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## Research Update:

# Austria-Based KA Finanz 'A-/A-2' Ratings Remain On CreditWatch Positive

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## Research Update:

# Austria-Based KA Finanz 'A-/A-2' Ratings Remain On CreditWatch Positive

## Overview

- On April 26, 2017, KA Finanz AG announced its intent to surrender its banking license.
- If approved, this could result in an accelerated wind-down of the bank's portfolio and stronger support from the Austrian government.
- We are therefore maintaining our 'A-/A-2' ratings on KA Finanz on CreditWatch with positive implications.
- We intend to resolve the CreditWatch by end-September 2017, when we expect to have more clarity on KA Finanz's transformation and on the likelihood of its approval by the authorities.

## Rating Action

On May 19, 2017, S&P Global Ratings maintained its 'A-' long-term and 'A-2' short-term counterparty credit ratings on Austria-based, state-owned KA Finanz AG on CreditWatch with positive implications.

We also maintained on CreditWatch positive the following issue ratings on KA Finanz's debt instruments:

- 'A-' ratings on its nonguaranteed senior unsecured program; and
- 'A-2' ratings on its nonguaranteed commercial paper.

We initially placed the aforementioned ratings on CreditWatch positive on April 27, 2017.

## Rationale

The CreditWatch placement reflects our view that, following KA Finanz's announcement in late April 2017 of its intent to surrender its banking license, the company's proposed transformation plan could lead to stronger ties with The Republic of Austria (AA+/Stable/A-1+) and, as a result, a positive rating action on the bank. In conjunction with the transformation, the bulk of KA Finanz's currently outstanding debt will be replaced by direct lending from the government. If the transformation goes ahead, we would consider whether the inflow of government funding implies that KA Finanz has a stronger link to and role for the Austrian government.

KA Finanz's plan to surrender its banking license and officially become a run-off company involves its heavier reliance on government-sourced funding and an accelerated wind-down of its assets. The plan would need the approval

of the Austrian authorities--notably the banking supervisor, the Financial Market Authority. While the exact timing is currently unclear, we now anticipate having sufficient clarity on this process by the end of the third quarter.

Putting aside the possible transformation plan, under our base case we expect that KA Finanz will remain unprofitable as it winds down the €12 billion of assets reported at end-2016. We base our opinion primarily on the slightly negative yield on those assets and operating costs that are currently inflated by liquidity guarantee fees. Notwithstanding the negligible €7 million of nonperforming loans as of end-2016, we continue to see tail risks in some of its international exposures, which could still cause further credit losses. Even though KA Finanz achieved stronger-than-originally-anticipated capitalization in 2016, these anticipated losses continue to mean that the bank's currently comfortable risk-adjusted capital (RAC) is likely to deteriorate significantly over the next two years, in our view.

We currently consider KA Finanz to be a government-related entity with a high likelihood of receiving timely and sufficient extraordinary government support if needed. We base this opinion on KA Finanz's important role for, and very important link with, the Austrian government. The Republic of Austria is the sole owner of KA Finanz and currently guarantees about 40% of its liabilities. We apply a three-notch uplift to our 'bbb-' assessment of KA Finanz's stand-alone credit profile, resulting in the 'A-' long-term rating and 'A-2' short-term rating.

Our 'AA+' ratings on KA Finanz's government-guaranteed €1 billion debt issue and our 'A-1+' ratings on its government-guaranteed commercial paper remain unchanged.

## **CreditWatch**

We intend to resolve the CreditWatch by end-September 2017, when we expect to receive greater clarity on KA Finanz's planned transformation into a run-off company, the likely associated increase in government support and the likelihood of its approval by the relevant authorities. In particular, if we find that the approval the transformation results in a change in the inflow of government funding that implies that KA Finanz has a stronger link to and role for the Austrian government, we could raise the ratings on KA Finanz by several notches, equalizing them with our sovereign credit ratings on Austria. Although the timing of the approval is unclear at this stage, we anticipate having sufficient clarity by the end of the third quarter. This implies a later resolution of the CreditWatch than we had first envisaged on April 27, 2017 ("Austria-Based KA Finanz 'A-/A-2' Ratings Put On Watch Positive On Expected Strengthening Of Government Support," published on RatingsDirect).

If the transformation is not approved, we would likely affirm the ratings on KA Finanz. This, however, would hinge on no change in our assessments of government support for KA Finanz or prospects for the company's intrinsic

creditworthiness.

## Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

## Related Research

- Ratings On KA Finanz's Public Sector Covered Bonds Placed On CreditWatch Positive After Similar Rating Action On Bank, May 5, 2017
- Austria-Based KA Finanz 'A-/A-2' Ratings Put On Watch Positive On Expected Strengthening Of Government Support; April 27, 2017
- Republic of Austria 'AA+/A-1+' Ratings Affirmed; Outlook Stable, March 17, 2017
- KA Finanz AG, June 28, 2016

## Ratings List

Ratings Kept On CreditWatch

KA Finanz AG

Counterparty Credit Rating  
Commercial Paper

A-/Watch Pos/A-2  
A-2/Watch Pos

N.B.: The ratings list does not include ratings on programs.

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