

Rating Action: Landesbank Baden-Wuerttemberg

Moody's puts LBBW's ratings on review for downgrade

Review to focus on earnings post costs for state aid

Frankfurt, June 23, 2009 -- Moody's Investors Service today placed the ratings of Landesbank Baden-Wuerttemberg (LBBW) on review for possible downgrade, which affects the C bank financial strength rating (BFSR), the Aa1 senior debt and deposit ratings and the Aa2 rating for senior and junior subordinated debt, including upper Tier 2 instruments ("Genussscheine"). The review for possible downgrade also affects the Aa1 senior debt and Aa2 junior debt ratings of outstanding bonds issued by the former LRP Landesbank Rheinland-Pfalz and Landesbank Sachsen, as well as Sachsen LB Europe plc. The Aaa ratings for grandfathered debt and the Prime-1 short-term debt ratings are not affected.

The rating action follows reports last week that the European Commission requires the bank to comply with compensation measures, in particular high dividend payments on the EUR5 billion fresh capital provided by its stakeholders, that will heavily affect the bank's internal capital generation capacity over the next few years. The review will also consider the medium-term probability of LBBW participating in the widely expected consolidation process of German Landesbanken, the resulting potential changes in the bank's ownership and Moody's assumptions regarding the probability of future support.

PRESSURE ON THE C BFSR DRIVEN BY WEAK INTERNAL CAPITAL GENERATION GOING FORWARD

Moody's decision to place LBBW's ratings on review for possible downgrade follows reports last week that the expected annual dividend payments on the EUR5 billion of fresh capital and the terms and conditions of the EUR12.7 billion guarantee (both provided by its public sector owners), as expected by the European Commission in compensation for state aid, could be more costly than the rating agency previously expected.

Following (yet unconfirmed) reports that the European Commission may expect substantial payments in dividends on the new capital provided, in addition to paying fees on the EUR12.7 billion guarantee, Moody's is concerned about the resulting limitations on LBBW's ability to post profits and internally generate capital in the foreseeable future. These payouts will materially hamper the bank's ability to rebuild reserves, as rising credit losses are expected to weaken its profitability over the next two-to-three years. As a consequence, LBBW has rather weak prospects of regaining its earlier financial strength and flexibility, which has been materially weakened by its takeover of the former Landesbank Sachsen in Q1 2008 and the ongoing global financial crisis.

FURTHER CONSOLIDATION AMONG LANDESBANKEN MAY INVOLVE LBBW, WITH NEGATIVE RATING IMPLICATIONS

In Moody's view, LBBW is one of the few Landesbanken to have made a material contribution to the consolidation process of German Landesbanken to date, having acquired and integrated the former LRP Landesbank Rheinland-Pfalz and the former Landesbank Sachsen in the course of 2008, at great cost to its financial resources.

As the political pressure to continue this process is rising, Moody's believes that the next steps in the consolidation process may involve LBBW as well as those other banks that have received external support during the financial crisis. These banks are WestLB (A2 negative/Prime-1/E+), Bayerische Landesbank (A1 stable/Prime-1/D-) and HSH Nordbank (A2 stable/Prime-1/E+), all of which are substantially weaker than LBBW in terms of franchise value and financial profile.

Whereas outright mergers may neither be feasible nor desirable in the short term, further steps in the consolidation process are expected within two-to-three years as the German government recently stepped up pressure on stakeholders for the Landesbanken to merge and reduce the risk stemming from their wholesale biased, relatively weak business models. As a result, Moody's is concerned that LBBW's asset and risk profile may change over the medium term, although the bank stressed that it will abstain from any transaction that would unduly put the bank at risk. However, any M&A transaction involving other Landesbanken will likely be rating-negative for LBBW.

LIKELY IMPLICATIONS FROM OTHER EU COMPENSATION MEASURES

Moody's expects that the European Commission may require LBBW to shrink its balance sheet which could affect not only non-core secondary market investments but also some of its participations. However, the rating agency does not expect that the group will be required to fundamentally change its business model, while restructuring targets will likely aim at reducing costs and freeing up capital, which the bank will in any case pursue as a matter of prudence.

More importantly, the European Commission does not expect any steps towards a privatisation of LBBW as part of the compensation measures. The bank will thus likely remain a public sector bank in the long term, and its senior debt and deposit ratings should continue to benefit from a relatively high probability of future support, should it be required. As a result, near-term pressure on the debt and deposit ratings would likely only be exerted by a BFSR downgrade, rather than a lowering of Moody's support assumptions.

EXPECTATION OF HIGH STAKEHOLDER SUPPORT RESTS ON CURRENT OWNERSHIP

Moody's recognises the strong commitment that LBBW's owners have shown by providing adequate additional resources for LBBW to weather rising credit losses as the global recession deepens. The rating agency believes that this high level of support will likely continue as long as the current ownership structure is maintained, which benefits from relatively uniform stakeholder interests among the bank's owners; therefore recent decisions on support were able to be made without much opposition.

However, given Moody's expectations regarding the likely sector-restructuring process, any takeover or similar transaction may trigger a change in the bank's current ownership structure, which could adversely affect the rating agency's assumption of future support.

RATING HISTORY AND MOODY'S METHODOLOGIES

The last rating action on LBBW was on 16 May 2008, when Moody's downgraded the bank's BFSR to C (with a stable outlook) from C+ and affirmed its Aa1 long-term debt and deposit ratings and Aa2 subordinated debt rating. The outlook on the long-term debt and deposit ratings and subordinated debt rating was changed to stable from negative.

The principal methodologies used in rating LBBW are "Bank Financial Strength Ratings: Global Methodology", "Incorporation of Joint Default Analysis into Moody's Bank Ratings: A Refined Methodology" as well as "Guidelines for Rating Bank Junior Securities", which can be found on www.moody.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating the issuer can also be found in the Credit Policy & Methodologies directory.

Domiciled in Stuttgart, Germany, LBBW reported total assets of EUR448 billion as at 31 December 2008 and a consolidated net loss for the year of EUR2.1 billion

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