



Transaction Update: KA Finanz AG

22-Mar-2016

Ratings Detail

Reference Rating Level	a-		Jurisdictional-Supported Rating Level	aa-		Maximum Achievable Covered Bond Rating	aa-		Covered Bond Rating	
Resolution Regime Uplift	+2	+	Jurisdictional Support Uplift	3	+	Collateral Support Uplift	0	=	AA-/Stable	
Systemic Importance	Very Strong		Jurisdictional Support Assessment	Very Strong		Overcollateralization Adjustment	0		Rating Constraints	aaa
Adjusted Issuer Credit Rating	bbb-		Legal Framework	Very Strong		Liquidity Adjustment	0		Counterparty Risk	aaa
GRE And Sovereign Support	3		Systemic Importance	Very Strong		Available Credit Enhancement	0		Country Risk	aaa
Issuer Credit Rating	A-		Sovereign Credit Capacity	Very Strong						

*The overcollateralization needed for the 'AA-' rating is 3.60%, which is the required credit enhancement to achieve the current 'AA-' rating, on the sole basis of its jurisdictional support.

Major Rating Factors

Strengths

- Very strong jurisdictional support assessment.
- High weighted-average asset rating of 'AA-' in the cover pool.

Weakness

- High concentration of Austrian local and regional governments in the cover pool, which we reflect in our analysis.

Outlook: Stable

The stable outlook on our covered bond ratings reflects the outlook on the long-term issuer credit rating on the issuing bank, [KA Finanz AG](#).

We would lower our ratings on the covered bonds if we were to lower our long-term rating on the issuer.

Rationale

On March 4, 2016, Standard & Poor's Ratings Services assigned its 'AA-' credit ratings to KA Finanz's public sector covered bond program and related issuances of "Fundierte Bankschuldverschreibungen" (see "[KA Finanz Public Sector Covered Bonds Assigned 'AA-' Ratings; Outlook Stable](#)").

Our covered bond ratings process follows the methodology and assumptions outlined in our "[Covered Bonds Criteria](#)," published on Dec. 9, 2014, and "[Covered Bond Ratings Framework: Methodology And Assumptions](#)," published on June 30, 2015.

The 'AA-' ratings reflect our reference rating level (RRL) of 'a-' and jurisdiction-supported rating level (JRL) of 'aa-' and the coverage of foreign Exchange risk at the 'AA-' rating level. We have not assigned any notches of collateral-based uplift above the JRL, because the available credit enhancement of 30.03% is below the level that we would consider to be commensurate with the first notch of collateral-based uplift, which is currently the result of our supplemental tests, at 37.35%.

Lastly, the ratings on the program and related issuances are not constrained by legal, operational, counterparty risks, or country risks.

Program Description

KA Finanz is a 100% state-owned bank. Its only task is the orderly run-down of legacy portfolios, without engaging in new business. The entity was set up in 2009. KA Finanz's exposure is primarily in public sector securities mainly within Austria.

In March 2015, it was announced that KA Finanz would absorb a part of Kommunalkredit Austria AG, including part of Kommunalkredit's covered bond program. The relevant authorities and regulators approved the transaction in September 2015.

As of December 2015, Kommunalkredit had transferred the €1.65 billion covered bond program to KA Finanz, together with the corresponding cover pool for the current final cover pool.

Table 1

Program Overview*

Jurisdiction	Austria
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. €)	1.65
Redemption profile	Hard bullet
Underlying assets	Public sector
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	55.61
Available credit enhancement (%)	30.32

*Based on data as of Dec. 31, 2015.

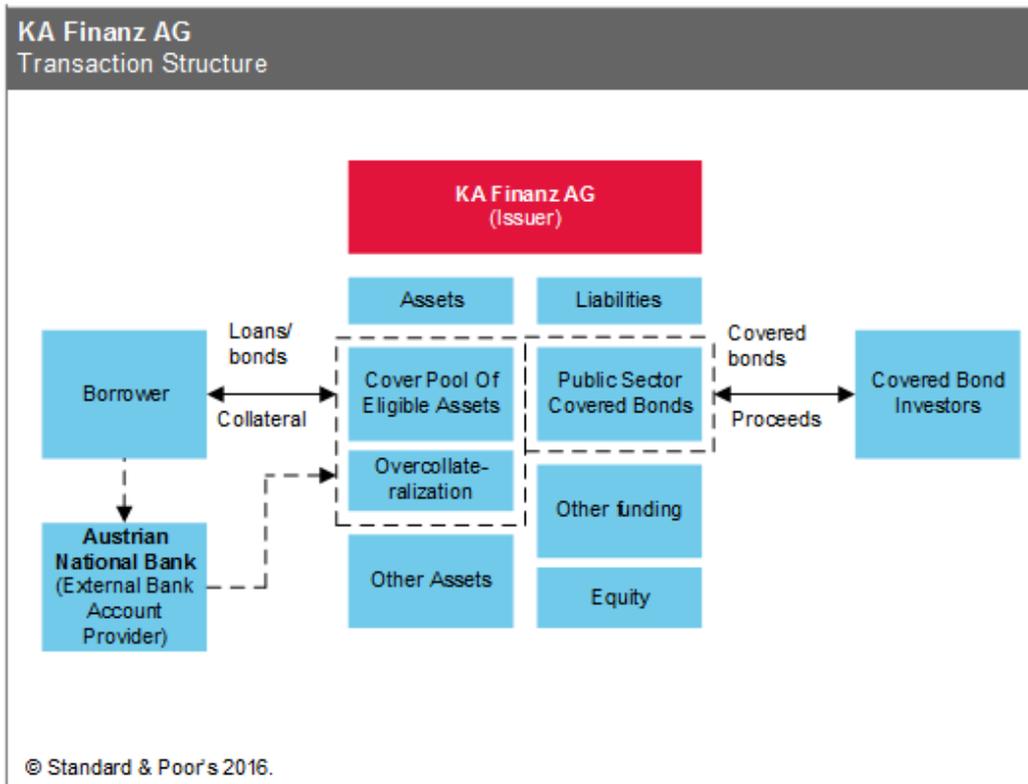
Table 2

Program Participants

Role	Name	Rating	Rating dependency
Issuer	KA Finanz AG	A-/Stable/A-2	Yes
Bank account provider	Austrian National Bank	AAA*	Yes

*As long as we believe Austria is unlikely to exit the eurozone (European Economic And Monetary Union), we consider Austrian National Bank's credit standing to be indistinguishable from that of the European Central Bank (unsolicited: AAA/Stable/A-1+).

Chart 1



Rating Analysis

Legal and regulatory risks

We base our legal analysis on our "[Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance](#)," criteria, published on Sept. 13, 2013, and our covered bond ratings framework.

The covered bonds are governed by the Austrian covered bank bonds act ("Gesetz betreffend fundierte Bankschuldverschreibungen").

From our analysis, we have concluded that the cover pool assets are effectively isolated from the insolvency of the issuer for the benefit of the covered bondholders. Upon issuer insolvency, a cover pool administrator is appointed by a court to continue the management of the cover pool and to satisfy the claims of the covered bondholders. The protection of the assets and continued management of the cover pool allows us to assign a higher rating to the covered bond program than we would to the long-term issuer credit rating (ICR) on KA Finanz.

Operational and administrative risks

We review operational risk according to our covered bonds rating framework criteria.

There are no operational risks that would require a particular adjustment to our standard credit or cash flow assumptions. The issuer has a track record of cautiously managing risks and overcollateralization within the covered bond program. We also believe that there is a high likelihood that the issuer could appoint a replacement cover pool manager if it became unable to manage the program following its default.

Resolution regime analysis

The rating reference level (RRL) on the issuer, which is the starting point for any further uplift in our

analysis, is 'a-'. We consider the following factors:

- The issuer is domiciled in Austria, which is subject to the EU's Bank Recovery And Resolution Directive (BRRD).
- We assess the systemic importance for Austrian public covered bonds programs as "very strong".
- The ICR on KA Finanz is 'A-' and the adjusted ICR is 'bbb-'.
- However, under our covered bonds criteria, the ICR constitutes a floor for the RRL.

Jurisdictional support analysis

In our jurisdictional support analysis, we assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market.

Our assessment of the expected jurisdictional support for Austrian public sector covered bond programs is "very strong", allowing three notches of uplift from the RRL to achieve a JRL of 'aa-' (see ["Assessments For Jurisdictional Support According To Our Covered Bonds Criteria,"](#) published Dec. 22, 2015).

In order to assign full jurisdictional-based uplift in the absence of any collateral-based uplift, and as the covered bond program is exposed to unhedged foreign exchange risk, coupled with the local legislation's lack of provisions to address this additional risk (such as stress testing the exposure, or the ability to require increased minimum overcollateralization levels, for example), we have included foreign exchange risk when calculating the required credit enhancement for a 'AA-' rating.

Collateral support analysis

We base our analysis on the loan-level data provided by the issuer as of Dec. 31, 2015. The pool comprises mainly highly rated public sector assets located in Austria (75.29%). This is reflected by the weighted-average asset rating of 'AA-' in the cover pool.

The scenario default rate that we consider to be commensurate with a 'AAA' credit stress is 41.06% as of Dec. 31, 2015. We have also determined a weighted-average recovery rate of 85.16%, based on our classification of the cover pool assets under our criteria for assessing public sector cover pools (see ["Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities,"](#) published on Dec. 9, 2014).

We have not assigned any notches of collateral-based uplift above the JRL, as the available credit enhancement of 30.03% is below the level that we would consider commensurate with the first notch of collateral-based uplift, which is currently the derived from our supplemental tests at 37.35%. The driving test is currently the largest industry test applied to Austrian local and regional governments (LRGs), which captures concentration risks in the cover pool.

The target credit enhancement that is commensurate with the maximum collateral-based uplift under our covered bonds criteria is 55.61%.

The tables below further summarize the results of our collateral based analysis.

Table 3

Key Credit Metrics**As of Dec. 1, 2015**

Weighted-average cover pool asset rating	AA-
Weighted-average loan asset maturity (years)	9.79
Largest obligor (% of the cover pool)	36.17
20 largest obligors (% of cover pool)	99.50

Credit analysis results

Scenario default rate (SDR; %)	41.06
Weighted-average recovery rate (%)	85.16
Weighted-average time to recovery (years)	3.78
Largest obligor test result (% of covered bonds)	37.35
Largest industry test result (% of covered bonds)	32.83

Table 4**Asset Distribution By Geography****As of Dec. 1, 2015**

	Percentage of cover pool (%)
Austria	75.29
Germany	12.67
Switzerland	10.86
Poland	1.18

Table 5**Recovery Assumptions For Cover Pool Assets***

Borrower type	'AAA' recovery rate (%)	Time to recovery (years)	Percentage of cover pool (%)
Category A LRG without currency risk§	90	4	82.56
Category B LRG without currency risk†	75	4	11.40
Category B LRG with currency risk†	60	4	0.53
Sovereigns	37	0	5.31
Corporate asset in Austria	16	-	0.20

*According to our criteria for pools of public sector assets. §Primarily Austrian and German states and Swiss cantons. †Austrian and Swiss municipalities. LRG--Local and regional governments.

Table 6**Asset Distribution By Rating****As of Dec. 1, 2015**

	Percentage of cover pool (%)
AAA	2.68
AA	78.66
A	17.28
BBB	0.64
BB or lower	0.74
Total	100.00

Table 7**Collateral Uplift Metrics****As of Dec. 1, 2015**

Asset WAM (years)	10.10
Liability WAM (years)	3.47
Available credit enhancement	30.03
Required credit enhancement for first notch of collateral uplift (%)	37.35
Target credit enhancement for maximum uplift (%)	55.61

WAM--Weighted-average maturity. N/A--Not applicable.

Counterparty risk

The ratings on the program and related issuances are not constrained by counterparty risks. For amounts channeled to dedicated accounts with Austrian National Bank, the account provider for the program, we would cap our rating on the program to the rating on the Austrian National Bank. We consider Austrian National Bank's credit standing to be identical to that of the European Central Bank (unsolicited: AAA/Stable/A-1+).

There are no derivatives registered in the cover pool.

We analyzed the counterparty risks according to our current counterparty criteria (see "[Counterparty Risk Framework Methodology And Assumptions](#)," published on June 25, 2013, and "[Counterparty Risk Analysis In Covered Bonds](#)," published on Dec. 21, 2015).

Country risk

The covered bond cover pool includes loans to obligors in multiple jurisdictions. When assigning covered bond ratings for multijurisdictional pools that exceed the ratings on sovereigns within the European Economic and Monetary Union (EMU), we apply our EMU criteria (see "[Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions](#)," published on June 14, 2011). We consider that, based on the geographic diversification of the cover pool and the high sovereign ratings of the largest exposures, sovereign default risk is appropriately captured in our credit analysis. Consequently, country risk does not constrain the rating on the covered bonds.

Related Criteria And Research**Related Criteria**

- [Counterparty Risk Analysis In Covered Bonds](#), Dec. 21, 2015
- [Covered Bond Ratings Framework: Methodology And Assumptions](#), June 30, 2015
- [Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities](#), Dec. 9, 2014
- [Covered Bonds Criteria](#), Dec. 9, 2014
- [Methodology For Assessing Mortgage Insurance And Similar Guarantees And Supports In Structured And Public Sector Finance And Covered Bonds](#), Dec. 7, 2014
- [Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance](#), Sept. 13, 2013
- [Counterparty Risk Framework Methodology And Assumptions](#), June 25, 2013

- [Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions](#), June 14, 2011
- [Understanding Standard & Poor's Rating Definitions](#), June 3, 2009

Related Research

- [KA Finanz Public Sector Covered Bonds Assigned 'AA-' Ratings; Outlook Stable](#), March 4, 2016
- [Still-High Refinancing To Fuel German, Swiss, And Austrian Local And Regional Government Borrowing In 2016](#), Feb. 10, 2016
- [Global Covered Bond Characteristics And Rating Summary Q4 2015](#), Dec. 29, 2015
- [Assessments For Jurisdictional Support According To Our Covered Bonds Criteria](#), Dec. 22, 2015
- [Assessments For Target Asset Spreads According To Our Covered Bonds Criteria](#), Dec. 22, 2015
- [Republic of Austria 'AA+/A-1+' Ratings Affirmed Despite HETA Resolution Law Proposal; Outlook Stable](#), Oct. 8, 2015
- [A Review Of Austria's Covered Bond Framework And Its Implications For S&P Ratings](#), Sept. 9, 2015
- [KA Finanz AG](#), June 15, 2015
- [Supplementary Analysis: Austria \(Republic of\)](#), April 24, 2015
- [Assessing Credit Quality By The Weakest Link](#), Feb. 13, 2012

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