

W&W Group

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W&W Group

Major Rating Factors

Strengths:

- A good position as a second-tier bancassurance group in Germany.
- Sound underwriting performance in non-life business.
- Funding stability and good loan quality in the combined banking segment.
- Adequate ERM capabilities with a positive trend.

Weaknesses:

- Continued pressure on bottom-line earnings because of low interest rates.
- Material exposure of the banking segment to market and credit spread risks.

Holding Company: Wuestenrot & Wuerttembergische AG
Counterparty Credit Rating <i>Local Currency</i> BBB/Stable/A-3
Operating Companies Covered By This Report
Financial Strength Rating <i>Local Currency</i> BBB+/Stable/--

Rationale

The ratings on the various core operating entities of the Germany-based Wuestenrot & Wuerttembergische bancassurance group (W&W) reflect Standard & Poor's Ratings Services' assessment of the group's position as a second-tier bancassurance player in Germany. We assess the group credit profile (GCP)--which reflects our opinion of a group's creditworthiness, if the group were a single legal entity--at 'bbb+'.

The one-notch-lower rating on the group's holding company Wuestenrot & Wuerttembergische AG (W&W AG; BBB/Stable/A-3) reflects the structural subordination of the holding company's creditors to the group's insurance policyholders. Additionally, the holding company relies predominantly on income from its regulated insurance and banking operating entities to meet its obligations.

In our view, W&W benefits from its good position as a second-tier bancassurance player in the German financial services market, and we consider its management and corporate strategy as supportive for the rating. We consider the insurance as well as the banking subgroups to be intrinsic parts of the group, which, as providers for protection and provision products, can draw on a broad and diversified sales network and customer base.

Overall, the group's strategy and risk appetite are, in our view, mostly aligned with the available resources. We also note W&W's complexity relative to its size, and its potentially limited capacities as it undergoes various restructurings. After completing its 2009 program, management started a new, major efficiency improvement program called "W&W 2012". The main goals of this program are sustainable above-market-average growth, and competitive cost and service levels via new information technology, to move net income toward the group's €250 million target.

We regard W&W group's overall earnings performance as good. Our base case assumes the group's prospects will improve while, due to the low interest rate environment, we regard the profitability increase as not sustainable. Additionally, the overall implementation costs for "W&W 2012" could cause short- to medium-term bottom-line pressures. We therefore think that W&W will be challenged to achieve the targeted net income of €250 million on a sustained basis in the short to medium term. W&W's 2011 IFRS net profit of €191.6 million has exceeded last

year's results, despite significant write-offs of Greek sovereign investments. However, these were largely offset by one-off tax benefits. We expect that the bulk of the profits will be retained at the group level, which will help protect the group's strong capitalization.

We believe that W&W is challenged to effectively leverage cross-selling opportunities between the building-savings bank and its insurance sales business. A contribution of 10% (measured by number of customers acquired by the group's tied sales organizations) to the overall sales of each segment in 2010 signaled modest progress. In our view, it will be ambitious for W&W to achieve the targeted cross-selling ratio of 15% in the short term.

We view W&W's ERM as adequate and improving. This reflects its success in implementing a strong, group-wide, and consistent risk management culture as well as strong controls for the group's main risk. Although W&W offers mainly retail products in only one geographical market, ERM is an important rating factor because of the complexity inherent in the business model, which operates both a building-savings and insurance business.

The SACP of the combined banking subgroup is 'bbb'. The starting point for our ratings on the banking subgroup is its 'a-' anchor, which is based on our view of the banking system in Germany. We consider the banking subgroup's business position to be "moderate" in view of its concentrated business profile, as defined in our criteria. We assess the banking subgroup's capital and earnings as "adequate" because we believe that the quality of capital is strong and we anticipate that the risk-adjusted capital (RAC) ratio might ease to a range of 10.0% to 10.5% over the coming 18-24 months. Our assessment of the banking subgroup's risk position as "moderate" reflects our view that it is exposed to significant risks not captured by our RAC analysis. We view the funding and liquidity of the banking subgroup as "adequate," based on a healthy mix of core deposits and capital market issuance, and adequate liquidity metrics. Standard & Poor's bases its ratings on the combined banking subgroup on its "core" status within W&W group.

Our assessment of the insurance subgroup as "core" to W&W group is based on its favorable competitive position, favorable operating performance, and the favorable capitalization of its core entities.

We view the group's primary non-life underlying underwriting performance as strong, reflecting a strong net combined (loss and expense) ratio of about 92.8% for 2011 (2010: 99.0%) and a five-year average of about 95%, which compares well with peers. In our base-case assumption, we believe that a net combined ratio clearly below 100% should be sustainable over the cycle.

However, sustained low interest rates have been putting pressure on W&W insurance subgroup's overall operating performance, both in life and non-life. Under our base-case assumption--that interest rates, at best, will moderately rise over the next two years--we anticipate that this pressure on investment returns will prevail in 2012 and 2013. For Wuerttembergische Lebensversicherung AG (the life business) we expect that low interest rates will also entail higher reserving requirements pressuring the gross surplus.

Outlook

The stable outlook reflects our view of the overall group's limited prospects to sustainably improve its bottom-line earnings while interest rates remain low. We also remain concerned about W&W's ability to more effectively exploit its potential cross-selling capacities. Furthermore, we consider that the group will find it difficult to translate the additional sales capacity from the recent banking acquisitions into meaningful, sustainable, and profitable organic

growth. Any change in the ratings on W&W group's core entities would affect the ratings on W&W AG.

We could consider revising the group credit profile if the group were to demonstrate notable progress in achieving and sustaining net earnings of €250 million after tax, and only if this would increase its capital ratios to a sustainable higher level via earnings retention, especially in the banking segment.

Conversely, we could lower the ratings if the group's operating performance and capitalization were to significantly deteriorate to a level materially lower than our expectations.

Group Profile: A Second-Tier Bancassurance Player In Germany

W&W is a second-tier player in the German financial services retail market and is involved in building-savings activity, retail banking, life and non-life insurance, and asset management. W&W's core operating insurance entities are Wuerttembergische Lebensversicherung AG (WL; life) and Wuerttembergische Versicherung AG (WV; non-life). The group's core banking entities are Wuestenrot Bausparkasse AG (WBSK), a building-savings (bauspar) bank, and Wuestenrot Bank AG Pfandbriefbank (WBP), a residential mortgage provider and covered bonds issuer (Pfandbriefe). The group expanded its activities in building-savings through acquiring Victoria Vereinsbank Bauspar AG (VVB) in 2009 and Allianz Dresdner Bauspar AG (ADB) and the subsequent merger into WBSK.

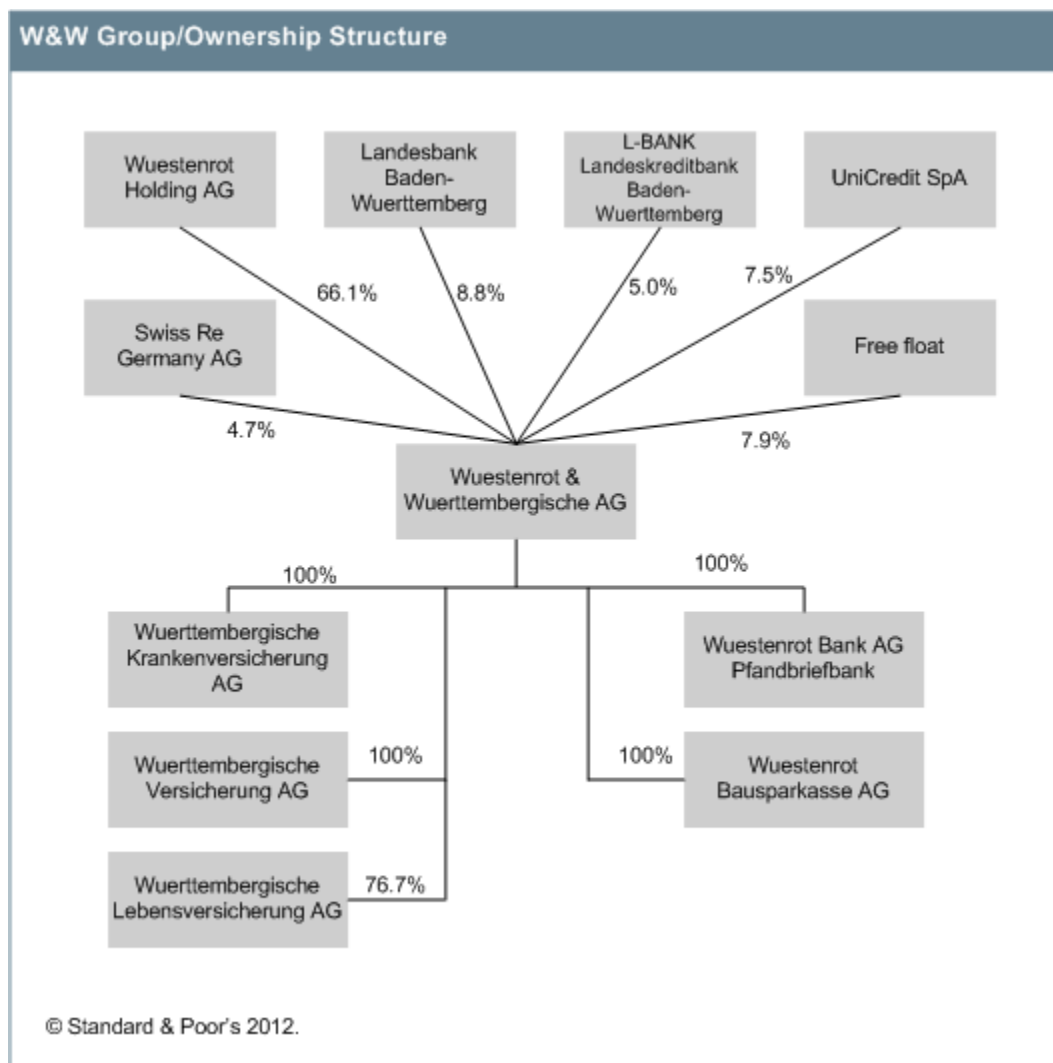
At year-end 2011, the group had €75.4 billion (€76.0 billion in 2010) in consolidated assets. Its two core segments, banking and insurance, each contributed about 50% of the group's consolidated assets (see table 1).

Table 1

W&W Group/Segment Reporting (as per IFRS)										
(Mil. €)	--Revenues*--		--Income before tax--		--Assets--		--Capital--		--Average staff--	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
Building-savings segment	419	374	-2	110	39,419	39,887	1,453	1,375	3,120	2,947
Life insurance	3,266	3,737	53	54	30,291	30,645	231	189	1,116	1,138
Non-life insurance	1,210	1,149	131	51	3,683	3,676	669	574	4,434	4,653
Other/consolidation	255	188	10	0	1,966	1,782	616	694	1,458	1,229
Total W&W group	5,150	5,448	192	215	75,359	75,990	2,969	2,832	10,128	9,967

*Revenues for building-savings segment include: reported net financial result gross of the building-savings segment's loan loss provisions; Revenues of the insurance segments include: net financial result + net income/expenses from investment property + net premiums earned.

W&W's core operating entities are joint-stock companies, owned by W&W AG, the group's holding company (see chart). W&W AG has profit-and-loss transfer agreements with WBP and WV.



With about 6,000 self-employed exclusive agents and a customer base of about six million (banking segment, 48%; insurance, 52%), we believe W&W should be well positioned to further benefit from cross-selling activities within the group.

Group Capitalization: At A Strong Level

W&W's overall capitalization is strong, in our view, thanks to solid shareholders' funds and sound life-policyholder bonus reserves. The statutory group solvency position for the financial conglomerates is also well above requirements.

Financial Flexibility: Limited Capital Needs

We view W&W's financial flexibility (defined as a company's ability to source capital relative to its needs) as strong. Since access to capital markets appears limited in the current environment, we expect retained earnings to be the

main source of equity funding. However, we don't anticipate the need for material external funding because we don't expect W&W group to undertake larger acquisitions any time soon. Future capital needs would likely stem mainly from organic growth and from smaller bolt-on acquisitions in the insurance segment.

Enterprise Risk Management: Improved to Adequate With Positive Trend

We assess the group's ERM to be adequate and improving. We do not expect the group to experience losses outside its risk tolerance limits. We view as strong the risk-management culture and controls for the group's main risks around asset liability management, and market and credit risks. Strong risk controls are, in our view, also in place for non-life underwriting including natural catastrophes as well as for new product risks. We assess as adequate the group's reserving, reinsurance, and operational risk controls, as well as its emerging risk management.

The group has implemented a strong and consistent risk management culture and governance across all insurance and banking segments and business units. This includes a consistent group risk appetite framework including risk tolerance levels and operational limit systems. The risk appetite is determined by the group's executive board, taking into account statutory as well as economic capital requirements and available financial resources.

We believe the group has further enhanced its strategic risk management capabilities by integrating risk and return targets into its value-based management approach, including performance measurement and remuneration systems for management and also for the sales organization. The group, however, has yet to deliver a more sustained track record of effective strategic execution.

Accounting: Disclosure Of Consolidated Accounts Under IFRS

W&W discloses consolidated financial statements under IFRS. Additionally, all group entities report under German generally accepted accounting principles (GAAP). We have based our consolidated group analysis mainly on IFRS figures, but used the German GAAP figures to supplement our evaluation of the individual segments. Our assessment of the life insurance performance is based on market-consistent embedded value (MCEV) metrics, which the group, however, has not yet publicly disclosed.

We assessed the capitalization of the combined banking and insurance group based on consolidated capital requirements according to our risk based models and the consolidated IFRS shareholders' equity, which we adjusted for the specific insurance and banking components, as follows:

- Crediting 50% of non-life reserve redundancies and 67% of the non-life loss reserve discount not included in the balance sheet;
- Crediting 50% of the life insurance value-in-force not included in the balance sheet;
- Adding the free and unallocated portion of the policyholder bonus reserve in life insurance; and
- Deducting WBSK's "Fonds zur baupartechnischen Absicherung", a reserve fund aimed to protect the savings/loan collective, which is part of IFRS equity. WBSK does not have full discretion over these funds.

Rationale: The Banking Subgroup

Anchor: 'a-' based on mostly German exposures

Under our bank criteria, we use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating (ICR). Our anchor for a commercial bank operating only in Germany is 'a-', based on an economic risk score of '1' and an industry risk score of '3'.

Our economic risk assessment reflects Germany's highly diversified and competitive economy and a lack of major economic imbalances. An export-led nation, Germany remains vulnerable to swings in global economies, trade flows, and capital market trends, however.

Industry risk benefits from Germany's extensive funding market and banks' domestic funding surpluses from low domestic credit growth and high savings rates. However, the sector's competitive dynamics result in relatively low profitability, which is fueled by significant disparities in the commercial targets and business and risk profiles of market players.

Table 2

Wuestenrot Bausparkasse AG Key Figures					
--Year-ended Dec. 31--					
(Mil. €)	2011	2010	2009	2008	2007
Adjusted assets	23,123.8	23,880.5	18,591.0	16,800.5	17,795.2
Customer loans (gross)	14,961.1	14,301.5	12,379.8	11,155.7	11,628.9
Adjusted common equity	781.0	780.4	677.4	676.8	676.9
Operating revenues	461.6	433.8	457.7	316.7	415.2
Noninterest expenses	435.1	450.9	356.6	317.6	349.2
Core earnings	48.7	98.4	70.0	(33.1)	14.5

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 3

Wuestenrot Bank AG Pfandbriefbank Key Figures					
--Year-ended Dec. 31--					
(Mil. €)	2011	2010	2009	2008	2007
Adjusted assets	15,139.8	15,462.9	15,301.3	13,289.0	14,351.0
Customer loans (gross)	9,460.9	9,638.7	9,555.5	10,139.4	11,256.0
Adjusted common equity	382.6	352.6	335.5	335.7	335.7
Operating revenues	126.5	109.2	118.0	120.5	114.4
Noninterest expenses	101.5	91.5	84.8	92.2	92.2
Core earnings	N/A	21.4	17.9	8.9	0.6

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Business position: Concentrated business profile

We assess the banking subgroup's business position as "moderate" in view of its concentrated business profile.

The subgroup's two banking entities are Wuestenrot Bausparkasse AG, a building-savings (Bauspar) bank, and Wuestenrot Bank AG, a Pfandbriefbank. As with most of its peers, the subgroup's business activities are focused on a relatively narrow range of products, supplemented by residential real estate lending via its Pfandbriefbank. Nevertheless, the subgroup benefits from some geographical diversification within Germany. It has a broad and

diversified sales network and customer base and has enhanced its market share in Bauspar contracts, about 12% at end-2011, by acquiring Victoria Vereinsbank Bauspar AG (VVB) in 2009 and Allianz Dresdner Bauspar AG (ADB) in 2010. The customers stayed with the banking subgroup during the financial crisis; there was very limited volatility in core customer deposits.

Nevertheless, the banking subgroup remains constrained by a high degree of competition and the need to develop its distribution capabilities and cross-selling opportunities. Its operating revenues have been somewhat volatile while interest rates have been low, and it could face execution risks in smoothly integrating its recent acquisitions.

Table 4

Wuestenrot Bausparkasse AG Business Position Ratios					
--Year-ended Dec. 31--					
(%)	2011	2010	2009	2008	2007
Return on equity	5.7	2.6	9.9	2.1	2.2

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 5

Wuestenrot Bank AG Pfandbriefbank Business Position Ratios					
--Year-ended Dec. 31--					
(%)	2011	2010	2009	2008	2007
Return on equity	1.9	0.2	5.3	2.7	0.2

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Capital and earnings: RAC projection drives the adequate assessment

The banking subgroup's capital and earnings are assessed as "adequate." Our combined risk-adjusted capital (RAC) ratio at end-2010 was 10.4%, which is broadly in line with the total regulatory capital ratios of 11.0% for the Bausparkasse and 9.5% for the Pfandbriefbank. Given continued slow growth in loans, and modest profitability, we expect our combined RAC ratio to slightly decrease to nearly 10.0% over the coming 18-24 months. The group's internal capital planning indicates that management aims to balance future risk-weighted asset growth with lower risk weights under the regulatory internal ratings based approach, which the banking subgroup plans to implement by 2013. However, these lower risk weights are already partly applied in our RAC framework, so we maintain our forecast that the RAC ratio will decline.

This development is underpinned by our view of the earnings buffer as modest. The buffer is a measurement of the capacity for a bank's earnings to cover normalized losses. We forecast this will be negative for 2011. We believe the buffer may turn positive from 2012, however, facilitated by a reversing trend of decreasing average net interest spreads on outstanding bauspar loans. The subgroup suffers from relatively costly deposits, exacerbated by the continuing low interest rate environment, which also affects its interest income on securities and loans to financial institutions with variable coupons.

Overall, we conclude that the banking segment's ability to strengthen capital through earnings generation is moderate. Moreover, we note that the banking subgroup's potential bonus payments, even under its most unfavorable tariff schemes, are not fully covered by reserves.

Table 6

Wuestenrot Bausparkasse AG Capital And Earnings Ratios

(%)	--Year-ended Dec. 31--				
	2011	2010	2009	2008	2007
S&P RAC ratio before diversification	N.A.	13.3	12.6	N.A.	N.A.
S&P RAC ratio after diversification	N.A.	13.6	12.8	N.A.	N.A.
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	99.7	80.9	82.3	80.8	75.0
Fee income/operating revenues	(13.1)	(9.5)	(3.5)	(8.5)	(0.7)
Market-sensitive income/operating revenues	(7.7)	13.2	N/A	0.0	0.0
Noninterest expenses/operating revenues	94.3	103.9	77.9	100.3	84.1
Preprovision operating income/average assets	0.1	(0.1)	0.6	(0.0)	0.4
Core earnings/average managed assets	0.2	0.5	0.4	(0.2)	0.1

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 7

Wuestenrot Bank AG Pfandbriefbank Capital And Earnings Ratios

(%)	--Year-ended Dec. 31--				
	2011	2010	2009	2008	2007
Tier 1 capital ratio	6.9	5.9	6.0	5.6	N/A
S&P RAC ratio before diversification	N.A.	7.5	7.5	N.A.	N.A.
S&P RAC ratio after diversification	N.A.	6.9	7.0	N.A.	N.A.
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	107.9	98.6	92.8	94.7	88.4
Fee income/operating revenues	4.1	(3.8)	(4.9)	(6.2)	(0.7)
Market-sensitive income/operating revenues	(19.2)	(1.3)	3.3	(0.5)	2.1
Noninterest expenses/operating revenues	80.2	83.8	71.9	76.5	80.6
Preprovision operating income/average assets	0.2	0.1	0.2	0.2	0.2
Core earnings/average managed assets	N/A	0.1	0.1	0.1	0.0

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 8

Wuestenrot Bausparkasse AG Risk-Adjusted Capital Framework

	EAD*	Basel II RWA†	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Government and central banks	1,594,356	5,438	0	174,399	11
Institutions	6,957,838	907,050	13	913,538	13
Corporate	98,903	82,238	83	65,650	66
Retail	11,184,124	5,019,238	45	3,324,183	30
Of which mortgage	8,288,225	2,997,325	36	1,574,763	19
Securitization§	0	0	0	0	0
Other assets	278,029	258,163	93	250,226	90
Total credit risk	20,113,250	6,272,125	31	4,727,996	24
Equity in the banking book**	154	75	97	1,584	1,031
Trading book market risk	--	0	--	0	--

Table 8

Wuestenrot Bausparkasse AG Risk-Adjusted Capital Framework (cont.)					
Total market risk	--	75	--	1,584	--
Total insurance risk	--	--	--	0	--
Total operational risk	--	757,900	--	1,228,287	--
RWA before diversification	--	7,030,100	--	5,957,867	100
Total adjustments to RWA	--	--	--	-104,460	-2
RWA after diversification	--	7,030,100	--	5,853,407	98
		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio before adjustments		664,452	9.5	780,450	13.1
Capital ratio after adjustments ¶¶		664,452	9.5	780,450	13.3

*EAD: Exposure At Default. ¶RWA: Risk-Weighted Assets. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. **Equity Exposure includes the minority equity holdings in financial institutions. ¶¶For Tier 1 ratio, adjustments are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). Source: Company data as of Dec. 31, 2010.

Table 9

Wuestenrot Bank AG Pfandbriefbank RACF [Risk-Adjusted Capital Framework] Data					
(€ 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	2,558,535	2,550	0	186,868	7
Institutions	4,231,225	741,975	18	464,808	11
Corporate	205,010	160,238	78	129,065	63
Retail	9,650,236	4,358,638	45	3,281,334	34
Of which mortgage	6,119,043	2,134,213	35	1,162,618	19
Securitization	0	0	0	0	0
Other assets	228,211	217,488	95	205,390	90
Total credit risk	16,873,217	5,480,888	32	4,267,465	25
Market risk					
Equity in the banking book ¶	373	300	102	3,382	906
Trading book market risk	--	24,988	--	37,481	--
Total market risk	--	25,288	--	40,863	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	196,000	--	410,445	--
		Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA
Diversification adjustments					
RWA before diversification		5,702,175		4,718,773	100
Total adjustments to RWA		--		359,472	8
RWA after diversification		5,702,175		5,078,246	108

Table 9

Wuestenrot Bank AG Pfandbriefbank RACF [Risk-Adjusted Capital Framework] Data (cont.)				
	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio				
Capital ratio before adjustments	335,541	5.9	352,588	7.5
Capital ratio after adjustments [§]	335,541	5.9	352,588	6.9

*Exposure at default. €Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. §Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2010, Standard & Poor's.

Risk position: Significant risks not captured by RACF

The banking subgroup's "moderate" risk position reflects our view that it is exposed to significant risks not captured by our RAC analysis. That said, we expect the subgroup to maintain its relatively conservative risk management stance over the medium term.

The subgroup's lending is concentrated in Germany, where we note positively that residential property values are less inflated than in other European countries. Therefore, the loan-loss experience has been broadly in line with that of other German residential real estate lenders, during the previous low interest rate environment. We expect mortgage quality to remain sound. Nevertheless, the benefit of a solid, granular mortgage book with a strong loan quality is offset by a substantial securities portfolio of about €9.9 billion (or 26% of segment assets at year-end 2011) with fair exposures to peripheral Europe. This implies some vulnerability to credit spreads and significantly hampers pre-tax profits, in our view.

Another difficulty for risk management is that the subgroup's products, especially in its Bauspar business, feature a complex range of customer options that are linked to interest rate movements and affected by their current low level. W&W aims to adjust its tariffs but we expect that this will only slowly improve the subgroup's risk profile. The recent acquisitions do not appear to have significantly changed its risk profile, apart from exposing it to legacy savings schemes at high deposit rates. We expect these schemes to continue to limit the subgroup's profits if interest rates remain low.

The organizational split between its Bausparbank and Pfandbriefbank and dual reporting (German generally accepted accounting practice and International Financial Reporting Standards) complicate matters further.

Table 10

Wuestenrot Bausparkasse AG Risk Position Ratios					
(%)	--Year-ended Dec. 31--				
	2011	2010	2009	2008	2007
Growth in customer loans	4.6	15.5	11.0	(4.1)	(6.4)
Total diversification adjustment / S&P RWA before diversification	N.M.	(2.3)	(1.3)	N.M.	N.M.
Total managed assets/adjusted common equity (x)	29.6	30.6	27.4	24.8	26.3
New loan loss provisions/average customer loans	(0.3)	(1.1)	0.1	0.3	0.4

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 11

Wuestenrot Bank AG Pfandbriefbank Risk Position Ratios					
	--Year-ended Dec. 31--				
(%)	2011	2010	2009	2008	2007
Growth in customer loans	(1.8)	0.9	(5.8)	(9.9)	(7.3)
Total diversification adjustment / S&P RWA before diversification	N.M.	7.6	7.1	N.M.	N.M.
Total managed assets/adjusted common equity (x)	39.6	43.9	45.6	39.6	42.7
New loan loss provisions/average customer loans	0.2	(0.0)	0.1	0.3	0.2

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: A healthy funding mix and adequate liquidity

We view the funding and liquidity of the banking subgroup as "adequate," based on its "average" funding and "adequate" liquidity.

The banking segment's relative funding stability is based on a healthy mix of core deposits and capital market issuance. Most of the funding base comprises a substantial volume of relatively stable and granular core/customer deposits, mainly sourced from its Bausparkasse. The combined customer loan/customer deposit ratio was about 105% at year-end 2011, and prospective loan growth is expected to be limited, in our view. We therefore anticipate that the banking subgroup will have very limited recourse to wholesale lending over the medium term, facilitated by covered bond issuance within its Pfandbriefbank. The subgroup's liquidity metrics are in line with most of its peers.

Table 12

Wuestenrot Bausparkasse AG Funding And Liquidity Ratios					
	--Year-ended Dec. 31--				
(%)	2011	2010	2009	2008	2007
Core deposits/funding base	86.3	84.4	87.4	82.2	85.7
Customer loans (net)/customer deposits	83.7	78.7	85.7	89.0	83.6
Long term funding ratio	86.9	85.0	87.9	82.9	86.4
Broad liquid assets/short-term wholesale funding (x)	0.8	0.9	1.2	1.0	1.7
Short-term wholesale funding/total wholesale funding	98.9	99.3	99.6	100.0	99.2

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 13

Wuestenrot Bank AG Pfandbriefbank Funding And Liquidity Ratios					
	--Year-ended Dec. 31--				
(%)	2011	2010	2009	2008	2007
Core deposits/funding base	37.1	37.9	38.5	37.8	31.1
Customer loans (net)/customer deposits	174.1	169.2	166.8	208.3	258.6
Long term funding ratio	78.0	63.8	64.7	73.3	70.3
Broad liquid assets/short-term wholesale funding (x)	0.2	0.1	0.1	0.3	0.4
Short-term wholesale funding/total wholesale funding	62.1	60.0	59.3	44.8	46.9

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

External support: One notch of group support

The GCP rating on W&W is one notch higher than the SACP of the banking subgroup, reflecting our view that the banking subgroup is core to the overall group. The group credit profile is 'bbb+'.

Additional rating factors: None

No additional factors affect this SACP.

Table 14

W&W Group Ratings Score Snapshot	
Group Credit Profile	bbb+
Holding Company Rating	BBB
SACP	bbb
Anchor	a-
Business Position	Moderate (-1)
Capital and Earnings	Adequate (0)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and adequate (0)
Support	0
GRE Support	0
Group Support	1
Sovereign Support	0
Additional Factors	0

Rationale: The Insurance Subgroup**Competitive position: Limited prospects despite sound service-driven business model****Table 15**

W&W Insurance Group/Competitive Position					
	--Year ended Dec. 31--				
(Mil. €)	2011	2010	2009	2008	2007
Wuerttembergische Versicherung AG					
Gross premiums written	1,380	1,324	1,305	1,287	1,474
Annual change (%)	4.2	1.5	1.4	(12.7)	(8.5)
Net premiums written	1,124	1,078	1,061	1,042	1,163
Gross premiums written by line of business (%)					
Accident and health/other	9.1	9.5	9.7	9.9	8.6
Liability	12.7	12.9	13.4	13.6	14.5
Motor	40.5	39.4	38.5	38.6	35.5
Property	28.2	28.8	28.8	28	28.1
Marine, aviation, and transport	1	1	1.1	1.3	4
Pecuniary	7	7.1	7.2	7.3	6.3
Other	1.4	1.3	1.3	1.3	3
Wuerttembergische Lebensversicherung AG					
Total gross premiums written	2,119	2,275	2,183	2,096	2,168
Annual change (%)	(6.9)	4.2	4.1	(3.3)	(3.4)
Total net premiums written	2,041	2,155	2,071	1,971	2,037
Annual change (%)	(5.3)	4.1	5	(3.2)	(2.7)

In its insurance subgroup W&W follows a distinct single brand strategy, which we believe it has pursued successfully based on its strong tied-agent network. The group's challenge will be to drive business expansion in difficult markets by successfully defending its service-oriented organization against the increasing competition of other low-cost competitors. In non-life, the group is in a very competitive and virtually stagnant market, whereas its life business--like the industry as a whole--is in a transition phase in view of continually low interest rates and preparations for the implementation of Solvency II regulations in the EU. In our view, however, W&W should be well positioned to protect its strong franchise given its solid fundamentals.

Insurance distribution mainly via tied agents: Through the traditional Wuerttembergische brand the group mainly serves clients via its tied-agent organization, which contributes about 64% to the group's non-life and 50% to its life business. The group's banking organization contributes about 7% and 17% respectively. Brokers and other sources contribute about 29% to non-life and 33% to life.

W&W's insurance arm measured by gross premiums written (GPW) was in the top-10 in the German life and non-life insurance industry in 2010.

Life insurance: Changes in product design initiated: WL's 2011 GPW decreased in line with the market trend by about 5% to about €2.1 billion. Whereas single premium business has been the major growth contributor in recent years for WL, as well as for the market, this business showed a significant decrease in 2011. The fact that about 25% of WL's GPW stem from single premium business brings potential volatility to the group's life development. The contribution from regular premiums nearly stagnated since 2011. For 2012, we expect WL's GPW growth will increase marginally, while the market decreases slightly overall. For 2013, we expect WL's GPW growth will increase to about 3%.

Whereas WL's business in force still focuses on traditional endowment and term policies and annuities, we believe its long-term success will mainly be based on innovative products combining unit-linked and guarantee features. In response to low interest rates and the potential burden of having to carry additional actuarial reserves, and in order to strengthen its capitalization in view of the forthcoming Solvency II regulatory system, WL has reduced its policyholders' bonuses to a comparatively low 3.5%. Additionally, WL is now selling products with more flexible guarantees in accordance with capital market trends and guarantee resets during the life of a policy.

Non-life insurance: Above-market growth while maintaining underwriting profitability: W&W's non-life segment caters for individuals and small and midsize enterprises. GPW grew in 2010 and 2011 by 1.5% and 4.2%, respectively, which compares well with market growth of 0.9% and 2.7%. This was mainly driven by business with corporate clients and by premium increases in the motor segment. Nevertheless, we believe that W&W will adhere to its profit-oriented underwriting policy, which should result in only slight increases for 2012 and 2013.

Investments : Prudent investment strategy

We view the investment strategy of W&W's insurance subgroup as strong, with an overall conservative asset allocation. We assess the liquidity of the insurance operations' large investments as high. The group monitors its investments daily, particularly to determine the level of cash needed to settle claims.

Market risk is W&W's key asset risk: We consider market risk to be the insurance subgroup's key risk. This applies particularly to its life operations, where the change in interest rates and to a lesser extent its exposure to equities constitute its main risks. According to the strategic asset allocation for 2011, equity exposure in the insurance subgroup has been limited to about 2% of total investments for life and for non-life. Equity risk is also still largely protected by derivatives.

Regarding interest rate fluctuations, W&W uses stochastic models that apply Monte Carlo simulations to assess ALM risks and monitors the interaction between reinvestment yield, net investment return, and guaranteed interest rates through scenario analyses and stress tests. Risks from ALM mismatches in life insurance have been mitigated by reducing the duration gap between assets and liabilities to a lower-than-market-average.

Investment returns are expected to have been about 3.8% for WL for 2011 following 4.3% in 2010. For 2012, we expect a similar return as for 2011. In order to strengthen its reserve buffers in preparation for the Solvency II regime WL has maintained its bonus rate at a comparatively low 3.5%.

Relatively low credit risk with a highly rated bond portfolio: We view the insurance subgroup's credit risk as a relative low risk factor, although about 90% of investments were in fixed-income securities in 2011. However, about 83% of investments were rated at least 'AA'. Only 2.4% was speculative grade or not rated. About 10% of the insurance subgroup's investments are in government bonds, which have a limited concentration in Italy, Germany, and France. The exposure to the eurozone periphery fell below 2.0% at Dec. 31, 2011, and exposure to Greece is below 0.1%.

Operating performance: Strong, but affected by continually low interest rates

Table 16

W&W Insurance Group/Operating Statistics					
(Mil. €)	--Year-ended Dec. 31--				
	2011	2010	2009	2008	2007
Wuerttembergische Versicherung AG					
Total revenue	1,215	1,170	1,148	1,240	1,284
Net income [¶]	114.1	62.4	136.6	(0.7)	32.4
Net loss ratio (%)	64.4	69.5	63.5	71.9	68.1
Net expense ratio (%)	28.4	29.5	28.6	29.2	29.1
Net combined ratio (%)	92.8	99.0	92.1	101.1	97.2
Portfolio performance					
Net investment income (excl.unrealized and realized items)	91.0	88.0	82.0	147.0	105.0
Direct yield on invested assets (%)	3.8	3.6	3.3	5.8	4.1
Yield (including realized) (%)	4.1	4.0	3.5	6.3	3.6
Total investment return (including unrealized and realized) (%)	2.9	3.5	3.4	1.4	2.9
Wuerttembergische Lebensversicherung AG					
Reported net income	45.0	37.0	15.0	12.0	20.0
Post tax RoA before bonus distribution	64.9	144.2	65.5	91.7	237.3
Administrative expense (GDV)	2.8	2.8	2.9	3.1	3.2
Acquisition expense (GDV)	5.8	6.4	6.8	6.4	6.4
Portfolio performance					
Net investment income (excl.unrealized and realized items)	979	1,006	990	1,270	1,287
Direct yield on invested assets (%)	3.8	4.0	3.9	5.0	5.0
Yield (including realized) (%)	4.3	4.6	4.4	6.3	5.4
Total investment return (including unrealized and realized) (%)	3.8	4.4	3.7	3.3	4.8

[¶]Adjusted for equalization reserve. GDV--According to the German Insurance Association guidelines.

We view the operating performance of W&W's insurance operations as strong, mainly based on the strong

underlying underwriting performance in the group's primary non-life business. They will likely contribute over 50% of the group's net income after adjustments for one-off impacts in 2011.

In its primary non-life business between 2006 and 2011, the average net combined ratio was favorable at about 95%, which compared well with peers. In 2010, it was affected by increased claims frequencies and pricing pressure in the motor business leading to a net combined ratio of 99.0%. In 2011, with a favorable ratio of 92.8%, a significant recovery was recorded. This, however, was partly supported by a planned reduction of the still-strong claims reserves. Also the return on revenue increased to 15.9% for 2011, from 11.3% in 2010. We believe that an underlying net combined ratio of about 97% to 100% and a return on revenue of about 10% should be sustainable over the cycle.

We expect the life business' bottom-line profitability, based on German GAAP accounts, to remain under pressure in the currently low interest rate environment. However, we also expect WL to benefit from its cautious bonus policy, which will allow it to show relatively stable net income and to further build its capital position in order to strengthen capitalization for the expected Solvency II requirements.

However, mainly because of the net investment yield declining to 3.8% (2010: 4.3%) WL's ROA after tax has reduced to about 65 basis points (bps) in 2011 down from 144 bps in 2010. In 2011, the company had to set an additional reserve cushion of €45 million, which by new law has to be set up to protect life insurers against the potential impact of continued low interest rates on traditional guarantee business in force. As a precautionary measure, the company also increased reserves for its annuity business in force by €52 million. WL's portfolio is still dominated by traditional products with an average guaranteed interest rate of 3.4%. We believe that it may take some time for the new product and sales strategy--which focuses on protection and innovative, less-interest-rate-sensitive life insurance products--to materially improve the new business margin.

WL's acquisition expense ratio of 5.8% (2010: 6.4%) is above the market average of 5.0%, mainly due to the launch of new products. The administrative expense ratio decreased to about 3.0%, which is above the market average of 2.4%. However, the lapse ratio of 4.1% in 2010 remained below the market average of 5.1%.

The group's life performance based on market-consistent embedded-value metrics has remained stable at about 10% in 2010 and 2009, but we expect some weakening to become apparent for 2011.

Capitalization: At a strong level

Table 17

W&W Insurance Group/Financial Statistics					
(Mil. €)	--Year ended Dec. 31--				
	2011	2010	2009	2008	2007
Wuerttembergische Versicherung AG					
Total assets	2,558	2,575	2,687	2,706	2,847
Total reported equity	209	209	207	207	207
Reinsurance utilization ratio (%)	18.6	18.6	18.7	19.0	21.1
Loss & unearned premium reserve/net premiums written (%)	150.1	160.8	164.1	175.4	160.6
Loss reserves / Net premium written (%)	140.3	150.5	153.2	163.9	146.0
Wuerttembergische Lebensversicherung AG					
Total assets	27,227	27,345	26,707	26,457	26,863
Total reported equity	233	189	165	162	170

We assess the capitalization of W&W's insurance subgroup as strong, characterized by strong capital adequacy, strong reserving, and an adequate reinsurance strategy.

Capital adequacy: We expect the insurance sub-group to maintain its overall strong capitalization. This is based mainly on the extremely strong capital adequacy of the non-life operation according to our risk-based capital model. Capitalization of the life operation is less comfortable although still good in our view. Although the free reserves for policyholders' bonuses (RfB) decreased in 2011, we take some comfort from various measures the insurance sub-group has undertaken. These include increasing retained earnings and reducing the risks in its products, which should help strengthen its solvency.

Quality of capital: We view the quality of capital of W&W's insurance subgroup as strong, benefiting from sound shareholders' funds and sizable equalization reserves.

Reserving: We consider the group's nonlife reserving practices to be prudent, reflected in what we see as a track record of consistently favorable development in loss reserves for occurrences in previous years. At about 140%, we regard the group's ratio of net loss reserves to net premiums as adequate for its book of business.

Reinsurance: In light of the composition of the group's nonlife portfolio and its risk-bearing capacity, the non-life reinsurance usage of about 19% appears prudent, with business predominantly placed with reinsurers rated 'A' or above.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Principles Of Credit Ratings, Feb. 16, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- BICRA On Germany Maintained At Group '2', Nov. 9, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Group Methodology, April 22, 2009
- Interactive Ratings Methodology, April 22, 2009
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Summary Of Standard & Poor's Enterprise Risk Management Evaluation Process For Insurers, Nov. 26, 2007
- Holding Company Analysis, June 11, 2009
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of April 24, 2012)

Holding Company: Wuestenrot & Wuertembergische AG

Financial Strength Rating

Local Currency

BBB/Stable/--

Issuer Credit Rating

Local Currency

BBB/Stable/A-3

Ratings Detail (As Of April 24, 2012) (cont.)**Operating Companies Covered By This Report****Wuerttembergische Lebensversicherung AG**

Financial Strength Rating

Local Currency

BBB+/Stable/--

Counterparty Credit Rating

Local Currency

BBB+/Stable/--

Subordinated

BBB-

Wuerttembergische Versicherung AG

Financial Strength Rating

Local Currency

BBB+/Stable/--

Issuer Credit Rating

Local Currency

BBB+/Stable/--

Subordinated

BBB-

Wuestenrot Bank AG Pfandbriefbank

Issuer Credit Rating

BBB+/Stable/A-2

Certificate Of Deposit

BBB+/A-2

Wuestenrot Bausparkasse AG

Issuer Credit Rating

BBB+/Stable/A-2

Certificate Of Deposit

BBB+/A-2

Domicile

Germany

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