FITCH AFFIRMS BAYERNLB'S IDR AT 'A+'; DOWNGRADES INDIVIDUAL RATING TO 'D/E'

Fitch Ratings-London/Frankfurt-26 March 2009: Fitch Ratings has today affirmed Germany-based Bayerische Landesbank's (BayernLB) Long-term Issuer Default (IDR) 'A+' rating on continued strong state support, despite pressure on the standalone credit profile arising from challenges relating to a major restructuring process and its vulnerability to deteriorating asset quality. The Individual rating was downgraded to 'D/E' from 'C/D'.

The bank's other ratings have been affirmed at Short-term IDR 'F1+', Support '1', and Support Rating Floor 'A+'. The Outlook for the Long-term IDR is Stable. Those obligations of BayernLB that continue to benefit from 'Gewaehrtraegerhaftung' (a guarantee from the Free State of Bavaria; rated 'AAA'/Outlook Stable) as well as those issued under the EUR15bn debt issuance programme guaranteed by the German Financial Market Stabilisation Fund (FMSF or 'Soffin) are affirmed at 'AAA'. The Long-term rating of BayernLB Capital Trust I USD850m trust preferred securities (XS 0290135358) was upgraded to 'B+' from 'CCC+' and placed on Rating Watch Negative.

The rating actions follow the publication of BayernLB's FY08 results, the presentation of details of the bank's restructuring plan, and its announcement of distributions on its hybrid Tier 1 capital instrument.

Fitch views positively the intention of the bank to focus on core businesses and to target defined customer segments in selected regions. The reduction of approximately EUR70bn risk-weighted assets, around 5,600 staff and some EUR700m costs should help to refocus the bank on activities with an attractive earnings potential, reduce its risk profile and increase efficiency. Nevertheless, Fitch notes that BayernLB will need to undergo a major restructuring to return profitability to an acceptable and sustainable level in the medium term. The bank has to absorb restructuring costs and the payments on the Free State of Bavaria's silent participation. Significant uncertainties also remain with regard to BayernLB's future structure and profitability, since the European Commission (EC) may impose conditions on the bank before finally approving state aid.

In addition to execution risks from the restructuring and the challenge to grow profitable, low-risk business in real estate finance and SME lending, credit risks on the bank's balance sheet are Fitch's main concern. "BayernLB's exposure to central and eastern Europe, largely via its subsidiaries MKB Bank and Hypo Group Alpe Adria, as well as exposures to sectors particularly under pressure in the deteriorating economic environment such as automotive and construction are likely to drive impairment charges up," says Andrea von Schnurbein, Director in Fitch's Financial Institutions team. "In our view, deteriorating asset quality will delay the bank's return to profitability and erode parts of the capital buffer."

BayernLB's EUR19.6bn structured credit securities portfolio has been covered by a EUR6bn risk shelter, of which EUR4.8bn was provided by the Free State of Bavaria and EUR1.2bn was absorbed by the bank. As a result, the bank is protected from additional write-downs and impairments up to this amount. Although actual losses have remained small, the substantial share of non-prime RMBS and CDOs are a concern. All these aspects are reflected in the downgrade of the Individual Rating by two notches.

The upgrade of the rating of BayernLB's USD850m trust preferred securities follows BayernLB's announcement on 24 March 2009 that the 2008 coupon on the hybrid Tier 1 capital security will be paid in May 2009. The EC expects the bank not to make any interest or dividend payments on profit participation, hybrid Tier 1 capital or silent participations unless the bank is contractually obliged to do so. According to the terms of the trust preferred security, periodic distributions will be made if a subsidiary declares or pays distributions on parity securities, even in the event that BayernLB does not report a distributable profit. Contrary to Fitch's expectation based on the bank's statement dated 18 December 2008 it appears that these conditions are now being met. However, Fitch has placed the hybrid on RWN to reflect the risk of future coupon deferral in the light of the subdued outlook for short-term profitability.

In line with the bank's expectations announced in Q408, BayernLB's reported EUR5.1bn net loss for 2008 was driven by EUR5.4bn negative impact from the financial market crisis, largely relating to write-downs and impairments on its ABS portfolio and its exposures to Icelandic banks and Lehman Brothers (EUR1.4bn in total). The EUR10bn capital injection by the Free State of Bavaria improved BayernLB's Tier 1 ratio to a more comfortable level of 9.2% as at end-2008 (EUR7bn of which will be booked in Q109) compared with 7.6% at end-H108.

BayernLB is one of Germany's largest Landesbanks by equity. It co-operates with the 75 Bavarian savings banks, which hold strong market shares in retail deposits and SME lending in one of Germany's strongest regional economies. BayernLB received support from the Free State of Bavaria in the form of a EUR4.8bn risk shield for its ABS portfolio and EUR10bn in fresh capital, EUR3bn of which were injected in the form of a silent participation. As a result, Bavaria's stake in the bank increased to 94%, diluting the Association of Bavaria Savings Banks' stake to 6%.

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