Moody's Investors Service

Global Credit Research
Rating Action
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Rating Action: Bayerische Landesbank, (Paris Branch)

Moody's downgrades BayernLB's ratings to A1/D- from Aa2/C-

All ratings carry a stable outlook

Frankfurt, May 13, 2009 -- Moody's Investors Service today downgraded the bank financial strength rating (BFSR) of Bayerische Landesbank (BayernLB) to D- from C-. The long-term senior debt and deposit ratings were downgraded to A1 from Aa2 and the subordinated liabilities to A2 from Aa3. At the same time, Moody's downgraded various hybrid instruments of BayernLB group entities, as detailed below.

Moody's affirmed, with a stable outlook, BayernLB's Aaa ratings for obligations qualifying for the grandfathering of "Anstaltslast" and "Gewaehrtraegerhaftung" (maintenance and guarantee obligations, respectively, of the federal state of Bavaria), which were abolished in July 2005, and the Aaa ratings guaranteed by the Federal Republic of Germany. The bank's Prime-1 short-term rating was also affirmed. The rating actions conclude the review of BayernLB initiated on 2 December 2008. All the ratings carry a stable outlook.

DOWNGRADE OF BFSR DUE TO ASSET QUALITY PRESSURE AND LOW PROFITABILITY, PARTIALLY BUFFERED BY RECAPITALISATION

The downgrade of BayernLB's BFSR to D-, which translates to a Baseline Credit Assessment (BCA) of Ba3, reflects Moody's expectations that the economic environment will remain challenging for the bank with regards to its considerable exposure to weakening Central and Eastern European markets and cyclical industries, including the automotive, aviation and real estate sectors. Consequently, the bank faces increasing pressure on its asset quality (exacerbated by some concentration risks in its loan portfolio), revenues and earnings. Moody's believes that BayernLB is unlikely to post a profit before 2010 or 2011.

"The historically low profitability in BayernLB's key segments only provides a small buffer for the bank to absorb a likely increase in risk provisioning due to the continuing downturn in the global economy," says Dominique Nutolo, a Frankfurt-based Moody's Assistant Vice President and lead analyst for BayernLB.

As positive factors, Moody's recognises the bank's strengthened capital base as a result of an injection of EUR10 billion from the federal state of Bavaria and a second-loss EUR4.8 billion risk shield for the bank's EUR20 billion structured credit portfolio. The rating agency recognises that the recent significant recapitalisation measures provide the bank with a substantially larger capital buffer to absorb likely further losses in all asset classes. It also believes that the risk shield effectively reduces BayernLB's exposure to structured assets and reduces its earnings volatility. Moreover, Moody's acknowledges the liquidity support from the funding guarantees of the German financial market stabilisation fund (the SoFFin), which amount to EUR15 billion.

Moody's further expects that the bank will focus on de-risking its current business profile, which may have positive rating implications in the long run. However, targeted restructuring measures remain dependent on the approval of the European Commission, which, according to information received from BayernLB, will not be granted before July 2009. As a result, major uncertainties remain with regard to the bank's future business profile.

Overall, Moody's believes that the D- BFSR better reflects the mixed profile of BayernLB, with its relatively low historical profitability and the challenges posed by the weak economic environment on the one hand, and its strengthened capital base along with the risk protection from further losses relating to its structured credit portfolio on the other.

SENIOR DEBT RATINGS BENEFIT FROM STRONG SECTOR, SHAREHOLDER AND SYSTEMIC SUPPORT

BayernLB's A1 long-term debt and deposit ratings continue to benefit from Moody's assessment of a high probability of co-operative, regional local government and systemic support. Moody's notes that the dependence of BayernLB's strong investment-grade ratings on outside support has increased, which is reflected by the increased (eight-notch) uplift from the Ba3 BCA.

DOWNGRADE OF HYBRID INSTRUMENTS REFLECTS INCREASED RISK OF COUPON LOSSES

Moody's does not expect BayernLB to make any interest payments on its hybrid capital instruments for 2008 unless it is contractually obliged to do so, based on the rating agency's expectations regarding the bank's future profitability and the bank's earlier announcement on the matter. Moody's understands that this was a European Commission condition for approving state aid provided by the federal state of Bavaria. Accordingly, Moody's took the following rating actions:

1) Moody's downgraded BayernLB's Upper Tier 2 "Genussscheine" Series 11 due at the end of 2010 to Caa1 from Aa3. The downgrade reflected Moody's view of the relatively high likelihood of three missed coupons. BayernLB has already announced that it will not pay coupons for 2008 due to insufficient distributable profits. While coupon payments are cumulative, Moody's does not expect a deferred payment of those coupons as it considers a return to profitability before the end of 2010 as unlikely.

2) The "Genussscheine" Series 12 due at the end of 2019 were downgraded to B2 from Aa3 as a result of the increased likelihood of three coupon losses. The downgrade was less severe than that applied to the Series 11 "Genussscheine" because of the fact that the instrument only matures in 2019 and therefore that payment of the cumulative deferred coupons in the future is more likely.

3) Moody's also downgraded the rated Tier 1 securities issued by BayernLB Capital Trust I to Caa1 from A1. The downgrade reflected the increased likelihood of two coupon losses. Moody's understands that the distributable profit trigger for coupon payments was breached in 2008. However, Moody's understands that the instrument's coupon is being served for 2008 given the contractual obligation to pay in the event of a subsidiary -- in this case Landesbank Saar -- declaring a payment on a parity or junior ranking security (dividend pusher).

RATING IMPACT ON SUBSIDIARIES

1) Landesbank Saar's D+ BFSR was placed on review for possible downgrade reflecting concerns about the bank's profitability and increased risks inherent in its SME loan portfolio against the deepening recession in Germany. The bank's debt and deposit ratings were downgraded to A1 from Aa2 as a consequence of the rating downgrade of BayernLB.

The support assumptions for the bank were not changed and remain in the "very high" bucket. Moody's believes that at this stage BayernLB's restructuring plans do not affect the expected support for Landesbank Saar from its parent. The outlook on the long-term ratings is stable, reflecting Moody's expectation that any downgrade of the bank's BFSR would likely be mild and would not adversely affect the long-term ratings.

2) Hypo Group Alpe Adria's (HGAA) D- BFSR was placed on review for possible downgrade reflecting the rating agency's concerns about the bank's profitability and increased risks inherent in its exposure to the Eastern European markets. The debt and deposit ratings of HGAA were downgraded to Baa1 from A2. The rating for the subordinated liabilities was downgraded to Baa2 from A3. The short-term rating was downgraded to Prime-2 from Prime-1. The Aa2 rating for debt backed by the Austrian federal state of Carinthia (a 12.4% shareholder) was affirmed with its stable outlook.

The downgrades reflect changes in the support assumptions. Moody's includes a high probability of support from HGAA's parent, BayernLB, in its assessment, in the light of a capital injection from BayernLB of EUR700 million. Furthermore, the rating agency believes that, at this stage, BayernLB's restructuring plans are unlikely to affect the probability of support for HGAA from its parent.

However, Moody's has lowered the probability of regional and local government and systemic support for the bank and, notably, the federal state of Carinthia did not participate in the capital increase. Nevertheless, overall HGAA remains in the high support category. HGAA's debt and deposit ratings remain on review for further possible downgrade due to the review of its D- BFSR.

Moody's downgraded the ratings on the hybrid securities (Tier 1 instruments) issued by HGAA's subsidiaries, Hypo Alpe Adria (Jersey) Ltd and Hypo Alpe Adria (Jersey) II Ltd, to Caa2 from Baa2 as a result of the rating agency's assumption of four coupon losses for these non-cumulative perpetual instruments. HGAA has announced that the instruments will not pay a coupon for 2008. The outlook on the rating of the hybrid securities is stable as these ratings are based on Moody's expected loss calculation.

3) This press release does not cover the following subsidiaries: MKB Bank Rt (Hungary) and MKB Union Bank AD (Bulgaria) as these entities will be covered in a separate press release.

The ratings for covered bonds of BayernLB are also not covered by this press release.

RATING HISTORY AND MOODY'S METHODOLOGIES

Moody's previous rating action on BayernLB was on 2 December 2008, when the bank's ratings were placed on review for possible downgrade.

The principal methodologies used in rating BayernLB are "Bank Financial Strength Ratings: Global Methodology" and "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology", which can be found on www.moodys.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 BayernLB can also be found in the Credit Policy & Methodologies directory.

Based in Munich, Germany, BayernLB reported 2008 net losses of EUR5.1 billion and total assets of EUR422 billion at the end of the year.

Frankfurt
Dominique Nutolo
Asst Vice President - Analyst
Financial Institutions Group
Moody's Deutschland GmbH
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Frankfurt
Carola Schuler
Managing Director
Financial Institutions Group
Moody's Deutschland GmbH
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454