



## RATING ACTION COMMENTARY

# Fitch Affirms BayernLB's Long-Term IDR at 'A-/Stable

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Fitch Ratings - Frankfurt am Main - 17 Mar 2022: Fitch Ratings has affirmed Bayerische Landesbank's (BayernLB) Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook. The bank's Viability Rating (VR) has also been affirmed at 'bbb'.

A full list of rating actions is detailed below.

Following the update of Fitch's Bank Rating Criteria on 12 November 2021, Fitch has withdrawn the bank's Support Rating of '1' as it is no longer relevant to the agency's coverage. In line with the updated Criteria, we have assigned BayernLB a Shareholder Support Rating (SSR) of 'a-'.

## KEY RATING DRIVERS

### IDRS, SSR, SENIOR NON-PREFERRED DEBT (SNP) RATINGS

BayernLB's IDRs, SSR and SNP ratings are driven by Fitch's view of strong support from the bank's owners, the savings banks (Sparkassen Finanzgruppe; SFG, A+/Stable) and the State of Bavaria. The Stable Outlook on BayernLB's Long-Term IDR mirrors that of SFG.

Fitch uses SFG's Long-Term IDR as the anchor rating because 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 on support, due to the requirement for state-aid examination under the EU competition rules. The two-notch difference also reflects BayernLB's strategic, but not key and integral, role for its owners.

BayernLB's Short-Term IDR of 'F1' is the higher of two possible ratings that map to an 'A-' Long-Term IDR, because the propensity of support by its institutional owners is more certain in the near term.

VR

BayernLB's VR reflects the bank's moderate earnings-generation capacity, which is undermined by expenses for the implementation of its medium-term transformation programme. It also reflects adequate asset quality, healthy capital ratios providing satisfactory buffers over regulatory minimums, and fairly stable funding. BayernLB's VR is one notch below the implied 'bbb+' rating, due to the bank's still moderate profitability, which we score 'bbb-'.

BayernLB's asset quality proved resilient through the pandemic across its main sectors, helped by material government-support measures. We expect resilient asset-quality metrics in the short term, with an impaired loan ratio of around 1% at end-2022. Given BayernLB's focus on Germany, we expect no material short-term direct impact on the bank's loan book from the Russia-Ukraine conflict. Our asset-quality projections are subject to second-order effects from the conflict.

BayernLB's profitability is moderate but improved in 9M21 towards pre-pandemic levels. The bank has capped its strategic loan growth to about EUR70 billion risk-weighted assets (RWAs) to end-2024, which moderately constrains its longer-term earnings potential. However, further expected growth in its subsidiary Deutsche Kreditbank AG, which provides stronger margins than the bank's wholesale business, is likely to support group profitability. We expect the four-year average operating profit to remain at about 1% of RWAs through the cycle.

BayernLB's common equity Tier 1 (CET1) ratio of 16.4% at end-3Q21 is robust compared with its peers' and above the bank's medium-term target. It provides satisfactory buffers over its regulatory requirements despite the macro-prudential measures announced by BaFin in January 2022. We estimate the CET1 ratio to have improved further at end-2021, assuming a profitable 4Q21. Thereafter the bank could face challenges from an increase in RWAs, mainly caused by stronger-than-anticipated loan growth.

Funding and liquidity are sound. BayernLB is wholesale funded, as reflected by a moderately higher loans/deposits ratio compared with commercial bank peers'. However, it benefits from a high share of deposit-driven retail business at DKB and moderate capital-market funding requirements, due to the bank's reliable placement capacity within the savings bank sector. Its liquidity position is strong, covered by a large portfolio of liquid assets.

## DERIVATIVE COUNTERPARTY RATINGS (DCR), DEPOSIT RATINGS AND SENIOR PREFERRED DEBT RATINGS

BayernLB's DCR, long-term deposit rating and senior preferred debt ratings are one notch above its Long-Term IDR. This reflects the protection of preferred creditors arising from the bank's large resolution buffers including SNP and more junior debt. The short-term deposit rating is the lower of the two ratings that map to its 'A' long-term deposit rating, in line with Landesbanken peers'. This is because we believe that, despite the owners' very high propensity to provide support to BayernLB, we see potential impediments to the prompt flow of funds that are not commensurate with an 'F1+' short-term rating, given the lengthy process required to support a Landesbank.

## GRANDFATHERED STATE-GUARANTEED SECURITIES

The 'AAA' ratings of BayernLB's grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes reflect our view of the creditworthiness of the State of Bavaria, which is closely linked to that of Germany (AAA/Stable), and reflect outstanding recovery prospects arising from the guarantee of Bavaria.

## NON-GUARANTEED TIER 2 SUBORDINATED DEBT

BayernLB's non-guaranteed Tier 2 subordinated bond rating is notched down twice from the bank's VR to reflect loss severity that is in line with Fitch's baseline approach.

## RATING SENSITIVITIES

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

A downgrade of SFG's IDRs, or an adverse change in BayernLB's ownership structure or in the owners' strategic commitment could lead to a downgrade of BayernLB's IDRs and SSR.

BayernLB's VR offers moderate headroom in downside scenarios to our baseline forecast. We could downgrade the VR if we expect severe and sustained pressure on asset quality, durably weakening the bank's four year-average impaired loan ratio to

above 3% and operating profit/RWAs below 0.5%. Also, a significant adverse change in its corporate structure could put pressure on its VR, particularly if it would impair the bank's revenue-generating capacity.

A downgrade of BayernLB's IDRs would trigger a downgrade of its DCR and deposit ratings. We could also downgrade these ratings if we expect its junior and SNP debt buffer to fall durably below 10% of its RWAs.

Adverse changes in Fitch's view of Bavaria's creditworthiness, which is closely linked to that of Germany, would lead to a downgrade of BayernLB's guaranteed debt ratings.

A downgrade of BayernLB's VR would lead to a downgrade of its subordinated debt ratings.

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

BayernLB's rating upside is limited. The IDRs and SSR are primarily sensitive to positive changes in our assumptions around the propensity or ability of BayernLB's owners to provide timely support. An upgrade of SFG's IDRs could lead to an upgrade of BayernLB's IDRs.

An upgrade of the VR would be contingent on a structural improvement in BayernLB's profitability, with an operating profit/RWAs sustainably above 1%, without negatively affecting the bank's risk profile.

An upgrade of the IDRs would trigger an upgrade of the DCR and deposit ratings, unless its resolution buffers decrease below 10% of its RWAs.

The ratings of the grandfathered state-guaranteed senior unsecured and Tier 2 subordinated notes are 'AAA', which is the highest level on Fitch's scale, and therefore cannot be upgraded.

An upgrade to the bank's VR would lead to an upgrade of its subordinated debt ratings.

### **VR ADJUSTMENTS**

The business profile score of 'bbb' has been assigned below the 'a' category implied score, due to the following adjustment reason: business model (negative).

The capitalisation and leverage score of 'bbb+' has been assigned below the 'aa' category implied score, due to the following adjustment reasons: internal capital generation and growth (negative)

## BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond 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, visit <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

BayernLB's ratings are driven by potential support from SFG.

## ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

## RATING ACTIONS

ENTITY / DEBT ◆	RATING ◆		PRIOR ◆
Bayerische Landesbank	LT IDR	A- Rating Outlook Stable	A- Rating Outlook Stable
	Affirmed		
	ST IDR	F1 Affirmed	F1

	Viability	bbb	Affirmed	bbb
	Support	WD	Withdrawn	1
	DCR	A(dcr)	Affirmed	A(dcr)
	Shareholder Support	a-	New Rating	
senior unsecured	LT	AAA	Affirmed	AAA
subordinated	LT	AAA	Affirmed	AAA
Senior non-preferred	LT	A-	Affirmed	A-
subordinated	LT	BB+	Affirmed	BB+
long-term deposits	LT	A	Affirmed	A
Senior preferred	LT	A	Affirmed	A
short-term deposits	ST	F1	Affirmed	F1
Senior preferred	ST	F1	Affirmed	F1

[VIEW ADDITIONAL RATING DETAILS](#)

## FITCH RATINGS ANALYSTS

**Markus Glabach**

Director

Primary Rating Analyst

+49 69 768076 195

markus.glabach@fitchratings.com

Fitch Ratings – a branch of Fitch Ratings Ireland Limited

Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

**Patrick Rioual**

Senior Director

Secondary Rating Analyst

+49 69 768076 123

patrick.rioual@fitchratings.com

**Olivia Perney**

Managing Director

Committee Chairperson

+33 1 44 29 91 74

olivia.perney@fitchratings.com

**MEDIA CONTACTS**

**Louisa Williams**

London

+44 20 3530 2452

louisa.williams@thefitchgroup.com

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**APPLICABLE CRITERIA**

[Bank Rating Criteria \(pub. 12 Nov 2021\) \(including rating assumption sensitivity\)](#)

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