MOODY'S
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# Rating Action: Moody's upgrades Bayerische Landesbank's senior unsecured ratings to A1, deposit ratings to Aa3; outlook stable

Global Credit Research - 13 Apr 2017

**Baseline credit assessment upgraded to baa3, reflecting sustained improvements in BayernLB's credit fundamentals**

Frankfurt am Main, April 13, 2017 -- Moody's Investors Service (Moody's) has today upgraded Bayerische Landesbank's (BayernLB) long-term deposit and senior senior unsecured debt ratings to Aa3 from A1, as well as its senior unsecured debt and issuer ratings to A1 from A2. The outlook on the long-term ratings is stable. At the same time, the rating agency upgraded BayernLB's baseline credit assessment (BCA) to baa3 from ba1, its adjusted BCA to baa1 from baa2, and its long-term Counterparty Risk Assessment (CR Assessment) to Aa3(cr) from A1(cr). The bank's short-term program and deposit ratings were affirmed at (P) P-1 and P-1, respectively, as well as its short-term CR Assessment at P-1(cr).

As part of today's rating action, Moody's also upgraded BayernLB's subordinated debt ratings to Baa2 from Baa3, its junior subordinated debt rating to Baa3(hyb) from Ba1(hyb), and the non-cumulative preferred stock rating of BayernLB Capital Trust I to Ba2(hyb) from Ba3(hyb).

The rating upgrade reflects the continued strengthening of the bank's financial fundamentals, in particular the improvement of its capitalization and asset quality, including Moody's assessment of lower tail risks in BayernLB's remaining non-core exposure. The stable outlook reflects Moody's expectation that BayernLB will be able to sustain its more solid credit metrics going forward.

BayernLB's Aaa rated guaranteed senior unsecured and subordinated debt obligations that qualify for 'grandfathering' under the public law guarantee ('Gewaehrtraegerhaftung') of the Free State of Bavaria (Aaa stable) remain unaffected.

A full list of affected ratings and rating inputs can be found at the end of this press release.

RATINGS RATIONALE

-- UPGRADE OF BAYERNLB'S BASELINE CREDIT ASSESSMENT

The upgrade of the BCA to baa3 from ba1 follows the strengthening of BayernLB's key credit metrics and reflects the bank's: (1) improved asset quality and lowered tail risks from its remaining non-core exposures; and (2) improved capital, which also benefited from ample earnings retention in 2016. At the same time, BayernLB's BCA continues to reflect its low risk-adjusted profitability and highly wholesale-dependent funding profile.

At end-2016, BayernLB's reported problem loans as a percentage of its gross credit exposure declined to 1.6% from 2.4% in 2015. The reduction reflects the overall benign domestic credit environment and the continued wind-down of the bank's non-core exposure, including the write-off of BayernLB's remaining impaired claim against Heta Asset Resolution AG (Heta, Carinthian state-guaranteed senior unsecured debt rating Ca stable). Moody's further believes that the tail risks from BayernLB's remaining non-core exposure are limited.

The upgrade of BayernLB's standalone BCA is further supported by the increase in its fully loaded Common Equity Tier 1 (CET1) capital ratio, which excludes the bank's remaining EUR1.0 billion of state aid it received from the Free State of Bavaria, to 13.2% at end-2016 from 12.0% in 2015. The improvement reflects the lowering of BayernLB's risk-weighted assets, which declined to EUR65.2 billion from EUR69.6 billion over the same time, and ample earnings retention. Excluding minorities, BayernLB reported net income of EUR545 million in 2016 compared with EUR495 million in 2015, benefiting from a reduction of credit provisions that declined to EUR87 million from EUR264 million.

However, BayernLB's BCA remains constrained by its highly wholesale-dependent funding profile and low risk-adjusted profitability. Moody's believes that BayernLB continues to face challenges to its profitability because of the bank's high dependence on interest income, which is under pressure from persistent low interest rates, as well as general cost inflation pressure.

-- UPGRADE OF LONG-TERM RATINGS

The upgrade of BayernLB's long-term ratings by one notch follows the one-notch upgrade of the bank's BCA. BayernLB's long-term ratings reflect: (1) its standalone baa3 BCA and baa1 Adjusted BCA, incorporating Moody's unchanged assessment of a high probability of BayernLB receiving affiliate support from Sparkassen-Finanzgruppe (S-Finanzgruppe, Corporate Family Rating Aa2 stable, BCA a2), which continues to result in two notches of rating uplift; (2) the unchanged results of Moody's Advanced Loss Given Failure (LGF) analysis, which provides three notches of uplift to the bank's deposit ratings and two notches of uplift to its senior unsecured debt ratings from its adjusted BCA; and (3) the rating agency's unchanged assumption of "moderate" government support, resulting in one notch of additional rating uplift for BayernLB's long-term ratings. In combination, these assumptions result in four notches of uplift to BayernLB's deposit ratings and three notches of uplift to the bank's senior unsecured debt ratings from its adjusted BCA.

-- RATIONALE FOR THE STABLE OUTLOOK

The stable outlook on BayernLB's long-term ratings reflects Moody's expectation that the bank will be able to sustain its improved credit profile, which will be supported by the benign domestic operating environment over the next 12 to 18 months, despite continued pressures from the persistent low interest-rate environment on the bank's earnings.

WHAT WOULD MOVE THE RATING UP / DOWN

An upgrade of BayernLB's long-term ratings could be triggered following (1) a two notch upgrade of the bank's standalone BCA which would be needed to trigger upwards pressure on the bank's baa1 adjusted BCA based on high sector support assumptions; and/or (2) a reduction of the expected loss severity following a shift in the bank's funding mix, which could result in higher rating uplift for its senior unsecured debt and issuer ratings as a result of Moody's LGF analysis; the bank's deposit and senior senior unsecured debt ratings already benefit from the highest possible uplift under the Advanced LGF analysis which is three notches and would therefore not benefit from such changes in the bank's funding mix.

An upgrade of BayernLB's BCA could develop from: (1) further improvements in asset risk, including a reduction of sector concentrations; (2) further improvements of its fully-loaded capital ratios and balance sheet leverage; and/or (3) persistent strengthening of recurring earnings.

A downgrade of BayernLB's long-term ratings could be triggered following: (1) a downgrade of the bank's standalone BCA or its adjusted BCA; and/or (2) an increase in the expected loss severity following a shift in the bank's funding mix, which could result in less rating uplift for senior debts and deposits as a result of Moody's LGF analysis.

A downgrade of BayernLB's BCA and adjusted BCA could develop from: (1) a deterioration of credit fundamentals leading to a lowering of the bank's baa3 BCA; (2) a reduction of Moody's affiliate support assumptions from the S-Finanzgruppe or a weakening of the cross-sector support mechanisms.

LIST OF AFFECTED RATINGS

Issuer: Bayerische Landesbank

..Upgrades:

....Long-term Counterparty Risk Assessment, upgraded to Aa3(cr) from A1(cr)

....Long-term Bank Deposits, upgraded to Aa3 Stable from A1 Stable

....Senior Senior Unsecured Regular Bond/Debenture, upgraded to Aa3 Stable from A1 Stable

....Senior Senior Unsecured Medium-Term Note Program, upgraded to (P)Aa3 from (P)A1

....Long-term Issuer Rating, upgraded to A1 Stable from A2 Stable

....Senior Unsecured Regular Bond/Debenture, upgraded to A1 Stable from A2 Stable

....Senior Unsecured Medium-Term Note Program, upgraded to (P)A1 from (P)A2

....Subordinate Medium-Term Note Program, upgraded to (P)Baa2 from (P)Baa3

....Subordinate Regular Bond/Debenture, upgraded to Baa2 from Baa3

....Junior Subordinated Regular Bond/Debenture, upgraded to Baa3(hyb) from Ba1(hyb)

....Adjusted Baseline Credit Assessment, upgraded to baa1 from baa2

....Baseline Credit Assessment, upgraded to baa3 from ba1

..Affirmations:

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Short-term Bank Deposits, affirmed P-1

....Other Short Term (MTN), affirmed (P)P-1

....Commercial Paper, affirmed P-1

..Outlook Action:

....Outlook remains Stable

Issuer: Bayerische Landesbank, (London Branch)

..Upgrades:

....Long-term Counterparty Risk Assessment, upgraded to Aa3(cr) from A1(cr)

....Long-term Bank Deposits, upgraded to Aa3 Stable from A1 Stable

....Senior Unsecured Medium-Term Note Program, upgraded to (P)A1 from (P)A2

....Subordinate Medium-Term Note Program, upgraded to (P)Baa2 from (P)Baa3

..Affirmations:

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

..Outlook Action:

....Outlook remains Stable

Issuer: Bayerische Landesbank, (New York Branch)

..Upgrades:

....Long-term Counterparty Risk Assessment, upgraded to Aa3(cr) from A1(cr)

....Long-term Bank Deposits, upgraded to Aa3 Stable from A1 Stable

....Senior Senior Unsecured Regular Bond/Debenture, upgraded to Aa3 Stable from A1 Stable

....Senior Senior Unsecured Medium-Term Note Program, upgraded to (P)Aa3 from (P)A1

....Senior Unsecured Regular Bond/Debenture, upgraded to A1 Stable from A2 Stable

..Affirmation:

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

..Outlook Action:

....Outlook remains Stable

Issuer: Bayerische Landesbank, (Paris Branch)

..Upgrades:

....Long-term Counterparty Risk Assessment, upgraded to Aa3(cr) from A1(cr)

....Senior Unsecured Medium-Term Note Program, upgraded to (P)A1 from (P)A2

....Subordinate Medium-Term Note Program, upgraded to (P)Baa2 from (P)Baa3

....Long-term Bank Deposits, upgraded to Aa3 Stable from A1 Stable

..Affirmation:

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

..Outlook Action:

....Outlook remains Stable

Issuer: BayernLB Capital Trust I

..Upgrade:

....Pref. Stock Non-cumulative, upgraded to Ba2(hyb) from Ba3(hyb)

..Outlook Action:

....No Outlook assigned

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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