FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Bayerische Landesbank's Outlook to Negative, Affirms IDR

Fri 03 Apr, 2020 - 2:17 PM ET

Fitch Ratings - Frankfurt am Main - 03 Apr 2020: Fitch Ratings has revised Bayerische Landesbank's (BayernLB) Outlook to Negative from Stable and affirmed the Long-Term Issuer Default Rating (IDR) at 'A-'. At the same time, BayernLB's Viability Rating (VR) was downgraded to 'bbb' from 'bbb+'.

The revision of the Outlook follows the revision of Sparkassen-Finanzgruppe's (SFG, A+/Negative; see 'Fitch Takes Actions on 6 German Banking Groups on Coronavirus Uncertainties' dated 27 March 2020) Outlook as BayernLB's IDR is driven by institutional support from SFG.

Fitch has upgraded BayernLB's long-term deposit rating, Derivative Counterparty Rating (DRC) and long-term senior preferred rating to 'A' from 'A-' because of the protection that could accrue from BayernLB's more junior bank resolution debt and equity buffers, which provides superior recovery prospects relative to its IDR.

A full list of rating actions is available at the end of this Rating Action Commentary.

RATING ACTIONS

ENTITY/DEBT	RATING		
Bayerische Landesbank	LT IDR	A-	Affirmed
	ST IDR	F1	Affirmed
	Viability	bbb	Downgrade
	Support	1	Affirmed
	DCR	A(dcr)	Upgrade
• senior unsecured	LT	AAA	Affirmed
• senior unsecured	LT	A-	Affirmed

VIEW ADDITIONAL RATING DETAILS

KEY RATING DRIVERS

IDRS, SUPPORT RATING, SENIOR UNSECURED AND SENIOR NON-PREFERRED DEBT (SNP) RATINGS

BayernLB's IDRs, senior unsecured and SNP ratings and Support Rating are driven by Fitch's view of a strong likelihood of support from the bank's owners.

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 SFG's Long-Term IDR as the anchor rating 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.

We notch down BayernLB's Long-Term IDR twice from SFG's 'A+', to reflect regulatory restrictions to support due to the requirement for state aid examination under the EU competition rules. Despite the short-term exception communicated by the European Commission in March 2020 that allows for state aid to compensate for losses that are directly related to the coronavirus outbreak, which we expect to be only temporary. The two-notch difference in the ratings also reflects BayernLB's strategic but not key and integral role for their respective owners.

BayernLB's Short-Term IDR is the higher of two possible ratings that map to an 'A-' Long-Term IDR on Fitch's rating scale, because propensity of support by its institutional owners is likely more certain in the near term.

VR

BayernLB's VR primarily reflects the bank's relative weak earnings generation capacity and Fitch's expectation that profitability will come under pressure from the fallout of the coronavirus crisis on the domestic and international economy. In addition, pressures are likely to emerge on the bank's asset quality and capitalisation and leverage while its funding and liquidity is expected to be more stable in light of its diversified profile and the ECB' extensive support measures. The VR also reflects risks related to BayernLB's strategic transition programme, which is aimed at concentrating on SME business and on retail business in its subsidiary DKB. The bank's planned reduction of its capital markets business should reduce earnings volatility and risk exposure in the medium term, but Fitch see execution risk in the reorganisation during the crisis.

BayernLB has significant exposure to the German corporate sector as it provides long-term commercial lending to the segment. The bank is particularly vulnerable as it has material exposure to cyclical industries. Fitch expects the German government's programmes to support the economy, but there is a heightened probability that corporate risks and a significant decline in consumer financial health will drive up loan impairment charges (LICs). Higher credit losses will pressure BayernLB's moderate operating profit. We expect additional pressure on profitability to come from the bank's planned investments into DKB and associated restructuring expenses. The pressure on the bank's profitability could be compounded by lower business volumes and even lower interest rates, which BayernLB's business model is sensitive to.BayernLB's capitalisation ranks well among German peers, but its leverage ratio is below most peers, and the bank's ability to generate capital internally is moderate. We expect a negative impact from credit deterioration on its risk-weighted assets (RWA) despite strategic measures to lower risk exposure in the core bank to finance expected growth in DKB. This will make it challenging for BayernLB to maintain its strategic target of a common equity Tier 1 ratio above 14% through the restructuring process.

BayernLB's loans-to-customer deposits ratio reflects its relative reliance on wholesale funding. However, BayernLB benefits from good access to domestic and international capital markets. It has access to the savings banks' strong liquidity and DKB's retail deposits. We expect BayernLB's capital market funding to moderately decline in coming years in line with the core bank's lower business volume. The structure of BayernLB's liabilities allows for comfortable compliance with expected minimum requirements for own funds and eligible liabilities. DCR, DEPOSIT AND SENIOR PREFERRED DEBT RATINGS

BayernLB's long-term deposit rating, senior preferred debt rating and DCR are rated one notch above its Long-Term IDR because of the protection provided by resolution buffers to these preferred creditors.

Bayern LB's short-term deposit rating is the lower of the two ratings that map to an 'A' long-term deposit rating because our assessment of BayernLB's funding and liquidity score is not sufficiently high to achieve a higher short-term rating.GRANDFATHERED STATE-GUARANTEED SECURITIES

The ratings of BayernLB's grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes are equalised with the State of Bavaria's Long-Term IDR because we expect Bavaria to honour its guarantee.

Fitch believes that the protection provided by the grandfathered guarantee is similar between senior and subordinated debt instruments because the statutory guarantor's liability (Gewaehrtraegerhaftung) does not differentiate the seniority among liabilities. In our view, regulatory and EU state aid frameworks do not constrain the level of support for grandfathered debt.NON-GUARANTEED TIER 2 SUBORDINATED DEBT

Bayern LB's subordinated debt is rated two notches below its VR. This reflects the change in BayernLB's VR and the change in our baseline notching for loss-severity to two notches (from one previously) since the bank does not meet the specific conditions under our criteria for applying a reduced notching.

RATING SENSITIVITIES

IDRS, SR, SENIOR UNSECURED AND SNP

The IDRs, SR, senior unsecured debt and SNP ratings are primarily 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.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of SFG's IDRs or a loosening of European state support regulation, which we do not expect, could lead to an upgrade of the above ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:A downgrade of SFG's IDRs, a change in the ownership structure or a change in the owners' strategic commitment to the bank could lead to a downgrade of the above ratings.

VR

Factors that could, individually or collectively, lead to positive rating action/upgrade:An upgrade of BayernLB's VR would require the economic shock from the pandemic to be short, followed by a swift recovery, resulting in a limited impact on the bank's financial metrics and a structural improvement in BayernLB's profitability, which in our view is unlikely in the near term.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

BayernLB has headroom to emerge with its VR intact, but this outcome will depend on the ultimate depth and duration of the coronavirus shock to the domestic economy. The VR would likely be downgraded if the economic and financial market disruption arising from the coronavirus outbreak is likely to reach a level that places sustained pressure on asset quality or earnings that ultimately make the bank's business model less sustainable. Further deterioration in the bank's profitability, which is a relative rating weakness, could indicate pressure on the business model.

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.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The ratings are 'AAA', which is the highest level on Fitch Ratings' scale. The ratings cannot be upgraded.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of the IDRs of Bavaria would lead to a downgrade of the ratings.

NON-GUARANTEED TIER 2 SUBORDINATED DEBT

The ratings of the Tier 2 subordinated notes are primarily sensitive to changes in the bank's VR, from which they are notched.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade in BayernLB's VR or a buffer of Tier 1 and Tier 2 debt sustainably exceeding 10% of RWAs.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of BayernLB'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 ratings would be downgraded if we expect BayernLB to include senior preferred debt in its resolution buffer or if the sum of SNP and more junior debt buffers fall below 10% of RWA.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of BayernLB's IDRs.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of BayernLB's IDRs or if we expect BayerLB to include senior preferred debt in its resolution buffer or if the sum of SNP and more junior debt buffers falls below 10% of RWA.

BEST/WORST CASE RATING SCENARIO

Ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

BayLB's ratings are driven by potential support from the bank's ultimate parent, SFG.

ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Bayerische Landesbank	EU Issued

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Germany
