FITCH AFFIRMS BAYERISCHE LANDESBANK AT 'A-'; OUTLOOK STABLE

Fitch Ratings-Frankfurt/London-11 April 2019: Fitch Ratings has affirmed Bayerische Landesbank's (BayernLB) Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook, Viability Rating (VR) at 'bbb+', Short-Term IDR at 'F1' and Support Rating (SR) at '1'. The rating actions have been taken in conjunction with Fitch's periodic review of three Landesbanken based in southern Germany.

A full list of rating actions is available at the end of this rating action commentary.

The affirmation of the IDRs and SR reflects Fitch's view of strong support from the bank's owners.

The 'bbb+' VR reflects the bank's stability, comfortable capitalisation and improved asset quality, following resolution of its defaulted exposure to HETA Asset Resolution AG. Earnings prospects remain moderate, in our view, despite BayernLB's strong financial performance in 2018, because competition in the German banking sector is likely to keep business margins under pressure. The VR also reflects some uncertainties on the bank's future strategy and risk appetite as its newly appointed CEO will join BayernLB in the summer.

KEY RATING DRIVERS

IDRS, SR, SENIOR UNSECURED AND SENIOR NON-PREFERRED DEBT RATINGS

BayernLB's IDRs, SR, senior unsecured and senior non-preferred debt ratings are driven by Fitch's view of strong likelihood of support from the bank's owners, the regional state of Bavaria (AAA/Stable), Bavaria's savings banks and Germany's savings banks group, Sparkassen-Finanzgruppe (SFG, A+/Stable).

Fitch's institutional support assumptions are underpinned by provisions contained in the statutes of the institutional protection fund of the SFG and the Landesbanken. Our support considerations are also based on the view that the owners view their investment in BayernLB as long-term and strategic. This is underpinned by BayernLB's focus on the bank's statutory roles, which include supporting the Bavarian economy as well as acting as the central institution for Bavaria's savings banks and as house bank for the State of Bavaria.

Fitch uses the lower Long-Term IDR of BayernLB's owners, SFG's Long-Term IDR, as anchor for determining the bank's support-driven ratings. Fitch believes support would need to be forthcoming from both SFG and the State of Bavaria to avoid triggering state-aid considerations and resolution under the German Recovery and Resolution Act if BayernLB fails. Our assessment of Bavaria's creditworthiness is underpinned by the stability of Germany's solidarity and financial equalisation system, which links Bavaria's creditworthiness to that of the German sovereign (AAA/Stable). SFG's support ability is strong, despite recent commitments from SFG's institutional protection scheme to recapitalise one of its member Landesbanken, Norddeutsche Landesbank Girozentrale (NORD/LB).

We notch down BayernLB's Long-Term IDR twice from SFG's 'A+', because we view the bank's role for its owners to be strategic, but not key and integral, and because of potential legal and regulatory barriers related to state-aid considerations and provisions of German resolution legislation. The Stable Outlook reflects steady support assumptions and the Stable Outlook on SFG's Long-Term IDR.

The bank's Short-Term IDR is at the higher of the two Short-Term IDRs that map to a 'A-' Long-Term IDR on Fitch's rating scale. This reflects BayernLB's strong links to SFG and privileged access to SFG's ample liquidity and funding resources. The ratings of BayernLB's senior unsecured obligations are equalised with the bank's IDRs

VR
BayernLB has reported strong growth broadly balanced across its corporate segments supported by Germany's benign economic environment. However, the rise in risk-weighted assets (RWA) of about 7% in 2018 only mildly affected its capitalisation because of strong profit retention.

BayernLB reported a common equity Tier 1 (CET1) ratio of 15.2% end-2018 (15.3% end-2017), which ranks well among German peers. It provides a comfortable buffer over its individual regulatory requirements for 2019 from the Supervisory Review and Evaluation process (SREP), accommodates for further growth and provides cushion for an expected regulatory upward drift under the revised Basel rules, which is expected to kick-in from 2022. BayernLB's leverage ratio of 4.1% at end-2018 is acceptable but not strong.

BayernLB's asset quality has improved due to corporate health in the German industry and is largely driven by resolution of it defaulted exposure of EUR1.3 billion to HETA Asset Resolution AG. The resolution has also removed financial tail risks from a legal dispute. We believe asset quality is now at a cyclical low and expect hardly any scope for further loan loss releases, which have been a key driver behind its financial performance in 2018. Similar to its Landesbanken peers, BayernLB's business model entails sector and single-name loan concentration, which weighs on our asset quality assessment.

We expect a normalisation in BayernLB's earnings and profitability from a strong 2018 because the bank benefited from a EUR135 million release of loan loss provisions and other non-recurring revenues. BayernLB reported a profit before taxes of EUR869 million at end-2018. Although growth in its operating segments allowed for higher net interest (NII) and fee income, its cost base remained high. BayernLB's direct bank DKB (Deutsche Kreditbank) proved a reliable revenue generator (56% of the group's NII), while its financial market business was weak, in line with other commercial banks.

BayernLB's funding is stable at low costs and benefits from a variety of funding instruments across geographical regions. It also benefits from DKB's improved funding profile and BayernLB's access to the savings banks' strong liquidity and DKB's retail deposits, which lower its reliance on capital market funding. The structure of BayernLB's liabilities allows for comfortable compliance with expected minimum requirements for own funds and eligible liabilities.

GRANDFATHERED STATE-GUARANTEED SECURITIES
The ratings of the grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes are equalised with the State of Bavaria's Long-Term IDR as we believe Bavaria's ability and propensity to honour its guarantee is very strong.

NON-GUARANTEED TIER 2 SUBORDINATED DEBT
BayernLB's Tier 2 subordinated notes are notched down once from the bank's VR to reflect our assessment of the notes' relative loss severity.

DCR, DEPOSIT AND SENIOR PREFERRED DEBT RATINGS
BayernLB's DCR, senior preferred debt and Deposit Ratings are equalised with the bank's IDRs. We believe the bank's buffers of junior and vanilla senior debt do not afford any obvious incremental probability of default benefit over and above the support benefit already factored into its IDRs. We do not apply any uplift for above-average recovery prospects in the event of default because of the limited visibility into recovery levels in such circumstances. In the highly unlikely

event that BayernLB fails and is not supported by its savings banks and state owners, its balance sheet would most likely differ substantially from the current one.

RATING SENSITIVITIES

IDRS, SR, SENIOR UNSECURED AND SENIOR NON-PREFERRED DEBT

The IDRs, SR, senior unsecured debt and senior non-preferred debt ratings are sensitive to changes in our assumptions around the propensity or ability of BayernLB's owners to provide timely support. This could result from a change to SFG's IDRs, to the owners' strategic commitment to BayernLB, or to the bank's importance for its home region or for the savings bank sector. A change to our assessment of the risks of triggering a resolution process ahead of support for Landesbanken could also affect the bank's IDRs, SR and senior unsecured debt and senior non-preferred debt ratings.

VR

An upgrade of the VR would require strong and sustainable earnings improvements without materially compromising on the bank's risk appetite. We believe this to be unlikely in the short term as the burden on profitability from the remaining investment costs is compounded by prevailing low interest rates and strong competition in BayernLB's key markets.

BayernLB's cyclical credit exposures make its VR highly dependent on Germany's economic environment, where a deterioration could be aggravated by the bank's sector concentration and its impact on the bank's asset quality, earnings and capitalisation. We expect its subsidiary DKB to fare better in such a scenario because of its higher granularity. The VR is also sensitive to significant changes to BayernLB's future strategic objectives. It could come under pressure if we observe a material deviation from risk-conscious underwriting standards, which could erode BayernLB's asset quality and capitalisation.

GRANDFATHERED STATE-GUARANTEED SECURITIES

The ratings of the grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes are sensitive to changes in Fitch's view of Bavaria's creditworthiness, which is closely linked to that of Germany.

NON-GUARANTEED TIER 2 SUBORDINATED DEBT

The ratings of the Tier 2 subordinated notes are sensitive to the same considerations that may affect the bank's VR.

DCR, DEPOSIT AND SENIOR-PREFERRED RATINGS

The DCR, senior-preferred debt and Deposit Ratings are primarily sensitive to changes in the bank's IDRs.

The rating actions are as follows:

Long-Term IDR: affirmed at 'A-'; Outlook Stable
Short-Term IDR: affirmed at 'F1'
Support Rating: affirmed at '1'
Viability Rating: affirmed at 'bbb+'
Derivative Counterparty Rating: affirmed at 'A-(dcr)'
Deposit Ratings: affirmed at 'A-'/'F1'
Senior unsecured, senior non preferred notes and debt issuance programme ratings: affirmed at 'A-'/'F1'
Senior preferred notes and debt issuance programme ratings: affirmed at 'A-'/'F1'
Commercial paper programme rating: affirmed at 'F1'
Grandfathered state-guaranteed senior unsecured and Tier 2 subordinated debt ratings: affirmed at 'AAA'

Tier 2 Subordinated debt rating: affirmed at 'BBB'

Contact:
Primary Analyst
Roger Schneider, CIIA
Director
+49 69 768 076 242
Fitch Deutschland GmbH
Neue Mainzer Strasse 46-50
60311 Frankfurt am Main

Secondary Analyst
Patrick Rioual
Senior Director
+49 69 76 80 76 123

Committee Chairperson
Artur Szeski
Senior Director
+48 22 338 6292

Media Relations: Louisa Williams, London, Tel: +44 20 3530 2452, Email: louisa.williams@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 12 Oct 2018)
https://www.fitchratings.com/site/re/10044408