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KA Finanz AG

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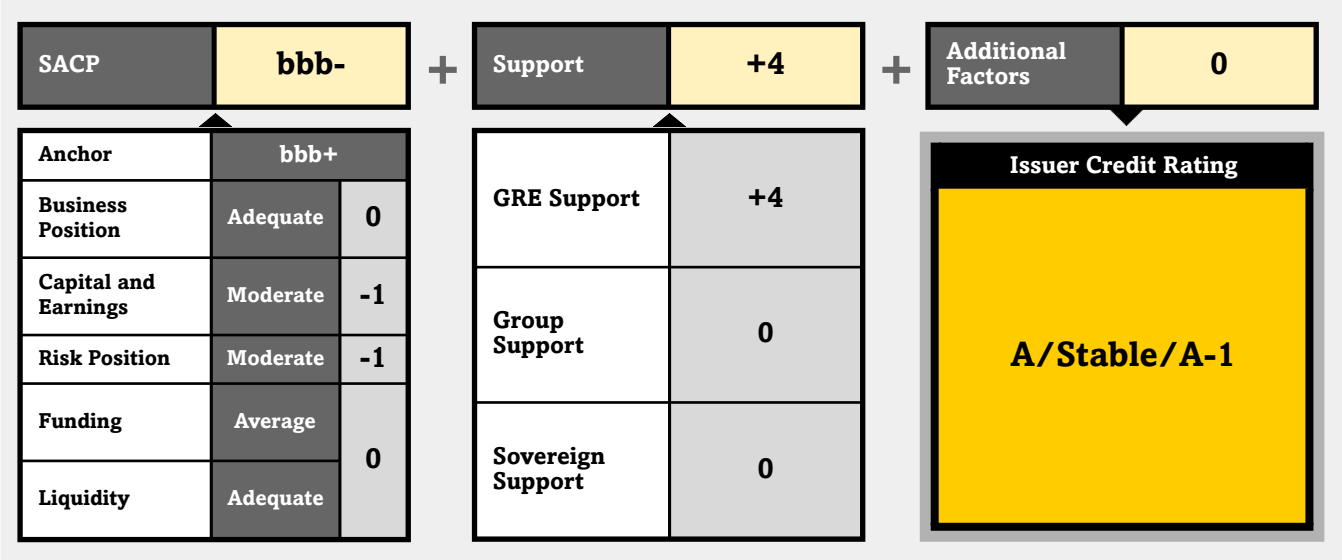
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KA Finanz AG



Major Rating Factors

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

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 indefinitely.

We expect that KA Finanz will maintain its current financial profile determined by its "run-off" status. Deterioration would likely trigger a negative rating action on the bank unless the government provided timely support. Expected support is a key component of our ratings.

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%. Its failure to sustain the ratio above this threshold 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 a positive rating action to be unlikely. We could raise the ratings if the legal support framework for KA Finanz's outstanding unsecured debt were to strengthen. We don't anticipate this to happen in the foreseeable future.

Rationale

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

We assess KA Finanz's stand-alone credit profile (SACP) at 'bbb-'. We consider the bank's business position to be "adequate," as our criteria define this term, and a neutral ratings factor. This is because, following its legal separation from Kommunalkredit Austria AG, KA Finanz has been working out legacy portfolio 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". Our assessment is based on the close ties to and likely ongoing support from the bank's sole owner, the Austrian government.

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

Anchor: 'bbb+' reflecting internationally diverse portfolios

Our bank criteria use our Banking Industry Country Risk Assessment's (BICRA'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'.

KA Finance exposure is primarily in securities, credit default swaps (CDS), and guaranties widely spread outside Austria. The proportion of Austrian exposure was only 6.7% as of end-2012. Because KA Finanz's assets 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.

The geographical split of the securities portfolio is likely to be changing during the run-off process. In the medium term we don't expect this shift to be of significance to trigger a change in the anchor.

Table 1

KA Finanz AG Key Figures					
	--Year-ended Dec. 31--				
(Mil. €)	2012	2011	2010	2009	2008
Adjusted assets	10,969.5	14,901.3	16,491.6	17,657.3	29,887.5
Customer loans (gross)	2,782.8	3,440.2	3,549.0	2,140.4	12,281.3
Adjusted common equity	403.6	474.3	110.6	(59.6)	147.4
Operating revenues	(153.6)	(187.2)	(228.5)	(140.2)	80.7
Noninterest expenses	19.9	30.3	26.3	31.7	26.4
Core earnings	(70.7)	(1,052.6)	(2.3)	(1,117.0)	(329.4)

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

Business position: Run-off entity executing political will

We consider the bank's business profile to be "adequate". The business position is a neutral rating factor because KA Finanz was formed to execute political policy to stabilize the Austrian banking market and its only task is the orderly run-off of legacy portfolios without engaging in new business. The assessment reflects our expectation that KA Finanz's business model will be preserved until the run-down is completed.

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. 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.

We would not expect the bank's set up to materially change if additional assets from Kommunalkredit Austria (or potentially any other troubled bank) were transferred to KA Finanz. We expect that any additional asset transfer would be accommodated by additional capital, funding, and liquidity support from the government. At this time, we don't see a sign of any additional asset transfer to KA Finanz.

Table 2**KA Finanz AG Business Position**

(%)	--Year-ended Dec. 31--				
	2012	2011	2010	2009	2008
Return on equity	(16.1)	(182.7)	0.0	(605.8)	N/A

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

Capital and earnings: Moderate assessment, including implicit benefits of state support

We assess KA Finanz's capital and earnings as "moderate" reflecting former state's support measures as well as our expectation that that Austria will provide the necessary capital support in times of need.

The risk-adjusted capital (RAC) ratio stood at 6.1% as of Dec. 31, 2012 and we project that it will remain in the 5%-7% range in the coming two years.

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 modest profitability.

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

Table 3**KA Finanz AG Capital And Earnings**

(%)	--Year-ended Dec. 31--				
	2012	2011	2010	2009	2008
Tier 1 capital ratio	8.3	7.3	7.5	7.6	N/A
S&P RAC ratio before diversification	6.1	5.2	1.6	(0.7)	N.M.
S&P RAC ratio after diversification	6.1	4.6	1.5	(0.7)	N.M.
Adjusted common equity/total adjusted capital	100.0	100.0	75.2	100.0	75.2
Net interest income/operating revenues	28.3	10.5	7.2	(7.6)	79.0
Fee income/operating revenues	65.9	98.7	85.5	102.3	8.7
Market-sensitive income/operating revenues	6.4	(8.5)	7.5	9.4	0.5
Noninterest expenses/operating revenues	(13.0)	(16.2)	(11.5)	(22.6)	32.7
Provision operating income/average assets	(1.3)	(1.4)	(1.5)	(0.7)	N/A
Core earnings/average managed assets	(0.5)	(6.7)	(0.0)	(4.7)	N/A

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

Table 4**KA Finanz AG RACF [Risk-Adjusted Capital Framework] Data**

(Mil. €)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	11,219	1,922	17	3,495	31
Institutions	6,107	694	11	548	9

Table 4

KA Finanz AG RACF [Risk-Adjusted Capital Framework] Data (cont.)					
Corporate	2,346	1,451	62	1,705	73
Retail	0	0	0	0	0
Of which mortgage	0	0	0	0	0
Securitization§	714	740	104	740	104
Other assets	68	66	97	77	114
Total credit risk	20,454	4,873	24	6,564	32
Market risk					
Equity in the banking book†	0	0	0	0	1,250
Trading book market risk	--	0	--	0	--
Total market risk	--	0	--	0	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	0	--	0	--
(Mil. €)		Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA
Diversification adjustments					
RWA before diversification		4,873		6,564	100
Total Diversification/Concentration Adjustments		--		(2)	0
RWA after diversification		4,873		6,563	100
(Mil. €)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio					
Capital ratio before adjustments		404	8.3	404	6.1
Capital ratio after adjustments‡		404	8.3	404	6.1

*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, 2012, 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 will remain the largest weakness to the risk profile, in our view. KA Finanz's exposure mainly relates to securities and 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 credit risk consists of short positions in CDS, resulting in a high sensitivity to spread movements. Because all trades are fully collateralized, subsequent collateral calls from correspondent banks could trigger sizable liquidity needs. This shows that KA Finanz's risk, funding, and liquidity positions are closely interlinked.

A positive is the substantial reduction in its short CDS position over the last two years, and the resulting diminishing liquidity risk.

The risk position is diminishing in line with the portfolio run-down and active sales. Between November 2008 and Dec. 31, 2012, risk exposure decreased by €15.1 billion. Of this, €5.3 billion was the contractual run-down of assets and €9.8 billion was due to portfolio sales.

Table 5

KA Finanz AG Risk Position					
	--Year-ended Dec. 31--				
(%)	2012	2011	2010	2009	2008
Growth in customer loans	(19.1)	(3.1)	65.8	(82.6)	N.M.
Total diversification adjustment / S&P RWA before diversification	N.M.	14.4	6.8	7.4	N.M.
Total managed assets/adjusted common equity (x)	27.2	31.4	149.2	(296.2)	202.7
New loan loss provisions/average customer loans	(3.3)	26.5	(8.4)	15.1	N/A

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

Funding and liquidity: Neutral assessment reflecting benefits due to state ownership

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 funding and liquidity 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, the Republic of Austria has provided a guarantee for some of KA Finanz's senior bonds and a €3 billion 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 resources, to provide support in a timely manner.

Table 6

KA Finanz AG Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2012	2011	2010	2009	2008
Core deposits/funding base	3.6	3.9	0.8	0.5	3.4
Customer loans (net)/customer deposits	769.3	643.7	2,908.6	2,814.2	1,240.3
Long term funding ratio	42.0	41.3	54.6	45.0	50.5
Broad liquid assets/short-term wholesale funding (x)	0.6	0.5	0.4	0.9	0.5
Net short-term interbank funding/total wholesale funding	(5.8)	8.4	17.1	(6.1)	4.9
Short-term wholesale funding/total wholesale funding	81.2	74.9	62.5	68.5	66.8

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.

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

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 28, 2013)

KA Finanz AG

Counterparty Credit Rating	A/Stable/A-1
Certificate Of Deposit	A/A-1
Senior Unsecured	A

Counterparty Credit Ratings History

25-Jan-2012	A/Stable/A-1
08-Dec-2011	A/Watch Neg/A-1
03-Mar-2010	A/Stable/A-1

Ratings Detail (As Of June 28, 2013) (cont.)

Sovereign Rating

Austria (Republic of) AA+/Stable/A-1+

Related Entities

Austria (Republic of)

Issuer Credit Rating AA+/Stable/A-1+

Transfer & Convertibility Assessment AAA

Commercial Paper

Local Currency A-1+

Senior Unsecured A-1+

Senior Unsecured AA+

Short-Term Debt A-1+

Subordinated AA+

*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.

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