

FITCH AFFIRMS KA FINANZ AG AT 'A+'; OUTLOOK STABLE

Fitch Ratings-London/Barcelona-31 October 2011: Fitch Ratings has affirmed KA Finanz AG's (KF) Long-term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook. The agency has also affirmed KF's Short-term IDR at 'F1+', Support Rating at '1' and Support Rating Floor at 'A+'.

At the same time, Fitch has downgraded KF's subordinated (lower Tier 2) debt to 'B' from 'A'. The subordinated debt rating remains on Rating Watch Negative. Given KF's significant exposure to Greek sovereign debt (EUR983.2m, EUR514.6m of which is in the form of CDS and total return swap (TRS) structures), Fitch believes that the likelihood of a second recapitalisation of KF by its majority shareholder, the Republic of Austria (rated 'AAA'/Stable), has increased.

Consequently, the probability that lower Tier 2 bondholders may be forced to carry losses has increased, even though according to current terms and conditions, the instruments are not loss-absorbing in a going-concern scenario. The rating action is also in line with Fitch's exposure draft on revised notching for subordinated and hybrid securities (see "Rating Bank Regulatory Capital Structures" dated 28 July 2011 at www.fitchratings.com).

The affirmation of KF's IDRs is based on Fitch's view that the Republic of Austria would support KF if required, given its 99.78% ownership and its commitment towards KF's former shareholder to maintain a 7% Tier 1 capital ratio. The agency expects KF to remain government-owned until it has been wound down.

KF's performance is significantly affected by the warranty payment to the Republic of Austria, a means for Austria to recoup its investment in KF. Fitch therefore expects KF to continue reporting net losses and given the bank's low earnings base and growing funding cost challenges only a moderate operating profit.

The bank intentionally runs a large funding gap, funding long-term assets through short-term debt. The agency believes that despite a further run-off of its asset base, KF's funding requirements will remain considerable amid increasingly demanding funding markets. Although decreasing, KF's funding profile continues to be dominated by state-guaranteed funding sources (42% at end-H111).

KF's Greek sovereign exposure is high (over 200% of Tier 1 capital at end-H111; around 65% if CDS, TRS and bonds issued by Greek public sector entities are excluded). In Fitch's opinion, any further meaningful write-down of Greek sovereign debt is likely to require a recapitalisation of the bank by the Austrian government. At end-H111, KF's regulatory Tier 1 capital ratio stood at 7.4%, significantly above Fitch's core capital ratio of 0.6%, which excludes participation capital from the former shareholders. However, the Republic of Austria has committed to maintaining a regulatory Tier 1 ratio of 7% provided the bank's former owners remain invested in KF's participation capital.

KF's sole purpose is the wind-down of the non-strategic assets of the former Kommunalkredit Austria AG (KA Old), and consequently, Fitch has not assigned a Viability Rating to KF, similar to other European institutions that are being run off.

KF is the result of a demerger of KA Old in November 2009. KA Old, a wholesale-funded public sector lender, was acquired by the Republic of Austria in November 2008 following severe funding and liquidity difficulties. KF, the legal successor of KA Old, holds KA Old's non-core assets and will be wound down over time.

The rating actions are as follows:

KA Finanz AG (KF)

Long-term IDR: affirmed at 'A+'; Outlook Stable

Short-term IDR: affirmed at 'F1+'
Support Rating: affirmed at '1'
Support Rating Floor: affirmed at 'A+'
Long-term senior unsecured notes: affirmed at 'A+'
Short-term senior unsecured notes: affirmed at 'F1+'
Subordinated notes: downgraded to 'B' from 'A'; RWN maintained
Junior subordinated: affirmed at 'C'/Recovery Rating 'RR5'
Government guaranteed notes: affirmed at 'AAA'
Government guaranteed commercial paper programme: affirmed at 'F1+'
Market linked securities: affirmed at 'A+emr'

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Additional information is available on www.fitchratings.com. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 16 August 2011, 'Treatment of Hybrids in Bank Capital Analysis', dated 11 July 2011 and 'Rating Hybrid Securities', dated 28 July 2011, are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=649171

Treatment of Hybrids in Bank Capital Analysis

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=641269

Rating Hybrid Securities

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=647091

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