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## Research Update:

# Germany-Based Wuestenrot & Wuerttembergische Group Ratings Affirmed On Bank Criteria Change; Outlook Stable

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## Research Update:

# Germany-Based Wuestenrot & Wuerttembergische Group Ratings Affirmed On Bank Criteria Change; Outlook Stable

## Overview

- Following a review of Wuestenrot & Wuerttembergische Group (W&W) under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we have affirmed our 'BBB+/A-2' ratings on the group. We also affirmed our ratings on the financial services holding company W&W AG at 'BBB'. The outlook on both ratings is stable.
- The combined stand-alone credit profile (SACP) of the banking subgroup is 'bbb,' which reflects its moderate business position, adequate capital and earnings, moderate risk position, average funding, and adequate liquidity.
- The rating on W&W group reflects our assessment of both the banking subgroup's and the insurance subgroup's status as "core" to W&W. Therefore, the group credit profile (GCP) is 'bbb+'.
- 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.

## Rating Action

As we previously announced on Dec. 8, 2011, Standard & Poor's Ratings Services affirmed its 'BBB+/A-2' long-term and short-term counterparty credit ratings on Wuestenrot & Wuerttembergische Group (W&W). The outlook is stable.

## Rationale

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 stand-alone credit profile (SACP) of the combined banking subgroup is 'bbb'. Standard & Poor's bases its ratings on the combined banking subgroup on its "core" status within W&W group, and its "moderate" business position, "adequate" capital and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity, as the criteria define these terms.

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.

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 enhanced its market share by acquiring Victoria Vereinsbank Bauspar AG (VVB) and Allianz Dresdner Bauspar AG (ADB) in recent years. 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.

The banking subgroup's capital and earnings are assessed as "adequate." Our combined risk-adjusted capital (RAC) ratio at end-2010 was 10.4%, and given continued slow growth in loans and modest profitability, we expect this ratio to slightly ease to a range of 10.0% to 10.5% over the coming 18 months. This development is underpinned by our modest earnings buffer and is forecast to be negative for 2011, but may turn positive from 2012 onward. The subgroup suffers from costly deposits, exacerbated by the continuing low interest rates.

The banking subgroup's "moderate" risk position reflects our view that it is exposed to significant risks not captured by our RAC analysis. The benefit of a solid, granular mortgage book is offset by a substantial securities portfolio with fair exposures to peripheral Europe, which implies some vulnerability to credit spreads. That said, we expect the subgroup to maintain its relatively conservative risk management stance over the medium term. The recent acquisitions do not appear to have significantly changed the subgroup's 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. Another difficulty for risk management is that the subgroup's products feature a complex range of customer options that are linked to movements in the interest rates, and affected by their current low level. The organizational split between its Bausparbank and Pfandbriefbank combined with dual reporting (German generally accepted accounting practice and International Financial Reporting Standards) complicate matters further.

We view the funding and liquidity of the banking subgroup as "adequate," based on "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 relatively stable core/customer deposits. The combined loan/deposit ratio was about 80% at end-2010, and prospective loan growth was expected to be slow. 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.

We judge W&W's banking subgroup to be core to the overall group. The same is true for W&W's insurance subgroup, on which we do not publish a separate SACP. The insurance subgroup's group status is based on its favorable competitive position, favorable operating performance, and the favorable capitalization of its core operations. The group credit profile (GCP) is 'bbb+'. W&W's core operating insurance entities are Wuerttembergische Lebensversicherung AG and Wuerttembergische Versicherung AG. The ratings on the various core operating entities of the Germany-based Wuestenrot & Wuerttembergische bancassurance group (W&W) reflect our assessment of the group's position as a second-tier bancassurance player in Germany.

## 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 effectively exploit its still-untapped 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 raising the GCP if the group were to demonstrate notable progress in achieving and sustaining net earnings after tax, and 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.

## 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         | 0                        |
| Sovereign Support     | 0                        |
| Additional Factors    | 0                        |

## Related Criteria And Research

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

- 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

## Ratings List

Ratings Affirmed

Wuestenrot Bausparkasse AG

Wuestenrot Bank AG Pfandbriefbank

|                            |                 |
|----------------------------|-----------------|
| Counterparty Credit Rating | BBB+/Stable/A-2 |
| Certificate Of Deposit     | BBB+/A-2        |

Wuerttembergische Lebensversicherung AG

Wuerttembergische Versicherung AG

|                            |                |
|----------------------------|----------------|
| Counterparty Credit Rating | BBB+/Stable/-- |
| Financial Strength Rating  | BBB+/Stable/-- |

Wuestenrot & Wuerttembergische AG

|                            |                |
|----------------------------|----------------|
| Counterparty Credit Rating | BBB/Stable/A-3 |
| Financial Strength Rating  | BBB/Stable/--  |

Wuerttembergische Lebensversicherung AG

|              |      |
|--------------|------|
| Subordinated | BBB- |
|--------------|------|

Wuerttembergische Versicherung AG

|              |      |
|--------------|------|
| Subordinated | BBB- |
|--------------|------|

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected

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