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## KA Finanz AG

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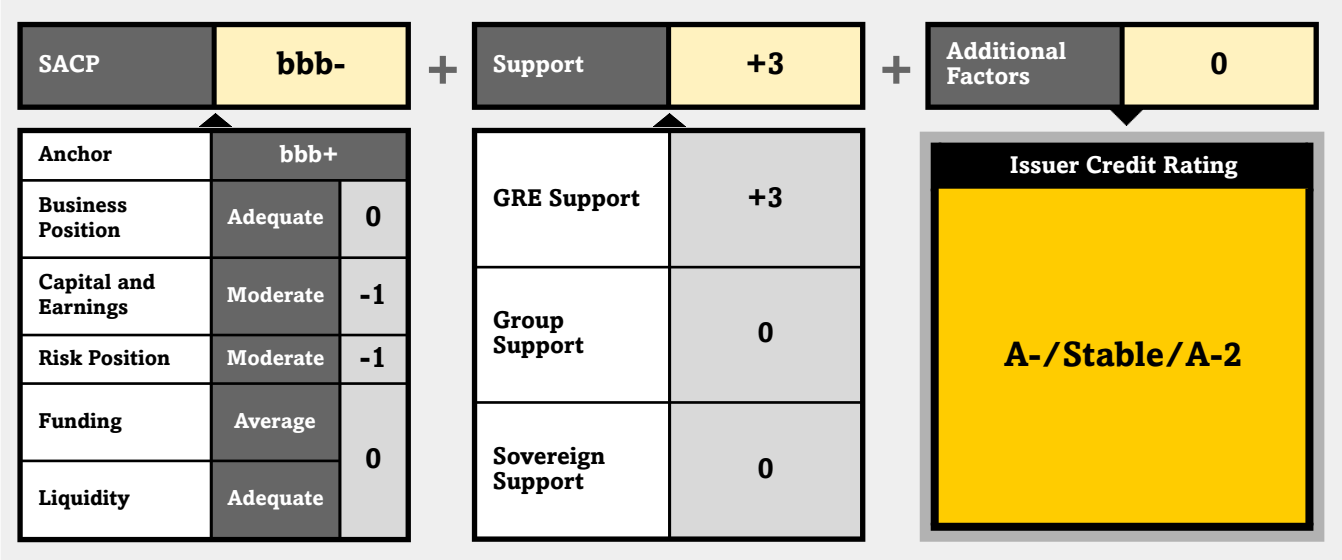
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# KA Finanz AG



## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• High likelihood of extraordinary government support from the Republic of Austria.</li> <li>• Strong implicit benefits for the stand-alone credit profile, due to the state's strategic ownership and repeated support actions.</li> </ul>	<ul style="list-style-type: none"> <li>• Business limits owing to its run-off status.</li> <li>• Very low earnings from the legacy portfolio.</li> <li>• Reliance on government support to close capital, funding, and liquidity gaps in case of need.</li> </ul>

## Outlook: Stable

Standard & Poor's Ratings Services' outlook on ratings on Austria-based KA Finanz is stable, because we expect KA Finanz will continue its wind down with the benefit of extraordinary government support. We anticipate that the upcoming merger with the nonprivatized part of Kommunalkredit Austria AG will not materially alter the bank's stand-alone credit profile (SACP).

We think that Austria will continue to support KA Finanz in terms of funding, liquidity, and capital. But, we note that Austria has no legal obligation to support KA Finanz indefinitely.

We expect that KA Finanz will maintain its current financial profile determined by its run-off status. Deterioration of our assessment of the bank's capitalization or access to external funding would likely trigger a negative rating action, unless the government provided timely support. Our expectation of government support to KA Finanz is a key component of our ratings.

We would lower the ratings if the Austrian government indicates a reduction in its current commitment to sustain the bank's regulatory Tier 1 capital ratio at more than 7%. Its failure to sustain the ratio above this threshold would indicate a deterioration of capital and lead us to reassess our view of the likelihood of state support. We would also lower the ratings if the bank proved unable to sustain its current funding and liquidity profile.

We consider a positive rating action to be unlikely, but one could occur if the legal support framework for KA Finanz's outstanding unsecured debt strengthened.

## Rationale

Our ratings on KA Finanz reflect its anchor of 'bbb+', which represents our view of the economic environment in the countries the bank is exposed to and banking industry risk in Austria.

KA Finanz's SACP is 'bbb-'. We view the bank's business position as "adequate," capital and earnings as "moderate," risk position as "moderate," funding as "average," and liquidity as "adequate," as our criteria define these terms.

The ratings factor in the bank's status as a government-related entity (GRE) and our view of a "high" likelihood of extraordinary support from the Austrian government. Due to expected extraordinary state support, we rate the bank three notches above its SACP.

### Anchor: 'bbb+' reflecting internationally diverse portfolios

Our bank criteria use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Austria is 'bbb+', based on an economic risk score of '2' and an industry risk score of '4'.

KA Finanz's exposure is primarily in securities widely spread outside Austria. Because KA Finanz's assets include riskier portfolios than its Austrian assets, the split of economic risks for KA Finanz is slightly worse than that for banks operating exclusively in Austria, but not to an extent to impact its anchor.

On the positive side, following the expected completion of the refill process in summer 2015, growth of lower risk assets share in the bank's overall portfolio will lead to some improvement of the economic risk split. Also, the

geographic division of the overall portfolio is likely to change during the run-off process. In the medium term, we don't expect the refill and the shift linked to run down to be significant enough to trigger a change in the anchor.

**Table 1**

KA Finanz AG Key Figures					
	--Year-ended Dec. 31--				
(Mil. €)	2014	2013	2012	2011	2010
Adjusted assets	7,285.4	8,194.2	10,969.5	14,901.3	16,491.6
Customer loans (gross)	2,249.8	2,301.9	2,782.8	3,440.2	3,549.0
Adjusted common equity	403.6	403.6	403.6	474.3	110.6
Operating revenues	(10.5)	(50.1)	(153.6)	(187.2)	(228.5)
Noninterest expenses	14.1	17.5	19.9	30.3	26.3
Core earnings	0	0	(70.7)	(1,052.6)	(2.3)

### Business position: Run-off entity executing political will

KA Finanz is 100% state owned. Its only task is the orderly run-down of legacy portfolios, without engaging in new business. The entity was set up following the failure of former Kommunalkredit Austria AG (Kommunalkredit Austria) with the aim to avoid disturbances in the financial markets. The "adequate" assessment of its business position reflects our expectation that KA Finanz's business model will be preserved until the run-off is complete. We therefore consider its business position to be a neutral factor for the rating.

As part of former Kommunalkredit Austria's restructuring, initiated after the liquidity crisis in 2008, the bank was split into two independent entities: Kommunalkredit Austria and KA Finanz. KA Finanz's function is to manage down all the non-core assets of the former Kommunalkredit. The European Commission approved the restructuring plan on March 31, 2011.

Furthermore, in March 2015, the decision was announced that KA Finanz would absorb the part of Kommunalkredit Austria, which remains after the re-privatization with total assets of approximately €7 billion, doubling KA Finanz's current balance sheet. Transferred assets will be sovereign exposure, near sovereign, public sector, and collateral for covered bonds. The transaction still needs to be approved by diverse authorities and regulators. If approved, the refill will take place retrospectively, as of Dec. 31, 2014. Banks' management expects the finalization of the transaction in summer 2015.

KA Finanz is and will remain reliant on the new Kommunalkredit Austria for services. We understand that despite the re-privatization of Kommunalkredit Austria, both banks intend to keep servicing agreements in place. We also understand that the bank does not expect to maintain the current management board composition. We consequently see some operational risks related to the potential shift in the management team.

We expect any unforeseen volatility relating to KA Finanz's work-out efforts to be mitigated by timely support from Austria. As such, weaknesses of the run-off-entity model are compensated by implicit state support, in our view.

**Table 2**

<b>KA Finanz AG Business Position</b>					
<b>--Year-ended Dec. 31--</b>					
<b>(%)</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Return on equity	0	0	(16.1)	(182.7)	0

### Capital and earnings: Moderate assessment, including implicit benefits of state support

The risk-adjusted capital (RAC) ratio stood at 12.5% as of Dec. 31, 2014. We understand that the upcoming assets refill will be accompanied with sufficient equity transfer to protect KA Finanz's overall capitalization.

Our capital assessment, however, accounts for uncertainties about potential impairment charges, in light of some risk concentrations relative to equity and earnings. We are also uncertain about the bank's capital policy during the run-off process. We cannot rule out the risk that the Austrian government may ask KA Finanz to upstream capital at any point during the run-off process.

Reflecting the uncertainties about the sustainability of the RAC ratio over the rating horizon, we assess KA Finanz's capital and earnings as "moderate." This assessment incorporates repeated former capital support measures from the state and our expectation that Austria will provide KA Finanz with the necessary capital support in times of need.

The weak link in the capital assessment is our expectation of volatility in the bank's earnings. This is owing to KA Finanz's concentration risks that might lead to loan loss impairments. We acknowledge, however, that the volatility of earnings is decreasing with the ongoing reduction of concentration risks. Also, the refill is favorable for the overall profile and stability of the earnings projection.

We believe KA Finanz's remains reliant on government commitment, but also that Austria would be able and willing to provide support if needed. The Austrian government has committed to ensuring that KA Finanz will sustain a Tier 1 regulatory capital ratio higher than 7%.

**Table 3**

<b>KA Finanz AG Capital And Earnings</b>					
<b>--Year-ended Dec. 31--</b>					
<b>(%)</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Tier 1 capital ratio	14.5	12.4	8.3	7.3	7.5
S&P RAC ratio before diversification	12.5	9.2	6.1	5.2	1.6
S&P RAC ratio after diversification	12.2	9.1	6.1	4.6	1.5
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	75.2
Net interest income/operating revenues	(107.8)	26.3	28.3	10.5	7.2
Fee income/operating revenues	207.9	105.2	65.9	98.7	85.5
Market-sensitive income/operating revenues	(0.1)	(31.5)	6.4	(8.5)	7.5
Noninterest expenses/operating revenues	(134.6)	(34.9)	(13.0)	(16.2)	(11.5)
Preprovision operating income/average assets	(0.3)	(0.7)	(1.3)	(1.4)	(1.5)
Core earnings/average managed assets	0	0	(0.5)	(6.7)	0

RAC--Risk-adjusted capital.

Table 4

KA Finanz AG Risk-Adjusted Capital Framework Data					
(€ 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
<b>Credit risk</b>					
Government and central banks	3,323,033	517,150	16	782,911	24
Institutions	2,565,152	282,551	11	198,851	8
Corporate	1,755,897	1,090,868	62	1,417,605	81
Retail	0	0	0	0	0
Of which mortgage	0	0	0	0	0
Securitization§	630,959	563,335	89	625,849	99
Other assets	202,501	198,405	98	206,509	102
Total credit risk	8,477,542	2,652,309	31	3,231,725	38
<b>Market risk</b>					
Equity in the banking book†	46	0	0	504	1,094
Trading book market risk	--	0	--	0	--
Total market risk	--	0	--	504	--
<b>Insurance risk</b>					
Total insurance risk	--	--	--	0	--
<b>Operational risk</b>					
Total operational risk	--	0	--	0	--
(€ 000s)		<b>Basel II RWA</b>		<b>Standard &amp; Poor's RWA</b>	<b>% of Standard &amp; Poor's RWA</b>
<b>Diversification adjustments</b>					
RWA before diversification	--	2,779,294	--	3,232,229	100
Total Diversification/Concentration Adjustments	--	--	--	80,366	2
RWA after diversification	--	2,779,294	--	3,312,596	102
(€ 000s)		<b>Tier 1 capital</b>	<b>Tier 1 ratio (%)</b>	<b>Total adjusted capital</b>	<b>Standard &amp; Poor's RAC ratio (%)</b>
<b>Capital ratio</b>					
Capital ratio before adjustments	--	403,598	14.5	403,598	12.5
Capital ratio after adjustments‡	--	403,598	14.5	403,598	12.2

\*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2014, Standard & Poor's.

### Risk position: High single-name concentrations

Our assessment of KA Finanz's risk position as "moderate" is mainly due to its exposure to tail risk and concentration in the securities portfolio. Following KA Finanz's legal separation from former Kommunalkredit Austria, its sole business purpose has been winding down the portfolio.

KA Finanz's exposure mainly relates to securities. The majority of exposures are to public-sector customers. The

portfolio run-off led to a reduction of the concentration risk and an improvement year on year. The upcoming refill contributes to an improvement but does not alter the bank's risk profile materially to trigger an improvement of the risk position assessment. Single-name-risk concentrations remain relatively high, in light of the bank's profitability and capitalization.

On a positive note, we see that risk is diminishing in line with the portfolio run-off and active sales. Between November 2008 and the end of 2014, KA Finanz's risk exposure decreased by €24 billion, of which €5.7 billion was the contractual run-off of assets and €17 billion was due to portfolio sales.

**Table 5**

<b>KA Finanz AG Risk Position</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Growth in customer loans	(2.3)	(17.3)	(19.1)	(3.1)	65.8
Total diversification adjustment / S&P RWA before diversification	2.5	1.6	(0.0)	14.4	6.8
Total managed assets/adjusted common equity (x)	18.1	20.3	27.2	31.4	149.2
New loan loss provisions/average customer loans	(0.5)	10.4	(3.3)	26.5	(8.4)
Gross nonperforming assets/customer loans + other real estate owned	2.7	1.7	N/A	N/A	N/A
Loan loss reserves/gross nonperforming assets	23.5	2.0	N/A	N/A	N/A

RWA--Risk-weighted assets. N/A--Not applicable.

### **Funding and liquidity: Neutral to the ratings, reflecting the benefits of state ownership**

We consider KA Finanz's funding to be "average" and its liquidity "adequate." Our assessment is based on KA Finanz's close ties to and expected ongoing funding and liquidity support from its owner, the Austrian government. KA Finanz's status as a GRE allows it to tap the senior unsecured market, which, in our view, would be closed to KA Finanz on a stand-alone basis.

Furthermore, Austria has provided a guarantee for €3 billion commercial paper program to allow sufficient funding. Liquidity is another area in which we believe the government would step in, in case of need.

**Table 6**

<b>KA Finanz AG Funding And Liquidity</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Core deposits/funding base	13.5	5.8	3.6	3.9	0.8
Customer loans (net)/customer deposits	251.2	546.3	769.3	643.7	2,908.6
Long term funding ratio	29.3	29.1	34.3	48.8	54.5
Stable funding ratio	66.3	61.8	77.6	105.2	116.2
Short-term wholesale funding/funding base	75.1	74.9	68.3	53.0	47.2
Broad liquid assets/short-term wholesale funding (x)	0.8	0.8	1.0	1.3	1.4
Net broad liquid assets/short-term customer deposits	(92.4)	(225.4)	(33.2)	464.0	2,357.1
Short-term wholesale funding/total wholesale funding	86.8	79.5	70.9	55.2	46.2

N/A--Not applicable.

### External support: Three notches of uplift to the SACP

We regard KA Finanz as a GRE under our criteria, with a "high" likelihood of timely and sufficient extraordinary support from the Austrian government in the event of financial difficulties.

We believe that the prospect of extraordinary government support for Austrian banks is now uncertain, following the full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers, in January 2015. However, we generally believe that resolution frameworks are less likely to impede the state owners' willingness to provide extraordinary support to banks we consider as GREs, including KA Finanz. Despite the reduced predictability of state support to systemically important commercial banks, we expect Austria to remain highly supportive of KA Finanz.

We believe that state support for KA Finanz is likely to remain in place at least in the medium term. As such, we incorporate three notches of uplift for extraordinary state support in our rating on KA Finanz. We see clear differences between KA Finanz and a wind-down entity of former Hypo Group Alpe Adria (HGAA) - Heta Asset Resolution AG (HETA), which was put under a resolution regime by the Austrian government.

In accordance with our criteria for GREs, our view of a "high" likelihood of timely and sufficient extraordinary government support is based on our assessment of KA Finanz's:

- "Important" role for the Austrian government in ensuring a controlled run-off of assets to minimize costs for the government as the owner of the bank, and ultimately for taxpayers; and
- "Very strong" link with the government. The bank plays an important public policy role as the work-out entity of the former Kommunalkredit Austria. The government has displayed a track record of support for KA Finanz and has stated its commitment to supporting the bank in the future.

If needed, KA Finanz may fully utilize the guarantee from Austria on its €3 billion commercial paper program. This relatively high proportion of guaranteed liabilities--even though not the key part of our analysis--further backs up our assessment of the likelihood of state support to the bank in case of need.

We think that the upcoming refill with further Kommunalkredit assets suggests the government sees a long-term role for KA Finanz in the restructuring of the Austrian banking sector.

We continue to rate KA Finanz's €3 billion commercial paper program guaranteed by Austria at the same level as the guarantor, reflecting our expectation that Austria will fully and timely honor its obligations under this guarantee.

## Related Criteria And Research

### Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- 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
- Use Of CreditWatch And Outlooks, Sept. 14, 2009



## Related Research

- Ratings On Some Austrian Banks Lowered On Less Predictable State Support And Increasing Industry Risks, June 9, 2015
- Credit FAQ: How Standard & Poor's Applied Its Government Support And ALAC Criteria To U.K., German, Austrian, And Swiss Banks, June 9, 2015
- S&P Takes Various Rating Actions On Certain U.K. And German Banks Following Government Support And ALAC Review, June 9, 2015
- Austria-Based KA Finanz Downgraded To 'A-/A-2' On Revised Expectation Of State Support; Outlook Stable, March 13, 2015

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

## Ratings Detail (As Of June 15, 2015)

### KA Finanz AG

Counterparty Credit Rating	A-/Stable/A-2
Certificate Of Deposit	A-/A-2/A-2
Commercial Paper	A-2
Senior Unsecured	A-

### Counterparty Credit Ratings History

13-Mar-2015	A-/Stable/A-2
13-Aug-2014	A/Stable/A-1
10-Jun-2014	A/Watch Neg/A-1
25-Jan-2012	A/Stable/A-1
08-Dec-2011	A/Watch Neg/A-1

### Sovereign Rating

Austria (Republic of)	AA+/Stable/A-1+
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### Related Entities

#### Austria (Republic of)

Issuer Credit Rating	AA+/Stable/A-1+
Transfer & Convertibility Assessment	AAA

### Ratings Detail (As Of June 15, 2015) (cont.)

Commercial Paper	
<i>Local Currency</i>	A-1+
Senior Unsecured	A-1+
Senior Unsecured	AA
Senior Unsecured	AA+
Short-Term Debt	A-1+
Subordinated	AA+

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's 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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