



# Changes regarding guarantee mechanisms

Questions and answers

Dear customers,  
dear business partners,

With effect from 19 July 2005 the guarantee mechanisms for German savings banks and landesbanks, and therefore also for BayernLB, will change.

During the last few years, the possible consequences have been the topic of much speculation - in the press, by the public and also among our customers. What does the loss of the Gewährträgerhaftung (guarantee obligation) and the Anstaltslast (maintenance obligation) mean for BayernLB? How has BayernLB prepared for the new conditions? And what will change for its customers?

We would like to answer these and other questions below. However, we would like to point out one thing right away: In the future, you will be able to count on us just like in the past. With all of our services and solutions. With proven and tested quality.

BayernLB

## Changes regarding guarantee mechanisms as of July 2005

### Contents

**1 Impact on guarantee mechanisms/grandfathering**

What will change on 19 July 2005 with respect to BayernLB's guarantee mechanisms, and what does "grandfathering" mean in this context?

**2 Adjustment of our business model/implementation of measures**

What are the changes to BayernLB's business model with respect to 19 July 2005, and to what extent have the planned strategic measures been implemented?

**3 Milestones achieved**

Milestones achieved under the new business model

**4 Reinforcement of cooperation with the Bavarian savings banks**

Which measures were taken to reinforce cooperation with the Bavarian savings banks? What is the role of the Bavarian savings banks in BayernLB's new business model?

**5 The new rating**

Which rating is applicable to new liabilities entered into as of 19 July 2005?

**6 Impact of the new rating on BayernLB's funding costs and on capital market issues**

How will the new rating affect BayernLB's funding costs? What are the changes for BayernLB in respect to future capital market issues?

**7 Impact of the planned capital increase on BayernLB's own funds structure**

What is the impact of the planned capital increase on BayernLB's own funds structure?

**8 Protection schemes to protect investors**

Which protection schemes will help protect investors?

## What will change on 19 July 2005 with respect to BayernLB's guarantee mechanisms, and what does "grandfathering" mean in this context?

Until now, BayernLB has benefited from its owners' guarantees in the form of "Anstaltslast" (maintenance obligation) and "Gewährträgerhaftung" (guarantee obligation); both mechanisms cover all liabilities which were incurred up to 18 July 2001 until their final maturity and are therefore unaffected by the changes.

Anstaltslast (maintenance obligation) means that the owners are obligated to ensure the Bank's solvency and make certain that the Bank can fulfil its financial obligations at all times.

Gewährträgerhaftung (guarantee obligation) means that the owners are fully and directly liable for the Bank's liabilities.

► **maintenance obligation and guarantee obligations will expire on 18 July 2005; grandfathering will protect originally guaranteed liabilities.**

While "Anstaltslast" is due to expire on 18 July 2005, "Gewährträgerhaftung" will remain in force through the so-called "grandfathering" which was agreed as an interim solution. In keeping with this concept, liabilities which are incurred from 18 July 2001 and up until 18 July 2005 and which mature no later than 31 December 2015 will continue to be covered (grandfathered) by "Gewährträgerhaftung".

This means that only those liabilities incurred after 18 July 2005 will not be covered (grandfathered) by "Gewährträgerhaftung", i.e. they are unguaranteed.

Regarding "grandfathering" (in addition to the regulations laid down in the law on Bayerische Landesbank), the Free State of Bavaria and the Association of Bavarian Savings Banks have stated the following: they will immediately fulfil their obligations under this guarantee system if and when the creditors of the relevant liabilities cannot be satisfied from the Bank's assets. Moreover, just recently they have reconfirmed without restriction that they will remain long-term majority owners of BayernLB Holding AG, which is entrusted exclusively with the duties of the sole shareholder of BayernLB as an institution under public law.

## What are the changes to BayernLB's business model with respect to 19 July 2005, and to what extent have the planned strategic measures been implemented?

The new business model defines BayernLB as a wholesale bank that focuses on core regions and collaborates closely with the Bavarian savings banks and other partners of the Sparkassen-Finanzgruppe.

Abolition of the guarantee mechanisms will result in changes in the competitive environment for landesbanks. However, this does not constitute the sole basis for BayernLB's decision to transform its business model. Rather, the market and competitive conditions for all banks in Germany have undergone a sea change. Market transparency is increasing, as is our customers' demand for product-related and advisory competence.

**BayernLB's strategy is based on the following pillars which, in turn, form the foundation for the specific strategies of the individual business areas:**

- **clear commitment of the owners to their Bank**
- **focus and efficiency**
- **network of the Sparkassen-Finanzgruppe**
- **strategic group subsidiaries as an integral element of the business model**

Implementation of this new business model has been carried out consistently since 2002. A number of milestones have already been achieved (see the adjacent text "Milestones achieved under the new business model").

With our new business model and the achievements already made we feel well prepared for meeting the future challenges. The satisfactory annual results for 2004 further underpin this development.

A visual expression of these changes is our new marketing image which conveys the new values and well-known strengths of BayernLB.

Our core message "Customised financial solutions – made in Bayern" says it all. Based on its business model, BayernLB focuses on its core competencies: rendering competent individual services to our customers with comprehensive product and market know-how.

► **Well prepared for future challenges with the new business model.**

## Milestones achieved in BayernLB's new business model

### Milestones achieved under the new business model

#### **Commitment of the owners to the Bank**

Substantial signs of the owners' commitment to BayernLB are (among others) the following:

- Capital increase in the amount of EUR 640m (payment in two tranches in 2005 and 2006).
- Establishing a regional guarantee fund to further underpin the cooperation of the Sparkassen-Finanzgruppe within Bavaria.

#### **Focus and efficiency**

The focus of BayernLB's business model is:

- The activities are primarily centered on the core market Bavaria and the bordering regions.
- BayernLB will continue to be present in selected economic and financial centres around the world (London, Paris, Milan, New York, Hong Kong and Shanghai).
- The needs of our customers are our main focus. We will support them in their important markets as well as in growth regions such as Eastern Europe.

#### **Sparkassen-Finanzgruppe network**

The development and expansion of the Sparkassen-Finanzgruppe Bayern network is on the right track.

- A master agreement was signed in December 2003 containing framework regulations for cooperative market development as well as the establishment and use of joint centres of competence between the Association of Bavarian Savings Banks and BayernLB.
- In the meantime, 75 of the 78 Bavarian savings banks signed individual agreements governing cooperative market development and collaboration with the centres of competence.
- Another important milestone of the cooperation is the joint "IT-Bayern" project which was started in 2004. The aim is to bundle the information technology of the companies involved into IZB SOFT in order to create a shared system house.

#### **Strategic group subsidiaries as an integral element of the business model**

The Bank's participations are oriented towards and measured against clearly defined strategic objectives.

- The strategic group subsidiaries mainly serve the purpose of supplementing the core business activities of the Bank and expanding the service range for our customers.
- In particular the subsidiaries DKB, MKB and SaarLB, based on their regional roots as well as their strong retail focus, ideally complement BayernLB's business model.

## Which measures have been taken to reinforce cooperation with the Bavarian savings banks? What is the role of the Bavarian savings banks in BayernLB's new business model?

Expansion of the Savings Banks Central Bank function, and with it the further intensification of joint marketing activities with the Bavarian savings banks, is an important pillar of BayernLB's business model. The aim is to enhance the S-Finanzgruppe's operating efficiency through jointly developed solutions and strengthen its market position. **BayernLB is the central bank to the Bavarian savings banks and an integral member of the Sparkassen-Finanzgruppe Bayern.** It is a service provider for the partner institutes of the Sparkassen-Finanzgruppe and helps them, with its support and product policies, to exploit existing market potential in the Bavarian market together with the savings banks.

In December 2003, a master contract between the Association of Bavarian Savings Banks and BayernLB was signed. This agreement regulates the framework conditions for **market development in cooperation** with the savings banks as well as the **establishment and use of joint centres of competence**. Under this master contract, the savings banks can bilaterally agree specific services with BayernLB for the various divisions. By now, a total of 75 out of 78 savings banks have signed an individual agreement.

At the same time, **BayernLB's entire sales activities for the savings banks were bundled** in the business area Savings Banks and Bavarian Market. The business area thus acts as the group-wide coordinator for the activities within the association. It serves and supports the savings banks in their various relationships with BayernLB, whether as customers, sales partners or service partners. It also works in harmony with the Bavarian savings banks to serve and support their customers.

► **Strengthening the market position of the S-Finanzgruppe Bayern is the declared objective.**

## Which rating is applicable to new liabilities entered into as of 19 July 2005?

The ratings for BayernLB’s unguaranteed unsecured liabilities are:

Rating	long-term	short-term
Standard & Poor’s	A	A-1
Moody’s	Aa2 (corresponds to AA by S&P/Fitch)	Prime-1
FitchRatings	A+	F1+

- ▶ BayernLB is already well positioned. Continue to strive for a rating of at least A+/A1 from all 3 rating agencies.

The ratings illustrate that BayernLB is well positioned for the period following the abolition of the guarantees, and it is quite certain that the rating agencies’ assessment will improve even further when additional progress is made in adjusting and expanding the business model.

**On 1 April 2005, S&P awarded for the first time a rating for BayernLB’s public pfandbrief issues. The top rating of AAA reflects, on the one hand, the high quality of the asset pool underlying the pfandbrief issues and, on the other, BayernLB’s voluntary commitment which sets forth the management of market risks and liquidity.**

If you wish to read more about our “Voluntary commitment for the management of the public pfandbrief register“, please visit our homepage under [www.bayernlb.de](http://www.bayernlb.de) > **Investor Relations > Voluntary Commitment/Pfandbriefe.**

In the meantime, the rating agency Moody’s has indicated a rating of Aaa (unchanged) for our future (unguaranteed) pfandbrief issues based on the unguaranteed long-term rating of Aa2 for BayernLB. A rating by FitchRatings will also be awarded shortly.

**As a result, BayernLB will be able to maintain its strong position in the well-established pfandbrief market in the future as well.**

## How will the new rating affect BayernLB's funding costs? What are the changes for BayernLB in respect to future capital market issues?

In light of the abolition of "Gewährträgerhaftung" and "Anstaltslast" in mid-2005, BayernLB's funding strategy was modified at an early stage. Extensive liquidity reserves in the double-digit billion range were therefore built up for the period following 18 July 2005. Most of these reserves can now be used through BayernLB's cover pool (AAA pfandbrief issuance) and for repo transactions, thus enabling the Bank to counteract future liquidity risks or increased funding costs. Access to adequate liquidity at all times in conformity with the planned business activities is ensured.

In conformity with this strategy, the Bank's issuing activities in the medium-term future will concentrate primarily on the successful pfandbrief market with effect from July 2005. BayernLB can thus draw on funding at AAA terms even in the long run, and investors will continue to enjoy a maximum of security and quality due to the asset pool (register of cover) underlying the pfandbrief issues.

► **Funding strategy was adjusted early on to deal with the changes.**

**In summary this means that although the AAA institution rating will be lost with effect from 19 July 2005 and the Bank's rating will therefore diminish, it is unlikely that this will affect the funding costs, and thus the Bank's earnings situation, short to medium-term due to the measures described above.**

## What is the impact of the planned capital increase on BayernLB's own funds structure?

► **Ownership structure remains unchanged.**

The capital increase is a clear demonstration of the owners' strong commitment to BayernLB. With the Free State of Bavaria and the Bavarian savings banks (through the Association of Bavarian Savings Banks) contributing 50% each to the capital increase, the ownership structure will remain unchanged. By increasing the Bank's capital and converting dated capital contributions of silent partners into undated ones, BayernLB's capital base will be reinforced considerably in terms of both quantity and quality. The capital increase is a core element for financing the planned growth and for achieving the target rating (minimum A+/A1 of all three rating agencies) and will thus strengthen the Bank's competitiveness following the abolition of "Anstaltslast" and "Gewährträgerhaftung".

## Which protection schemes will help protect investors?

BayernLB is a member of the nationwide **cross-guarantee system of the Sparkassen-Finanzgruppe**. This mechanism comprises 11 regional support funds of the savings banks, the guarantee fund of the Landesbanks and the guarantee fund of the Landesbausparkassen.

All of the above funds are linked to one another to form a guarantee alliance. Therefore, although the funds are independent, the assets of all funds can be used to assist a specific institution if necessary. BayernLB and Landesbausparkasse are members of the institutional deposit guarantee fund of the German Savings Bank Organisation through the Landesbank deposit guarantee reserve and, in the case of Landesbausparkasse, also through the guarantee fund of the regional home loan and savings associations.

Securing the Bank's liquidity goes hand in hand with securing customer deposits.

**Moreover, BayernLB is a member of the "Bayerischer Reservefonds" (Bavarian Reserve Fund), with a total volume of EUR 1bn, which has been established by the Bavarian savings banks and BayernLB to take effect as of 1 July 2005.** The Bavarian Reserve Fund is a regional guarantee fund which subsists **in addition** to the joint guarantee schemes of the Sparkassen-Finanzgruppe. Its purpose is to guarantee both protection of the institute and creditor protection in case of economic difficulties experienced by one of the Bavarian savings banks or BayernLB. This means that the creditors have payment claims against the Association of Bavarian Savings Banks once a case requiring support has been identified, independent of whether or not institute protection has been granted in the individual case. The payment claims cover the total volume of the Bavarian Reserve Fund unless it has been depleted by supporting measures within the framework of institute protection.

► **National cross-guarantee system and regional guarantee fund offer a high degree of security.**

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