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KA Finanz AG

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KA Finanz AG

Major Rating Factors

Issuer Credit Rating

AA+/Stable/A-1+

| Strengths: | Weaknesses: |
|--|--|
| <ul style="list-style-type: none">• Almost certain likelihood of extraordinary government support from the sole owner, the Republic of Austria.• A direct €8.2 billion refinancing agreement with government-owned Abbaumanagementgesellschaft des Bundes (ABBAG).• Critical public policy role for the workout of the former Kommunalkredit Austria AG's nonstrategic and nonperforming assets. | <ul style="list-style-type: none">• No internal capital generation capacity and reliance on government support to offset expected negative equity from accelerated portfolio runoff measures.• Reliance on the government to close any funding and liquidity gaps.• No new business as a pure run-off company. |

Outlook

S&P Global Ratings' stable outlook on KA Finanz AG reflects that on Austria. As a result, any rating action on Austria will prompt a similar rating action on KA Finanz.

Any weakening of KA Finanz's role for and link to Austria could cause us to take a negative rating action on the company. However, we currently do not anticipate any adverse changes. We believe that the almost certain likelihood of government support will remain unchanged over the next two years.

Rationale

We equalize our ratings on KA Finanz with the ratings on its sole owner and support provider, Austria. The equalization reflects our opinion that there is an almost certain likelihood that the Austrian government would provide timely and sufficient extraordinary support to KA Finanz in the event of financial distress.

KA Finanz was set up following the restructuring of the troubled former Kommunalkredit Austria through a demerger that took place in 2009 with the aim of avoiding a disturbance in the financial markets. As part of its restructuring, the former Kommunalkredit Austria was split into two independent entities: Kommunalkredit Austria and KA Finanz. The

European Commission approved the restructuring plan on March 31, 2011, with KA Finanz not being allowed to take on any new lending business. The new Kommunalkredit Austria was reprivatized in September 2015 via its sale to a private equity investor.

Since the lapse of its banking license on Sept. 6, 2017, KA Finanz has been operating as a nonbank run-off company according to section 162 of the Austrian Bank Recovery and Resolution Act. In its relations with KA Finanz, the Austrian government acts through a fully owned state company, ABBAG, which has replaced KA Finanz's market refinancing structure by providing a funding framework of up to €8.2 billion. KA Finanz continues to be supervised by the Austrian Financial Market Authority.

KA Finanz's nonbank status allows for an accelerated 10-year wind-down plan, as it is not subject to regulatory capital requirements and only has to comply with a reduced scope of the banking regulatory framework. We expect that KA Finanz will continue to receive government support over the accelerated run-off term to compensate for losses that we assume will exceed KA Finanz's equity base for the full-year 2018. The obligation to redeem the funding received from ABBAG may reduce accordingly.

As of December 2017, KA Finanz's gross exposure at default was mainly split between Austria (36%), the U.S. (17%), the U.K. (14%), Germany (9%), and Italy (5%), with other European countries, including Central Europe, accounting for the rest. KA Finanz plans to proactively wind down more of its remaining exposure outside Austria, Germany, and Switzerland by the end of 2018, and reduce the total balance sheet to approximately €7.4 billion (versus €8.8 billion as of June 30, 2018).

The nonperforming loans ratio stood at 0.02% as of June, 30, 2018, and we expect it to remain negligible over the coming years, given that the pace of the accelerated wind-down prioritizes assets in the riskier geographical regions.

The net operating income remains negative and dropped significantly over full-year 2017 (net loss of €528 million) and over the first half of 2018 (net loss of €214 million), compared with negative €38 million reported on June 30, 2017. This drop results predominantly from the net valuation adjustments and realizations from the market values of the receivables or securities that are being wound down. The process has accelerated more over the recent 12 months than we initially anticipated. We expect KA Finanz to post structural losses for the full-year 2018 and the years ahead.

As of June, 30, 2018, KA Finanz's legacy funding amounted to €2.6 billion, including €1.1 billion in covered bonds and a government-guaranteed bond of €1.0 billion. Outstanding funding from ABBAG amounted to €5.9 billion. The liquidity guarantee for the commercial paper program was terminated together with the program itself in January 2018. KA Finanz's outstanding covered bonds, loans, and private placements continue to be honored and redeemed at their full nominal value on the relevant due dates. We assume that about €120 million of subordinated debt and private placements maturing after the 10-year wind-down period will eventually be redeemed.

KA Finanz does not have a back-office structure of its own. As of year-end 2017, it had 15 employees working for it on the basis of a staff-leasing agreement with Kommunalkredit Austria. In May 2018, KA Finanz approved a service agreement with a new general outsourcing contractor that will replace Kommunalkredit Austria from April 2019. Moreover, as a result of a project that ABBAG is pursuing aimed at generating possible operational synergies, KA Finanz signed a framework agreement with two other government controlled wind-down entities, immigon

portfolioabbau ag and HETA Asset Resolution AG.

External support

We base our view of an almost certain likelihood that the Austrian government would provide timely and sufficient extraordinary support to KA Finanz in the event of financial difficulties on KA Finanz's:

- Critical role as a key government policy tool to stabilize the banking system and minimize potential long-term losses to taxpayers through the orderly wind-down of the noncore assets of the former Kommunalkredit Austria; and
- Integral link with the Austrian government, since we think the government not only fully owns KA Finanz but also supports the company's management, which should enable effective governance, monitoring, and control during the envisaged 10-year wind-down period.

We have no doubts regarding the Austrian government's propensity to support KA Finanz. We believe the government has sufficient financial resources to do so and, as such, we do not consider government support to be subject to transition risk.

We do not expect KA Finanz's ownership status or the state-support mechanism to weaken. We expect KA Finanz's public policy role as a run-off company will continue until this task is complete, since we believe an accelerated wind-down could not be easily undertaken by a private entity given its advanced and accelerated stage.

Despite the reduced predictability of government support to systemically important commercial banks, we expect Austria will remain supportive of KA Finanz. The implemented EU Bank Recovery and Resolution Directive does not affect the owner's willingness or ability to support KA Finanz as a run-off company, in our opinion.

Additional rating factors: None

No additional factors affect the rating.

Table 1

| KA Finanz AG Key Figures | | | | | |
|--------------------------|------------------------|---------|----------|----------|---------|
| | --Year-ended Dec. 31-- | | | | |
| (Mil. €) | 2018* | 2017 | 2016 | 2015 | 2014 |
| Adjusted assets | 8,810.9 | 9,843.8 | 11,949.6 | 14,391.1 | 7,285.4 |
| Customer loans (gross) | 5,357.6 | 5,894.3 | 6,784.7 | 7,163.1 | 2,249.8 |
| Adjusted common equity | (184.7) | 29.1 | 453.0 | 481.0 | 403.6 |
| Operating revenues | 0.0 | (22.4) | (42.8) | (46.6) | (10.5) |
| Noninterest expenses | 13.1 | 34.9 | 22.5 | 21.5 | 14.1 |
| Core earnings | (213.9) | N/A | (28.0) | (63.6) | 0.0 |

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

Table 2

| KA Finanz AG Capital And Earnings | | | | | |
|---|------------------------|-------|-------|-------|-------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2018* | 2017 | 2016 | 2015 | 2014 |
| Tier 1 capital ratio | N/A | N/A | 17.2 | 15.3 | 14.5 |
| Adjusted common equity/total adjusted capital | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Table 2

| KA Finanz AG Capital And Earnings (cont.) | | | | | |
|--|-------------------------------|-------------|-------------|-------------|-------------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2018* | 2017 | 2016 | 2015 | 2014 |
| Market-sensitive income/operating revenues | 14.0 | 0.2 | (0.1) | (0.4) | (0.1) |
| Preprovision operating income/average assets | (0.3) | (0.5) | (0.5) | (0.6) | (0.3) |
| Core earnings/average managed assets | (4.6) | N/A | (0.2) | (0.6) | 0.0 |

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

Table 3

| KA Finanz AG Risk Position | | | | | |
|---|-------------------------------|-------------|-------------|-------------|-------------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2018* | 2017 | 2016 | 2015 | 2014 |
| Growth in customer loans | (18.2) | (13.1) | (5.3) | 218.4 | (2.3) |
| Total managed assets/adjusted common equity (x) | (47.7) | 337.8 | 26.4 | 29.9 | 18.1 |
| New loan loss provisions/average customer loans | 7.1 | 5.7 | (0.5) | (0.1) | (0.5) |
| Gross nonperforming assets/customer loans + other real estate owned | 0.0 | 0.1 | 0.1 | 1.7 | 2.7 |

*Data as of June 30.

Table 4

| KA Finanz AG Funding And Liquidity | | | | | |
|--|-------------------------------|-------------|-------------|-------------|-------------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2018* | 2017 | 2016 | 2015 | 2014 |
| Core deposits/funding base | 70.4 | 67.3 | 9.3 | 7.8 | 13.5 |
| Customer loans (net)/customer deposits | 88.5 | 92.8 | 653.9 | 681.9 | 251.2 |
| Long term funding ratio | 88.2 | 86.0 | 33.4 | 35.3 | 29.3 |
| Stable funding ratio | 114.2 | 117.1 | 49.1 | 52.7 | 60.7 |
| Short-term wholesale funding/funding base | 11.6 | 14.0 | 69.3 | 67.1 | 75.1 |
| Broad liquid assets/short-term wholesale funding (x) | 2.3 | 2.0 | 0.5 | 0.6 | 0.8 |
| Net broad liquid assets/short-term customer deposits | 255.9 | 254.3 | (380.7) | (421.7) | (125.5) |
| Short-term wholesale funding/total wholesale funding | 39.1 | 42.8 | 76.4 | 72.7 | 86.8 |

*Data as of June 30.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Austria 'AA+/A-1+' Ratings Affirmed; Outlook Stable, Sept. 14, 2018
- Austria-Based KA Finanz Upgraded To 'AA+/A-1+' On Almost Certain Likelihood Of Government Support; Outlook Stable, Sept. 11, 2017

Ratings Detail (As Of October 17, 2018)

KA Finanz AG

| | |
|----------------------|-----------------|
| Issuer Credit Rating | AA+/Stable/A-1+ |
| Senior Secured | AA+/Stable |

Issuer Credit Ratings History

| | |
|-------------|------------------|
| 11-Sep-2017 | AA+/Stable/A-1+ |
| 27-Apr-2017 | A-/Watch Pos/A-2 |
| 13-Mar-2015 | A-/Stable/A-2 |
| 13-Aug-2014 | A/Stable/A-1 |
| 10-Jun-2014 | A/Watch Neg/A-1 |

Sovereign Rating

| | |
|---------|-----------------|
| Austria | AA+/Stable/A-1+ |
|---------|-----------------|

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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