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Research Update:

Austrian Bank KA Finanz 'A/A-1' Ratings On CreditWatch Negative On Risks Of Diminishing State Support

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Overview

- The Austrian government has recently proposed legislation to bail in holders of Hypo Group Alpe Adria's subordinated debt, despite a grandfathered guarantee provided by the State of Carinthia.
- This extraordinary development could lead to our reassessment of the likelihood of state support to the government-related entity KA Finanz.
- Therefore, we are placing our 'A/A-1' ratings on KA Finanz on CreditWatch negative.
- The CreditWatch mainly reflects our expectation that the link to and/or role for Austria or Austria's propensity to support KA Finanz may weaken if the law is enacted.

Rating Action

On June 10, 2014, Standard & Poor's Ratings Services placed its 'A/A-1' long- and short-term counterparty credit ratings on Austria-based KA Finanz AG on CreditWatch with negative implications.

Rationale

The CreditWatch placement follows the Austrian government's decision to introduce special legislation to bail in Hypo Group Alpe Adria's (HGAA's) subordinated debtholders, despite a grandfathered guarantee provided by the State of Carinthia. We understand that this legislation will form a part of the upcoming law concerning the transformation of HGAA from a bank to a wind-down unit.

In our view, if losses are ultimately imposed on HGAA's bondholders despite a grandfathered guarantee from the State of Carinthia, or if developments surrounding HGAA trigger a general change in the Austrian government's attitude toward bank support, the result may be a weakening of state support for systemically important banks and government-related entities (GREs) in the country (see "Decision Pending Over Hypo Alpe Adria's Future Has No Immediate Rating Impact On Austrian Banks Or GREs," published on March 7, 2014, on RatingsDirect).

In such a scenario, we might change our opinion on the probability of support for KA Finanz from its 100% owner, the Republic of Austria, if we believed

that KA Finanz's role for and link to Austria had weakened. We currently regard KA Finanz as a GRE under our criteria, with a "very high" likelihood of timely and sufficient extraordinary government support in the event of financial distress. This is based on our view of KA Finanz's "very important" role for and "very strong" link with the Austrian government. The bank plays an important public policy role as the work-out entity of the former Kommunalkredit Austria. Due to expected extraordinary state support, we currently rate the bank four notches above its stand-alone credit profile (SACP) of 'bbb-', which results in the final rating of 'A'.

CreditWatch

The CreditWatch reflects our opinion that the introduction of the legislation and the political considerations around the restructuring of HGAA may decrease the likelihood of state support from Austria to its GRE KA Finanz.

We would likely downgrade the bank if the law is enacted as currently under discussion. We expect to resolve the CreditWatch over the next three months or once there is clarity on the timing and details of the upcoming law.

A downgrade could also be triggered by our reassessment of the economic and industry risks for banks operating in Austria, leading to a weaker starting point for our ratings on Austrian banks.

We could affirm the ratings if the government decided not to impose losses on HGAA's grandfathered bondholders.

Ratings Score Snapshot

| | |
|----------------------------|--------------------------|
| Counterparty Credit Rating | A/Watch Neg/A-1 |
| SACP | bbb- |
| Anchor | bbb+ |
| Business Position | Adequate (0) |
| Capital and Earnings | Moderate (-1) |
| Risk Position | Moderate (-1) |
| Funding and Liquidity | Average and Adequate (0) |
| Support | +4 |
| GRE Support | +4 |
| Group Support | 0 |
| Sovereign Support | 0 |
| Additional Factors | 0 |

Related Criteria And Research

Related Criteria

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec 6, 2010
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Seven Austrian Banks Placed On CreditWatch Negative On Planned Bail-In Of State-Guaranteed Debt Of Hypo Group Alpe Adria, June 10, 2014
- Ratings On Seven Austrian Banks Affirmed, With Various Outlooks, On Stabilizing Economic Risks, June 3, 2014
- Banking Industry Country Risk Assessment: Austria, June 3, 2014
- Banking Industry Country Risk Assessment Update: May 2014, May 13, 2014
- Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review, April 29, 2014
- Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks, April 29, 2014
- Austria (Republic of), April 25, 2014
- Decision Pending Over Hypo Alpe Adria's Future Has No Immediate Rating Impact On Austrian Banks Or GREs, March 7, 2014

Ratings List

CreditWatch/Outlook Action

| | To | From |
|----------------------------|-----------------|--------------|
| KA Finanz AG | | |
| Counterparty Credit Rating | A/Watch Neg/A-1 | A/Stable/A-1 |
| Certificate Of Deposit | A/Watch Neg/A-1 | A/A-1 |
| Senior Unsecured | A/Watch Neg | A |
| Commercial Paper | A-1/Watch Neg | A-1 |

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