Rating Action: Moody's affirms Landesbank Baden-Wuerttemberg's ratings

20 Aug 2019

Outlook remains stable

Frankfurt am Main, August 20, 2019 -- Moody's Investors Service (Moody's) has today affirmed all ratings (except when the instrument rating benefits from a legacy public law guarantee) 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 senior unsecured, junior senior unsecured and subordinated debt obligations that qualify for ‘grandfathering’ under the public law guarantee ('Gewaehrtraegerhaftung') 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 reflects our expectation of an overall stable to moderately positive trend in LBBW's key credit metrics. This assessment also takes account of LBBW's gradual shift towards a more international footprint. Despite maintaining its strong domestic focus, this shift gradually increases the bank’s exposure to regions that are less strong than those of Germany, as part of its revived growth strategy.

The baa2 BCA further considers LBBW's strong asset quality metrics, displaying a problem loan ratio of only 0.8% as of year-end 2018, its solid capitalization as evidenced by a Tangible Common Equity (TCE) ratio of 16.1% and a Common Equity Tier 1 (CET1) ratio of 15.1%, as well as its highly liquid balance sheet. The BCA further takes account of LBBW's low -- yet relatively stable -- profitability metrics and its meaningful dependence on confidence-sensitive wholesale funding, which exposes the bank to refinancing risks in a more 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 commercial real estate (CRE) and the automotive industry. While LBBW displays a generally sound history of low credit losses from these sectors, a weakening macroeconomic development as well as the structural challenges facing the automotive industry challenges LBBW in maintaining its sound asset quality and below-average loan loss charges. This, together with continued strain on earnings resulting from the low interest-rate environment as well as rising investments into digital banking services and infrastructure, 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, Aa2 stable, 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.

Based on outstanding volumes of deposits and debt instruments as of year-end 2018, the rating agency's forward-looking Advanced LGF analysis continues to indicate an extremely low loss-given-failure for deposits and senior unsecured liabilities, a very low loss-given-failure for junior senior unsecured debt instruments and
a high loss given failure for subordinated debt instruments, which are all resulting in unchanged rating uplift respectively.

-- 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 will be able to sustain its current intrinsic financial strength, as well as to maintain sufficient volumes of bail-in-able liabilities safeguarding the currently assigned rating uplift resulting from Moody's Advanced LGF analysis.

WHAT COULD CHANGE THE RATING UP/DOWN

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 sustainable shift of the bank's activities to very strong banking systems, in combination with a meaningful and sustained reduction in the bank's reliance on capital market-sensitive funding or a material increase in liquid resources, or if the bank diversifies its lending book such that it significantly reduces existing high sector concentration risks.

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; and/or if the volume of subordinated or other debt instruments designed to be loss absorbing in resolution decreases substantially and beyond the rating agency's expectations, compared with the bank's tangible banking assets.

Downward pressure on LBBW's BCA could result from a significant deterioration in its overall credit profile, especially if caused by significantly higher-than-anticipated loan loss charges or an unexpected and sustained weakening in the bank's capital adequacy metrics.

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
....Commercial Paper, affirmed P-1
....Other Short Term, affirmed (P)P-1
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Outlook Action:
....Outlook remains Stable
Issuer: Landesbank Baden-Wuerttemberg, New York
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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
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Outlook Action:
....Outlook remains Stable
Issuer: Landesbank Baden-Wuerttemberg, Singapore Br
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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
....Senior Unsecured Medium-Term Note Program, affirmed (P)Aa3
....Junior Senior Unsecured Medium-Term Note Program, affirmed (P)A2
....Subordinate Medium-Term Note Program, affirmed (P)Baa2
....Other Short Term, affirmed (P)P-1

..Outlook Action:

....Outlook remains Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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