

FITCH AFFIRMS KA FINANZ AG AT 'A+', OUTLOOK STABLE

Fitch Ratings-London-20 August 2013: Fitch Ratings has affirmed KA Finanz AG's (KF) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook, its Short-Term IDR at 'F1+', its Support Rating at '1' and its Support Rating Floor at 'A+'. A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS - IDRS, SUPPORT RATING, SUPPORT RATING FLOOR AND SENIOR DEBT

KF's issuer ratings and senior debt ratings are support-driven and reflect Fitch's view that support for KF from the Republic of Austria (AAA/Stable), KF's sole owner, is extremely likely. The Austrian government has stated that it intends to remain KF's shareholder until KF has been wound down. In August 2013, the Austrian government injected EUR200m of additional capital in KF to ensure the bank's compliance with Basel III regulations and to allow for further active reduction in risk-weighted assets.

Fitch believes that KF's cumulative operating losses before guarantee payments and credit impairment charges until end-2015 could range between EUR100m and EUR200m due to the bank's sensitivity to funding cost developments. KF expects no additional capital requirements for the foreseeable future. However, depending on the magnitude of any credit losses and the speed of risk-weighted assets disposals, further capital injections by the Austrian government could, in Fitch's view, become necessary. Should this be the case, Fitch believes that the Austrian government's propensity to provide capital and/or funding support to KF remains extremely high, even if additional capital requirements would prove to be substantial.

The Stable Outlook on KF's Long-term IDR reflects the Stable Outlook of Austria's sovereign rating. Any change in Austria's sovereign rating is therefore likely to be reflected in KF's IDRs.

RATING SENSITIVITIES - IDRS, SUPPORT RATING, SUPPORT RATING FLOOR AND SENIOR DEBT

KF's IDRs are sensitive to Austria's propensity to provide support to KF. Should Fitch perceive the state's propensity to support the bank to be lower than currently assumed, i.e. by indicating that the state would only be willing to support the bank up to a certain level of losses, this would be negative for KF's IDRs. Fitch views a change in the support structure provided by the state as unlikely in the foreseeable future due to the nature of KF as a run-off institution.

The bank's issuer and issue ratings are also sensitive to deterioration in the creditworthiness of the Republic of Austria, or to a change in the support structure provided by the state. Fitch views this eventuality as unlikely in the foreseeable future due to the Stable Outlook on Austria's 'AAA' sovereign rating.

Fitch also notes that there is a clear political intention to ultimately reduce the implicit state support for systemically important banks in Europe, as demonstrated by a series of policy and regulatory initiatives aimed at curbing systemic risk posed by the banking industry. This might result in Fitch revising SRFs downwards in the medium term, although the timing and degree of any change would depend on developments with respect to specific jurisdictions.

While this mostly affects large, systemically relevant banks, it could ultimately also put pressure on government-owned banks' SRFs.

KF's sole purpose is the wind-down of the non-strategic assets of the former Kommunalkredit Austria AG (KA Old), and consequently, Fitch has not assigned a Viability Rating to KF, similar to other European institutions that are being run off.

Performance improved for 2012 and H113 following significant losses on Greek sovereign exposure in 2011, although the bank was still loss-making overall for both periods. High funding cost pressures and warranty payments made in exchange for the state's support measures place severe constraints on bank performance, meaning that KF is likely to remain loss-making and its capital base will reduce in line with a reduction of its asset base. However, Fitch believes that the Austrian government will remain committed to maintaining a Tier 1 capital ratio of at least 7%.

KF's overall asset quality is solid although high concentration and exposures to European periphery countries represent a risk to the bank. KF made use of improved market conditions in 2012 to dispose of some of its higher-risk assets. However, KF does not mark-to-market its assets and since book values significantly exceed current market values, further disposals are likely to be costly and limited under current market conditions. KF's asset redemption profile means that asset redemptions will also be limited in the short-term but they will increase significantly in the medium-term, notably after 2015.

KEY RATING DRIVERS AND SENSITIVITIES - SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The ratings of KF's junior subordinated debt reflects the fact that coupons have been deferred and coupon payments are in Fitch's view unlikely to be resumed during KF's wind-down.

The ratings of KF's subordinated (lower Tier 2) debt reflects substantial risks of potential non-performance and losses which are not captured by the IDR as the IDR is entirely based on extraordinary state support. The low rating of KF's subordinated debt reflects Fitch's view that KF could incur losses on its existing assets of a magnitude that would make necessary material further state support in order to sustain the required level of capitalisation. In such a scenario subordinated debt could face the risk of burden-sharing in Fitch's view.

The rating actions are as follows:

Long-term IDR: affirmed at 'A+'; Outlook Stable

Short-term IDR: affirmed at 'F1+'

Support Rating: affirmed at '1'

Support Rating Floor: affirmed at 'A+'

Long-term senior unsecured notes: affirmed at 'A+'

Short-term senior unsecured notes: affirmed at 'F1+'

Subordinated notes: affirmed at 'B'

Junior subordinated: affirmed at 'C'

Government guaranteed notes: affirmed at 'AAA'

Government guaranteed commercial paper programme: affirmed at 'F1+'

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Additional information is available on www.fitchratings.com.

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 15 August 2012, 'Evaluating Corporate Governance', dated 12 December 2012, and 'Assessing and Rating Bank Subordinated and Hybrid Securities', dated 5 December 2012, are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686181

Evaluating Corporate Governance

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=694649

Assessing and Rating Bank Subordinated and Hybrid Securities

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=695542

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