

Rating Action: Moody's affirms Landesbank Baden-Wuerttemberg's ratings; outlook remains stable

16 Oct 2020

Frankfurt am Main, October 16, 2020 -- Moody's Investors Service (Moody's) has today affirmed the ratings of Landesbank Baden-Wuerttemberg (LBBW), including its Aa3 long-term deposit and senior unsecured debt ratings, its A2 junior senior unsecured debt ratings, and its Baa2 subordinated debt ratings. The outlook on the long-term deposit and senior unsecured debt ratings remains stable. Concurrently, the rating agency has affirmed LBBW's baa2 Baseline Credit Assessment (BCA) and its baa1 Adjusted BCA.

LBBW's Aaa-rated guaranteed junior senior unsecured and subordinated debt obligations that qualify for 'grandfathering' under the public law guarantee ('Gewährträgerhaftung') remain unaffected by today's rating action.

A full list of affected ratings and rating inputs can be found at the end of this press release.

RATINGS RATIONALE

-- AFFIRMATION OF LBBW'S BASELINE CREDIT ASSESSMENT

The affirmation of the bank's baa2 BCA considers LBBW's still strong asset quality metrics, displaying a problem loan ratio of only 1.0% as of 30 June 2020, its solid capitalization as evidenced by a Tangible Common Equity (TCE) ratio of 15.5% and a transitional Common Equity Tier 1 (CET1) ratio of 14.4% as of the same date, as well as its highly liquid balance sheet. The BCA further takes account of LBBW's subdued profitability metrics and its meaningful dependence on confidence-sensitive wholesale funding, which exposes the bank to refinancing risks in an adverse market environment.

In its assessment, the rating agency also reflects the inherent concentration risks of LBBW's significant exposures to highly cyclical sectors like the automotive industry and commercial real estate (CRE). While LBBW displayed a generally sound history of low credit losses from these sectors, the weakened macroeconomic environment due to the coronavirus crisis, as well as structural changes facing the automotive industry, challenges LBBW in maintaining its sound asset quality and below-average loan loss charges, which the bank exhibited in recent years. This, together with continued strain on earnings resulting from the low interest-rate environment, is likely to exert additional pressure on LBBW's already low risk-adjusted profitability, thereby limiting its capital generation capacity.

-- AFFIRMATION OF SHORT-TERM AND LONG-TERM RATINGS

The affirmation of LBBW's ratings follows the affirmation of the bank's baa1 Adjusted BCA, which incorporates Moody's unchanged assessment of a high probability of LBBW receiving affiliate support from Sparkassen-Finanzgruppe (S-Finanzgruppe, Corporate Family Rating Aa2 negative, BCA a2), resulting in one notch of rating uplift from its baa2 BCA.

The affirmation also reflects the results of Moody's Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss in resolution for LBBW's different liability classes and an unchanged assumption of a moderate likelihood of government support for deposits and senior unsecured debt instruments in case of need, which continues to provide one notch of rating uplift for these liabilities.

LBBW's balance sheet expanded by 13% in the first half of 2020, which was mostly driven by the bank's €20 billion participation in the latest ECB tender program (TLTRO III) [1] but also by rising lending volumes. This results in increasing loss-given-failure, in particular for junior senior unsecured debt instruments. However, the rating agency expects a significant portion of LBBW's balance sheet expansion to be temporary in nature and continues to assume a very low loss-given-failure for junior senior unsecured debt, resulting in unchanged two notches of rating uplift from the forward-looking Advanced LGF analysis.

Based on outstanding volumes of deposits and debt instruments as of 30 June 2020, the rating agency's Advanced LGF analysis continues to indicate an extremely low loss-given-failure for deposits and senior

unsecured liabilities, and a high loss given failure for subordinated debt instruments, resulting in an unchanged notching result for these debt classes.

-- OUTLOOK REMAINS STABLE

The outlook on the bank's long-term deposit and senior unsecured debt ratings is stable, reflecting Moody's view that LBBW's strong capitalization and comfortable liquidity buffer will allow it to withstand the expected deterioration of asset quality and profitability, thus maintaining its current intrinsic financial strength. Moody's also considers that LBBW will be able to keep sufficient volumes of bail-in-able liabilities safeguarding the currently assigned rating uplift resulting from Moody's Advanced LGF analysis.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of LBBW's senior unsecured debt and deposit ratings would be subject to an upgrade of its BCA, because these ratings already benefit from the highest possible rating uplift from Moody's Advanced LGF analysis.

Upward pressure on LBBW's BCA could be triggered by a reduction in cyclical sector concentrations and continued low problem loan formation, by strengthened capitalisation, or by a meaningful and sustainable improvement in profitability.

A downgrade of LBBW's ratings could result from a multi-notch downgrade of its BCA; developments within the S-Finanzgruppe that would trigger a reduction of Moody's sector support assumptions; or from lower results from Moody's Advanced LGF analysis.

Downward pressure on LBBW's BCA could result from a significant deterioration in its overall credit profile, especially if caused by an outsized increase in problem loan formation, an unexpected and sustained weakening in the bank's capital adequacy metrics, and a weakening of its funding and liquidity profile.

In addition, LBBW's ratings could be downgraded if the volume of instruments that are designed to be loss absorbing in resolution decreases relative to the bank's tangible banking assets, because this could result in fewer notches of rating uplift from Moody's Advanced LGF analysis.

LIST OF AFFECTED RATINGS

Issuer: Landesbank Baden-Wuerttemberg

..Affirmations:

....Long-term Counterparty Risk Ratings, affirmed Aa3

....Short-term Counterparty Risk Ratings, affirmed P-1

....Long-term Bank Deposits, affirmed Aa3, outlook remains Stable

....Short-term Bank Deposits, affirmed P-1

....Long-term Counterparty Risk Assessment, affirmed Aa3(cr)

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Long-term Issuer Ratings, affirmed Aa3, outlook remains Stable

....Short-term Issuer Ratings, affirmed P-1

....Baseline Credit Assessment, affirmed baa2

....Adjusted Baseline Credit Assessment, affirmed baa1

....Senior Unsecured Regular Bond/Debenture, affirmed Aa3, outlook remains Stable

....Senior Unsecured Medium-Term Note Program, affirmed (P)Aa3

....Junior Senior Unsecured Regular Bond/Debenture, affirmed A2

...Junior Senior Unsecured Medium-Term Note Program, affirmed (P)A2
...Subordinate Regular Bond/Debenture, affirmed Baa2
...Subordinate Seniority Medium-Term Note Program, affirmed (P)Baa2
...Preferred Stock Non-Cumulative, affirmed Ba1(hyb)
...Preferred Stock Non-Cumulative Medium-Term Note Program, affirmed (P)Ba1
...Commercial Paper, affirmed P-1
...Other Short Term, affirmed (P)P-1

..Outlook Action:

...Outlook remains Stable

Issuer: Landesbank Baden-Wuerttemberg, New York

..Affirmations:

...Long-term Counterparty Risk Ratings, affirmed Aa3
...Short-term Counterparty Risk Ratings, affirmed P-1
...Long-term Bank Deposits, affirmed Aa3, outlook remain Stable
...Long-term Counterparty Risk Assessment, affirmed Aa3(cr)
...Short-term Counterparty Risk Assessment, affirmed P-1(cr)
...Long-term Issuer Ratings, affirmed Aa3, outlook remains Stable
...Short-term Issuer Ratings, affirmed P-1
...Senior Unsecured Medium-Term Note Program, affirmed (P)Aa3
...Subordinate Medium-Term Note Program, affirmed (P)Baa2
...Commercial Paper, affirmed P-1
...Other Short Term, affirmed (P)P-1

..Outlook Action:

...Outlook remains Stable

Issuer: Landesbank Baden-Wuerttemberg, Singapore Br

..Affirmations:

...Long-term Counterparty Risk Ratings, affirmed Aa3
...Short-term Counterparty Risk Ratings, affirmed P-1
...Long-term Counterparty Risk Assessment, affirmed Aa3(cr)
...Short-term Counterparty Risk Assessment, affirmed P-1(cr)
...Long-term Issuer Ratings, affirmed Aa3, outlook remains Stable
...Short-term Issuer Ratings, affirmed P-1

..Outlook Action:

...Outlook remains Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1147865 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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REFERENCES/CITATIONS

[1] Public Interim Financial Statements 30-Jun-2020

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