

KA Finanz AG

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Major Rating Factors

Strengths:

- "Very high" likelihood of government support from the Republic of Austria.
- "Very strong" and durable link to the Republic of Austria through intended long-term ownership.
- "Very important" role as the workout bank for Kommunalkredit's nonperforming and nonstrategic assets, contributing to domestic financial market stability.

Counterparty Credit Rating

A/Stable/A-1

Weaknesses:

- Continual losses and reliance on government support to meet capital and liquidity needs.
- Uncertainty about how the European Commission's final decision would affect KA Finanz's access to state support and its financial profile.

Rationale

The 'A' rating on Austria's 100% state-owned workout entity KA Finanz AG reflects Standard & Poor's Ratings Services' opinion that there is a "very high" likelihood that the Republic of Austria (AAA/Stable/A-1+) would provide timely and sufficient extraordinary support to KA Finanz in the event of financial distress. The Austrian government has mandated KA Finanz to administer and wind down the nonstrategic and nonperforming assets of the former Kommunalkredit Austria AG, which failed in 2008. The new scaled-down Kommunalkredit Austria AG was established in 2009 from the failed bank's strategic business.

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

- "Very strong" link with its 99.78% owner, the Republic of Austria (the remaining 0.22% is also held by the public sector), which we expect to continue in the long term; and
- "Very important" role in implementing a key national policy to restore and maintain the proper functioning of the interbank market.

We therefore assess the likelihood of the state providing timely and sufficient extraordinary support to KA Finanz in the event of financial distress to be "very high", lifting the ratings four notches above our assessment of KA Finanz's stand-alone credit profile (SACP) of 'bbb-'.

KA Finanz's creditors have no direct claim against the Republic of Austria, due to the lack of a statutory guarantee. However, we assume the government would be willing to provide additional extraordinary and timely support to KA Finanz because its default could have a material impact on Austria's reputation. Furthermore, we believe that the government has incentive to provide additional support to ensure that KA Finanz does not default on obligations that the state directly guarantees.

As of Feb. 28, 2011, KA Finanz's outstanding government-guaranteed debt was reportedly €6 billion or about 34% of total liabilities as of June 30, 2010, according to Austrian generally accepted accounting principles. We believe that KA Finanz will be able to receive additional (most likely short-term) funding support in line with Austria's Financial Market Stabilization Act. Access to state-guaranteed funding via Austria's temporarily established legislation to strengthen the interbank market (Interbankmarktstärkungsgesetz) expired at the end of 2010.

In addition, KA Finanz benefits from the government's commitment to maintain a Tier 1 capital ratio of at least 7% compared with 7.2% at year-end 2009 and on June 30, 2010. This is as long as Kommunalkredit's previous owners, Oesterreichische Volksbanken AG (not rated) and Dexia Credit Local (A/Negative/A-1), hold KA Finanz's Tier 1 participation capital notes.

We consider KA Finanz's SACP relatively weak, taking into account the funding and capital support already received. The SACP also factors in our expectation that Austria will continue to provide capital and liquidity support to KA Finanz in line with existing commitments. We expect KA Finanz to continue to report losses, in particular when taking into account compensation payments on its government-guaranteed debt. Furthermore, KA Finanz relies heavily on access to wholesale funding because the duration of its assets materially exceeds that of its liabilities. The weak SACP also reflects our expectation that KA Finanz's funding gaps and corresponding reliance on short-term funding will increase.

We understand that KA Finanz will not enter into new business, but purely focus on managing down its assets and liabilities. We do not expect KA Finanz to acquire additional assets.

The quality of KA Finanz's credit exposures is, in our view, satisfactory. The majority of exposures are to public-sector type customers and international banks. A sizable portion of the credit risk is in the form of short positions in credit default swaps (total net notional value €10.2 billion as of June 30, 2010), resulting in a high sensitivity toward spread movements. The bank plans to moderately reduce its total credit exposures by year-end 2011.

As we understand, almost all derivatives are covered by daily margined bilateral collateral agreements with correspondent banks. We believe this will continue to stretch KA Finanz's liquidity in the event of further spread widening following subsequent additional collateral calls.

KA Finanz's capitalization remains a weakness, in our view. Our estimated risk-adjusted capital ratio before diversification adjustments improved to 1.6% at year-end 2010 from -0.7% in 2009, which is well below regulatory ratios. In line with our criteria, KA Finanz's total adjusted capital includes €36 million out of a total €434 million of hybrid capital, that is, up to our limit of 33% of adjusted common equity. Nonetheless, we consider the remaining €398 million of hybrids in our capital analysis because we believe that they provide an additional buffer to cover unexpected losses through coupon suspension and principal write-downs.

Some uncertainty remains about how the European Commission's final ruling on state aid for the former Kommunalkredit will affect KA Finanz's access to state support and its financial profile. That said, we believe that the negative impact on KA Finanz will be limited because the restructuring appears to have allocated a significant portion of the burden to Kommunalkredit's previous owners.

Outlook

The stable outlook reflects our view that Austria's ability and willingness to support KA Finanz 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.

We may lower the ratings if we conclude that KA Finanz's SACP has weakened, most likely because of higher funding mismatches or our perception of a lower likelihood of state support. Although we consider it unlikely, we cannot rule out that the European Commission's final ruling, which we expect in the first half of 2011, negatively affects KA Finanz's funding and the potential for state support.

Although we consider an upgrade unlikely at this stage, we could take a positive rating action if KA Finanz's internal capital generation were to strengthen significantly or if the government were to reinforce its support framework.

Table 1

KA Finanz AG--Profitability Ratios	--Austrian GAAP--			--IFRS--		
	--As of Dec. 31--					
	2010*	2009	2008	2010*	2009	2008
(%)						
Net interest income/average earning assets	0.08	0.05	N/A	(0.10)	0.15	N/A
Net interest income/revenues	55.03	(7.58)	79.04	1.99	5.33	(7.37)
Fee income/revenues	(679.18)	102.33	8.73	20.32	(21.27)	(1.69)
Market-sensitive income/revenues	18.60	9.43	0.55	80.03	115.19	109.18
Personnel expense/revenues	0.00	(7.21)	16.48	0.00	3.63	(1.79)
Noninterest expenses/revenues	78.68	(22.60)	32.70	(2.90)	8.90	(17.98)
New loan loss provisions/revenues	21.35	(777.97)	471.66	0.00	27.74	(3.40)
Net operating income before loan loss provisions/loan loss provisions	99.83	(15.76)	14.27	N.M.	328.35	(3,466.79)
Net operating income after loan loss provisions/revenues	(0.04)	900.57	(404.36)	102.90	63.35	121.39
Pretax profit/revenues	(0.04)	187.51	(404.36)	102.90	63.33	121.41
Tax/pretax profit	(300.00)	(1.55)	(0.96)	1.79	2.82	1.74
Core earnings/revenues	(0.14)	N/A	(408.26)	101.05	61.57	119.27
Core earnings/average adjusted assets	(0.00)	N/A	N/A	(4.28)	1.48	N/A
Noninterest expenses/average adjusted assets	0.11	0.13	N/A	0.12	0.21	N/A
Core earnings/average risk-weighted assets	(0.00)	N/A	N.M.	(14.74)	5.72	(15.80)
Core earnings/average adjusted common equity	0.09	N/A	(223.43)	132.24	(60.39)	153.03
Pretax profit/average common equity	0.02	(596.56)	N/A	97.92	(43.74)	N/A

*Data as of June 30. N/A--Not applicable. N.M.--Not meaningful.

Table 2

(Mil. €)	KA Finanz AG--Summary Balance Sheet					
	--Austrian GAAP--			--IFRS--		
	--Year ended Dec. 31--					
	2010*	2009	2008	2010*	2009	2008
Assets						
Cash and money market instruments	161	611	470	149	2,710	3,940
Securities	3,578	4,207	5,833	4,762	4,775	7,158
Trading securities (marked to market)	N/A	N/A	N/A	N/A	0	2
Nontrading securities	3,578	4,207	5,833	4,762	4,775	7,156
Loans to banks (net)	10,626	9,864	10,032	6,607	4,027	4,768
Customer loans (gross)	2,329	2,140	12,281	7,210	6,535	18,158
Loan loss reserves	52	52	62	145	230	53
Customer loans (net)	2,277	2,088	12,220	7,065	6,305	18,104
Earning assets	16,564	16,276	28,449	18,578	17,488	33,853
Equity interests/participations (nonfinancial)	N/A	N/A	7	N/A	1	2
Investments in unconsolidated subsidiaries (financial companies)	1	1	188	N/A	N/A	N/A
Fixed assets	N/A	N/A	2	4	6	46
Derivatives credit amount	N/A	N/A	N/A	N/A	3,462	3,301
Accrued receivables	84	57	71	N/A	2	0
All other assets	656	830	1,065	3,501	119	137
Total assets	17,382	17,657	29,888	22,088	21,407	37,457
Adjusted assets	17,382	17,657	29,888	22,088	21,407	37,456
Liabilities						
Total deposits	7,977	8,453	12,107	8,894	9,643	15,512
Noncore deposits	7,902	8,379	11,121	8,853	9,597	14,510
Core/customer deposits	75	74	985	42	47	1,002
Other borrowings	8,073	7,964	16,560	8,130	7,197	17,186
Other liabilities	915	866	873	5,882	4,818	5,921
Total liabilities	16,965	17,283	29,540	22,906	21,658	38,618
Total equity	417	375	348	(818)	(251)	(1,161)
Common shareholders' equity (reported)	(17)	(59)	148	(1,252)	(685)	(1,362)
Share capital and surplus	22	22	22	22	22	22
Revaluation reserve	N/A	N/A	N/A	(336)	(192)	(413)
Retained profits	(346)	(346)	(346)	(466)	435	(1,455)
Other equity	76	76	76	N/A	N/A	N/A
Total liabilities and equity	17,382	17,657	29,888	22,088	21,407	37,457

*Data as of June 30. N/A--Not applicable.

Table 3

(Mil. €)	--Austrian GAAP--			--IFRS--		
	--Year ended Dec. 31--					
	2010*	2009	2008	2010*	2009	2008
Net interest income	7	11	64	(9)	38	90
Interest income	7	1,877	2,685	0	2,546	3,196
Interest expense	0	1,867	2,622	9	2,509	3,106
Operating noninterest income	6	(151)	17	(452)	669	(1,306)
Fees and commissions	(86)	(144)	7	(94)	(150)	21
Trading gains	0	0	0	0	3	1
Other market-sensitive income	2	(13)	0	(369)	811	(1,329)
Equity in earnings of unconsolidated subsidiaries	0	0	8	N/A	1	0
Other noninterest income	89	5	1	11	4	1
Operating revenues	13	(140)	81	(461)	707	(1,217)
Noninterest expenses	10	32	26	13	63	219
Personnel expenses	N/A	10	13	N/A	26	22
Other general and administrative expense	10	21	13	13	35	195
Preprovision operating income	3	(172)	54	(474)	644	(1,435)
Credit loss provisions (net new)	3	1,091	381	0	196	41
Operating income after loss provisions	(0)	(1,263)	(326)	(474)	448	(1,477)
Nonrecurring/special income	N/A	1,000	N/A	N/A	N/A	N/A
Pretax profit	(0)	(263)	(326)	(474)	448	(1,477)
Tax expense/credit	0	4	3	(8)	13	(26)
Net income (before minority interest)	(0)	(267)	(329)	(466)	435	(1,451)
Net income before extraordinary	0	(267)	(329)	(466)	435	(1,451)
Net income after extraordinary	0	(267)	(329)	(466)	435	(1,451)

*Data as of June 30. N/A--Not applicable.

Table 4

(Mil. €)	--Austrian GAAP--			--IFRS--		
	--Year ended Dec. 31--					
	2010*	2009	2008	2010*	2009	2008
Net income (before minority interest)	(0)	(267)	(329)	(466)	435	(1,451)
Minus nonrecurring/special income	0	(1,000)	0	0	0	0
Core earnings	(0)	N/A	(329)	(466)	435	(1,451)

*Data as of June 30. N/A--Not applicable.

Table 5

(Mil. €)	--Austrian GAAP--			--IFRS--		
	--Year ended Dec. 31--					
	2010*	2009	2008	2010*	2009	2008
Common shareholders' equity (reported)	(17)	(59)	148	(1,252)	(685)	(1,362)
Minus revaluation reserves	0	0	0	336	192	413
Adjusted common equity	(17)	(60)	147	(916)	(493)	(948)
Plus admissible preferred and hybrids	0	0	49	0	0	0
Total Adjusted Capital	(17)	(60)	196	(916)	(493)	(948)
Minus equity in unconsolidated subsidiaries	(1)	(1)	(188)	0	0	0
Adjusted total equity	(18)	(60)	8	(916)	(493)	(948)

*Data as of June 30.

Related Criteria And Research

- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009
- Rating Sovereign-Guaranteed Debt, April 6, 2009
- FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004

Ratings Detail (As Of March 30, 2011)*

KA Finanz AG	
Counterparty Credit Rating	A/Stable/A-1
Certificate Of Deposit	A/A-1
Commercial Paper	A-1
Counterparty Credit Ratings History	
03-Mar-2010	A/Stable/A-1
Sovereign Rating	
Austria (Republic of)	AAA/Stable/A-1+
Related Entities	
Austria (Republic of)	
Issuer Credit Rating	AAA/Stable/A-1+
Transfer & Convertibility Assessment	AAA
Commercial Paper	A-1+
Senior Unsecured (2 Issues)	A-1+
Senior Unsecured (201 Issues)	AAA
Short-Term Debt (3 Issues)	A-1+
Autobahnen- und Schnellstrassen-Finanzierungs-Aktiengesellschaft	
Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured (8 Issues)	AAA
OeBB-Infrastruktur AG	
Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured (1 Issue)	AAA

Ratings Detail (As Of March 30, 2011)***(cont.)****Oesterreichische Entwicklungsbank AG**

Issuer Credit Rating	AA+/Stable/A-1+
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Oesterreichische Kontrollbank AG

Issuer Credit Rating	AAA/Stable/A-1+
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Certificate Of Deposit	
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<i>Local Currency</i>	A-1+
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Senior Unsecured (1 Issue)	AAA
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*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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