FITCH UPGRADES KA FINANZ TO 'A+' ON REFINANCING PLANS

Fitch Ratings-London-20 June 2017: Fitch Ratings has upgraded KA Finanz AG's (KF) Long-Term Issuer Default Rating (IDR) to 'A+' from 'BBB+'. The Outlook remains Stable. A full list of rating actions is at the end of this rating action commentary.

The rating actions follow KF's announcement that it has agreed with the Austrian state (AA+/Stable/F1+) a long-term refinancing plan covering most of the bank's funding needs with state funds until the completion of KF's accelerated run-off plan.

KEY RATING DRIVERS
IDRs, SUPPORT RATING, SUPPORT RATING FLOOR (SRF) AND SENIOR DEBT
The upgrade of KF's IDRs, Support Rating, SRF and senior debt ratings reflects Fitch's assessment that the bank's state funding and accelerated wind-down plans have positive implications for the bank's senior creditors.

On 9 June 2017, KF signed a framework agreement with the state-owned Abbaumanagement-gesellschaft des Bundes (ABBAG), which holds participations in run-off Austrian institutions on behalf of the government. Under this agreement, almost all of KF's market funding without any direct state support, which formed about 60% of the bank's total funding at end-2016 and included covered bonds, repos and European Central Bank tenders, will be replaced as it matures by mostly long-term funding from the state via ABBAG.

As part of the agreement with ABBAG, KF has also applied for approval from the banking regulator, the Austrian Financial Market Authority (FMA), to revoke its banking licence and change its status to a run-off institution pursuant to section 162 of the Austrian Bank Recovery and Resolution Act, which implements the European Bank Recovery and Resolution Directive (BRRD) in Austria. KF foresees a completion of the wind-down by end-2026, well ahead of the current 2040 target.

As a run-off institution, KF will remain within the scope of the BRRD and the Single Resolution Mechanism (SRM). As a result, resolution measures affecting senior unsecured creditor bail-in cannot be formally excluded if unexpected losses over the course of KF's accelerated wind-down trigger the need for sovereign support measures beyond those included in the new agreement. However, we view this as extremely unlikely.

We believe that, once approved by the FMA, KF's status as a non-bank run-off institution will considerably reduce the risk of bail-in being imposed by the resolution authorities, even if large unexpected wind-down losses make significant additional state support necessary beyond the new state funding foreseen under the agreement. This is because the non-bank run-off status will exempt KF from the minimum regulatory capital and liquidity requirements to which it has been subject as a regulated bank and which create a strong incentive for resolution authorities to impose bail-in when they deem an institution to be failing or likely to fail.

In addition, we believe that the planned refinancing structure would made creditor bail-in highly ineffective, thus considerably reducing the probability of bail-in being imposed on KF's non-state creditors. This is because bail-in would predominantly affect the state in its capacity as KF's owner and (once the refinancing plan is implemented) dominant creditor.

We believe that the accelerated wind-down plan and refinancing agreement offer sufficient flexibility to absorb unexpected losses or calls on KF's liquidity in realistic stress scenarios in the course of its wind-down without necessitating additional state support.

We judge that the refinancing agreement significantly increases the likelihood of state support. This is because the state will become KF's dominant creditor and intends to remain the sole shareholder until the wind-down is completed, thus increasing the state's incentive to support. The accelerated wind-down plan and refinancing agreement confirm our view that Austria's approach to KF's wind-down plan was clearly formulated at an early stage and has been consistently implemented. Our view of Austria's strong ability to support is derived from the state's high degree of financial flexibility reflected in the sovereign's Long-Term IDRs.

Although FMA's formal approval is not expected before the autumn 2017, we view a rejection or potential amendments to the agreement that would materially affect the position of non-state senior creditors as extremely unlikely.

The refinancing agreement does not affect our opinion that, due to its wind-down status, KF would not be viable without state support. For this reason, we do not assign a Viability Rating to KF as we cannot meaningfully assess its standalone profile.

The upgrade of the Short-Term IDR and non-guaranteed senior unsecured short-term debt reflects our view that the refinancing agreement significantly improves KF's liquidity profile by replacing its large stock of short-term market funding (essentially commercial papers) with long-term state funding, whose maturity matches KF's wind-down horizon. We believe that the agreement also provides KF with a sufficient liquidity buffer in the form of undrawn committed facilities.

SUBORDINATED DEBT
In the absence of a VR or alternative anchor rating, the rating of the subordinated Tier 2 notes maturing between 2021 and 2031 has thus far reflected our view that, while performing, the notes have been exposed to significant bail-in risk due to the high reliance on state support inherent in KF's wind-down business model.

The Rating Watch Positive (RWP) reflects our expectation that, similar to senior debt, the planned refinancing will significantly reduce the exposure of these instruments to bail-in risk. The extent to which KF's new funding mix will reduce the risks of non-performance and loss severity for the Tier 2 instruments relative to the new funds to be provided by the state will determine the extent of the upgrade. We expect to assess these relative risks upon FMA's final approval of the new funding structure.

STATE-GUARANTEED DEBT
The ratings of the EUR1 billion senior unsecured notes and EUR3.5 billion commercial paper (CP) programme reflect their respective state guarantees as we believe that Austria has an extremely high incentive to honour its guarantees in full even in a scenario in which a resolution of KF would trigger a bail-in of senior unsecured creditors. We understand from management that KF will discontinue its CP programme in the next few months and rely on ABBAG refinancing lines for liquidity management.

RATING SENSITIVITIES
IDRS, SUPPORT RATING, SUPPORT RATING FLOOR AND SENIOR DEBT
The ratings are primarily sensitive to Austria's propensity and ability to provide support. The latter is unlikely to diminish materially as long as the sovereign rating remains in the 'AA' category. Given the state's position as KF's sole owner and dominant long-term creditor once the refinancing plans are implemented, we expect the propensity of support to remain extremely high until the wind-down is completed and all third-party liabilities have been repaid.

A downgrade could result from a rejection by FMA of KF's transformation into a non-bank run-off institution or FMA imposing material changes to the agreement that we deem detrimental to non-state senior unsecured creditors.

We could upgrade the Long-Term IDR and the long-term ratings of the senior unsecured notes (and of the programme under which they have been issued) if, during the course of the accelerated wind-down plan, the stock of outstanding senior debt held by third parties becomes so immaterial that it further reduces bail-in risk.

A downgrade of KF's Short-Term IDR and non-guaranteed senior unsecured short-term debt would most likely result from a downgrade of the Long-Term IDR.

SUBORDINATED DEBT
We expect to upgrade the subordinated Tier 2 notes upon FMA's final approval of the new funding structure.

STATE-GUARANTEED DEBT
The ratings of the state-guaranteed senior notes and CP programme are sensitive to the same factors as the sovereign's IDRs.

The rating actions are as follows:

KA Finanz AG
Long-Term IDR: upgraded to 'A+' from 'BBB+'; Outlook Stable
Short-Term IDR: upgraded to 'F1+' from 'F2'
Support Rating: upgraded to '1' from '2'
Support Rating Floor: revised to 'A+' from BBB+'
Long-term senior unsecured notes: upgraded to 'A+' from 'BBB+'
State-guaranteed long-term senior unsecured note (XS1270771006): affirmed at 'AA+'
State-guaranteed commercial paper programme: affirmed at 'F1+'
Debt issuance programme: upgraded to 'A+'/'F1+' from 'BBB+'/'F2'
Non-guaranteed CP programme: upgraded to 'F1+' from 'F2'
Subordinated Tier 2 debt (XS0257275098, AT0000441209, XS0185015541, XS0144772927 and XS0255270380): 'B' placed on RWP

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Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051

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