116,231	111,900	93,646	92,101	85,989
Interbank and other short-term funding	114,229	109,973	89,569	79,346	68,069
Other long-term funding	65,197	62,768	56,110	55,737	46,748
Trading liabilities and derivatives	26,383	25,400	23,533	29,508	34,202
Total funding and derivatives	322,040	310,041	262,858	256,692	235,008
Other liabilities	4,427	4,262	4,378	4,815	6,614
Preference shares and hybrid capital	1,688	1,625	1,656	1,695	1,830
Total equity	14,027	13,504	13,452	13,247	13,178
Total liabilities and equity	342,182	329,432	282,344	276,449	256,630
Exchange rate		USD1 = EUR0.96274	USD1 = EUR0.884173	USD1 = EUR0.821963	USD1 = EUR0.89015

Source: Fitch Ratings, Fitch Ratings, LBBW

Key Ratios

	30 Jun 22	31 Dec 21	31 Dec 20	31 Dec 19
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.1	1.0	0.4	0.8
Net interest income/average earning assets	0.9	0.8	0.7	0.7
Non-interest expense/gross revenue	65.7	65.1	69.3	70.8
Net income/average equity	4.7	3.1	1.3	3.4
Asset quality				
Impaired loans ratio	0.9	0.9	0.9	0.9
Growth in gross loans	0.3	7.8	1.7	4.7
Loan loss allowances/impaired loans	130.8	128.5	115.2	90.6
Loan impairment charges/average gross loans	0.2	0.2	0.5	0.2
Capitalisation				
Common equity Tier 1 ratio	13.9	14.8	15.1	14.6
Tangible common equity/tangible assets	4.0	4.7	4.7	5.0
Basel leverage ratio	4.3	5.1	4.7	4.9
Net impaired loans/common equity Tier 1	-2.5	-2.3	-1.1	0.8
Funding and liquidity				
Gross loans/customer deposits	100.9	120.3	113.4	119.5
Liquidity coverage ratio	123.0	141.1	135.4	123.6
Customer deposits/total non-equity funding	38.1	37.7	39.1	39.7
Net stable funding ratio	111.6	108.5	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions, LBBW

Support Assessment

Shareholder Support Rating KRDs	
Shareholder IDR	A+
Total Adjustments (notches)	-2
Shareholder Support Rating:	**a-**
Shareholder ability to support	
Shareholder Rating	A+/ Stable
Shareholder regulation	2+ Notches
Relative size	1 Notch
Country risks	Equalised
Shareholder propensity to support	
Role in group	1 Notch
Reputational risk	1 Notch
Integration	2+ Notches
Support record	Equalised
Subsidiary performance and prospects	1 Notch
Legal commitments	1 Notch

The colours indicate the weighting of each KRD in the assessment.

Higher influence Moderate influence Lower influence

LBBW's SSR reflects a strong likelihood of support from SFG, Baden-Wuerttemberg and Stuttgart. Our support assumptions are underpinned by LBBW's statutory roles and by its membership in SFG's IPS. We derive LBBW's support-driven ratings from SFG's Long-Term IDR as we believe support would need to come from both SFG and Baden Wuerttemberg to avoid triggering state-aid considerations and resolution if LBBW fails. We notch LBBW's SSR down twice from SFG's 'A+' to reflect regulatory restrictions to support due to the EU's requirement for state-aid examination. The two-notch difference also reflects LBBW's strategic, but not key and integral role, for its owners.

Environmental, Social and Governance Considerations

FitchRatings **Landesbank Baden-Wuerttemberg**

Banks
Ratings Navigator

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	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	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.

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	Business Profile (incl. Management & governance); Risk Profile	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; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

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.

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.

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.