

## KA Finanz AG

**Primary Credit Analyst:**

Anna Lozmann, Frankfurt (49) 69-33-999-166; anna\_lozmann@standardandpoors.com

**Secondary Contact:**

Alois Strasser, Frankfurt (49) 69-33-999-240; alois\_strasser@standardandpoors.com

### Table Of Contents

---

Major Rating Factors

Outlook

Rationale

Related Criteria And Research

# KA Finanz AG

<b>SACP</b>	<b>bbb-</b>		+	<b>Support</b>	<b>+4</b>	+	<b>Additional Factors</b>	<b>0</b>			
<b>Anchor</b>	<b>bbb+</b>			<b>GRE Support</b>	<b>+4</b>		<table border="1"> <tr> <th colspan="2">Issuer Credit Rating</th> </tr> <tr> <td colspan="2" style="text-align: center; background-color: #FFC000;"><b>A/Stable/A-1</b></td> </tr> </table>	Issuer Credit Rating		<b>A/Stable/A-1</b>	
Issuer Credit Rating											
<b>A/Stable/A-1</b>											
<b>Business Position</b>	Adequate	<b>0</b>		<b>Group Support</b>	<b>0</b>						
<b>Capital and Earnings</b>	Moderate	<b>-1</b>		<b>Sovereign Support</b>	<b>0</b>						
<b>Risk Position</b>	Moderate	<b>-1</b>									
<b>Funding</b>	Average	<b>0</b>									
<b>Liquidity</b>	Adequate										

## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• Very high likelihood of extraordinary government support from the Republic of Austria.</li> <li>• Strong implicit benefits for the stand-alone credit risk profile due to the state's strategic ownership.</li> <li>• Funding advantage due to the link with the state.</li> </ul>	<ul style="list-style-type: none"> <li>• Business limits owing to its "run-off" status.</li> <li>• Very low earnings from the legacy portfolio.</li> <li>• Reliance on government support to meet capital and liquidity needs.</li> </ul>

## Outlook: Stable

Standard & Poor's Ratings Services' outlook on Austria-based KA Finanz is stable. This reflects our view that the bank's ownership structure and its parent's strong commitment are unlikely to change in the foreseeable future. We think that Austria's ability and willingness to support KA Finanz in terms of funding, liquidity, and capital will remain unchanged in the medium term. However, we note that Austria has no legal obligation to support KA Finanz.

The negative outlook on the Republic of Austria (AA+/Negative/A-1+) does not have a direct impact on the outlook on KA Finanz because a possible sovereign downgrade by one notch would not affect the ratings on the bank.

We expect that KA Finanz will maintain its current financial profile. Deterioration would likely trigger a negative rating action on the bank unless the government provided timely support.

We would lower the ratings if the government did not deliver on its commitment to sustain the bank's regulatory Tier 1 capital ratio at more than 7%, which would cause a deterioration of capital and lead us to reassess our view of the likelihood of state support. We would also lower the ratings if the bank proved unable to sustain its current funding and liquidity profile.

We consider positive rating actions unlikely. We could raise the ratings if the legal support framework for KA Finanz's outstanding unsecured debt were to strengthen.

## Rationale

Our ratings on KA Finanz reflect its anchor of 'bbb+', which represents our view on the economic environment in countries where the bank operates and the banking industry risk in Austria.

We consider the bank's business position to be "adequate," as our criteria define this term, and a neutral factor. This is because following its legal separation from Kommunalkredit Austria AG (not rated) KA Finanz has been working out legacy loans and no longer engages in new business. We assess the bank's capital and earnings as "moderate," owing to the state support that restored the bank's depleted capital base after it suffered sizable losses from the restructuring of Greek government debt. We also assume that the state is committed to keeping the bank's regulatory Tier 1 capital ratio at more than 7%. In our assessment, KA Finanz's risk position is "moderate", mainly due to exposure to tail risk and concentration in the securities portfolio. We view funding as "average" and liquidity as "adequate", but our assessment is based on the close ties to and likely ongoing support from the bank's sole owner, the Austrian government. We assess KA Finanz's stand-alone credit profile (SACP) at 'bbb-'.

The ratings also factor in the bank's status as a government-related entity (GRE) and our view of a "very high" likelihood of support from the Austrian government.

### Anchor: 'bbb+' reflecting internationally diverse portfolios

Our bank criteria use our Banking Industry Country Risk Assessment's 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-', based on an economic risk score of '2' and an industry risk score of '3'.

Our economic risk assessment reflects Austria's wealthy, diverse, and highly competitive economy, with strong economic fundamentals, strong ties to both the European Union and Central and Eastern Europe, and a comparably high level of domestic foreign currency lending.

With regard to industry risk, Austrian banks, in our view, benefit from an increasing share of core customer

deposits, both domestically and at their foreign operations. At the same time, we believe strong competition from a relatively high number of banks will maintain the pressure on risk-adjusted margins.

Because KA Finanz's risks are internationally widely spread and include riskier portfolios than its Austrian assets, our anchor for KA Finanz is 'bbb+', one notch lower than that for banks operating exclusively in Austria.

**Table 1**

<b>KA Finanz AG Key Figures</b>				
	<b>--Year-ended Dec. 31--</b>			
<b>(Mil. €)</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Adjusted assets	14,901.3	16,491.6	17,657.3	29,887.5
Customer loans (gross)	3,440.2	3,549.0	2,140.4	12,281.3
Adjusted common equity	474.3	110.6	(59.6)	147.4
Operating revenues	(187.2)	(228.5)	(140.2)	80.7
Noninterest expenses	30.3	26.3	31.7	26.4
Core earnings	(1,052.6)	(2.3)	(1,117.0)	(329.4)

The comparison between years is distorted by the reorganization of the old Kommunalkredit Austria AG and changes in the group structure.

### **Business position: Run-off entity executing political will**

We consider the bank's business profile to be "adequate" in line with the industry risk score of '3'. The business position is a neutral rating factor because KA Finanz was formed to execute political policy to stabilize the Austrian banking market.

As part of Kommunalkredit Austria's restructuring, initiated after the liquidity crisis in 2008, it was split into two independent entities: Kommunalkredit Austria and KA Finanz. The new Kommunalkredit Austria AG conducts core business, mainly municipal and infrastructure-related projects, while KA Finanz's function is to manage down all the non-core assets of the former Kommunalkredit. The European Commission approved the restructuring plan on March 31, 2011. KA Finanz is 100% state owned.

We expect any unforeseen volatility relating to KA Finanz's work-out efforts to be mitigated by a timely response from the Republic of Austria. As such, weaknesses of the run-off-entity model are compensated by our assessment of implicit state support. Also, risks with regard to KA Finanz's reliance on the new Kommunalkredit Austria for certain services and expertise are mitigated by the state's ownership of both entities.

**Table 2**

<b>KA Finanz AG Business Position Ratios</b>				
	<b>--Year-ended Dec. 31--</b>			
<b>(%)</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Return on equity	(182.7)	0.0	(605.8)	N/A

N/A--Not applicable. The comparison between years is distorted by the reorganization of the old Kommunalkredit Austria AG and changes in the group structure.

### **Capital and earnings: Moderate assessment, due to state support**

We assess KA Finanz's capital and earnings as "moderate" reflecting the state's support measures, which restored the bank's depleted capital base after it reported sizable losses from the restructuring of Greek government debt. After the inflow of state support, the risk-adjusted capital (RAC) ratio stood at 5.2% as of Dec. 31, 2011.

The weak link in the capital assessment is our expectation of volatility in the bank's earnings. This is owing to KA

Finanz's concentration risks and exposure to cyclical industries that might lead to loan loss impairments, particularly in light of the bank's currently modest profitability.

We believe the company's capital position would continue to need ongoing government commitment and support, but we also believe that Austria will be able and willing to provide the necessary support in times of need. The Austrian government has committed to ensuring that KA Finanz will sustain a Tier 1 regulatory capital ratio of more than 7%.

**Table 3**

<b>KA Finanz AG Capital And Earnings Ratios</b>				
	<b>--Year-ended Dec. 31--</b>			
<b>(%)</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Tier 1 capital ratio	7.3	7.5	7.6	N/A
S&P RAC ratio before diversification	5.2	1.6	(0.7)	N.M.
S&P RAC ratio after diversification	4.6	1.5	(0.7)	N.M.
Adjusted common equity/total adjusted capital	100.0	75.2	100.0	75.2
Net interest income/operating revenues	10.5	7.2	(7.6)	79.0
Fee income/operating revenues	98.7	85.5	102.3	8.7
Market-sensitive income/operating revenues	(8.5)	7.5	9.4	0.5
Noninterest expenses/operating revenues	(16.2)	(11.5)	(22.6)	32.7
Provision operating income/average assets	(1.4)	(1.5)	(0.7)	N/A
Core earnings/average managed assets	(6.7)	(0.0)	(4.7)	N/A

N/A--Not applicable. N.M.--Not meaningful. The comparison between years is distorted by the reorganization of the old Kommunalkredit Austria AG and changes in the group structure.

**Table 4**

<b>KA Finanz AG RACF [Risk-Adjusted Capital Framework] Data</b>						
<b>(Mil. €)</b>	<b>Exposure*</b>	<b>Basel II RWA</b>	<b>Average Basel II RW (%)</b>	<b>Standard &amp; Poor's RWA</b>	<b>Average Standard &amp; Poor's RW (%)</b>	
<b>Credit risk</b>						
Government and central banks	15,707	2,072	13	3,921	25	
Institutions	8,611	1,015	12	921	11	
Corporate	3,151	1,762	56	2,805	89	
Retail	0	0	0	0	0	
Of which mortgage	0	0	0	0	0	
Securitization	826	1,446	175	922	112	
Other assets	312	127	41	320	103	
Total credit risk	28,607	6,421	22	8,890	31	
<b>Market risk</b>						
Equity in the banking book¶	0	0	0	0	1,250	
Trading book market risk	--	0	--	0	--	
Total market risk	--	0	--	0	--	
<b>Insurance risk</b>						
Total insurance risk	--	--	--	0	--	

Table 4

KA Finanz AG RACF [Risk-Adjusted Capital Framework] Data (cont.)					
Operational risk					
Total operational risk	--	75	--	184	--
(Mil. €)	Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA	
Diversification adjustments					
RWA before diversification	6,496		9,074	100	
Total adjustments to RWA	--		1,307	14	
RWA after diversification	6,496		10,381	114	
(Mil. €)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)	
Capital ratio					
Capital ratio before adjustments	474	7.3	474	5.2	
Capital ratio after adjustments <sup>§</sup>	474	7.3	474	4.6	

\*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, 2011, Standard & Poor's.

### Risk position: High single-name concentrations

Our assessment of KA Finanz's risk position as "moderate" is mainly due to its exposure to tail risk and concentration in the securities portfolio. Following KA Finanz's legal separation from Kommunalkredit Austria, its sole business purpose has been winding down the portfolio.

High risk concentration is the largest weakness to the risk profile, in our view. KA Finanz's exposure mainly relates to securities and credit default swaps (CDS). The majority of exposures are to public-sector customers and international banks. Single-name risk concentrations are very high, particularly in light of the bank's low profitability and capitalization. Also, a sizable portion of the credit risk consists of short positions in CDS, resulting in high sensitivity to 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.

The risk position is diminishing in line with the portfolio run-down and active sales. Between November 2008 and Dec. 31, 2011 the risk exposure decreased by a total of €10 billion. A further €1 billion decrease was recorded in the first quarter 2012 leading to the reduction of the total portfolio to € 17.7 billion.

Table 5

KA Finanz AG Risk Position Ratios				
	--Year-ended Dec. 31--			
(%)	2011	2010	2009	2008
Growth in customer loans	(3.1)	65.8	(82.6)	N.M.
Total diversification adjustment / S&P RWA before diversification	14.4	6.8	7.4	N.M.
Total managed assets/adjusted common equity (x)	31.4	149.2	(296.2)	202.7
New loan loss provisions/average customer loans	26.5	(8.4)	15.1	N/A

**Table 5****KA Finanz AG Risk Position Ratios (cont.)**

N/A--Not applicable. N.M.--Not meaningful. The comparison between years is distorted by the reorganization of the old Kommunalkredit Austria AG and changes in the group structure.

**Funding and liquidity: Benefits from state support**

We consider KA Finanz's funding as "average" and its liquidity position as "adequate". Our assessment is based on KA Finanz's close ties to and expected ongoing support from its owner, the Austrian government. KA Finanz's status as a 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.

**Table 6****KA Finanz AG Funding And Liquidity Ratios**

(%)	--Year-ended Dec. 31--			
	2011	2010	2009	2008
Core deposits/funding base	3.9	0.8	0.5	3.4
Customer loans (net)/customer deposits	643.7	2,908.6	2,814.2	1,240.3
Long term funding ratio	41.3	54.6	45.0	50.5
Broad liquid assets/short-term wholesale funding (x)	0.5	0.4	0.9	0.5
Net broad liquid assets/short-term customer deposits	(1,226.1)	(4,929.4)	(4,232.4)	(1,677.4)
Net short-term interbank funding/total wholesale funding	8.4	17.1	(6.1)	4.9
Short-term wholesale funding/total wholesale funding	74.9	62.5	68.5	66.8

The comparison between years is distorted by the reorganization of the old Kommunalkredit Austria AG and changes in the group structure.

**External support: Four notches uplift to the SACP**

We regard KA Finanz as a GRE under our criteria, with a "very high" likelihood of timely and sufficient extraordinary support from the Austrian government in the event of financial difficulties.

In accordance with our criteria for GREs, our view of a "very high" likelihood of extraordinary government support is based on our assessment of KA Finanz's:

- "Very important" role for the Austrian government. KA Finanz's default could destabilize the Austrian banking system and tarnish Austria's reputation. In addition, the bank is meeting a key political objective; and
- "Very strong" link with the government. The bank plays an important public policy role as the work-out entity of the former Kommunalkredit Austria. The government has displayed a track record of support for KA Finanz and has stated its commitment to supporting the bank in the future.

We expect KA Finanz's role for the government and its link to the government to remain unchanged, at least in the medium term, whereas Kommunalkredit Austria may be reprivatized in the future.

**Additional rating factors: None**

## 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
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

### Debt rating

Senior Unsecured\* AA+/A-1+

\*Guaranteed by the Republic of Austria.

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

### Ratings Detail (As Of June 19, 2012)

<b>KA Finanz AG</b>	
Counterparty Credit Rating	A/Stable/A-1
Certificate Of Deposit	A/A-1
Commercial Paper	A-1
<b>Counterparty Credit Ratings History</b>	
25-Jan-2012	A/Stable/A-1
08-Dec-2011	A/Watch Neg/A-1
03-Mar-2010	A/Stable/A-1
<b>Sovereign Rating</b>	
Austria (Republic of)	AA+/Negative/A-1+
<b>Related Entities</b>	
<b>Austria (Republic of)</b>	
Issuer Credit Rating	AA+/Negative/A-1+

**Ratings Detail** (As Of June 19, 2012) (cont.)

Transfer & Convertibility Assessment	AAA
Commercial Paper	
<i>Local Currency</i>	A-1+
Senior Unsecured	A-1+
Senior Unsecured	AA+
Short-Term Debt	A-1+

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

**Additional Contact:**

Financial Institutions Ratings Europe; FIG\_Europe@standardandpoors.com

Copyright © 2012 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).