Disclosure Report in accordance with the German Solvency Ordinance

as of December 31, 2009.

Landesbank Baden-Württemberg

LB BW

Contents.

1 Fundamentals.

The Basel Committee on Banking Supervision has defined internationally applicable standards for the capital adequacy of banks and the associated disclosure requirements in the Basel capital standards recommendation (Basel II) which are translated into national law primarily in the Solvency Ordinance (SolvV).
The Solvency Ordinance substantiates the capital adequacy of institutions required by section 10 (1) sentence 9 of the Kreditwesengesetz (KWG – German Banking Act). By publishing the SolvV in conjunction with section 26a KWG, disclosure requirements in accordance with pillar III of Basel II have been transferred to national legislation.

Since January 1, 2008, Landesbank Baden-Württemberg (LBBW) has applied the Internal Ratings-based Approach (basic IRB approach) approved by the German Federal Financial Supervisory Authority (BaFin) for establishing capital backing for counterparty risk from the main receivables classes. With the SolvV report as at December 31, 2008, it was possible for the first time to determine capital backing for general interest rate risk, general equity price risk and associated option price risks on the basis of the internal market price risk model.

LBBW prepares the Disclosure Report in aggregate form at Group level in its role as a parent company in accordance with section 10a (1) sentence 1 KWG.
In terms of qualitative disclosures, LBBW utilizes this opportunity in accordance with section 320 (1) SolvV and refers to these reports, provided that the information has already been disclosed in the context of other publicity requirements.

The Disclosure Report is published on the Internet as an independent report alongside the annual financial statements and management report for LBBW in accordance with HGB accounting standards and the annual report for the LBBW Group in accordance with IFRS, which also includes the risk report. By publishing the Financial Stability Forum report, LBBW also addresses the key disclosure recommendations from the Financial Stability Forum (FSF) of April 7, 2008.

2 Risk management.
(section 322 SolvV)

The risk management system is determined by the Board of Managing Directors and the Administrative Board in the risk strategies consistent with business strategy.

Corporate policy and risk strategy guidelines for risk management are specified through risk principles in the Group risk strategy, which applies Group-wide and across all risk categories. Processes, business strategies and earnings targets are also stipulated for the front and back office divisions using a combined top-down/bottom-up process in the specific risk strategies.

LBBW's credit risk strategy and credit regulations deal with all provisions for dealing with lending business in a responsible and risk-oriented way. Similarly, they also provide a risk-adequate framework for dealing with the market dynamic in a flexible and customer-oriented way. Credit decisions are made in a system of graded competencies which are regulated in the bank's decision-making systems.

The risk strategy for market price risk describes the activities of LBBW which involve market price risks and specifies an aware and controlled way of dealing with these risks in order to use the opportunities involved strategically.
Interest rate risks are managed at LBBW as part of market price risks.

The objective of the OpRisk strategy is to establish the LBBW Group's basic policy for dealing with operational risks in an appropriate and responsible way. It defines, for all business activities, the necessary basic conditions for a uniform system throughout the Group for identifying, assessing, managing, monitoring and communicating about operational risks.

In general, LBBW ensures that risk strategies are created and developed properly through appropriate structural and procedural regulations. These are documented in the organization guidelines of the divisions and the subsidiaries.

A detailed presentation of the aims and principles of the management of individual risk areas can be found in the LBBW Risk Report.

3 Scope.

(section 323 SolvV)

Unless otherwise indicated, all disclosures in this report relate to the regulatory scope of consolidation of the LBBW Group in accordance with the KWG as at the reporting date December 31, 2009. This largely corresponds to the scope of consolidation in line with IFRS accounting standards.

However, significant differences with the IFRS scope of consolidation do arise with regard to the following aspects:

- Most special purpose vehicles (SPVs) are consolidated in accordance with IFRS, but are not included in the regulatory scope of consolidation as they do not meet the requirements for classification as a subsidiary in accordance with section 1 (7) KWG or they carry out business activities which do not trigger a consolidation obligation in accordance with KWG.
- Companies outside the financial sector are also consolidated in the IFRS consolidated financial statements if it is possible to exercise control in accordance with IFRS. However, these companies do not form part of the regulatory scope of consolidation.
- Conversely, companies which do not meet the consolidation criteria in accordance with IFRS or are not consolidated due to being of minor significance are also included in the scope of consolidation in accordance with KWG.

The option in line with section 2a KWG, whereby individual institutions can be excluded if organizational and procedural conditions of certain regulations for equity funding and reportability at an institution level are fulfilled (waiver regulation), is not used within the LBBW Group.

There are no limitations or other significant obstacles to carrying forward funds or liable equity capital to be taken into account in the LBBW Group.

As at the reporting date December 31, 2009, none of the subsidiaries that are not included in consolidation in accordance with section 10a KWG, but are deducted from the liable equity capital, had a capital deficit.

In the table below, the main companies included in the regulatory scope of consolidation are classified according to the type of business and its regulatory treatment and are shown alongside their classification in the scope of consolidation under IFRS. Both scopes of consolidation also include a large number of smaller companies, which are not listed due to their low materiality. These companies have been classified in line with the definitions in section 1 KWG.

		Regulatory treatment				Consolidation in accordance with accounting standard	
		Consolidation					
Description	Name	Full	Proportionate	Deduction method	Risk-weighted investments	Full	Measured at equity
Banks	Landesbank Baden-Württemberg	X				X	
	LBBW Bank CZ a.s.	X				X	
	LBBW Immobilien GmbH	X				X	
	LBBW Luxemburg S.A.	X				X	
	LBBW México	X					
	LBBW Securities, LLC	X				X	
	MKB Mittelrheinische Bank GmbH	X				X	
	Vorarlberger Landes- und Hypothekenbank AG			X			X
Financial services institutions	ALVG Anlagenvermietung GmbH	X				X	
	LHI Leasing GmbH	X					X
	MDL Mitteldeutsche Leasing GmbH	X					
	SüdFactoring GmbH	X				X	
	SüdLeasing GmbH	X				X	
Investment companies	LBBW Asset Management Investmentgesellschaft mbH	X				X	
	LRI Invest S.A.	X				X	
Financial enterprises	BW Capital Markets Inc.	X					
	BWK GmbH Unternehmensbeteiligungsgesellschaft		X				X
	CFH Beteiligungsgesellschaft mbH	X				X	
	Dresden Fonds GmbH	X					
	LBBW Asset Management (Ireland) plc	X				X	
	LBBW Dublin Management GmbH	X				X	
	LBBW Equity Partners GmbH & Co. KG		X				
	LBBW Pensionsmanagement GmbH	X					
	LBBW Venture Capital GmbH	X					
	LRP Capital GmbH	X				X	
	SL Financial Services Corporation	X					
	Süd KB Unternehmensbeteiligungsgesellschaft mbH	X					
	SüdImmobilien GmbH	X					
	Süd-Kapitalbeteiligungs-Gesellschaft mbH	X				X	
	SüdLeasing Espana E.F.C.S.A.	X					

		Regulatory treatment				Consolidation in accordance with accounting standard	
		Consolidation					
Description	Name	Full	Proportionate	Deduction method	Risk-weighted investments	Full	Measured at equity
Providers of related banking services	Financial ServiceS GmbH	X					
	LBBW Grundstücksverwaltungsgesellschaft mbH & Co. KG Objekt Am Hauptbahnhof Stuttgart	X					
	LBBW Grundstücksverwaltungsgesellschaft mbH & Co. KG Objekt am Pariser Platz Stuttgart	X				X	
	LG Grundstücksanlagen-Gesellschaft mbH & Co. KG – Immobilienverwaltung –	X					
	Stuttgarter Aufbau Bau- und Verwaltungs-Gesellschaft mbH	X					
Other companies	Baden-Württemberg L-Finance N.V.				X	X	
	Landesbank Baden-Württemberg Capital Markets Plc				X	X	

Figure 1: Regulatory scope of consolidation (section 323 (1) no. 2 SolvV)

4 Equity.
(sections 324 and 325 SolvV)

Equity structure

The following table shows combined equity as defined in accordance with section 10a KWG. Disclosures relate to the regulatory scope of consolidation of LBBW as of December 31, 2009.

in EUR million	
Paid-in capital	2 584
Capital reserves and other retained reserves	8 246
Special reserves for general banking risks in accordance with section 340g HGB	480
Other Tier 1 capital components	5 072
Deduction items in accordance with section 10 (2a) sentence 2 KWG	– 196
Deduction items in accordance with section 10 (6) and (6a) KWG	– 1 069
Total Tier 1 capital in accordance with section 10 (2a) KWG	**15 117**
Total Tier 2 capital before items with funds withdrawn in accordance with section 10 (2b) KWG	5 794
Deduction items from Tier 2 capital in accordance with section 10 (6) and (6a) KWG	– 1 069
Retained Tier 3 funds in accordance with section 10 (2c) KWG	551
Total of Tier 2 capital in accordance with section 10 (2b) KWG and retained Tier 3 funds in accordance with section 10 (2c) KWG	**5 276**
Total of modified available equity in accordance with section 10 (1d) KWG and retained Tier 3 funds in accordance with section 10 (2c) KWG	**20 393**
thereof: Value adjustment deficits and expected loss amounts for IRBA items in accordance with section 10 (6a) no. 1 and 2 KWG	**536**

Figure 2: Equity structure (section 324 (2) SolvV)

The Tier 1 capital of the LBBW Group is composed of paid-in capital, which also includes contributions made by silent partners, and of capital reserves and other retained reserves. Furthermore, special reserves for general banking risks in accordance with section 340g HGB and, to a lesser extent, the Tier 1 capital components from consolidated subsidiaries are also recognized under this item.

The majority of contributions made by silent partners are provided with a permanent duration. The owners of LBBW in turn hold the majority of these. There is an option to terminate these after ten years in accordance with the individual contracts, but this can only be exercised subject to the approval of BaFin. Some of the permanent capital contributions were received in foreign currency (US$ 500 million). Temporary capital contributions by silent partners are held by insurance companies and savings banks. The original duration of these contracts is between 10 and 30 years. Depending on the original issuing bank, silent partners' contributions participate in the net loss or accumulated loss by reducing silent partners' contributions commensurate to the proportion of total equity components contributing to the loss in the respective fiscal year. In the event of insolvency or liquidation, capital contributions by silent partners are repaid only after all non-subordinated liabilities are satisfied.

Hybrid capital in the form of preference shares also counts towards Tier 1 capital. These were issued by two foreign subsidiaries and are available to the LBBW Group as Tier 1 capital. Preference shares have an indefinite duration. After ten years, LBBW has the right to terminate which must also be approved by BaFin. The terms of these securities satisfy the requirements of the Basel Committee on Banking Supervision.

Intangible assets fully deductible from the Tier 1 capital, the carrying amounts of the investments (half of which is to be deducted) and other capital from unconsolidated banks and financial enterprises are included in deductible items in accordance with section 10 (2a) KWG. Value adjustment deficits and expected loss amounts from investment items in the IRB approach as well as pre-settlement risks in accordance with section 10 (6a) KWG are also included on an equal basis.

The Tier 2 capital of LBBW includes liabilities arising from profit participation rights and longer-term subordinated liabilities.

Depending on the original issuing bank, profit participation rights participate in the net loss or accumulated loss by reducing capital generated by profit participation certificates commensurate to the proportion of total equity components contributing to the loss in the respective fiscal year. In the event of insolvency or liquidation, profit participation rights are repaid only after all non-subordinated creditors and subordinated liabilities are satisfied. The original duration of the participation certificates structured as bearer instruments or registered securities is between ten and twenty years.

In the case of insolvency or liquidation, longer-term subordinated liabilities are repaid only after all non-subordinated creditors have been satisfied. In contrast to profit participation rights, these do not play a part in any net loss for the year or accumulated loss. The original duration of longer-term subordinated liabilities structured as bearer instruments or registered securities is between ten and forty years.

The Tier 3 funds of LBBW consist of short-term subordinated liabilities. In contrast to longer-term subordinated liabilities, principal and interest payments do not have to be made on these if this were to cause the equity of the Bank or the banking group to no longer fulfill the respective applicable legal requirements in accordance with sections 10 and 10a KWG. Short-term subordinated liabilities are also structured as bearer instruments and registered securities. The original duration is between two and four years. In the two years prior to maturity, profit participation certificates and longer-term subordinated liabilities that have a Tier 3 clause are also recognized as Tier 3 capital.

Modified liable capital in line with section 10 (1d) KWG is calculated by finding the difference between the total of expected loss amounts, consisting of all IRB approach items for the central governments, banks and corporate businesses receivables classes, and the allowance for losses recognized for these items, consisting of valuation adjustments and provisions. This difference, together with the expected loss amounts for investments in the IRB approach, is to be deducted equally from Tier 1 and Tier 2 capital. Furthermore, pre-settlement risks in the context of trading book securities must be deducted if the consideration has still not been paid five business days after maturity.

As at the reporting date December 31, 2009, the value adjustment deficit was dominated by the rating deteriorations apparent on both the German and international markets, which pushed up the expected loss to be included in the valuation allowance comparison significantly. The value adjustment deficit will balance out after approval of the annual financial statements, as a result of which the newly created valuation allowances and provisions will be recognized in equity. In accordance with the Solvency Ordinance, only loan loss provisions which were included in the recently adopted annual financial statements are recognized in the comparison.

Presentation of key changes in the 2009 fiscal year

As a result of the financial market crisis, there were rating downgrades, particularly for securitized items in the first six months of 2009. There was therefore a drastic increase in regulatory equity requirements within a very short time, at the same time as a significant increase in market expectations as regards the Tier 1 ratio of a bank. As well as protecting a significant proportion of the portfolio of securitized products with a maximum guarantee, the owners of LBBW provided additional equity in the amount of EUR 5 billion in June 2009. This additional equity is reported on a proportionate basis under paid-in capital and capital reserves.

As a result of the net loss for the year reported in the 2009 fiscal year, silent partners' contributions and profit participation certificates will participate in the loss for the first time by means of a capital reduction after approval of the annual financial statements. These will participate in the loss according to their ratio to the total equity components contributing to the loss.

Internal equity management

Capital management

Capital management at LBBW is designed to ensure solid capitalization within the LBBW Group. In order to guarantee adequate capital from various perspectives, the Bank analyzes capital ratios and structures both from the perspective of economic capital and the perspective of regulatory capital requirements. LBBW's capital management system is embedded in the overall bank management process, the strategies, rules, monitoring mechanisms, and organizational structures of the LBBW Group.

In this process, the Capital Committee prepares decisions for the Board of Managing Directors and supports it in ensuring the adequacy of the LBBW Group's capital resources, structure and target figures. Resolutions are then passed by the Board of Managing Directors as a whole. The committee is coordinated by financial controlling and comprises the Chairman of the Board of Managing Directors, the members of the Board of Managing Directors in charge of trade and monitoring and certain division managers, including from trading, financial controlling and accounting divisions.

Regulatory management

The regulatory equity management of the LBBW Group is based on the KWG requirements and the relevant capital adequacy requirements (SolvV) stipulated by the supervisory authorities and applicable to groups of credit institutions.

Internal targets for the capital ratio (ratio of Tier 1 capital to risk positions) and the overall capital ratio (ratio of equity to risk positions[1]) are defined for the regulatory equity management of the LBBW Group.

[1] Total capital charges for counterparty, market price and operational risks

Actual developments, forecast accounts and scenario calculations for the planning period are currently monitored in order to ensure that these two solvency ratios are always observed. Stress tests are also carried out on a regular basis in order to analyze the impact of extreme situations.

Regulatory capital allocation is carried out during the planning process integrated on an annual basis and is monitored regularly by the Group's Board of Managing Directors.

Economic management
LBBW ensures risk-bearing capacity by means of a Group-wide compilation of risks across all major risk categories and subsidiaries and the comparison of this with the capital required for business purposes (aggregate risk cover).

Aggregate risk cover describes the extent of the LBBW Group's ability to absorb possible unexpected losses from positions at risk on the basis of the result, reserves and capital.

Economic capital is calculated as a uniform risk measure at the highest level. In contrast to the capital stipulated by regulatory bodies, this represents the capital backing required by LBBW for business purposes that is calculated using risk models. LBBW's economic capital is in principle expressed by value-at-risk (VaR) at a confidence level of 99.95 % and with a holding period of one year. The standard regulatory approach is applied for operational risks.

The upper risk limit for economic capital represents the upper limit for all risks at LBBW. The following are currently quantified as the key risk categories in calculating the economic capital at LBBW:

- credit risks
  (including counterparty and country risks)
- market price risks
- operational risks
- real estate risks
- investment risks

The material liquidity risks are managed separately from the economic capital approach.

This upper risk limit reflects LBBW's maximum willingness to take risks and was set well below the total resources available to cover risks in line with a conservative risk policy. Economic capital limits for the various risk categories are derived from this maximum limit for losses.
The remaining portion serves as a buffer for other risks that are not directly quantifiable

- strategic risks
- business performance risks
- reputation risks
- pension risks
- own credit risks
- model risks
- viability risks

and for risks arising from unforeseeable stress situations or strategic requirements.

There is a defined escalation process for high utilization of limits and for exceeding limits.

Capital requirements

The following table summarizes regulatory capital backing in terms of regulation-relevant risk types (counterparty risk, market price risk and operational risks).
Equity requirements for counterparty risks are reported in accordance with the receivables classes specified for the credit risk standard approach (CRSA) or those specified for the internal ratings-based approach (IRB approach).

In the case of capital backing for securitization transactions, a distinction is also drawn between CRSA and IRB securitizations.

Equity requirements for investment positions are calculated as follows:

- Investment positions acquired before January 1, 2008 are recognized in the CRSA up to December 31, 2017 with a risk weight of 100% in the context of the transition regulation (grandfathering).
- Investment positions acquired after this date are backed according to the rating class, if a rating is available. Otherwise, the simple risk-weighting approach is applied with the corresponding fixed risk weight.

The equity requirements for market price risks relating to the general interest rate risk and share risk as well as the associated option price risks of the LBBW Bank are calculated using the internal model approved by BaFin. Other market price risks are calculated according to the standard procedure.

Capital backing for operational risks is calculated using the standard approach.

in EUR million

	Equity requirements
1 Counterparty risks	
1.1 Credit risk standard approach (CRSA)	
Central governments	0
Regional governments and local government units	8
Other public sector	7
Multilateral development banks	0
International organizations	0
Banks	81
Covered bonds issued by banks	0
Corporates	1 802
Bulk business	574
Items collateralized with real estate	254
Investment units	8
Other items	117
Past-due items	131
Total CRSA	**2 982**
1.2 Internal ratings-based approach (IRB approach)	
Central governments	165
Banks	1 032
Corporates	4 044
Bulk business	0
of which: secured by real estate liens	0
of which: qualified, revolving	0
of which: other	0
Other assets not dependent on credit	229
Total IRB approach	**5 470**

in EUR million

	Equity requirements
1.3 Securitizations	
Securitizations in the CRSA approach	244
Securitizations in the IRB approach	1 463
Total securitizations	**1 707**
1.4 Risks from investment items	
Investments in the IRB approach	263
of which: model-controlled	0
of which: PD/LGD approach	54
of which: simple risk-weighting approach	209
of which: listed	6
of which: not listed but sufficiently diversified	19
of which: other	184
Investments in the CRSA approach	140
of which: interests held with method continuation/grandfathering	43
Total investments	**403**
Total counterparty risks	**10 562**
2 Market price risks	
Standard procedure	1 148
Approach in accordance with internal model	205
Total market price risks	**1 353**
3 Operational risks	
Basic indicator approach	0
Standard approach	398
Advanced measurement approach	0
Total operational risks	**398**
Total equity requirements	**12 313**

Figure 3: Equity requirements (section 325 (2) no. 1 to 4 SolvV)

Capital ratios

The following table shows the regulatory capital ratios for the LBBW Group, the LBBW Bank and the consolidated significant subsidiary banks. The ratios were calculated in accordance with the provisions of the Solvency Ordinance.

in %

	Overall capital ratio	Capital ratio
LBBW Group	**13.3**	**9.8**
LBBW Bank	15.2	11.2
LBBW Bank CZ a.s.	15.4	15.4
LBBW Luxemburg S.A.	13.5	11.2
MKB Institut	14.7	7.5

Figure 4: Capital ratios (section 325 (2) no. 5 SolvV)

The information for individual banks is disclosed without including transactions within the Group. The carrying amount deduction to be carried out in the context of consolidation results in lower ratios at Group level than at individual bank level.

5 General counterparty risk.
(section 327 SolvV)

The following quantitative information on general reporting requirements for counterparty risk is disclosed on the basis of the management approach. This means that LBBW Group's risk situation is reported based on this data, according to which internal risk management and internal reporting to the Board of Managing Directors and the executive bodies is carried out. The internal view of risk differs in some cases from the balance sheet reporting and regulatory approach. Key reasons for differences between the figures used for internal management and for external financial reporting are different bases of consolidation and the definition of the loan volume as »exposure« (utilization/fair values plus open external commitments).

As well as LBBW, the following subsidiaries relevant in terms of counterparty risk are included in the scope of consolidation for internal reporting purposes:

- LBBW Luxembourg
- SüdLeasing Gruppe
- LBBW Securities, LLC.

This basis of consolidation is reviewed at least annually and is adjusted to reflect current developments as needed.

Breakdown of credit volume by region, industry and residual term

The following tables show the main credit risk exposure categories of the LBBW Group, broken down by region, industry and residual term.[1]

The following table shows the credit volume, broken down according to region and type of loan.[2]

in EUR million

Region	Loans, commitments and other non-derivative off-balance sheet assets	Securities	Derivative financial instruments	Total
Germany	208666	65270	26942	300877
Western Europe	49169	44723	57379	151271
Eastern Europe	4222	823	2098	7143
Asia/Pacific	4646	1735	2920	9301
North America	19161	8031	9691	36882
Latin America	2943	2306	66	5316
Africa	100	73	66	240
Other	110	391	133	634
Total	**289018**	**123351**	**99295**	**511664**

Figure 5: Credit volume by region (section 327 (2) no. 1 and 2 SolvV)

[1] Rounding differences of +/– one unit may arise in the tables due to computational reasons.

[2] In order to maintain consistency with presentation elsewhere, in this report division by region is based on the domicile principle and is thus alternative to the allocation using the country of domicile principle in accordance with the country limit system as mentioned in the annual report.

The following table shows the credit volume, broken down according to internal risk-oriented industry category and type of loan.

in EUR million

Industry	Loans, commitments and other non-derivative off-balance sheet assets	Securities	Derivative financial instruments	Total
Financial institutions	**122033**	**87166**	**50802**	**260001**
Savings banks + regional banks	60338	26398	2821	89558
Private banks	17811	31823	37495	87129
Other banks	14949	8752	5313	29015
Financial services (excluding banks and insurance companies)	28935	20192	5172	54299
Companies and organizations, private individuals, sole enterprises	**114000**	**9272**	**26630**	**149902**
Automobiles	12600	1064	3540	17204
Construction	7910	280	784	8974
Cross-industry service for companies	4275	123	314	4712
Commercial real estate	22545	1046	388	23979
Foodstuffs and other non-cyclical consumer goods	4473	346	1530	6349
Telecommunications	1644	1015	3251	5911
Transport and logistics	6007	680	638	7326
Health care	4427	36	209	4672
Insurance	2640	944	3086	6671
Utilities	11099	553	2783	14434
Other broadly diversified sectors	36380	3185	10105	49669
Public sector	**32193**	**26899**	**21726**	**80818**
Employed private individuals	**20792**	**14**	**137**	**20943**
Total	**289018**	**123351**	**99295**	**511664**

Figure 6: Credit volume by industry (section 327 (2) no. 1 and 3 SolvV)

The »Other broadly diversified sectors« category groups summarize industries representing less than 3% of the company portfolio.

The following table shows the credit volume, broken down according to contractual residual term and type of loan.

in EUR million

Residual term	Loans, commitments and other non-derivative off-balance sheet assets	Securities	Derivative financial instruments	Total
Payable on demand	20705	0	0	**20705**
< 1 year	57590	43139	15181	**115909**
Up to 5 years	82472	51844	51502	**185818**
> 5 years	107254	26500	32612	**166367**
No information	20998	1868	0	**22866**
Total	**289018**	**123351**	**99295**	**511664**

Figure 7: Credit volume by residual term (section 327 (2) no. 1 and 4 SolvV)

Definitions of loan loss provisions

Information on procedures applied in the recognition of loan loss provisions is disclosed in the »Credit risks« chapter in the Risk Report within the Group Management Report and in the »Allowance for Losses on Loans and Advances« chapter in the Notes to the Consolidated Financial Statements.

LBBW distinguishes between two types of commitment where there has been a default on payment:

A transaction is defined as »in arrears to a significant extent« when the committed credit facility (including a minimum limit) is exceeded. This is the case when there are arrears in the form of unpaid interest or principal and other receivables for more than five days.

A customer is considered »in default« when

- a valuation allowance has been set up (this is the case when there is an objective indication of an impairment)
- the customer was given a default rating in accordance with section 125 SolvV or
- payment of one of the customer's loans is in default by at least 90 days

and the above criteria are not cancelled out by a current recovery report.

Defaulting and past-due loans by region and industry

The following tables show defaulting and past-due loans and the reporting date balances for loan loss provisions and changes therein during the 2009 fiscal year.[1]

The following table shows loans in default and in arrears, broken down by region.

in EUR million

Region	Total utilization of loans in default and in arrears (with write-down requirements)	Loans in arrears (without write-down requirement)	Individual valuation allowance	Portfolio valuation allowance	Provisions
Germany	4173	66	2169	236	116
Western Europe	1806	0	805	50	67
Eastern Europe	217	1	82	20	9
Asia/Pacific	104	0	42	12	1
North America	888	0	319	41	6
Latin America	105	0	29	6	1
Africa	2	1	4	0	0
Other	5	0	8	3	0
Total	**7298**	**69**	**3458**	**369**	**199**

Figure 8: Loans in default and in arrears, broken down by region (section 327 (2) no. 5 SolvV)

[1] Rounding differences of +/– one unit may arise in the tables due to computational reasons

The following table shows loans in default and in arrears, broken down by internal risk-oriented industry category.

in EUR million

Industry	Total utilization of loans in default and in arrears (with write-down requirements)	Loans in arrears (without write-down requirement)	Individual valuation allowance	Portfolio valuation allowance	Provisions	Net additions/ reversals of specific valuation allowances/ global valuation allowances/ provisions	Direct write-downs	Direct write-downs/ reversals of write-downs on investment securities	Recoveries on loans previously written off
Financial institutions	**1 739**	**0**	**917**	**42**	**56**	**383**	**18**	**542**	**4**
Savings banks + regional banks	0	0	1	0	0	1	0	0	0
Private banks	956	0	565	12	2	191	4	60	1
Other banks	92	0	4	7	0	10	12	–4	1
Financial services (excluding banks and insurance companies)	691	0	347	23	54	181	3	487	2
Companies and organizations, private individuals, sole enterprises	**5 141**	**46**	**2 373**	**262**	**137**	**997**	**36**	**–52**	**6**
Automobiles	839	0	458	48	21	312	15	0	0
Construction	522	0	232	25	19	59	2	0	0
Cross-industry service for companies	173	1	95	8	1	34	2	0	0
Commercial real estate	1 405	38	600	41	32	183	1	7	0
Foodstuffs and other non-cyclical consumer goods	43	0	16	4	1	9	0	0	0
Telecommunications	41	0	28	1	1	2	0	0	0
Transport and logistics	202	0	81	14	2	43	0	0	0
Health care	135	1	52	6	1	–5	1	0	0
Insurance	42	0	4	2	0	0	0	0	0
Utilities	81	0	55	6	3	35	0	0	0
Other broadly diversified sectors	1 659	5	751	106	56	324	14	–59	6
Public sector	**6**	**16**	**4**	**2**	**2**	**2**	**2**	**0**	**0**
Employed private individuals	**413**	**7**	**165**	**63**	**5**	**–20**	**15**	**1**	**0**
Total	**7 298**	**69**	**3 458**	**369**	**199**	**1 362**	**72**	**492**	**10**

Figure 9: Loans in default and in arrears, broken down by industry (section 327 (2) no. 5 SolvV)

Development of loan loss provisions on loans and advances

The following table shows the change in loan loss provisions in the 2009 fiscal year.

in EUR million

	Opening value Jan. 1, 2009*	Additions	Reversals	Utilization	Exchange rate-related and other changes	Closing value Dec. 31, 2009
Individual valuation allowances	2157	1796	554	115	174	3458
Portfolio valuation allowances	296	288	206	9	0	369
Provisions	184	113	75	23	0	199
Total	**2637**	**2197**	**835**	**147**	**174**	**4026**

* Deviations from the previous year are due to the altered scope of consolidation.

Figure 10: Development of loan loss provisions on loans and advances (section 327 (2) no. 6 SolvV)

There is a difference between the risk costs recognized in the annual financial statements under IFRS (risk provisioning for loans and advances) and the net amount from additions and reversals recognized in the table above. This results from reversals from unwinding (discounting interest income for one year in accordance with IFRS) or from discounting of provisions which are included in this Disclosure Report in the »Reversals« column but are not included in the risk costs pursuant to IFRS. In addition, there is differing recognition for the whole development of risk provisioning due to the fact that the scope of consolidation is not the same (see page 15).

6 Counterparty risk in the CRS approach. (section 328 SolvV)

In order to calculate regulatory equity requirements according to the credit risk standard approach, only external credit rating assessments from the following three ratings agencies are consulted:

- Standard & Poor's Ratings Services
- Moody's Investors Service
- Fitch Ratings Ltd.

These are applied on a standardized basis for all relevant CRSA receivables classes.

If a position-based external rating does not exist for a receivable in CRSA, this is considered unrated. For items that do not have a rating (with the exception of those for which there is an effective short-term credit rating assessment in accordance with section 45 (1) SolvV), the Bank must assign an effective credit rating assessment by means of comparative receivables.

Under section 45 (2) SolvV, comparative receivables are receivables which must be assigned to a CRSA item from the same obligor and for which there is a usable issue rating from a ratings agency nominated by the Bank. The grade of the comparative receivable must be taken into account when deriving the credit rating assessment to be used.

In LBBW, potential further (comparative) receivables from the same obligor which have a usable issue rating are calculated mechanically using customer-related information. Using the stipulated selection criteria, the reporting software will then allocate a rating to the previously unrated receivable if available.

Total position values under the CRS approach and IRB approach position values calculated using the simple risk-weighting method

The following table shows position values by risk-weighting based on external ratings or fixed regulatory flat-rate weighting.

For the CRS approach, position values are presented before and after credit risk minimization effects from collateral. Due to financial collateral, there may be both a change within the risk weight classes and a decrease in the volume of the position values.

IRB approach positions with a fixed risk weight are also reported in the table. These are position values for investments, for items secured with real estate liens and for special-purpose finance. Accordingly, items in the investments receivables class in accordance with section 98 SolvV which are not traded on the stock exchange and are part of a sufficiently diversified portfolio are reported with a risk weight of 190%. Investments traded on the stock exchange are recognized with a risk weight of 290% and all other investments with a risk weight of 370%. If an item secured with real estate liens in accordance with section 85 (5) SolvV is reported, this is given the alternative risk weight of 50%. In the case of special-purpose finance in accordance with section 97 SolvV, these are recognized at risk weights of between 0% and 115% or of 250%, depending on the remaining term and risk weight class.

in EUR million

Risk weight	Total position values before credit risk minimization under CRSA	Total position values after credit risk minimization under CRSA	IRB approach (investments, positions secured by real estate liens and special-purpose finance)
0%	92 987	97 666	60
10%	2	2	
20%	5 876	6 332	
35%	7 870	7 870	
50%	1 045	1 077	1 013
70%			398
75%	11 441	9 561	
90%			708
100%	47 622	24 693	
115%			674
150%	1 777	1 660	
190%			122
200%	0	0	
250%			0
290%			28
350%	0	0	
370%			623
1 250%	28	0	
Capital deduction	208	208	
Total	**168 856**	**149 069**	**3 626**

Figure 11: Total position values under the CRS approach and IRB approach position values subject to the simple risk-weighting method (section 328 (2) and section 329 SolvV)

7 Counterparty risk in the IRB approach. (section 335 SolvV)

Since January 1, 2008, LBBW has been granted admission to the basic IRB approach for both the Bank and further companies of the LBBW Group. Since then, regulatory capital backing has been based on the following rating systems in line with the IRB approach:

- Banks
- Country and transfer risks
- Insurance
- Project finance
- Corporates
- International real estate finance
- Savings bank real estate business
- German Savings Bank Association Joint Liability Scheme
- German Savings Bank Association Standard Rating Procedure
- Specific special rating classes
- IAA procedure for measuring securitizations

For all other portfolios of the LBBW Bank and all other companies included in the regulatory scope of consolidation of the LBBW Group which do not yet use the IRB approach, the transition regulation is used, i. e. temporarily handling these in line with the CRS approach.

By 2012, all materially significant portfolios and subsidiaries will be handled in line with the IRB approach. There is an approved implementation plan for the transition of these portfolios to the IRB approach for both the LBBW Group and the LBBW Bank.

LBBW applies the regulation on portfolio business eligible for exceptions in accordance with section 68 (3) SolvV for private building finance entered into before November 1, 2006 and the option of portfolio protection for investments in accordance with section 338 (4) SolvV. Accordingly, capital backing for these positions is calculated in line with the regulations of the CRS approach.

Description of the internal rating procedures

The internal rating procedures of LBBW can basically be divided into two categories:

- scorecard-based rating procedures
  A scorecard procedure is a standardized valuation procedure. The development of these procedures consists of the valuation of quantitative and qualitative factors and is supplemented by the inclusion of liability relationships. Finally, transferences and warning signals are included in the rating result.

- simulation-based rating procedures
  In contrast to a scorecard-based rating procedure, which estimates the probability of default on the basis of the current status of factors, a simulation-based rating generates scenarios for the future cash flow development of, for example, a project finance company (SPV). This process analyses the entire term of the exposure and its structure. In addition, the simulation also includes macroeconomic scenarios (e. g. interest and exchange rates) if relevant.

The following table gives a detailed overview of the various rating procedures.

Business area	Sub-group	Rating/ assessment procedure	Method
Private and investment customers	**Private loans**	For liabilities > EUR 500 thou. (of which unsecured > EUR 250 thou.): basic RKV	Expert-based procedure
	Dependent individuals with private building finance	Application scoring for building finance Portfolio scoring for building finance In future: savings banks customer scoring	Scorecard
Corporate customers	**Basic customers**	Savings banks standard rating plus customer compact rating (liabilities between EUR 50 thou. and EUR 250 thou.)	Scorecard Scorecard
	Business customers		
	Corporate customers		
	Corporate customers/ key accounts	Rating for corporates	Scorecard
	Non-profit organizations	Basic RKV	Expert-based procedure
	Start-ups	Basic RKV	Expert-based procedure
Project and special-purpose finance	**National commercial real estate**	Savings bank real estate rating	Simulation-based calculation
	International commercial real estate	Rating for international commercial real estate (ICRE), RKV for special-purpose finance if applicable	Simulation-based calculation
	Open-ended real estate funds	Rating for open-ended real estate funds	Scorecard
	Aircraft finance	Airlines: Rating for corporates	Scorecard
		SPC: Rating for aircraft finance, RKV for special-purpose finance if applicable	Simulation-based calculation Scorecard
	Ship finance	RKV for special-purpose finance	Scorecard
	Other project finance	Rating for project finance, RKV for special-purpose finance	Simulation-based calculation Scorecard
	SPC real estate leasing	Rating for leasing refinancing	Simulation-based calculation
	Leverage finance	Rating for Leverage Finance	Scorecard
	Structured export finance	Rating for structured commodity trade finance (SCTF)	Scorecard

Business area	Sub-group	Rating/ assessment procedure	Method
Wholesale	**Banks**	Rating for banks	Scorecard
		Rating for German Savings Bank Association Joint Liability Scheme	Simulation-based calculation
	Insurance companies	Rating for insurance companies	Scorecard
	Leasing companies	Rating for leasing companies	Scorecard
	Securitization positions for own ABCP program	Internal classification procedure for securitizations for ABCP program	Simulation-based calculation
	Synthetic CDO securitization tranches	If no external rating available: CDO shadow rating	Simulation-based calculation
	Securitization positions for SEALINK structure	RKV SEALINK	Simulation-based calculation
	Other securitization transactions	RKV for ABS	Simulation-based calculation
	National government units/ public sector loans	Rating inheritance	n/a
	International government units	Rating for international government units	Scorecard
	Municipal corporations	Savings banks standard rating Corporates rating Basic RKV	Scorecard Scorecard Expert-based procedure
	Sovereigns & transfer risks	Rating for country and transfer risks	Scorecard
	Government supported enterprises (GSE)	RKV for government supported enterprises	Scorecard
	Hedge funds	RKV hedge funds	Scorecard
	Holding/Group structures	Basic RKV	Expert-based procedure
	Strategic investments	Suitable rating in each case (bank investments with bank rating etc.), provided there is no reason to forgo a rating. Otherwise basic RKV	Subject to procedure Expert-based procedure

Figure 12: Internal rating procedures of LBBW (section 335 (1) no. 2a SolvV)

All rating procedures produce a result in terms of a one-year probability of default in the local currency (local currency PD). The transfer risk which is sometimes present is taken into account in foreign currency (foreign currency PD). Using the master scale used uniformly within the Savings Banks Finance Group, these probabilities of default are translated into a rating class. The master scale differentiates between a total of 18 rating classes, the first of which is divided into eight further sub-classes. Rating classes 16 to 18 are default classes.

		LBBW rating master scale	Probability of default (%)
Creditworthiness classes	**Investment grade**	1(AAAA)	0.00%
		1(AAA)	0.01%
		1(AA+)	0.02%
		1(AA)	0.03%
		1(AA–)	0.04%
		1(A+)	0.05%
		1(A)	0.07%
		1(A–)	0.09%
		2	0.12%
		3	0.17%
		4	0.26%
		5	0.39%
	Speculative grade	6	0.59%
		7	0.88%
		8	1.32%
		9	1.98%
		10	2.96%
		11	4.44%
		12	6.67%
		13	10.00%
		14	15.00%
		15	20.00%
	Default classes	16	100.00%
		17	100.00%
		18	100.00%

Figure 13: LBBW rating master scale (section 335 (1) no. 2a SolvV)

Further use of internal estimates

The internal rating procedures of LBBW are key instruments in the credit process and credit risk management. As a component of the credit application and the foundation for calculating competency levels, the rating results are incorporated into the lending process. The rating results are also used to determine the credit risk strategy, define support intensity and calculate the standard risk costs.

The ratings form a basis for the overall bank management instruments of portfolio management, capital allocation, stress tests and risk-bearing capacity and influence the calculation of impairment in line with IFRS.

Control mechanisms for the rating systems

Within LBBW, responsibility for the rating systems lies with the credit risk controlling department, which operates independently of front office and back office up to the Board of Managing Directors level. Credit risk controlling plays the role of the counterparty risk monitoring unit and is responsible in particular for the design, selection, introduction, ongoing monitoring and performance of rating systems.

The majority of rating procedures at LBBW were developed in joint projects, further work on which was put on a new legal and organizational basis by forming Sparkassen Rating und Risikosysteme GmbH, Berlin (SR) and RSU Rating Service Unit GmbH & Co. KG, Munich (RSU). SR is responsible for processes for commercial savings banks customers (corporate and business clients, retail clients and commercial real estate finance). All other jointly developed processes are regularly maintained and developed further as appropriate by RSU. The staff of LBBW support these activities.

The rating systems of LBBW are subject to a regular update process, the central element of which is conducted under the guidance of RSU or SR (this activity was outsourced in line with section 25a KWG and presented accordingly). The database consists of the pooled data of RSU (pooled data for Landesbanken) and SR (pooled data from Landesbanken and savings banks).

The core element of the maintenance process is the annual validation, the central task of which is backtesting, benchmarking and checking the model design and data quality. The results are presented to a working group responsible for independently reviewing the validation and ensuring the consistency of the methods used for all processes in all modules. In validation, the rating procedure and its parameter estimates are either confirmed or adjusted and optimized as necessary. Before introducing modified procedures, LBBW performs a test to ensure representativeness. In turn, this ensures that the rating procedures are also accurate and valid for the LBBW portfolio and can therefore be applied without restriction. In addition, the correct use of rating systems is checked by rating controlling at LBBW.

Process of allocating positions or obligors to rating classes or risk pools

The receivable classes are calculated at a system level located downstream from the operating posting systems. Each transaction included in an IRB approach portfolio is allocated to a receivable class. Allocation is usually based on the rating procedure used. If a clear allocation using the rating procedure is not possible, receivables classes are distinguished further on the basis of additional information, such as customer group allocation or transaction-specific information such as collateral. The rating procedures used for each class of receivable and their scope are described below. Allocation is an essential element of capital backing.

Responsibility for designing, implementing and monitoring the functionality of the internal rating procedures lies with the credit risk controlling department.

Central governments receivables class
Country and transfer risks are measured using a special rating procedure at LBBW. The key points are the economic situation, the political environment and the domestic and foreign economic trends of the respective country. The rating procedure for central governments is used to classify receivables from obligors assigned to the »central governments« IRB approach receivables class in line with section 74 SolvV.

Banks receivables class
The rating procedure for banks classifies all obligors which are assigned to the »banks« IRB approach receivables class in line with section 75 SolvV. The aim of rating procedures for banks is to measure their global risks of default. In terms of content, their use is limited to rating items that mostly perform typical banking transactions (material interpretation of the term »bank«). Thus, bank holdings, home savings and loan associations, state finance agencies, financial and finance companies and financial service providers should also be rated with the banks module regardless of their legal form if they mostly perform typical banking transactions. Similarly, institutions that do not have a banking license but effectively mostly perform typical banking activities are rated using the rating procedure for banks. Furthermore, only rating items that are subject to regulation and therefore operate in a regulated environment are rated.

Corporates receivables class
The rating systems for corporate clients classify obligors assigned to the »corporates« IRB approach receivables class in line with section 80 SolvV.
A substantial portion of this portfolio is subject to the corporates rating. Large German customers with consolidated sales of more than 100 million EUR and all international corporate clients are rated using the corporates rating. German borrowers with sales of EUR 100 million or less are rated with the standard rating and can be classified as corporates under certain conditions. Also, banks assessed with the rating procedure for insurance companies are also assigned to the corporates receivables class. The aim of the insurance company rating is to measure the risks of default for insurance companies. In this context, »insurance companies« also include companies that generate most of their income from typical insurance transactions, which also includes bancassurance providers.

Corporates receivables class: special-purpose finance subclass

The rating systems for special-purpose finance clients classify obligors also assigned to the »corporates« IRB approach receivables class in line with section 81 SolvV. They are a sub-class of the corporates receivables class.

Ratings for project finance are usually based on the cash flow or the user/recipient of the project results. Compared to other special-purpose finance, project finance is distinguished by the fact that cash flows are generated from a narrowly defined activity and not several business concepts in parallel.

Real estate loan business where the loan is served only from income in the form of rental, lease or disposal proceeds arising from the financed item are also assigned to the special-purpose finance sub-class. The rating procedure developed for this is based on the total international commercial real estate finance business if the property being financed is located abroad.

Investments receivables class

Investments are processed in a special organizational unit. Depending on the type of investment, the same rating procedures can be used as for the above receivables classes. System allocations and product numbers ensure that these can be clearly identified and thus assigned to the above receivables classes or the investments receivables class. In addition, some investments are handled using the standard approach in the context of grandfathering (portfolio protection).

Bulk business receivables class

Receivables due to LBBW which are assigned to bulk business are not yet handled in line with the IRB approach.

LBBW applies the regulation on portfolio business eligible for exceptions for private building finance. LBBW is targeting authorization to use self-estimated loss ratios (IRB Retail).

Position values by probability of default classes in the IRB approach

The following table shows the following key figures, based on the receivables classes recognized in the IRB approach – central governments, banks, corporates and investments – and broken down by risk class:

- the total position values and the position values for unutilized credit commitments
- the position values weighted with average probabilities of default (PDs)
- the position values weighted with average risk weights
- the total position values weighted with risk weights

in EUR million

Receivables class	Position values	of which outstanding credit commitments	Ø PD	Ø Risk weight	Position value weighted with risk weight
PD classes 1(AAAA) – 1(A–) 0.000% to ≤ 0.101%					
Central governments	62156	1316	0.00	2.41	1500
Banks	48321	132	0.05	14.58	7043
Corporates	17078	1515	0.06	21.06	3596
of which small and medium-sized enterprises (SME)	1346	28	0.07	16.45	221
of which special-purpose finance	2934	97	0.05	19.95	585
of which purchased receivables	0	0	–	–	0
Investments	125	0	0.02	76.62	96
Total	**127680**	**2963**			**12235**
PD classes 2 – 5 0.102% to ≤ 0.477%					
Central governments	322	26	0.20	42.50	137
Banks	11906	122	0.19	32.99	3928
Corporates	29405	3904	0.24	46.85	13774
of which small and medium-sized enterprises (SME)	1758	119	0.24	37.03	651
of which special-purpose finance	3836	121	0.25	48.16	1847
of which purchased receivables	0	0	–	–	0
Investments	241	0	0.39	189.80	457
Total	**41874**	**4052**			**18296**
PD classes 6 – 10 0.478% to ≤ 3.628%					
Central governments	564	1	0.81	75.68	427
Banks	1777	1	0.99	91.46	1625
Corporates	19812	1981	1.30	99.79	19771
of which small and medium-sized enterprises (SME)	2085	73	1.36	86.91	1812
of which special-purpose finance	6146	485	1.39	104.11	6399
of which purchased receivables	0	0	–	–	0
Investments	54	0	1.01	209.12	112
Total	**22207**	**1983**			**21935**

in EUR million Receivables class	Position values	of which outstanding credit commitments	Ø PD	Ø Risk weight	Position value weighted with risk weight
PD classes 11 – 15 3.629% to ≤ 99.99%					
Central governments	1	0	16.46	240.00	2
Banks	177	4	5.24	173.65	307
Corporates	5 819	300	10.42	192.78	11 215
of which small and medium-sized enterprises (SME)	573	11	7.92	154.40	885
of which special-purpose finance	2 624	78	12.24	211.96	5 562
of which purchased receivables	0	0	–	–	0
Investments	2	0	4.44	369.52	7
Total	**5 998**	**304**			**11 531**
PD classes 16 – 18 100% (default)					
Central governments	17	0	100.00	–	0
Banks	831	0	100.00	–	0
Corporates	4 300	86	100.00	–	0
of which small and medium-sized enterprises (SME)	280	4	100.00	–	0
of which special-purpose finance	610	34	100.00	–	0
of which purchased receivables	0	0	–	–	0
Investments	0	0	–	–	0
Total	**5 148**	**86**			**0**
Total					
Central governments	63 060	1 343	0.04	3.27	2 066
Banks	63 011	259	1.44	20.48	12 903
Corporates	76 413	7 786	6.87	63.28	48 356
of which small and medium-sized enterprises (SME)	6 042	236	5.93	59.08	3 570
of which special-purpose finance	16 150	814	6.36	89.13	14 394
of which purchased receivables	0	0	–	–	0
Investments	421	0	0.40	159.41	672
Total	**202 906**	**9 388**			**63 997**

Figure 14: Total credit volume by credit rating assessment (not including Retail) in the IRB approach (section 335 (2) no. 1, 2a and 2c SolvV)

Actual losses on loans and advances

The following table shows actual losses on loans and advances (including banking book securities and derivatives, but not including securitizations as these form a separate receivables class within SolvV). Actual losses are defined as the total of direct write-downs and additions and reversals of individual valuation allowances/provisions less recoveries on loans previously written off.

in EUR million

	Actual losses on loans and advances (including securities and derivatives)		
Receivables class	**Between Jan. 1, 2009 and Dec. 31, 2009**	**Between Jan. 1, 2008 and Dec. 31, 2008**	**Changes**
Central governments	18	0	18
Banks	308	375	– 67
Corporates	796	913	– 117
Investments	175	343	– 168
Bulk business	0	0	0
of which qualified, revolving	0	0	0
of which residential real estate loans	0	0	0
of which other	0	0	0
Total	**1 297**	**1 631**	**– 334**

Figure 15: Actual losses on loans and advances (section 335 (2) no. 4 and 5 SolvV)

The financial and economic crisis influenced the loss history of the past two years. Loan defaults, particularly in the banks and corporates receivables classes, led to continuing high actual losses. Write-downs continued to be carried out on interests impacted by the financial and economic crisis.

Expected losses and actual losses on traditional loans and advances

The following table compares the expected losses and actual losses for transactions reported under the IRB approach in accordance with SolvV in the 2009 reporting year. The information relates only to the traditional lending business (not including banking-book securities or derivatives) for the respective receivables classes in the IRB approach.

Actual losses are defined as the total of direct write-downs and additions and reversals of individual valuation allowances/provisions less recoveries on loans previously written off. Expected losses are calculated in line with the provisions of the IRB approach and include only »living transactions«, i. e. only those lending transactions which were classed as performing as at January 1, 2009. Lending transactions already in default on January 1, 2009 (probability of default (PD) of 100 %) are not included.

Comparability with the previous year's figures is only possible to a limited extent, as these did not include the transactions of the former SachsenLB and the former Landesbank Rheinland-Pfalz which came about during the course of 2008. The previous year's value also does not include transactions which were rated for the first time in 2008.

in EUR million

	Losses on traditional loans and advances (not including banking-book securities or derivatives)			
	From Jan. 1, 2009 to Dec. 31, 2009		Losses from Jan. 1, 2008 to Dec. 31, 2008	
Receivables class	**Expected losses (EL)**	**Actual losses**	**Expected losses (EL)**	**Actual losses**
Central governments	1	9	0	0
Banks	21	23	12	10
Corporates	294	263	107	120
Investments	3	2	1	0
Bulk business	0	0	0	0
of which qualified, revolving	0	0	0	0
of which residential real estate loans	0	0	0	0
of which other	0	0	0	0
Total	**319**	**297**	**120**	**130**

Figure 16: Expected losses and actual losses on traditional loans and advances (section 335 (2) no. 6 SolvV)

Credit deteriorations resulting from the crisis, particularly in the corporates receivables class, have led to a sharp increase in expected and actual losses.

8 Credit risk minimization techniques.
(section 336 SolvV)

Process of controlling and recognizing credit risk minimization techniques

Control is effected in line with the specifications in the regulations of the Bank on the types of collateral permitted and the carrying amounts. In order to include collateral in the calculation of capital adequacy, LBBW has implemented the regulatory requirements in collateral management.

Presentation of the main types of collateral

Taking costs and benefits into consideration, basically all types of collateral can be used to reduce credit risk, though fungible collateral with sustained value is preferred.

Collateral primarily includes traditional forms of collateral, such as real estate liens, guarantees, sureties, securities, pledges, assignments, and transfers of title of property. LBBW aims to achieve risk-adequate collateralization depending on the type of product, intended use, maturity, and repayment terms.

At present, the following collateral is considered to reduce weighting in the context of the SolvV:

- guarantees, particularly warranties and sureties
- real estate secured by real estate liens (already included in the receivables classification where relevant)
- registered liens (aircraft)
- securities
- life insurance
- cash contributions (in own or third-party custody)
- export credit insurance

At LBBW, guarantees/warranties from domestic and foreign local government units and banks and guaranties from state export credit insurers are of particular significance. These are usually guarantors with first class credit ratings.

In addition to conventional collateral for loans and advances, for regulatory purposes LBBW also utilizes various risk-reducing hedging instruments for trading and capital market business. It mainly uses:

- financial collateral for securities
- admissible guarantees and credit derivatives
- netting agreements for derivatives plus collateral agreements (in accordance with section 9)

Credit derivatives are mainly concluded with banks that have very good credit ratings overall. The main hedging instruments used at LBBW are also used for regulatory purposes as they satisfy the requirements of admissible credit risk reducing techniques.

The subsidiaries of LBBW do not apply any risk minimization techniques that go beyond those of the LBBW Bank.

Measuring and managing the collateral used

Credit collateral is entered in the collateral management system (SIM) with all relevant information and updated on an ongoing basis. The internal processes and systems in place ensure that collateral is only used for weighting if it meets all the requirements of the Solvency Ordinance.

The procedures for measuring and managing the collateral eligible under SolvV are compiled in the Bank's regulations. Collateral is measured on the basis of appraisals prepared by recognized experts or on the basis of conservative, internal principles, or – in the case of guarantees – on the basis of the guarantor's credit rating assessment.

Values are calculated and carrying amounts are reviewed by the back office divisions.

Collateral is measured and checked on its acceptance and usually at least once per year during the term of the credit. Regardless of this, collateral is checked for impairment immediately if negative information becomes known. If there is a significant positive correlation between the value of an item of collateral and the borrower providing the collateral, the calculated collateral value is of no significance for the credit decision.
The decision as to whether or not the transaction can be concluded without measurable collateral is made in line with the assignment of approval authorities.

In order to minimize legal risks, the legal department has developed a large number of its own contract forms and sample contracts or approved them for use by the business areas of LBBW after examining them. Legal enforceability is ensured at all times and general legal conditions are monitored on an ongoing basis.

Credit derivatives with a hedging effect are essentially charged as guarantees for regulatory purposes. The procedure for recognizing a credit derivative as collateral is set out accordingly in the internal provisions. One exception to charging credit derivatives as guarantees is balance sheet forms of credit derivative, for example own issues in credit linked notes as the protection purchaser, which are charged as cash hedging, i. e. as financial collateral.

Management of concentration risks in the credit and collateral portfolio

In measuring the risk arising from collateral, LBBW distinguishes between collateral in conventional lending business and collateral in trading business. Concentrations of collateral in capital market business are limited by a restrictive collateral policy. Individual and portfolio risks (e. g. those in relation to repo and securities lending transactions) are regularly monitored by means of a steering committee within trading. Guarantees and credit derivatives are concluded with counterparties with strong credit ratings and are charged at the corresponding individual limits. Concentrations of collateral in the case of OTC derivatives are prevented by only accepting cash collateral or first class government bonds. In addition, timely measurement of collateral contributes to risk limitation.

The collateral portfolio of LBBW in the conventional lending business is broken down into personal collateral, balances and securities, as well as real estate as the main protection instrument. Options exist for evaluating real estate, e. g. according to region or type of use. The collateral portfolio is regularly presented in management reporting and includes LBBW's largest collateral providers.

Total amount of secured position values (not including securitization)

The following table shows the position values by CRSA receivables classes secured by financial collateral or guarantees (including warranties and credit derivatives).

in EUR million

Receivables class	Financial collateral	Guarantees
Central governments	0	0
Regional governments	1	0
Other public sector	1	3
Multilateral development banks	0	0
International organizations	0	0
Banks	10989	4
Covered bonds issued by banks	0	0
Corporates	9203	14433
Bulk business	398	87
Items collateralized with real estate	0	0
Investment units	0	0
Investments	0	0
Other items	28	0
Past-due items	1	11
Total	**20621**	**14538**

Figure 17: Total amount of the secured position values in the CRS approach (not including securitization) (section 336 no. 2 SolvV)

The following table shows the position values by IRB approach receivables classes secured by financial collateral, other/physical collateral or guarantees (including warranties and credit derivatives).

in EUR million

Receivables class	Financial collateral	Other/physical collateral	Guarantees
Central governments	370	0	456
Banks	16 712	1	3 517
Corporates	2 206	6 785	7 156
Bulk business	0	0	0
of which qualified, revolving	0	0	0
of which residential real estate loans	0	0	0
of which other	0	0	0
Investments	0	0	0
of which: simple risk-weighting approach	0	0	0
of which: model-controlled	0	0	0
of which: PD/LGD approach	0	0	0
Other assets not dependent on credit	0	0	0
Total	**19 288**	**6 786**	**11 129**

Figure 18: Total amount of the secured position values in the IRB approach (not including securitization) (section 336 no. 2 SolvV)

9 Derivative counterparty risks.
(section 326 SolvV)

The exchange-traded derivatives used by LBBW (including options and futures) are generally settled via a central counterparty (e. g. Eurex Clearing).
In the case of OTC derivatives, LBBW concludes master agreements with the individual counterparties.

Capital allocation on the basis of economic capital

LBBW does not carry out specific capital allocation or separate limiting for default risks as regards counterparties with derivative items. This is carried out in line with the generally applicable processes for limiting counterparty risks – see section 4 »Economic capital management«.

Risk reduction measures

At LBBW, risk reduction measures in connection with derivative counterparty risk positions are applied through the conclusion of master netting agreements and the hedging of OTC derivatives.
The procedure for concluding and managing master agreements for OTC derivative netting and collateral agreements is stipulated in the internal regulations of the Bank and the working instructions of the responsible back office. Netting for OTC derivatives has been used for equity and interest rate derivatives since 2002, since 2004 for currency derivatives and since 2009 for trading book credit derivatives.
Furthermore, derivative transactions are concluded with savings bank customers via an intermediary procedure, which are guaranteed by the intermediary savings bank.

Impact of a rating downgrade on the collateral amount

In the majority of cases, the agreements concluded do not provide for an increase in collateral in the event of an LBBW rating downgrade. However, a gradual increase in collateral is provided for in the event of a downgrade of LBBW for some individual counterparties.

Loan loss allowances

At LBBW, loan loss allowances for derivatives are formed by including the fair values in the measurement basis for valuation allowances. This applies both for HGB and for IFRS.

Correlation between market price risks and credit risks

Market price risks and credit or counterparty risks are pooled using economic capital within the Group-wide economic capital limit.

The economic capital of the various risk categories is aggregated taking correlations into account. Assumption of correlations between market price risks and credit risks is based on an independently validated expert estimate and is considered by LBBW as a conservative value.

Derivative counterparty risk positions, netting positions and collateral

The following table shows the derivative counterparty risk positions in the form of the positive market values (corresponds to the potential replacement costs before add-on in accordance with section 19 SolvV) before and after charging derivative netting positions and collateral, broken down by types of contract.

in EUR million

Type of contract	Positive replacement costs before netting and collateral	Netting options	Eligible collateral	Positive replacement costs after netting and collateral
Interest rate contracts	32 872			
Currency contracts	4 383			
Share/index contracts	2 104			
Credit derivatives	819			
Commodity contracts	65			
Other contracts	3			
Total	**40 246**	**33 650**	**1 168**	**5 428**

Figure 19: Positive replacement costs before and after charging netting agreements and collateral (section 326 (2) SolvV)

Unlike in the annual report, here transactions are classified according to the definition of market risk positions in SolvV.

The following table shows the creditable counterparty default risk for derivative default risk positions in the form of the position value after credit risk minimization (conversion factor (CCF) generally not taken into consideration for derivatives) for the respective method used. LBBW uses the market measurement method for this.

in EUR million

	Duration method	Market measurement method	Standard method	Internal model
Counterparty default risk positions	0	17 399	0	0

Figure 20: Counterparty default risk (section 326 (2) SolvV)

The following table shows the nominal value of credit derivatives eligible for regulatory purposes which are used for hedging purposes.

in EUR million

	Nominal value of hedge
Credit derivatives (protection buyer)	2 913

Figure 21: Nominal value of credit derivatives for hedging purposes (section 326 (2) SolvV)

The following table shows the nominal values of the credit derivatives bought and sold for LBBW's own credit portfolio, broken down by type of credit derivative. Credit derivatives from brokering activities were not used by LBBW in 2009.

in EUR million

	Nominal value from utilization for own credit portfolio	
Type of contract	**Bought**	**Sold**
Credit default swaps	33 082	56 745
Total return swaps	2 294	2 000
Credit linked note	915	142
Other	0	0
Total	**36 291**	**58 887**

Figure 22: Nominal value of credit derivatives by type of use (section 326 (2) SolvV)

10 Securitizations.

(section 334 SolvV)

LBBW acts on the financial markets as an investor, sponsor and originator of securitization positions.

LBBW acts as a sponsor and/or arranger of securitization programs in the context of customer transactions, offering the customers innovative, capital market oriented financing alternatives. Furthermore, LBBW primarily played the role of an investor for securitization in the credit substitute business.

As an **investor**, LBBW is predominantly involved with the following types of product: collateralized debt/loan obligations (CDO/CLO), residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), and other asset-backed securities (ABS). In addition, LBBW also invests in synthetic CDOs, where firstly in the context of relative value strategies protection is bought and sold on different parts of the capital structure, and secondly, from a risk/return point of view, investments are made in selected parts of the capital structure.

The securitization positions in which LBBW invests are rated by at least one or usually two recognized rating agencies (Standard & Poor's, Moody's or Fitch Ratings) and generally have a good to first-class rating.

LBBW did not enter into any significant new business as an investor in the area of securitizations in 2009. It has been decided that the credit substitute business will be scaled back as part of the restructuring of LBBW. This decision will lead to the gradual shrinking of the portfolio of securitized products in the next few years.

However, in its role as **sponsor and/or arranger** of customer transactions, LBBW still even has the high net worth SMEs in Germany on its side in 2009 thanks to new financing solutions. For this reason, this securitization segment is not impacted by the reduction plans and is to be expanded further as part of the new target customer orientation.

As part of its securitization programs, LBBW provides the appropriate special-purpose entities with facilities to improve credit, liquidity facilities and/or refinancing facilities, as well as swap lines if necessary, in addition to its role as a service provider.

These securitization items, for which LBBW maintains risk-weighted securitization values in its role as sponsor and/or arranger, are predominantly rated using the internal assessment approach (IAA). If LBBW has also acquired commercial papers for its securitization program, these are rated by two recognized rating agencies (Standard & Poor's[1] and Moody's).

As an **originator**, LBBW has been actively involved with the ABS transactions »Entry« (borrower note loan securitization) and »Prime« (securitization of mezzanine profit participation rights under the name SmartMezzanine) since 2006. LBBW's functions here also included service provider (for Entry only), loan provider (for Prime only) and swap counterparty (in both cases) in 2009. Due to the financial market crisis, acquisition services for these two securitization programs were suspended towards the end of 2008 and no more new assets were generated for placement purposes.

[1] The rating agreement with Standard & Poor's was not extended as at the end of 2009 at the request of LBBW. This led to Standard & Poor's withdrawing the rating for the commercial papers in January 2010. As part of a program reorganization, the commercial papers are instead also rated by Fitch Ratings.

Securitizations were also carried out in 2009 with »S-Fix«, a portfolio of corporate loans. All tranches were assumed by LBBW, whereby the senior tranche can be submitted to the Bundesbank as collateral for the purposes of ECB repo transactions.

In connection with securitization transactions for which LBBW still maintains risk-weighted securitization values in its role as originator (mainly »Prime«), some of the positions are rated by the ratings agency Standard & Poor's and some remain unrated.

Presentation of the procedures for determining position values

In the IRB approach, the Bank almost exclusively uses the rating-based approach for its investment portfolio and only uses the derived credit rating assessment in line with section 256 SolvV. In the CRSA approach, the relevant paragraphs are applied for CRSA securitization items.

The majority of investments are classified as high quality and granular and almost exclusively had at least one rating from a recognized rating agency on acquisition. If there is no available external rating, the Bank uses the regulatory formula approach in line with section 258 SolvV. Synthetic investor positions are also predominantly classified using this approach.
In the case of unrated CRSA securitization positions, section 243 (2) SolvV is used.

With the exception of retail underlying tranches, true sale investor positions are recognized as securitization positions in the IRB approach. Retail underlying tranches are recognized as CRSA securitization positions.

The liquidity lines and swaps provided as part of the Asset Back Commercial Paper (ABCP) program are measured using the internal classification procedure (IAA, Internal Assessment Approach). LBBW developed and introduced appropriate models for the measurement of trading receivables, interest-bearing receivables and ABS bonds for this purpose in 2008.

Cross-program credit enhancement and purchased commercial papers (CPs) are classified as overlapping positions. This means that the risk positions are already covered by the liquidity lines, meaning that no further capital backing is necessary.

In originator activities, risk transfers are demonstrated in line with SolvV.

Accounting policies for securitizations

In its role as an originator for »Entry« and »PRIME« securitization transactions, LBBW acquired promissory note receivables and profit participation certificates up to fall 2008 as part of a regulated process and initially took these onto its own balance sheet. Receivables generated in this way were already sold onto the SPVs »Entry« and »PRIME« at the end of 2006. By performing true sale transactions, LBBW ensures that it retains neither the rights nor obligations. Therefore, under HGB (IDW RS HFA 8) and IFRS 39.20a, assets are no longer recognized on the LBBW balance sheet. However, assets which are still generated after this time and are not securitized are still recognized on the LBBW balance sheet as corresponding receivable items.

By way of contrast, in the case of the »S-Fix« securitization transaction, an economic risk transfer did not take place in accordance with HGB (IDW RS HFA 8) and IFRS 39.20a, as LBBW still holds all securitization tranches. The assets in question are therefore still recognized on the balance sheet. However, the ABS tranches acquired and the corresponding liabilities are deducted from the IFRS consolidated balance sheet due to the consolidation of the SPV.

The securitization products acquired as an investor (mainly ABS, CDO/CLO, RMBS, CMBS) are usually investment book portfolios. At the time of their acquisitions the products are assigned to the held for trading, fair value option, available for sale or loans and receivables categories under IAS 39.9 in line with their documented purpose and measured accordingly (for more information on IFRS accounting see also item 8 in the notes »Financial instruments«). Under HGB, acquired securitization products are classified as securities measured in the trading portfolio, the liquidity reserve and the portfolio as non-current assets (for information on HGB accounting see also the notes to the 2009 LBBW separate financial statements, »Accounting policies«).

HGB accounting

Trading portfolio securities are measured in line with the strict principle of lower of cost or market and write-downs are reversed as required. Gains and losses on remeasurement and realization are shown under net income from financial transactions. Current gains and losses are shown under net interest income.
Liquidity reserve securities are measured in line with the strict principle of lower of cost or market and write-downs are reversed as required. Gains and losses on remeasurement and realization are shown under amortization and write-downs and income from reversals of write-downs on specific securities. Current gains and losses are shown under net interest income.
Securities treated as non-current assets are measured in line with the moderated principle of lower of cost or market and write-downs are reversed as required. Gains and losses on remeasurement and realization are shown under amortization and write-downs and income from reversals of write-downs on securities treated as non-current assets. Current gains and losses are shown under net interest income.

IFRS accounting

Financial instruments classified as held for trading or using the fair value option are measured at fair value. Gains and losses on remeasurement and realized gains and losses are recognized under net trading income or net income from fair value option financial instruments. Current gains and losses are reported under net interest income.
Financial instruments assigned to the available for sale category are measured at fair value. Gains and losses on remeasurement are reported in equity (revaluation surplus). In the event of impairment or disposal, gains and losses on remeasurement are reported in income under net income from investment securities. Current gains and losses are shown under net interest income.
Financial instruments assigned to the loans and receivables category are measured at amortized cost. In the event of impairment, the amount is recognized in the income statement. Current gains and losses are reported under net interest income.

In assessing whether securitization products include separable, embedded derivatives or synthetic structures, LBBW distinguishes between

- non-separable cash structures, in which the backing receivables and/or securities are solely in the portfolio of the SPV issuing the securitization products and
- separable synthetic structures, where the credit risk of a portfolio of assets is mainly transferred by way of a derivative to an SPV that is not the direct owner of the portfolio.

In synthetic structures, the embedded derivatives are measured separately from the respective host contract if the securitization product as a whole has not already been assigned to the fair value option. Combinations of cash structures and synthetic structures are treated as synthetic structures for accounting purposes.

At present, LBBW predominantly uses indicative prices provided by external market data providers in fair value measurement. For some securitization products, models are used for measurement purposes.

Risk shield

Considering the turbulence in the financial markets, LBBW arranged risk protection with the state of Baden-Württemberg to protect against losses on securities at risk in the form of a guarantee structure in effect from June 30, 2009. A total guarantee of EUR 12.7 billion was granted to LBBW to hedge for losses on reference assets in the portfolio of securitized products in which LBBW has invested and for losses on loans issued by LBBW to the Irish special-purpose entity Sealink Funding.

One part of the guarantee in the amount of EUR 6.7 billion serves to hedge a portfolio of securitized products with an outstanding volume of EUR 15.3 billion (as at December 31, 2009). LBBW will bear the first losses from this guarantee portfolio up to an amount of EUR 1.9 billion. Any losses beyond this will initially be absorbed by the guarantee. Losses exceeding a volume of EUR 8.6 billion[1] will then be borne by LBBW.
The remaining EUR 6.0 billion of the guarantee relates to a loan granted by LBBW to the special-purpose entity Sealink Funding.

Total amount of securitized receivables

The total amount of receivables in the corporates receivables class effectively securitized by LBBW in its role as originator (including promissory note receivables and profit participation certificates) amounts to EUR 367 million.

These are securitized receivables which have been transferred to the special-purpose entities »Entry« and »Prime« on the balance sheet and in full. By performing true sale transactions, LBBW ensures that it retains neither the rights nor obligations. Synthetic securitizations without a transfer of receivables were not carried out.

As regards the total amount of securitized receivables for which LBBW acts as originator, EUR 35.7 million is attributable to securitized receivable amounts defined as in default (subject to rating) or in arrears. The recovery rate for this is 9.56 %. As some of the receivables classified as in default are still contractually service interest and repayments (if not bullet maturity), further recovery revenues are still expected up until the receivables become due (mainly in 2011).

[1] This amount comprises the part of the guarantee of EUR 6.7 billion and LBBW's first loss of EUR 1.9 billion.

During the current fiscal year 2009, LBBW only structured the »S-FIX« securitization transaction in its role as originator, for which no risk transfer was carried out as defined by SolvV, which is why it is not looked into in the following overview.

The following table comprises both retained securitization positions from own receivables securitized by the Bank as originator and securitization positions in connection with third-party receivables (sponsor/investor). Retained and purchased securitization positions are broken down according to the underlying Solvency Ordinance approach and the type of securitized receivable.

in EUR million

Securitization positions	Position values in CRSA	Position values in IRB approach
Receivables from home construction loans	861	1 087
Receivables from whole or partial commercial real estate loans	0	75
Receivables from companies (including SMEs)	0	5
Receivables from own and acquired lease receivables	0	72
Receivables from car finance (excluding leases)	9	18
Receivables from other retail business (e.g. credit cards, student loans)	174	1
Receivables from CDO and ABS	33	1 058
Credit improvement measures	2 263	802
Guarantee portfolio	0	15 265
Other balance sheet items	1 558	217
Total balance sheet items	**4 898**	**18 600**
Liquidity facilities	0	1 734
Derivatives	3	19
Positions specifically for synthetic transactions	0	226
Other non-balance sheet items	0	98
Total non-balance sheet items	**3**	**2 077**
Total	**4 901**	**20 677**

Figure 23: Total amount of retained or purchased securitization positions (section 334 (2) no. 3 SolvV)

The guarantee portfolio includes securities from various types of securitization positions.

The following table shows the respective position values and capital backing for securitizations, broken down by risk-weighting bands, for the CRS and IRB approach.

in EUR million

	CRSA		IRB approach	
Risk-weighting band	**Position values**	**Equity requirement**	**Position values**	**Equity requirement**
≤ 10%	0	0	16413	60
> 10% ≤ 20%	2483	40	552	8
> 20% ≤ 50%	87	1	856	26
> 50% ≤ 100%	756	38	396	28
>100% ≤ 650%	1558	148	176	48
>650% ≤1 250%/capital deduction	17	17	2284	1294
Total	**4901**	**244**	**20677**	**1464**

Figure 24: Total amount and equity requirements for retained or purchased securitization positions according to risk-weighting bands (section 334 (2) no. 4 SolvV)

The provisions of the Solvency Ordinance apply for the information provided in Figures 23 and 24. These may differ from the presentation for securitization positions shown in other reports.

11 Investments in the banking book.

(section 332 SolvV)

LBBW distinguishes between its own strategic investment business and its commercial investment business. In line with risk and return considerations, the former serves to help the Bank achieve its operating policy, thus strengthening the market position of LBBW in terms of target customers and key products. By outsourcing market, staff and operating functions into subsidiaries and equity holdings, this allows for the ideal utilization of market potential. On the other hand, as an independent business area, the commercial investment business provides a range of products/services, particularly for the small and medium-sized customers of LBBW, and includes credit-equivalent or credit-substituting commitments aimed at generating risk-adequate margins.

The same profitability requirements generally apply for LBBW's own strategic investment business and its commercial investment business as for its front office divisions.

In addition to the equity investments that are consolidated for regulatory purposes or deducted from liable equity capital (see section 3 Scope, Figure 1), LBBW also has further investments in its banking book with capital backing in the context of the IRB or CRS approach.

On the date of acquisition, the investments – if not consolidated – are measured at cost in line with IFRS provisions and subsequently at fair value. For listed companies, the respective market price as of the balance sheet date is used for valuation. For non-listed companies, the fair value is calculated on the basis of available multi-year planning with the help of an earnings power model in line with the provisions of the Institut der Wirtschaftsprüfer (IDW). In special cases, valuations are made using alternative procedures based on real estate, portfolio or transaction values. In the event that no valuation procedure can be used in an individual case, then this is valued at amortized cost.

For regulatory purposes, LBBW distinguishes between investment positions which are part of a portfolio managed in terms of probability of default (PD/LGD method) and those handled using the simple risk weighting method. Investment positions which were already held before January 1, 2008 are exempt from the application of the IRB approach in accordance with section 338 (4) SolvV (grandfathering regulation) and may therefore continue to be provisionally reported in the CRS approach.

Carrying amounts of investment instruments in the banking book

The following table is broken down by type of investment item and the extent to which they can be traded for investment items which are not consolidated and are not deduced from liable equity capital and shows both the balance sheet value and the fair value. For listed companies the fair value is the stock market value. If a fair value has not been calculated for internal or external purposes, then the carrying amount is used.

in EUR million

Groups of investment instruments	Carrying amount in accordance with HGB	Fair value	Stock market value
Investments in banks	**99**	**118**	**0**
of which: exchange-traded	0	0	0
of which: not traded on an exchange, but part of a sufficiently diversified investment portfolio	99	118	
Investments in financial services institutions	**0**	**0**	**0**
of which: exchange-traded	0	0	0
of which: not traded on an exchange, but part of a sufficiently diversified investment portfolio	0	0	
Investments in other companies	**804**	**781**	**302**
of which: exchange-traded	361	302	302
of which: not traded on an exchange, but part of a sufficiently diversified investment portfolio	443	479	
Subsidiaries – banks	**8**	**8**	**0**
of which: exchange-traded	0	0	0
of which: not traded on an exchange, but part of a sufficiently diversified investment portfolio	8	8	
Subsidiaries – financial services institutions	**0**	**0**	**0**
of which: exchange-traded	0	0	0
of which: not traded on an exchange, but part of a sufficiently diversified investment portfolio	0	0	
Subsidiaries – other companies	**265**	**315**	**4**
of which: exchange-traded	4	4	4
of which: not traded on an exchange, but part of a sufficiently diversified investment portfolio	261	311	
Total	**1 176**	**1 222**	**306**

Figure 25: Carrying amounts of investment instruments in the banking book (section 332 no. 2 SolvV)

The following table reports realized and unrealized gains and losses from banking book investment business for the reporting period and in accordance with IFRS accounting.

in EUR million	
Realized gains and losses from sales and settlement	**– 12**
Unrealized gains and losses from investment instruments	**46**
of which amounts recognized:	**0**
in Tier 1 capital	0
in Tier 2 capital	0

Figure 26: Realized and unrealized gains/losses from investment positions (section 332 no. 2 SolvV)

12 Market price risk.
(section 330 SolvV)

LBBW defines market price risks as potential losses resulting from unfavorable changes in market prices. This includes share prices, interest rates, exchange rates, credit spreads and commodities prices as well as volatility or correlations as market parameters.

The market risk positions of LBBW are measured daily in the Group Risk Control division on a mark-to-market basis. Business results are calculated on the basis of this. Market price risks are quantified using a value-at-risk approach, which is supplemented by sensitivity measurements and stress tests. The risk indicators are accompanied by corresponding portfolio limits, which are used to limit market price risks.

Internal model in accordance with the German Solvency Ordinance

At LBBW, the value-at-risk (VaR) from market price risks is calculated at a confidence level of 99% and a holding period of ten days. A 95% confidence level and one-day holding period are applied for internal Bank management purposes. This calculation is based on a procedure involving a traditional Monte Carlo simulation. In most cases, the simulation enables LBBW to not simply estimate market-induced value fluctuations, but to measure them fully, even for complex transactions. Historical time series for the preceding 250 days are equally weighted in covariance estimates. LBBW's market risk model is also used for subsidiaries of the Group that are integrated in Group-wide standardized management based on the value-at-risk risk indicator.

Capital backing using LBBW's internal risk model is based on the so-called »Solvency Ordinance portfolio«. This consists of all trading book positions excluding investment funds. Capital backing is undertaken for the general interest rate and share risks as well as the associated option price risks in this portfolio.

At LBBW, market price risks are consistently measured in the trading book and banking book using the same VaR methodology. Trading portfolios and the strategic position of the banking book can be affected by potentially detrimental developments in market interest rates. Both absolute levels and the shape of the yield curve can have a significant influence on the LBBW interest position. These types of developments are included in full in the simulations used in calculating VaR. Moreover, basis risks that arise due to relative movements of various interest rate markets in relation to each other are included in risk calculations. Basis risks are very strongly dependent on the correlation of the underlying yield curves.

Credit spread risks from bonds and ABSs are measured with the general and issuer-specific-risk. For this purpose, the transactions of the trading book and the banking book that are sensitive to creditworthiness are mapped onto rating- and industry-dependent yield curves. This is carried out for all transactions executed through the trading system (in particular fixed-income securities) and also for the traditional lending business. The issuer-specific risk is calculated using the spread (and the spread volatility) of individual clients.

In the course of the financial market crisis, the credit spread risks have become an important part of LBBW's market price risk. The credit spread risks from all credit derivatives are determined using a multi-index model. The respective credit spreads of the reference debtor are entered into the risk calculation.

Equity risks, along with foreign exchange and commodities risks, are less significant for LBBW than interest rate and spread risks. The former also include risks from precious metals and currency portfolios, which LBBW only holds to a limited degree.

Backtesting and validation

The VaR value calculated by the risk model represents a statistical forecast of expected portfolio losses from market price risks over the respective time periods. In order to verify the suitability of the model, it is necessary to test the quality of forecasts. This is carried out as part of a regular validation process using various validation and analysis procedures. This can initially be assessed by means of backtesting. In concrete terms, this process involves counting the number of times VaR is exceeded by actual portfolio value changes (called »outliers«) as the result of changes in market data. The Solvency Ordinance portfolio, which comprises the trading portfolios, for which capital adequacy for general equity and interest rate risks is measured using the internal risk model, did not show any outliers. This means that no additional equity needs to be recognized for model outliers for regulatory purposes.

As well as backtesting, further quantitative validation procedures are used and the risk model is assessed on a qualitative basis. This includes a discussion of the model design, resulting in particular in model risks being identified. Such model risks are examined, e. g. in the area of stochastic risk modeling. The forecast quality of a VaR model also depends on the quality of measurement methods in place within the risk model. Market data ultimately constitutes a key factor in the success of VaR forecasts. This is entered into the measurement models and is thus a key factor in determining the quality of the simulated portfolio measurements. In addition, the future risk conduct (volatility and correlations) for the individual market factors is derived from the price histories for these factors.

Model risks are measured with regard to their materiality and are entered into the release planning for the risk model subject to the need for action. Model changes are carried out according to the »Model Change Policy« and communicated to the supervisory authorities.

Stress tests

Stress testing is used to examine how the value of the portfolio changes under extreme market conditions. Historical and synthetic (self-defined) scenarios are established in LBBW's risk system. Synthetic scenarios mainly refer to selected market factor groups (such as interest shifts, share shifts) or stress testing of basis risks (e. g. of different yield curves). Historical scenarios have been generated from data analyses of market shocks, with stress tests for the financial crisis having been specifically added to the scenarios in question. These scenarios are applied to the portfolio on a weekly basis together with the specified market data changes, and changes in present value are reported as the stress test value. Financial market scenarios are currently of huge importance to LBBW. By means of the scenarios »EUR financial market crisis«, »Subprime crisis« and »Lehman crisis«, the historical market data changes for the financial market crisis of summer 2007 and the start of 2008 as well as the most recent crisis triggered by the insolvency of Lehman Brothers in autumn 2008 are all included in stress testing. In this process, the market data for the observed period was analyzed by us and implemented in the respective scenario.

The most significant stress values for the LBBW Group up to December 31, 2009 are shown in the following table.

CBS-CDS, Euro financial market crisis of summer 2007
10-day spread increase in bond and CDS sector (Shift in Euro financials yield curves up to +38 bp, CDS spreads up to 260% after mapping, remaining guarantors +5%)
Shares – 10%, share volatility +5%
Subprime, US mortgage market crisis at the start of 2008
10-day spread increase in bond and CDS sector (Shift in all yield curves up to –69/+72 bp, CDS spreads up to 170% after mapping, remaining guarantors +5%)
Shares +5%, share volatility +5%
Lehman crisis of fall 2008
10-day spread increase in bond and CDS sector (Shift in all yield curves up to –313/+358 bp, historic displacement of CDS Spreads on an individual basis according to guarantor)
Shares –24%, share volatility +40%

Figure 27: Stress test scenarios (section 330 (2) no. 1 SolvV)

The interest rate shock defined in BaFin Circular 07/2007 is also calculated regularly for the banking book (Basel II – Interest Rate Shock). Experience shows that the change in present value as its effect very clearly falls within the thresholds defined there.

Measurement of trading book positions

LBBW measures its trading book positions at market prices which are obtained on a daily basis from sources independent of trading and are quality assured specially or which are supplied by the trading units and examined in Risk Control. Risk Control also has consistent standards and processes to carry out an independent price verification (IPV) process, in which trading prices are monitored on an independent basis. The providers of market data used include Reuters, Bloomberg, MarkIT and UBS. If the data are not directly observable on the market, then LBBW uses measurement models which include the parameters derived from market prices. As a result of the prudence principle, measurement provisions for model risks have also been recognized.

Equity requirements for market risk positions

The following table shows the equity requirements for market price risks broken down by the following types of risk:

in EUR million

	Equity requirement	
	Standard method	Internal model
Interest rate risk	974	150
Equity risk	5	55
Currency risk	157	0
Risks from commodities positions	12	0
Other risks	0	0
Total	**1 148**	**205**

Figure 28: Equity requirements for market risk positions (section 330 (1) and (2) SolvV)

The following table illustrates the composition of the total VaR of the trading book (99 %/10 days) by risk type at Bank level:

in EUR million

	During reporting period			
	VaR at end of reporting period	Highest VaR value	Lowest VaR value	Average VaR value
Interest rate risk	53	90	40	59
Equity risk	14	27	13	19
Currency risk	2	19	2	6
LBBW Bank trading book	**62**	**98**	**50**	**69**

Figure 29: Overview of VaR for portfolios in the trading book (section 330 (2) SolvV)

13 Interest rate risk in the banking book.

(section 333 SolvV)

All new customer commitments are refinanced at matching maturities within a narrow time frame. On the basis of this operating policy strategy at LBBW, further strategic positions are entered into by the trading committee which are focused on current market events. These items include risks in the form of cash flow incongruities (structural risks), risks from leveraging interest rate gaps between individual market segments (basic risk) and options risks from financial transactions and/or customer transactions which have been entered into.

Quantification

All relevant interest-bearing and/or interest-sensitive positions in the banking book are included in measurement in accordance with LBBW's own procedures for measuring interest rate risks. All those related to individual transactions and/or portfolios are measured daily, with margin or retail-oriented business entered in calculations in the form of aggregated items when the portfolio is updated monthly.

For variable interest transactions with retail and business customers (particularly deposits), records made on grounds of conduct are taken into account by using the deposit base theory in connection with the concept of moving averages. Effects from early loan repayments are incurred according to the model by means of synthetic options in the context of BaFin interest rate shock calculations.

Interest rate risks are measured daily on the basis of a Monte Carlo simulation. Here, changes in the value of the banking book as a whole or even for individual portfolios are specified for each currency using randomly selected interest rate scenarios. Together with the confidence level, the distribution arising from this serve to determine the VaR (confidence level of 95 % and holding period of one trading day). The VaR subsequently reported indicates a potential loss which with 95 % probability will not be exceeded within one day of trading.

In addition to daily reporting, further stress and worst-case scenarios are calculated on a weekly basis and made available for further analysis. All scenarios help to show the future effects of extreme events on the financial markets which are not sufficiently presented in the VaR normal impact event on the respective book. Extreme historic market fluctuations and self-defined scenarios are used in this respect.

Interest rate risks in the banking book

From a regulatory viewpoint, the effect of the interest rate shock on the economic value has to be disclosed in the banking book. This involves a parallel shift in the yield curve by + 130 basis points (rising interest) upwards and by – 190 basis points (falling interest) downwards. In accordance with section 24 (1) no. 14 KWG, a negative change in present value of more than 20% of regulatory equity must be reported to the supervisory authorities. The change in value calculated on a daily basis in the LBBW Group remained below this reportable threshold throughout the 2009 reporting year.

The following table shows the change in net present value, broken down into the main currencies

in EUR million

	Change in present value due to interest rate shock	
Currency	**Positive interest rate shock +130 basis points**	**Negative interest rate shock –190 basis points**
CHF	– 5	8
EUR	– 806	1 179
GBP	– 1	2
JPY	– 43	63
USD	15	– 22
Total	**– 840**	**1 230**

Figure 30: Interest rate risks in the banking book (section 333 (1) SolvV)

14 Operational risk.

(section 331 SolvV)

In accordance with regulatory provisions, operational risks are defined as »the risk of losses arising due to the unsuitability or failure of internal processes and systems, people, or due to external events«. This definition also includes legal risks. Strategic risk and reputation risk do not form part of operational risks.

LBBW has a comprehensive system for the management and controlling of operational risks. In accordance with the dual overall strategy, the decentralized management of operational risks is the responsibility of the specialized divisions. An independent, centralized organizational unit within Group Risk Control is tasked with further developing methods and tools.

One of the main goals of management and control activities is to identify operational risks at an early stage and to reduce or avoid the resulting losses by implementing the appropriate measures. Various tools are used to identify and assess the risk situation. As well as the internal and external incident database, the risk inventory (self-assessment and scenario analysis) and the analysis of risk indicators, the management of measures also plays an important role in the management of operational risks.

For regulatory purposes, the standard approach is used to determine the equity requirement. As at December 31, 2009, the equity requirement totaled EUR 398 million.

More detailed information on operational risks can be found in the Risk Report.

Abbreviations.

ABCP	Asset backed commercial paper
ABS	Asset backed securities
AktG	Aktiengesetz (German Stock Corporation Act)
BaFin	German Federal Financial Supervisory Authority
CCF	Credit conversion factor
CDO	Collateralized debt obligation
CDS	Credit default swap (credit derivative)
CLN	Credit linked notes (credit derivative)
CLO	Collateralized loan obligation
CMBS	Commercial mortgage backed securities
CP	Commercial paper
CRD	Capital Requirement Directive
CRSA	Standardized Approach
EAD	Exposure at default; synonym: position values
EC	European Community
EK	Equity
EL	Expected loss
GS I	Principle I
HGB	Handelsgesetzbuch (German Commercial Code)
IAA	Internal Assessment Approach
IAS	International Accounting Standard(s) (since 2002: IFRS)
ICAAP	Internal Capital Adequacy Assessment Process
IDW	Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany)
IFRS	International Financial Reporting Standards
IMM	Internal Model Method

IPV	Independent price verification
IRBA	Internal Ratings-based Approach
ISDA	International Swaps and Derivatives Association
IVA	Individual valuation allowance
KI	Banks as defined by KWG (German Banking Act)
KWG	Kreditwesengesetz (German Banking Act)
LGD	Loss given default
ÖKap	Economic capital
OTC	Over-the-counter
PD	Probability of default
PVA	Portfolio-based valuation allowances
RMBS	Residential Mortgage Backed Securities
RSU	Rating Service Unit GmbH & Co. KG
RW	Risk weight
RWA	Risk-weighted assets
SIM	Collateral management
SM	Standard method
SME	Small and medium-sized enterprises
SolvV	Solvabilitätsverordnung (German Solvency Ordinance)
SPV	Special purpose vehicle
SR	Sparkassen Rating und Risikosysteme GmbH
TRS	Total return swap (credit derivative)
VaR	Value at risk
WM	Security notifications

Index of tables.

The tables are largely based on the application examples provided by the specialist committee on disclosure requirements of the Deutsche Bundesbank of November 2006.

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