

## DBRS Morningstar Assigns First-Time Ratings to Landesbank Baden-Württemberg; LT Issuer Rating at 'A' (high), Stable Trend

### BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) assigned first-time ratings to Landesbank Baden-Württemberg (LBBW or the Bank), including Issuer Ratings at A (high) / R-1 (middle). DBRS Morningstar also assigned an 'A' Senior Non-Preferred Debt rating, an A (low) Subordinated Debt Rating and Critical Obligations Ratings (COR) of AA / R-1 (high). The trend on all ratings is Stable. The ratings and the trend are all in line with the broader Sparkassen-Finanzgruppe (SFG). LBBW's Intrinsic Assessment (IA) is 'A' and its Support Assessment is SA1. For a complete list of ratings, please see the table at the end of this press release.

### KEY RATING CONSIDERATIONS

LBBW's ratings reflect its membership in the Sparkassen-Finanzgruppe (SFG) and in the Institutional Protection Scheme (IPS) of the SFG. Each member of the IPS, including LBBW, is generally rated at the floor level, which is currently A (high) with a Stable trend.

The 'A' Intrinsic Assessment (IA) takes into account LBBW's well established universal banking franchise with an emphasis on commercial clients and a regional focus on Southern Germany. The Bank acts as a central institution and clearing bank for the savings banks in its designated regions of Baden-Württemberg, Rhineland-Palatinate and Saxony, has its own savings bank in Stuttgart, and has a growing asset and wealth management franchise. The Bank's liquidity position is solid and is supported by its membership in the SFG and its established covered bond franchise. LBBW has healthy capital ratios with cushions well above minimum requirements, which we expect to be maintained over the medium-term. The IA also takes into account the still modest earnings power, which is somewhat mitigated by the stability of earnings. Although DBRS Morningstar expects to see an increase in profitability over time as the Bank implements its growth strategy, the repercussions from the war in Ukraine, measures by central banks globally to fight inflation and delayed effects from the COVID-19 pandemic could adversely affect profitability in the near-term. Risk is well managed and has benefitted from the relatively benign German economic environment, both of which are reflected in favourable asset quality metrics. However, some concentration risk exists, and the same factors affecting earnings could lead to weaker asset quality.

The A (low) Subordinated Debt Rating is two notches below the floor rating, reflecting the support for the Bank as a member of the IPS.

The AA / R-1 (high) Critical Obligations Ratings (COR) reflect LBBW's status as an 'other systemically important institution' within Germany, its position as a major counterparty in the German capital markets, and its complex role in the local market, including its position as the central bank to savings banks with its designated area. The Long-Term COR is placed two notches above the SFG floor rating, rather than the Bank's IA, reflecting our expectation of initial support from the IPS scheme which targets to protect the institution as a whole and not individual creditor groups.

## RATING DRIVERS

LBBW's Issuer Ratings benefit from the SFG's IPS, and therefore a change in SFG's ratings would lead to a change in LBBW's ratings. The Bank's Intrinsic Assessment (IA) would be upgraded if the Bank improves its profitability metrics, while maintaining solid asset quality. A significant deterioration in asset quality or a material and sustained decline in profitability would lead to a downgrade of the IA.

## RATING RATIONALE

### Franchise Combined Building Block (BB) Assessment: Strong / Good

LBBW has a well-established universal banking franchise with a strong focus on commercial clients in Southern Germany and select markets both domestically and outside Germany. The Bank also serves retail banking clients in the greater Stuttgart area, has a growing asset and wealth management franchise and serves as a central bank to the savings banks in its designated region. DBRS Morningstar notes that across some products and parameters, LBBW can find itself competing with some of its owner savings banks as well as the national scope of services offered by central SFG entities such as Deka Bank and other Landesbanken. This internal competition within the SFG, as well as the potential for economies of scale, are a driver of consolidation and specialisation within the Landesbanken sector, in which LBBW is actively participating.

### Earnings Combined Building Block (BB) Assessment: Moderate / Weak

LBBW has consistently been profitable in recent years, displaying a high degree of stability in revenues and profits, with the exception of 2020, when higher provision needs, driven by the pandemic, suppressed profits. While LBBW compares well to German peers in terms of profitability, metrics are at the lower end when compared to international peers. Reasons for this include the low rate environment, the highly competitive German market, a high cost structure, and relatively high regulatory levies. In addition, German labour laws make swift cost cutting measures difficult. As a result, the Bank is following a strategy to improve efficiency through digitalisation and a growth strategy with the intention to create operating leverage. In 2021 LBBW reported a profit before tax of EUR 817 million, up from EUR 252 million a year earlier, as revenues increased by 11.4% year-on-year (YoY) based on strong customer business and the benefits of the TLTRO III, while provisioning needs declined by EUR 304 million to EUR 240 million. Although expenses increased by 4.2%, in part driven by regulatory factors, the increased income led to an improvement in the cost/income ratio (CIR) to 64.7%. Pre-tax return on equity was 6.0%.

### Risk Combined Building Block (BB) Assessment: Strong / Good

In DBRS Morningstar's view risk is generally well managed and also benefits from the benign German economic environment, which is reflected in relatively strong asset quality metrics. Excluding 2020, the cost of risk has been below 20 basis points in each of the last five years. As of end-2021, the Bank had a EUR 1.33 billion allowance for losses on loans and receivables, to cover EUR 1.11 billion of Stage 3 loans to customers. Being based in Southern Germany, LBBW has traditionally had significant exposure to the automobile industry, however, this has been reduced in recent years to reflect structural changes in the industry. DBRS Morningstar does note that with the announced acquisition of Berlin Hyp, exposure to commercial real estate is expected to increase. While the gross NPL ratio of 1.0% (as calculated by DBRS Morningstar) has been improving in recent years, we note that a reversal in this trend could be driven by a weakening economy due to factors such as delayed effects from the pandemic, supply chain disruptions, high energy prices and possibly higher interest rates.

### Funding and Liquidity Combined Building Block (BB) Assessment: Strong / Good

DBRS Morningstar views LBBW's funding and liquidity profile as solid. The loan-to-deposit ratio of 126% is in line with similarly

rated peers. While LBBW does not have a large retail deposit base, this is mitigated by (i) the Bank's access to the savings banks liquidity pool, (ii) the well-established access to the covered bond market which DBRS Morningstar considers a stable source of funding, and (iii) access to unsecured markets. Approximately one third of annual funding needs is expected to come from capital market funding and the funding needs are evenly distributed over the coming years. At end-2021 the Liquidity Coverage Ratio (LCR) was 141.1% and the Net Stable Funding Ratio (NSFR) was 108.5%.

Capitalisation Combined Building Block (BB) Assessment: Good

With a fully loaded CET1 ratio of 14.6% at end-2021 and a total capital ratio of 21.4%, LBBW has solid capital ratios with cushions well over minimum requirements. The minimum CET1 ratio requirements for LBBW increased to 8.81% as of March 1, 2022, up from 8.73%, and DBRS Morningstar notes that by March 1, 2023 the Bank has to fully comply with an additional countercyclical buffer of 0.75% of risk-weighted German receivables and the sectoral systematic risk buffer for risk-weighted German receivables backed by residential real estate. Even though we believe that a deterioration of the economic outlook could prompt regulators to revisit the buffers, in DBRS Morningstar's view the Bank's healthy capital cushions, afford management flexibility in response to the new requirements. A moderate decline in capital cushions would be unlikely to impact the current ratings. The financial strength derived from the solid capital cushions is partly mitigated by the modest capital generation capacity through retained earnings and the Bank's limited access to capital markets due to its ownership structure.

Further details on the Scorecard Indicators and Building Block Assessments can be found at <https://www.dbrsmorningstar.com/research/395588>.

## ESG CONSIDERATIONS

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://www.dbrsmorningstar.com/research/373262>.

DBRS Morningstar notes that this Press Release was amended on April 21, 2022 to incorporate the solicited rating status.

### Notes:

All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (19 July 2021) <https://www.dbrsmorningstar.com/research/381742/global-methodology-for-rating-banks-and-banking-organisations> Other applicable methodologies include the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (3 February 2021) <https://www.dbrsmorningstar.com/research/373262/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>

The sources of information used for this rating include Morningstar Inc. and Company Documents, LBBW 2017-2021 Annual Reports, LBBW H1 2021 & 2021 Results Presentations, and LBBW H1 2021 & 2020 Disclosure Reports. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

This rating concerns a newly rated issuer. This is the first DBRS Morningstar rating on this issuer.

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot

independently verify that information in every instance.

Generally, the conditions that lead to the assignment of a Negative or Positive trend are resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: <https://www.fca.org.uk/firms/credit-rating-agencies>.

The sensitivity analysis of the relevant key rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/395587>.

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Initial Rating Date: April 21, 2022

Last Rating Date: Not applicable as there is no last rating date.

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For more information on this credit or on this industry, visit [www.dbrsmorningstar.com](http://www.dbrsmorningstar.com).

## Ratings

### Landesbank Baden-Wuerttemberg

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
21-Apr-22	Long-Term Issuer Rating	New Rating	A (high)	Stb	<b>EU</b> <b>U</b>
21-Apr-22	Short-Term Debt	New Rating	R-1 (middle)	Stb	<b>EU</b> <b>U</b>
21-Apr-22	Short-Term Deposits	New Rating	R-1 (middle)	Stb	<b>EU</b> <b>U</b>
21-Apr-22	Short-Term Issuer Rating	New Rating	R-1 (middle)	Stb	<b>EU</b> <b>U</b>

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
21-Apr-22	Long-Term Critical Obligations Rating	New Rating	AA	Stb	<b>EU</b> <b>U</b>
21-Apr-22	Short-Term Critical Obligations Rating	New Rating	R-1 (high)	Stb	<b>EU</b> <b>U</b>
21-Apr-22	Senior Non-Preferred Debt	New Rating	A	Stb	<b>EU</b> <b>U</b>
21-Apr-22	Long-Term Deposits	New Rating	A (high)	Stb	<b>EU</b> <b>U</b>
21-Apr-22	Long-Term Senior Debt	New Rating	A (high)	Stb	<b>EU</b> <b>U</b>
21-Apr-22	Subordinated Debt	New Rating	A (low)	Stb	<b>EU</b> <b>U</b>

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