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Research Update:

Austria-Based KA Finanz 'A/A-1' Ratings Affirmed, Outlook Stable

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Overview

- Standard & Poor's lowered the long-term sovereign credit rating on the Republic of Austria to 'AA+' on Jan. 13, 2012, and removed the rating from CreditWatch with negative implications.
- As a result, we are affirming our 'A/A-1' ratings Austria-based KA Finanz AG and removing the ratings from CreditWatch negative.
- The ratings on KA Finanz reflect our view of the bank's adequate business position, very weak capital and earnings, moderate risk position, average funding, and adequate liquidity, reflecting a stand-alone credit profile of 'b+'.
- We classify KA Finanz as a government-related entity (GRE) under our criteria and consider there is a "very high" likelihood of timely and sufficient extraordinary government support from the Austrian government in case of need.
- The stable outlook reflects our view that the Republic of Austria's ability and willingness to support KA in terms of funding, liquidity, and capital will remain unchanged.

Rating Action

As we previously announced, on Jan. 25, 2012, Standard & Poor's Ratings Services affirmed its 'A' long-term and 'A-1' short-term counterparty credit ratings on Austria-based KA Finanz AG (KA Finanz). We removed the ratings from CreditWatch, where they were placed with negative implications on Dec. 8, 2011. The outlook on the long-term rating is stable.

Rationale

The rating action follows that on the Republic of Austria (AA+/Negative/A-1+; for further details see "Research Update: Austria's Long-Term Ratings Lowered To 'AA+'; Outlook Negative", published Jan. 13, 2012, on RatingsDirect on the Global Credit Portal.)

Standard & Poor's bases its stand-alone credit profile (SACP) on KA Finanz on the company's "adequate" business position, "very weak" capital, and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. The SACP is at 'b+'.

Our bank criteria use our Banking Industry Country Risk Assessment economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank

operating only in Austria is 'a-' and is based on an economic risk score of '2' and an industry risk score of '3'. However, because KA Finanz's risks are internationally widely spread and include more risky portfolios when compared with Austrian assets, our anchor for KA is 'bbb+', one notch lower than for banks exclusively active in Austria.

We regard KA Finanz's business position as "adequate". This is mainly because its function is to manage down all the noncore assets of the former Kommunalkredit AG, which was taken over by the Republic of Austria during the financial market crisis in 2008. The business position is therefore a neutral rating factor because KA Finanz was formed to execute political policy to stabilize the Austrian banking market. We expect any unforeseen volatility relating to KA Finanz's workout efforts to be mitigated by a timely response from the Republic of Austria, KA Finanz's sole owner.

We currently view KA Finanz's capital and earnings as "very weak" because we expect sizable losses from the planned restructuring of Greek government debt to have a detrimental impact on its capital base. However, we expect that additional short-term government support will restore KA Finanz's capital and raise it to moderate levels. This is because the Austrian government has committed itself to ensuring that KA Finanz will sustain a Tier 1 ratio of more than 7%. We further believe that Austria is able and willing to provide necessary support in times of need. However, we do not expect the risk-adjusted capital (RAC) ratio, which stood at less than 2% as of Dec. 31, 2010, to reach a level we would consider "adequate" in the near future. In addition, we believe the company's capital position would continue to need ongoing government commitment and support.

Our assessment of KA Finanz's risk position as "moderate" reflects our view that the quality of KA Finanz's credit exposures is satisfactory but is exposed to tail risks. The majority of exposures are to public-sector customers and international banks. However, a sizable portion of the credit risk consists of short positions in credit default swaps, resulting in high sensitivity toward spread movements. Because all trades are fully collateralized, subsequent collateral calls from correspondent banks could trigger sizable liquidity needs. This illustrates that KA Finanz's risk, funding, and liquidity positions are highly interlinked.

We currently consider KA Finanz's funding to be "average" and its liquidity "adequate", exclusively based on its close ties to and expected ongoing support from its owner, the Austrian government. In addition, KA Finanz's status as a government-related entity (GRE) allows it to tap the senior unsecured market, which, in our view, would be closed to KA Finanz on a stand-alone basis. Furthermore, Austria has provided a guarantee for some of KA Finanz's senior bonds and a commercial paper program to allow sufficient funding. Liquidity is another area in which we believe the government would step in, in case of need. We understand that the government is willing, and has the sources available, to provide support in a timely manner.

The long-term counterparty credit rating on KA Finanz is eight notches higher

than the SACP, reflecting an uplift for potential government support. Under our GRE criteria, we consider there to be a "very high" likelihood that KA Finanz would receive timely and sufficient extraordinary support from the Austrian government in case of need. This is based on KA Finanz's:

- "Very important" role for the government because KA Finanz's default could destabilize the Austrian banking system and tarnish Austria's reputation and the company is meeting a key political objective; and
- "Very strong" link with the government, owing to its public policy role as the workout entity of the former Kommunalkredit Austria.

Any change in KA Finanz's role for and link to the Austrian government could lead us to review the likelihood of KA Finanz receiving extraordinary government support.

Outlook

The stable outlook reflects our view that the Republic of Austria's ability and willingness to support KA Finanz in terms of funding, liquidity, and capital will remain unchanged. Given its status as a wind-down bank and the existing support framework, we expect KA Finanz to maintain its current financial profile. The negative outlook on the Republic of Austria does not have a direct impact on the outlook of KA Finanz because a possible sovereign downgrade by one notch would not impact the rating on the bank.

We would lower the ratings if additional short-term support was not forthcoming from Austria or if such support was of a lesser extent than we currently expect. We could also lower the ratings if our assessment of KA Finanz's role for, or link to the government were to change.

Ratings Score Snapshot

Issuer Credit Rating	A
SACP	b+
Anchor	bbb+
Business Position	Adequate (0)
Capital and Earnings	Very weak (-5)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	8
GRE Support	4
Group Support	0
Sovereign Support	4
Additional Factors	0

Related Criteria And Research

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

Related criteria

- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology For Banks, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Related research

- Standard & Poor's Affirms Ratings On Various Austrian Banks Following Resolution Of CreditWatch On Austria, Jan. 25, 2012
- Research Update: Austria's Long-Term Ratings Lowered To 'AA+'; Outlook Negative, Jan. 13, 2012
- Standard & Poor's Takes Various Rating Actions On 16 Eurozone Sovereign Governments, Jan. 13, 2012
- Analytical Linkages Between Sovereign And Bank Ratings, Dec. 6, 2011

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
KA Finanz AG		
Counterparty Credit Rating	A/Stable/A-1	A/Watch Neg/A-1
Certificate Of Deposit	A/A-1	A/Watch Neg/A-1
Commercial Paper	A-1	A-1/Watch Neg

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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