

Research Update:

Austrian Bank KA Finanz AG Rated 'A/A-1' On Very High Likelihood Of Government Support; Outlook Stable

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Overview

- We consider Austria-based bank KA Finanz AG a government-related entity. KA Finanz is almost 100% owned by the Austrian government.
- We assess the likelihood of extraordinary government support as "very high", based on KA Finanz's "very strong" link to the Republic of Austria and the "very important" public policy role it is executing.
- We are assigning our 'A/A-1' counterparty credit ratings to KA Finanz.
- The outlook is stable because we expect the government's ownership of KA Finanz to be stable and long term.

Rating Action

On March 3, 2010, Standard & Poor's Ratings Services assigned its 'A' long-term and 'A-1' short-term counterparty credit ratings to Austria-based bank KA Finanz AG. The outlook is stable. The 'AAA' ratings on KA Finanz's outstanding government-guaranteed debt are unaffected. This is because the ratings on these obligations solely reflect the unconditional and irrevocable guarantee of payment of scheduled interest and principal provided by the Republic of Austria (AAA/Stable/A-1+).

Rationale

KA Finanz is the legal successor of former Austria-based Kommunalkredit Austria AG (Kommunalkredit; not rated). The name change became effective on Nov. 28, 2009. KA Finanz's purpose is to consolidate and manage down all noncore assets of former Kommunalkredit. Government intervention in November 2008 prevented the former Kommunalkredit's failure and, in the process, the government assumed almost full ownership. The former Kommunalkredit's core assets were transferred to a newly established entity named Kommunalkredit Austria AG.

In accordance with our criteria for government-related entities (GREs) the ratings reflect KA Finanz's:

- "Very strong" link to its 99.78% owner the Republic of Austria; and
- "Very important" role in implementing a key national policy to restore the proper functioning of the interbank market.

We therefore assess the likelihood of the state providing timely and sufficient extraordinary support to KA Finanz in the event of financial

distress to be "very high", lifting the ratings four notches above our assessment of KA Finanz's stand-alone credit profile.

KA Finanz's creditors have no direct claim against the government through a statutory guarantee. However, we assume the government would be willing to provide additional extraordinary support to KA Finanz because a default would have a material impact on Austria's reputation and credibility. Since the onset of the financial market crisis the Austrian government has provided financial support to all of its systemically important banks, including Kommunalkredit.

As of February 2010, KA Finanz had about €6.5 billion of government-guaranteed debt outstanding. We understand that KA Finanz benefits from the government's commitment to maintain a Tier 1 capital ratio of at least 7% over the next five years and beyond, as long as Kommunalkredit's former owners hold Tier 1 participation capital notes issued by KA Finanz. We also believe that KA Finanz would be able to receive additional funding support under Austria's legislation to strengthen the interbank market (Interbankmarktstärkungsgesetz). Such support arrangements underpin Austria's commitment to KA Finanz. They are also fundamental, in our view, to maintain KA Finanz's stand-alone credit profile. We expect KA Finanz to report losses after compensation payments on its government-guaranteed debt. Furthermore, we believe that KA Finanz relies on access to wholesale funding owing to funding gaps that arise because the duration of assets is materially above that of its liabilities.

We understand that KA Finanz will not enter into new business, but purely focus on managing down the transferred assets and managing the corresponding liabilities, which were part of the transfer. We don't expect KA Finanz to acquire additional assets. The quality of transferred risk assets of about €27 billion is, in our view, satisfactory. They include mainly public-sector risk (57% of risk assets) and a large international bank portfolio (30%). A sizable portion of the risk assets is in the form of short positions in credit default swaps (CDS; 39%), resulting in a high sensitivity toward spread movements. As we understand, the majority of the CDS are monitored under daily margined bilateral collateral agreements with correspondent banks. We believe this may stretch KA Finanz's liquidity in the event of further spread widening following subsequent additional collateral calls.

Although the regulatory Tier 1 capital ratio is likely to be slightly higher than 7% as of Dec. 31, 2009, we expect capitalization to remain less than 5% under our risk-adjusted capital framework because we assign higher risk weights to KA Finanz's credit risk.

Outlook

The stable outlook reflects our view that the government will remain supportive and KA Finanz's key owner in the long term.

A negative rating action could follow if we were to perceive a weakening of KA Finanz's stand-alone credit profile or the government's commitment to supporting KA Finanz. We will also review whether the European Commission's final decision on Kommunalkredit's restructuring plan and the state aid it received would have material negative implications on KA Finanz.

Although we consider an upgrade unlikely at this stage, we could take a positive rating action if KA Finanz's stand-alone credit profile were to strengthen or the government were to reinforce its support arrangements for KA Finanz.

Related Research

- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009
- Rating Sovereign-Guaranteed Debt, April 6, 2009
- FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004

Ratings List

New Rating

KA Finanz AG

Counterparty Credit Rating	A/Stable/A-1
Certificate Of Deposit	A/A-1

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