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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 Austria, KA Finanz AG's sole owner.• A direct €8.2 billion refinancing agreement with government-owned Abbaumanagementgesellschaft des Bundes (ABBAG), with €4.3 billion already provided as of June 30, 2020.• Critical public policy role for the wind-down of the former Kommunalkredit Austria AG's nonstrategic assets.	<ul style="list-style-type: none">• New business limits as a nonbank wind-down entity.• No internal capital generation capacity and reliance on government support to offset negative equity from accelerated portfolio runoff measures.• Reliance on the government to close funding and liquidity gaps in case of need.

Outlook

S&P Global Ratings' stable outlook on KA Finanz reflects that on Austria (AA+/Stable/A-1+). 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 do not anticipate any adverse changes. We believe that the almost-certain likelihood of government support will not change over at least the next two years.

Rationale

We equalize our ratings on KA Finanz with the ratings on its sole owner and support provider, Austria. This 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 case of financial distress. KA Finanz's business model is based entirely on Austria's interest in an orderly wind-down of its contingent liabilities from the troubled former Kommunalkredit Austria.

KA Finanz was established in 2009 with the aim of avoiding disturbance in the financial markets. As part of its restructuring, the former Kommunalkredit Austria was separated into two independent entities: Kommunalkredit Austria and KA Finanz. The new Kommunalkredit Austria was reprivatized in September 2015.

KA Finanz operates as a nonbank wind-down unit according to section 162 of the Austrian Bank Recovery and Resolution Act since the lapse of its banking license in 2017, and is supervised by the Austrian Financial Market Authority. The entity's nonbank status allows for an accelerated 10-year wind-down plan until 2026, because it is not subject to regulatory capital requirements and only has to comply with a reduced scope of the banking regulatory framework.

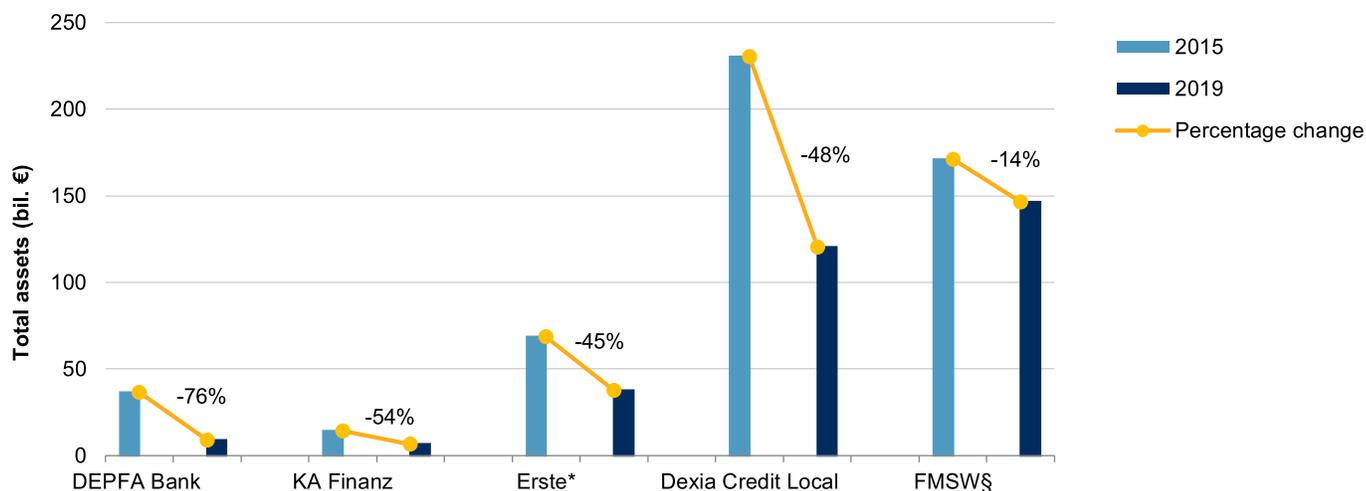
We expect KA Finanz will continue to receive government support over the accelerated runoff term. In its relations with KA Finanz, the Austrian government acts through a state-owned company, ABBAG, which provides a funding framework of up to €8.2 billion. This framework includes a loss-absorbing tranche of €988 million, which covers operating and wind-down losses exceeding KA Finanz's equity base. This loss-absorption mechanism was triggered for the first time in 2018, when KA Finanz's equity was depleted. Since then, repayment obligations have fallen by €294 million. We expect the remaining capacity of the loss-absorbing tranche to be sufficient to cover further losses until the end of the runoff term.

As of June 2020, KA Finanz had assets of €6.5 billion, reflecting a material progress in the wind-down of assets (see chart 1). Overall, exposures have fallen by 86% since the restructuring process started in 2008. The main measure of the balance-sheet runoff remains asset sales, with €21.2 billion in positions sold in total since 2008, followed by accelerated redemptions of €9.1 billion. We believe KA Finanz is on track to reach its goal of completing the wind-down by 2026, and, in our opinion, its total assets will fall well below €6.0 billion by end-2020.

Chart 1

Wind-Down Of Assets Proceeds Quickly At KA Finanz

KA Finanz and wind-down peers



*Erste Abwicklungsanstalt. §Germany-based FMS Wertmanagement AöR. Source: S&P Global Ratings.

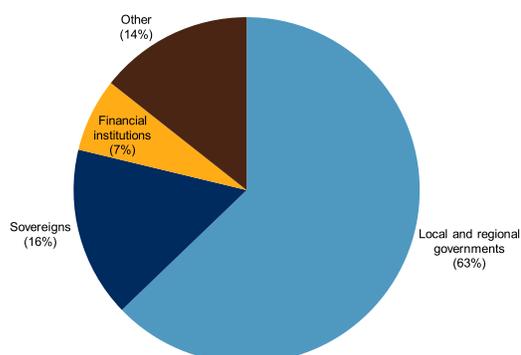
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KA Finanz entered the current economic downturn with strong asset quality. As of June 2020, there were no nonperforming loans on the entity's books. While we expect KA Finanz's asset quality metrics will deteriorate somewhat following the pandemic, we believe its nonperforming loan ratio will remain significantly below the Austrian average over the coming 12-24 months thanks to the previous reduction of exposure to higher-risk geographies and the ongoing decrease of complexity.

As of end-2019, KA Finanz's asset base included predominantly exposures to the public sector (79% of total exposure) and the eurozone (75%), which translates into generally high portfolio quality (see charts 2 and 3). In June 2020, 97% of exposures were investment-grade, roughly 80% of which were rated 'AA' or higher. Although KA Finanz's portfolio is highly concentrated, with the top 20 exposures accounting for 80.5% of the total in June 2020, the low-risk nature of the assets mitigates this risk in our view.

Chart 2

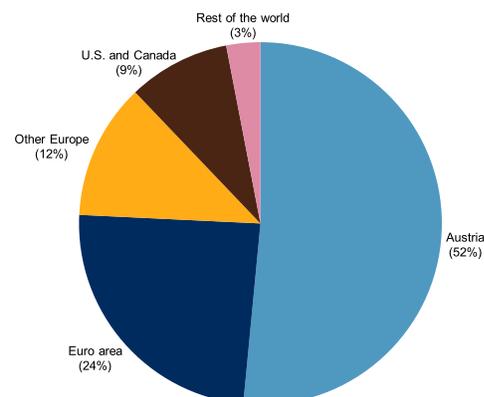
KA Finanz's Portfolio Is Tilted Toward Local And Regional Governments...
Breakdown of exposures by sector



Data as of December 2019. Other includes public-sector entities, quasi-public enterprises, and securitizations. Source: S&P Global Ratings. Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

Chart 3

...Particularly In Austria And The Eurozone
Breakdown of exposures by geography



Data as of December 2019. Source: S&P Global Ratings. Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

KA Finanz has posted negative net operating profit of about €50 million in 2019, and €39 million in first-half 2020. This results predominantly from the net valuation adjustments and realizations from the market values of receivables or securities being wound down. We expect the entity will post structural losses for 2020 and beyond, which we expect will be covered by reductions in the repayment obligations toward ABBAG.

Since 2017, KA Finanz's capital market funding has been gradually replaced by funding provided by ABBAG, which amounted to €4.3 billion as of June 2020. The capital markets legacy funding reached €1.7 billion as of June 2020, which included a government guaranteed bond of €1 billion redeemed in August this year. As such, KA Finanz is no longer required to pay guarantee fees to Austria, compared with €14 million in 2019.

KA Finanz's covered bonds, loans, and private placements continue to be honored and redeemed at their full nominal value on the relevant due dates, including a €500 million covered bond that is to mature in February 2021. We assume that remaining subordinated debt and private placements maturing after the 10-year wind-down period will eventually be redeemed.

KA Finanz has only a very limited back-office structure as essential parts of its processes are outsourced to Ithuba Capital AG and subproviders on the basis of a service agreement, which replaced Kommunalkredit as outsourcing contractor in April 2019.

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 the entity'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 because of full ownership by the government and the credible

government-support mechanism.

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 do not consider government support subject to transition risk.

We do not expect KA Finanz's ownership status or the state-support mechanism will weaken. We expect the entity's public policy role as a wind-down entity will continue until this task is complete, because we believe an accelerated wind-down could not be easily nor more efficiently undertaken by a private entity, given its advanced stage.

We expect Austria will remain supportive of KA Finanz and that the implemented EU Bank Recovery and Resolution Directive does not affect its willingness or ability to support the entity as a wind-down entity, in our opinion.

Additional rating factors: None

No additional factors affect the rating.

Table 1

	--Year ended Dec. 31--				
	2020	2019	2018	2017	2016
Key figures (mil. €)					
Adjusted assets	6,498.0	6,565.3	7,222.0	9,843.8	11,949.6
Customer loans (gross)	3,733.0	3,868.0	4,802.1	5,894.3	6,784.7
Adjusted common equity	(39.0)	0.0	0.0	29.1	453.0
Operating revenues	3.4	3.8	(1.0)	(22.4)	(42.8)
Noninterest expenses	9.6	23.8	23.7	34.9	22.5
Core earnings	(39.0)	(49.9)	(245.3)	(423.9)	(28.0)
Capital and earnings (%)					
Tier 1 capital ratio	N/A	N/A	N/A	N/A	17.2
Adjusted common equity/total adjusted capital	100.0	N.M.	N.M.	100.0	100.0
Net interest income/operating revenues	242.3	323.9	(1,649.8)	(6.6)	9.2
Fee income/operating revenues	(210.4)	(398.1)	1,769.9	109.5	94.8
Market-sensitive income/operating revenues	(11.3)	(1.0)	(1.5)	0.2	(0.1)
Cost to income ratio	282.0	625.2	(2,342.8)	(155.7)	(52.5)
Provision operating income/average assets	(0.2)	(0.3)	(0.3)	(0.5)	(0.5)
Core earnings/average managed assets	(1.2)	(0.7)	(2.9)	(3.9)	(0.2)
Risk position (%)					
Growth in customer loans	(7.0)	(19.5)	(18.5)	(13.1)	(5.3)
Total managed assets/adjusted common equity (x)	(166.4)	N.M.	N.M.	337.8	26.4
New loan loss provisions/average customer loans	1.7	0.7	4.1	5.7	(0.5)
Gross nonperforming assets/customer loans + other real estate owned	0.0	0.0	0.0	0.1	0.1
Funding and liquidity (%)					
Core deposits/funding base	72.6	71.0	73.8	67.3	9.3
Customer loans (net)/customer deposits	81.0	85.8	93.4	92.8	653.9
Long-term funding ratio	91.2	90.1	91.5	86.0	33.4

Table 1

KA Finanz AG Selected Financial Indicators (cont.)					
Stable funding ratio	135.2	130.1	115.2	117.1	49.1
Short-term wholesale funding/funding base	8.8	9.9	8.5	14.0	69.3
Broad liquid assets/short-term wholesale funding (x)	3.9	3.4	2.8	2.0	0.5
Net broad liquid assets/short-term customer deposits	756.6	709.5	1,808.9	254.3	(380.7)
Short-term wholesale funding/total wholesale funding	31.9	34.0	32.5	42.8	76.4

*Data as of June 30. N/A--Not applicable. N.M.--Not meaningful. Source: S&P Global Ratings.

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
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Austria Rating Affirmed At 'AA+/A-1+'; Outlook Stable, Sept. 11, 2020

Ratings Detail (As Of October 27, 2020)*

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

Sovereign Rating

Austria	AA+/Stable/A-1+
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*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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