

Issuer Comment: Kommunalkredit Austria AG

Moody's comments on Kommunalkredit's break-up; rating review continues

Moody's Investors Service today commented on the announcement by Kommunalkredit Austria AG (Kommunalkredit) of a restructuring plan that will divide the bank into a 'going concern' bank and an entity to be wound down.

The bank announced the restructuring plan on 19 June and it was handed to the European Commission a week before that date. Moody's expects the European Commission's first comments and the formal initiation of its review process, which will most likely focus on whether the aid measures taken by the Austrian government to rescue Kommunalkredit after it had been hit by the financial crisis are in line with Common Market rules under the EU Treaty, in mid-July at the earliest. Moody's review of Kommunalkredit's ratings, which is ongoing, is expected to be closed shortly thereafter.

All the ratings of Kommunalkredit and its subsidiaries - except for the Aaa/stable long-term ratings on debt guaranteed by the Republic of Austria - were placed on review for possible downgrade earlier this year. Moody's will closely review the details of the restructuring, particularly the allocation of assets and debt (including hybrid instruments), capital injections and state guarantees, to assess the new rating levels for each institution.

"It will be important to understand how risks assumed in the past will be allocated to the two new banks and buffered via the aid provided by the Republic of Austria, namely capital injections and guarantees, and how this will affect the ratings. However, we also need to determine the business purpose of the going concern bank and how it will fit into the Austrian banking system," comments Dominique Nutolo, a Frankfurt-based Moody's Assistant Vice President and lead analyst for Kommunalkredit.

The restructuring plan stipulates that the entity to be wound down will hold Kommunalkredit's CDS and securities portfolios; i.e. those portfolios that led to Kommunalkredit's liquidity squeeze in 2008 and in turn to the bank's nationalisation. This bank will not initiate any new business and is planned to be wound down over the next couple of years. Moody's understands that the going concern bank is supposed to continue to lend to municipalities and is expected to be privatised within the next three years.

The last rating action on Kommunalkredit was on 17 February 2009 when Moody's downgraded its BFSR to D from C-. At the same time, the Tier 1 preferred securities of Kommunalkredit and Kommunalkredit Capital I Limited were downgraded to Caa1 from A2, and Kommunalkredit's upper Tier 2 securities were downgraded to B1 from A1. All the ratings (including the Aa3 senior debt and deposit ratings as well as the P-1 short-term rating) remained on review for further downgrade.

The principal methodologies used in rating Kommunalkredit are "Bank Financial Strength Ratings: Global Methodology" and "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology", which can be found on www.moody's.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating Kommunalkredit can also be found in the Credit Policy & Methodologies directory.

Headquartered in Vienna, Kommunalkredit reported consolidated assets of EUR37.5 billion at the end of December 2008 and an after-tax loss of EUR1.5 billion for the full year.

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