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## KA Finanz AG

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# KA Finanz AG

<b>SACP</b>	<b>bbb-</b>		+	<b>Support</b>	<b>+3</b>	+	<b>Additional Factors</b>	<b>0</b>
<b>Anchor</b>	<b>bbb+</b>			<b>ALAC Support</b>	<b>0</b>		<b>Issuer Credit Rating</b>  <div style="background-color: yellow; padding: 10px; text-align: center;"> <b>A-/Stable/A-2</b> </div>	
<b>Business Position</b>	<b>Adequate</b>	<b>0</b>		<b>GRE Support</b>	<b>+3</b>			
<b>Capital and Earnings</b>	<b>Moderate</b>	<b>-1</b>		<b>Group Support</b>	<b>0</b>			
<b>Risk Position</b>	<b>Moderate</b>	<b>-1</b>		<b>Sovereign Support</b>	<b>0</b>			
<b>Funding</b>	<b>Average</b>	<b>0</b>						
<b>Liquidity</b>	<b>Adequate</b>							

## 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**

S&P Global Ratings' stable outlook on Austria-based KA Finanz AG, reflecting our expectation that KA Finanz will continue its wind down, benefitting from extraordinary government support. Our outlook reflects our expectations for the next two years.

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 is a key component of our long-term rating on KA Finanz.

We would lower the rating 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 also lead us to reassess our view of the likelihood of state support. We would also lower the rating 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**

We do not consider that the merger with the nonprivatized part of Kommunalkredit Austria AG (Kommunalkredit) has materially altered the KA Finanz's stand-alone credit profile (SACP).

Our rating on the enlarged KA Finanz reflects 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.

Our assessment of 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'.

The transfer of assets from Kommunalkredit Old (entity before the demerger in 2015) resulted in the growth of the share of lower-risk assets in the bank's overall portfolio. The gross exposure at default for KA Finanz's is now split mainly between Austria (40%), the U.K. (15%), the U.S. (10%), Germany (10%), and the remainder split mainly among

Western European countries. Because KA Finanz's assets include riskier portfolios than its Austrian assets, the split of economic risks for KA Finanz is worse than that for banks operating exclusively in Austria, but not to an extent that it affects its anchor.

The geographic division of the overall portfolio is likely to change during the run-off process. In the next two years, however, we don't expect the transfer of assets from Kommunalkredit and the shift linked to the 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. €)	2015	2014	2013	2012	2011
Adjusted assets	14,391	7,285	8,194	10,969	14,901
Customer loans (gross)	7,161	2,250	2,302	2,783	3,440
Adjusted common equity	481	404	404	404	474
Operating revenues	(47)	(10)	(50)	(154)	(187)
Noninterest expenses	21	14	17	20	30
Core earnings	(64)	0	0	(71)	(1,053)

### 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 the former Kommunalkredit Austria AG (the entity prior to the demerger) in a demerger that took place in 2009 with the aim of avoiding disturbances in the financial markets. Our 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.

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.

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 run down all the noncore assets of the former Kommunalkredit Austria. 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 former Kommunalkredit Austria, which remained after the re-privatization (Kommunalkredit Old), with total assets of approximately €7 billion. It doubled KA Finanz's balance sheet. Assets transferred in 2015 related to sovereign exposure, near sovereign, public sector, and collateral for covered bonds.

KA Finanz is and will remain reliant on the new Kommunalkredit Austria for services. Despite the re-privatization of Kommunalkredit Austria, both banks intend to keep servicing agreements in place.

**Table 2**

KA Finanz AG Business Position					
	--Year ended Dec. 31--				
	2015	2014	2013	2012	2011
Return on equity (%)	(6.6)	0.0	0.0	(16.1)	(182.7)

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

We assess KA Finanz's capital and earnings as moderate, reflecting the uncertainties about the sustainability of the risk-adjusted capital (RAC) ratio through 2017. 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, which might lead to loan loss impairments in case of tail events. We acknowledge, however, that the volatility of earnings is decreasing with the ongoing reduction of concentration risks.

We believe that KA Finanz remains reliant on the government's commitment. We also believe 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%.

The RAC ratio stood at 9.4% as of Dec. 31, 2015. Even though the RAC ratio decreased since Dec. 31, 2014, when it was 12.5%, in our view, the transfer of assets from Kommunalkredit was accompanied with sufficient equity transfer to protect KA Finanz's overall capital buffer against risk. Also, the transfer of assets from Kommunalkredit is favorable for the overall profile and stability of the earnings projection.

Our capital assessment is forward looking and accounts for uncertainties about potential impairment charges, in light of some risk concentrations relative to equity and earnings. We expect that the reduction of the operational cost base is unlikely to keep pace with the loss accumulation, and as such, expect that our RAC projection for year-end 2018 will decrease to around 6%.

We reflect in our projection the assumption that KA Finanz will be loss making in the next two years, also due to the material burden related to fees paid it must pay to the Republic of Austria for liquidity guarantees (which amounted to €25 million in 2015), as well as contributions to the Bank Resolution Fund payable for the first time in 2015 (€4 million).

**Table 3**

KA Finanz AG Capital And Earnings					
	--Year ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Tier 1 capital ratio	15.3	14.5	12.4	8.3	7.3
Our RAC ratio before diversification	9.4	12.5	9.2	6.1	5.2
Our RAC ratio after diversification	9.5	12.2	9.1	6.1	4.6
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0

Table 3

KA Finanz AG Capital And Earnings (cont.)					
	--Year ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Net interest income/operating revenues	43.0	(107.8)	26.3	28.3	10.5
Fee income/operating revenues	59.4	207.9	105.2	65.9	98.7
Market-sensitive income/operating revenues	(0.4)	(0.1)	(31.5)	6.4	(8.5)
Noninterest expenses/operating revenues	(46.1)	(134.6)	(34.9)	(13.0)	(16.2)
Preprovision operating income/average assets	(0.6)	(0.3)	(0.7)	(1.3)	(1.4)
Core earnings/average managed assets	(0.6)	0.0	0.0	(0.5)	(6.7)

Table 4

KA Finanz AG Risk-Adjusted Capital Framework Data						
(€ 000s)	Exposure*	Basel III RWA	Average Basel III RW (%)	S&P Global Ratings' RWA	Average S&P Global Ratings' RW (%)	
<b>Credit risk</b>						
Government and central banks	7,633,421	694,881	9	962,267	13	
Institutions	3,553,826	450,216	13	317,196	9	
Corporate	1,803,597	1,086,254	60	1,401,425	78	
Retail	0	0	0	0	0	
Of which mortgage	0	0	0	0	0	
Securitization	688,263	464,391	67	576,958	84	
Other assets	1,842,208	276,502	15	1,834,183	100	
Total credit risk	15,521,315	2,972,243	19	5,092,030	33	
<b>Market risk</b>						
Equity in the banking book¶	0	0	0	1	1,250	
Trading book market risk	--	0	--	0	--	
Total market risk	--	0	--	1	--	
<b>Insurance risk</b>						
Total insurance risk	--	--	--	0	--	
<b>Operational risk</b>						
Total operational risk	--	0	--	0	--	
(€ 000s)	Basel III RWA		S&P Global Ratings' RWA		% of S&P Global Ratings' RWA	
<b>Diversification adjustments</b>						
RWA before diversification	3,134,586		5,092,031		100	
Total adjustments to RWA	--		(41,270)		(1)	
RWA after diversification	3,134,586		5,050,761		99	

Table 4

KA Finanz AG Risk-Adjusted Capital Framework Data (cont.)				
(€ 000s)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings' RAC ratio (%)
<b>Capital ratio</b>				
Capital ratio before adjustments	481,042	15.3	481,042	9.4
Capital ratio after adjustments§	481,042	15.3	481,042	9.5
*Exposure at default. €Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. ¶Exposure and S&P Global Ratings' 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, 2015, S&P Global Ratings.				

### 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 (before the demerger in 2009), its sole business purpose continues to be the orderly wind down of the portfolio.

The transfer in 2015 contributed to an improvement of the bank's asset quality and concentration risks, but does not alter the bank's risk profile materially to trigger an improvement of the risk position assessment.

The majority of KA Finanz's exposures are to public-sector customers. The portfolio's run-off led to a reduction of the concentration risk and an improvement year on year. Single-name-risk concentrations decreased after the transfer, but remain relatively high, in light of the bank's profitability and capitalization.

On a positive note, we see that risk is further diminishing in line with the portfolio run-off and active sales. Between November 2008 and the end of 2015, KA Finanz's risk exposure decreased by €25 billion, of which €6.6 billion was the contractual run-off of assets and €18.2 billion was due to portfolio sales.

Table 5

KA Finanz AG Risk Position					
	--Year ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Growth in customer loans	218.3	(2.3)	(17.3)	(19.1)	(3.1)
Total diversification adjustment / Our RWA before diversification	(0.8)	2.5	1.6	0	14.4
Total managed assets/adjusted common equity (x)	29.9	18.1	20.3	27.2	31.4
New loan loss provisions/average customer loans	(0.1)	(0.5)	10.4	(3.3)	26.5
Gross nonperforming assets/customer loans + other real estate owned	1.7	2.7	1.7	N/A	N/A
Loan loss reserves/gross nonperforming assets	0.8	23.5	2.0	N/A	N/A
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, the Austrian government has provided a guarantee for a €3.5 billion commercial paper program and for a five-year senior unsecured bond in the amount of €1.0 billion to allow sufficient funding.

KA Finanz's liquidity ratios have been deteriorating in the last year. Liquidity is another area in which we believe the government would step in, in case of need.

**Table 6**

KA Finanz AG Funding And Liquidity					
	--Year ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Core deposits/funding base	7.8	13.5	5.8	3.6	3.9
Customer loans (net)/customer deposits	681.9	251.2	546.3	769.3	643.7
Long term funding ratio	35.3	29.3	29.1	34.3	48.8
Stable funding ratio	57.5	66.3	61.8	77.6	105.2
Short-term wholesale funding/funding base	67.1	75.1	74.9	68.3	53.0
Broad liquid assets/short-term wholesale funding (x)	0.6	0.8	0.8	1.0	1.3
Net broad liquid assets/short-term customer deposits	(340.5)	(92.4)	(225.4)	(33.2)	464.0
Short-term wholesale funding/total wholesale funding	72.7	86.8	79.5	70.9	55.2

### 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 for the foreseeable future. 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--Heta Asset Resolution AG, 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 entity before the demerger in 2009). 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 €3.5 billion commercial paper program. Also, the state guarantee on the senior unsecured bonds in the amount of €1.0 billion granted in 2015 evidences continued willingness to support. This relatively high five-year senior unsecured bond 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 transfer of 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 €3.5 billion commercial paper program and the five-year senior unsecured bond in the amount of €1.0 billion guaranteed by Austria at the same level as the guarantor, reflecting our expectation that Austria will honor its obligations under this guarantee fully and on time.

## Related Criteria And Research

### Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Group Rating Methodology, Nov. 19, 2013
- Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- 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
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Rating Sovereign-Guaranteed Debt, April 6, 2009
- Commercial Paper I: Banks, March 23, 2004

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 28, 2016)

#### KA Finanz AG

Counterparty Credit Rating	A-/Stable/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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\*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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