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Research Update:

Austria-Based KA Finanz Downgraded To 'A-/A-2' On Revised Expectation Of State Support; Outlook Stable

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Overview

- We observe that the Austrian government is increasingly willing to pass the burden of bank failures to senior unsecured creditors, given its recent decision to put HETA, the wind-down unit for Hypo Alpe Adria Group, under its new national resolution legislation.
- We therefore see somewhat less certainty around the Austrian government's willingness to provide extraordinary government support to KA Finanz AG.
- We are lowering our ratings on KA Finanz AG to 'A-/A-2' from 'A/A-1'.
- The outlook is stable, as we expect KA Finanz will continue its wind down with the benefit of extraordinary government support in case of need. We believe that the potential merger with the nonprivatized part of Kommunalkredit Austria AG would not materially alter the bank's stand-alone credit profile.

Rating Action

On March 13, 2015, Standard & Poor's Ratings Services lowered its long- and short-term counterparty credit ratings on Austria-based KA Finanz AG to 'A-/A-2' from 'A/A-1'. The outlook is stable.

At the same time, we affirmed the 'A-1+' short-term rating on KA Finanz's commercial paper program, which has a guarantee from the Republic of Austria.

Rationale

The rating action reflects our view that there is increasing uncertainty around the Austrian government's willingness to provide extraordinary government support to KA Finanz. KA Finanz is the run-down entity of former Kommunalkredit Austria AG.

Our action follows the Austrian government's decision to put Heta Asset Resolution AG (HETA) under a resolution regime. HETA is a wind-down entity of former Hypo Group Alpe Adria (HGAA).

In our view, the government's decision to put HETA into a debt-servicing standstill on debt that is to be included for potential bail-in indicates the government's increasing willingness to pass the burden of bank failures to senior unsecured creditors.

Nevertheless, we see clear differences between KA Finanz and HETA, as explained below, which make us 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.

In accordance with our criteria for government-related entities, 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 safeguard confidence in the Austrian banking sector, and 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 expect that the announced potential takeover by KA Finanz of assets from Kommunalkredit Austria during 2015 will not materially alter the stand-alone credit profile (SACP) of KA Finanz. We will examine the impact on the SACP once the details of the transfer are known. We expect that the government will accommodate the asset transfer with sufficient equity to preserve KA Finanz's current capitalization. In our view, this takeover 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.

Outlook

The outlook is stable, as we expect KA Finanz will continue its wind down with the benefit of extraordinary government support. We believe that the potential merger with the nonprivatized part of Kommunalkredit Austria will not materially alter the bank's SACP.

We think that Austria will continue to support KA Finanz in terms of funding, liquidity, and capital. 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 SACP would likely trigger a negative rating action, unless the government provided timely support. As such, 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.

Ratings Score Snapshot

Counterparty Credit Rating	A-/Stable/A-2	A/Stable/A-1
SACP	bbb-	bbb-
Anchor	bbb+	bbb+
Business Position	Adequate (0)	Adequate (0)
Capital and Earnings	Moderate (-1)	Moderate (-1)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	+3	+4
GRE Support	+3	+4
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria And Research

Related Criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- 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
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- Resolution Of HETA Has No Immediate Impact On Bank Ratings In Austria, March 6, 2015
- Moratorium On HETA Debt Service Has No Immediate Impact On Republic of Austria Ratings, March 3, 2015
- Republic of Austria 'AA+/A-1+' Ratings Affirmed Despite An Increase In Debt; Outlook Stable, Sept. 26, 2014

Ratings List

Downgraded

	To	From
KA Finanz AG		
Counterparty Credit Rating	A-/Stable/A-2	A/Stable/A-1
Certificate Of Deposit	A-/A-2	A/A-1
Senior Unsecured	A-	A
Commercial Paper	A-2	A-1

Ratings Affirmed

KA Finanz AG	
Commercial Paper*	A-1+

*Guaranteed by the Republic of Austria.

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