

**Rating Action: Moody's affirms Landesbank Baden-Wuerttemberg's Aa3 deposit and A1 senior debt ratings**

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Global Credit Research - 13 Sep 2017

**Outlook changed to negative for long-term senior unsecured ratings**

Frankfurt am Main, September 13, 2017 -- Moody's Investors Service (Moody's) has today affirmed Landesbank Baden-Wuerttemberg's (LBBW) Aa3 deposit and senior senior unsecured debt ratings, and its A1 senior unsecured debt ratings. Concurrently, the rating agency upgraded baseline credit assessment (BCA) to baa2 from baa3. The outlook on the long-term deposit and senior senior unsecured debt ratings is stable, while the outlook on the long-term senior unsecured ratings was changed to negative from stable.

Further, Moody's affirmed LBBW's long-term and short-term Counterparty Risk Assessment (CR Assessment) of Aa3(cr)/P-1(cr), as well as the bank's other short-term program, CP and deposit ratings at (P)P-1 and P-1, respectively, and its subordinated debt ratings at Baa2.

The BCA upgrade reflects the continued strengthening of the bank's financial fundamentals, in particular a stabilisation of its capitalization and an improvement in asset quality, including Moody's assessment of stable profitability despite the pressures from the low-yield environment.

The stable outlook on the deposit reflects Moody's expectation that LBBW will be able to sustain its solid credit metrics going forward. The negative outlook on the senior unsecured ratings is driven by the results of Moody's Advanced Loss Given Failure (LGF) analysis, which now implies a lower cushion for this rating class, with potential negative implications on the two notches of rating uplift going forward.

LBBW's Aaa rated guaranteed senior unsecured and subordinated debt obligations that qualify for 'grandfathering' under the public law guarantee ('Gewahrtraegerhaftung') remain unaffected.

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

**RATINGS RATIONALE**

**-- UPGRADE OF LBBW's BASELINE CREDIT ASSESSMENT**

The upgrade of the BCA to baa2 from baa3 follows the sustained strengthening of LBBW's key credit metrics and reflects the bank's: (1) improved asset quality, despite its still significant exposures to highly cyclical industries like automotive and commercial real estate (CRE); and (2) a stabilization of capital, which primarily reflects the bank's successful deleveraging after the reduction of high risk exposures following the financial crisis. At the same time, LBBW's BCA continues to reflect its low but stable risk-adjusted profitability and highly wholesale-dependent funding profile.

As of half-year 2017, the bank's problem loan ratio was 0.99%, down from 1.2% as of year-end 2016 (1.8% as of year-end 2015), and risk-related charges declined further to very low levels, reflecting a benign point in the credit cycle. Despite the bank's sizeable CRE concentration risks, LBBW's CRE portfolio has a sound history of low credit losses compared with its peers.

The upgrade of LBBW's standalone BCA is further supported by the increase in its fully loaded Common Equity Tier 1 (CET1) to 15.8% as of half-year 2017, up from 15.2% as of year-end 2016. The improvement reflects the lowering of LBBW's risk-weighted assets.

However, LBBW's BCA remains constrained by its wholesale-dependent funding profile and low risk-adjusted profitability. Moody's believes that LBBW continues to face challenges to its profitability because of the bank's high dependence on interest income, which is under pressure from persistent low interest rates, as well as general cost inflation pressure.

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

The affirmation of LBBW's long-term ratings follows the affirmation of the bank's baa1 adjusted BCA, incorporating Moody's unchanged assessment of a high probability of LBBW receiving affiliate support from Sparkassen-Finanzgruppe (S-Finanzgruppe, Corporate Family Rating Aa2 stable, BCA a2). However, the rating uplift is reduced to one from two notches, despite unchanged support assumptions as LBBW's higher BCA is converging more towards that of S-Finanzgruppe. The affirmation also reflects the unchanged results of LGF analysis, which provides three notches of uplift to the bank's deposit ratings and two notches of uplift to its senior unsecured debt ratings from its adjusted BCA; and the rating agency's unchanged assumption of "moderate" government support, resulting in one notch of additional rating uplift for LBBW's senior and deposit ratings. In combination, these assumptions result in four notches of uplift to LBBW's deposit ratings and three notches of uplift to the bank's senior unsecured debt ratings from its adjusted BCA.

#### -- OUTLOOK CHANGE TO NEGATIVE FOR SENIOR DEBT; STABLE OUTLOOK FOR DEPOSITS

The outlook on the bank's long-term deposit and senior unsecured debt ratings is stable, reflecting our view of immaterial changes to the liability structure over the 12-18 month outlook horizon and the expectation of a stable adjusted BCA.

However, for senior unsecured, the liability structure provides less of a buffer than previously anticipated, as the bank has financed its balance sheet expansion predominantly through preferred liability instruments, such as customer deposits, in addition to updated Moody's assumptions on the volume of senior instruments outstanding, which increases the expected loss on instruments ranking lower in restructuring or resolution situations. As a consequence, it is now very close to the thresholds that results in fewer notches of rating uplift than the current two notches of uplift that derive from Moody's LGF analysis.

A stabilization of the rating outlook will depend on (1) the development of LBBW's balance sheet size, with Moody's expectation of its balance sheet shrinking by year-end 2017 (primarily via a reduction of interbank business) in combination with (2) an increase in issuance volume of senior unsecured debt by year-end 2017. Only issuance of senior unsecured instruments that significantly exceed upcoming redemptions, and therefore impact the outstanding volume of senior unsecured debt positively, will preserve the two notch ratings uplift over the next 12 months. With a lower tranche volume and the resulting higher loss severity for senior debt in resolution, the LGF analysis would result in one notch of rating uplift (instead of the current two) for senior debt.

#### WHAT COULD CHANGE THE RATING - UP / DOWN

An upgrade of LBBW's long-term ratings would be likely in the event of an upgrade of the BCA. LBBW's senior unsecured debt ratings could also be upgraded if the volume of its subordinated instruments increases meaningfully relative to the bank's tangible banking assets, which could result in one additional notch of rating uplift from our LGF analysis. LBBW's senior and deposit ratings already benefit from the highest possible rating uplift from our LGF analysis.

Upward pressure on LBBW's baa2 BCA could result from a combination of (1) a reduction of single-name credit concentrations and sector concentrations; (2) a marked and sustainable improvement in risk-adjusted profitability and efficiency and (3) a significant reduction in the bank's market funding dependence.

A downgrade of LBBW's long-term ratings could be triggered following (1) a multi-notch downgrade of its BCA; (2) weakening cross-sector support assumptions; and/or (3) a reduction in rating uplift resulting from our LGF analysis.

Downward pressure on the bank's BCA could result from (1) a deterioration of the bank's financial strength, especially if followed by an unexpected and sustained weakening of its capital adequacy metrics; and (2) a material deterioration in asset quality, evidenced by a strongly rising problem loan ratio.

In addition, LBBW's debt and deposit ratings could be downgraded if their volume, or that of its subordinated instruments, decreases relative to the bank's tangible banking assets. This could result in fewer notches of uplift resulting from our LGF analysis.

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

#### LIST OF AFFECTED RATINGS

Upgrades:

..Issuer: Landesbank Baden-Wuerttemberg

.... Baseline Credit Assessment, Upgraded to baa2 from baa3

Affirmations:

..Issuer: Landesbank Baden-Wuerttemberg

.... LT Bank Deposits, Affirmed Aa3 Stable

.... ST Bank Deposits, Affirmed P-1

.... Senior Senior Unsecured Regular Bond/Debenture, Affirmed Aa3 Stable

.... Senior Unsecured Regular Bond/Debenture, Affirmed A1 Negative From Stable

.... Subordinate Regular Bond/Debenture, Affirmed Baa2

.... Senior Unsecured MTN, Affirmed (P)A1

.... Senior Senior Unsecured MTN, Affirmed (P)Aa3

.... Subordinate MTN, Affirmed (P)Baa2

.... Commercial Paper, Affirmed P-1

.... ST Deposit Note/CD Program, Affirmed P-1

.... Other Short Term, Affirmed (P)P-1

.... Adjusted Baseline Credit Assessment, Affirmed baa1

.... Counterparty Risk Assessment, Affirmed Aa3(cr)

.... Counterparty Risk Assessment, Affirmed P-1(cr)

..Issuer: Landesbank Baden-Wuerttemberg, New York

.... LT Bank Deposits, Affirmed Aa3 Stable

.... Senior Unsecured MTN, Affirmed (P)A1

.... Subordinate MTN, Affirmed (P)Baa2

.... Other Short Term, Affirmed (P)P-1

.... Commercial Paper, Affirmed P-1

.... Counterparty Risk Assessment, Affirmed Aa3(cr)

.... Counterparty Risk Assessment, Affirmed P-1(cr)

..Issuer: Landesbank Baden-Wuerttemberg, Singapore Br

.... Senior Unsecured MTN, Affirmed (P)A1

.... Subordinate MTN, Affirmed (P)Baa2

.... Other Short Term, Affirmed (P)P-1

.... Counterparty Risk Assessment, Affirmed Aa3(cr)

.... Counterparty Risk Assessment, Affirmed P-1(cr)

..Issuer: LRP Landesbank Rheinland-Pfalz

... Senior Unsecured Regular Bond/Debenture, Affirmed A1 Negative From Stable

Outlook Actions:

..Issuer: Landesbank Baden-Wuerttemberg

...Outlook, Changed To Stable(m) From Stable

..Issuer: Landesbank Baden-Wuerttemberg, New York

...Outlook, Remains Stable

..Issuer: Landesbank Baden-Wuerttemberg, Singapore Br

...Outlook, Remains Stable

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