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FITCH AFFIRMS LBBW'S PUBLIC SECTOR COVERED BONDS AT 'AAA'

Fitch Ratings-London/Frankfurt-05 July 2010: Fitch Ratings has today affirmed Landesbank Baden-Wuerttemberg's (LBBW, rated 'A+'/Stable/'F1+') public sector covered bonds at 'AAA' following an annual review of the programme.

As of 31 March 2010, LBBW's outstanding public sector covered bonds of EUR56.82bn were backed by a cover pool of EUR69.94bn, resulting in nominal overcollaterialisation (OC) of 23.1%. German exposure accounted for 95.2% of the cover pool followed by Greek (1.1%) and Swiss (1.0%) borrowers.

Fitch has maintained LBBW's public sector covered bonds' Discontinuity Factor (D-Factor) at 7.4%. Fitch D-Factors measure the likelihood of a default of covered bonds following an issuer default. Together with the bank's Long-term Issuer Default Rating (IDR) of 'A+', a D-Factor of 7.4% enables LBBW's public sector Pfandbriefe to be rated up to 'AAA' on a probability of default (PD) basis, provided that OC between the cover assets and the covered bonds is sufficient to sustain the 'AAA' stress level. Everything else being equal, LBBW's covered bonds' rating could be maintained at 'AAA' if the issuer is rated at least 'BBB'.

Fitch has revised its view on the level of nominal OC sufficient to support an 'AAA' stress scenario to 14% from 10.1%. This increase in supporting overcollateralization (SOC) is driven by several factors. The 'AAA' Rating Default Rate and Rating Recovery Rate assumptions, equating to 22.2% and 76.1% respectively, have deteriorated compared to the last review. These results reflect the lack of detailed information at the individual borrower level which Fitch overcame through conservative assumptions regarding the distribution of the portfolio. In addition, Fitch has identified a general negative rating migration on the exposure to German municipalities, which increases the default probability. Due to these factors, the portfolio was assumed to have a 'BBB' rating on average. Finally, in its cash flow modelling, Fitch has assumed higher refinancing costs to account for the higher volatility in the market observed in recent quarters.

The SOC will be affected, among other factors, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuances. Therefore it can not be assumed that the current level of OC supporting the assigned rating will remain stable going forward.

At 38.9%, German saving banks represent the largest debtor group within the cover pool. The exposure to German guaranteed public sector banks and Landesbanks currently stands at 25.1%. As substantial volumes of guaranteed assets from the Landesbanks and German savings banks are no longer available in the primary market, the cover pool volume is expected to further diminish in future years.

The cash flow profiles are relatively well-matched in terms of maturity and currencies while significant mismatches exist on the interest rate positions. The weighted average residual maturity of cover assets and liabilities are 4.25 and 3.25 years, respectively. A high percentage of the assets (97.39%) and of the liabilities (98.42%) is EUR-denominated. The initial open position in variable interest rate assets is notable (26.41% of assets versus 7.75% of liabilities carry variable interest) and will only diminish within the next five years due to the redemption of some variable assets. Fitch has taken all mismatches into account in modelling the expected cash flows by applying appropriate stresses to interest rates and currency movements.

Applicable criteria, 'Assessment of Liquidity Risks in Covered Bonds', dated 2 March 2010, 'Covered Bonds Rating Criteria', dated 18 December 2009, and 'German Municipalities - Important Role Within the Federal System', published 20 January 2010, are available at www.fitchratings.com.

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Additional information is available on www.fitchratings.com.

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