FITCH AFFIRMS KA FINANZ AT 'BBB+'; OUTLOOK STABLE

Fitch Ratings-London-17 January 2017: Fitch Ratings has affirmed KA Finanz AG's (KF) Long-Term Issuer Default Rating (IDR) at 'BBB+' with a Stable Outlook. A full list of rating actions is at the end of this rating action commentary.

The rating actions are part of a review of Fitch-rated eurozone institutions in wind-down.

KEY RATING DRIVERS

IDRs, SUPPORT RATING, SUPPORT RATING FLOOR (SRF) AND SENIOR DEBT

KF's Long- and Short-Term IDRs, senior debt ratings, Support Rating, and SRF reflect Fitch's assessment of the high likelihood that support for KF would be made available by the Republic of Austria (AA+/Stable/F1+), if required. Our assessment is driven primarily by KF's state ownership, significant state-guaranteed funding and the reasonable flexibility available to Austria to support KF. The government has stated that it intends to remain KF's sole shareholder until the bank's wind-down is completed.

Fitch believes that the Austrian government's propensity to provide capital or funding support to KF would remain high, even if substantial additional capital is required. This could be the case, for example, if KF posts large credit losses following an accelerated wind-down or asset disposal.

However, this is not our base case expectation as we believe that its orderly wind-down will progress as planned, without requiring recapitalisation from the state.

As a regulated bank, KF would be subject to the EU's Bank Recovery and Resolution Directive (BRRD), which together with the Single Resolution Mechanism (SRM), could require KF to take resolution measures including senior creditor bail-in instead of or ahead of a bank receiving sovereign support. The BRRD and its bail-in tool were fully implemented into Austrian law on 1 January 2015. Nonetheless, we believe that the effectiveness of bail-in would be limited as it would predominantly hit the state as owner and funding guarantor and only more moderately third-party creditors.

Austria's approach to KF's wind-down plan was clearly formulated at an early stage and has been consistently implemented. Under reasonable stress assumptions, we expect KF to incur only manageable losses commensurate with its loss absorption capacity.

Similar to other monoline public-sector lenders, we view KF's high concentration on single exposures as the main potential source of large, unexpected losses. However, concentration has been declining rapidly, which makes the risk of large single losses increasingly manageable.

Since 2009, KF has received EUR2.2bn of state support net of guarantee fees paid to the government, including EUR1bn in 2011 following Greece-driven losses, and a EUR350m contribution in 2013 to ensure compliance with Basel III regulations while actively reducing risk-weighted assets via asset disposals. At end-1H16 KF's common equity Tier 1 ratio was 16.9% and its total capital ratio 20.7%.

Beside KF's state ownership, our assumption that Austria will remain committed to supporting KF is underpinned by state guarantees covering a large share of KF's funding. These were substantially increased after the implementation of BRRD. KF has EUR1bn of guaranteed five-year notes outstanding, and the maximum volume that it can draw under its guaranteed commercial paper

(CP) programme is EUR3.5bn. Assuming full utilisation of the CP programme, these funding guarantees are the equivalent of around one-third of KF's total end-1H16 liabilities.

This extensive guaranteed funding significantly mitigates KF's refinancing risk, both directly and indirectly by raising confidence, especially among unguaranteed creditors. However, adverse market developments obliging KF to increase durably its usage of guaranteed funding could erode its loss absorption capacity due to the relatively high cost of state guarantees.

We do not assign a Viability Rating to KF because due to its wind-down status, it would not be viable without external support.

SUBORDINATED DEBT
The subordinated lower Tier 2 notes maturing between 2021 and 2031 have been affirmed at 'B' to reflect our analysis of the risks of non-performance and loss severity in the absence of a VR or alternative anchor rating. While the notes are performing, the 'B' factors in the lack of financial flexibility for subordinated debt, which could be bailed in if additional state support is required to accompany KF's orderly wind-down under the BRRD.

We derive the lower Tier 2 debt rating by stressing profit forecast and credit exposures of KF and similar issuers and comparing their related potential losses with their respective available capital buffers to determine and compare the potential need for extraordinary state support.

STATE-GUARANTEED DEBT
The EUR1bn guaranteed senior notes' long-term rating of 'AA+' and the EUR3.5bn guaranteed CP programme's short-term rating of 'F1+' reflect the state guarantees supporting the notes and the programme as we believe that Austria will honour its guarantees in full even in a scenario in which a resolution of KF would trigger a bail-in of senior unsecured creditors.

RATING SENSITIVITIES
IDRS, SUPPORT RATING, SUPPORT RATING FLOOR AND SENIOR DEBT
KF's 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 and we do not expect a change in Austria's propensity to provide support based on KF's current wind-down plan. The ratings are also sensitive to large single credit losses that may necessitate a capital injection from the state, increasing the risk of senior unsecured creditor bail-in under BRRD.

SUBORDINATED DEBT
If KF's capital ratios and ability to absorb large losses from single borrower defaults improves significantly as its wind-down progresses, this could create upside for the lower Tier 2 notes' rating. However, this potential will be low in the medium term as the large guarantee fees to be paid to the state will prevent capitalisation from materially strengthening. Downside arises from the risk of the notes being bailed-in if new state aid is required. A bail-in would likely result in high loss severity, which could trigger a downgrade to 'CC' or 'C'.

STATE-GUARANTEED DEBT
The ratings of the EUR1bn government-guaranteed senior notes and the EUR3.5bn state-guaranteed CP programme have the same sensitivities as the sovereign's IDRs.

The rating actions are as follows:

KA Finanz AG (KF)
Long-Term IDR: affirmed at 'BBB+'; Outlook Stable
Short-Term IDR: affirmed at 'F2'
Support Rating: affirmed at '2'

Support Rating Floor: affirmed at 'BBB+'
Long-term senior unsecured notes: affirmed at 'BBB+'
State-guaranteed Long-term senior unsecured note (XS1270771006): affirmed at 'AA+'
State-guaranteed commercial paper programme: affirmed at 'F1+'
Debt issuance programme: affirmed at 'BBB+'/'F2'
Commercial paper programme: affirmed at 'F2'
Subordinated tier 2 debt (XS0257275098, AT0000441209, XS0185015541, XS0144772927 and XS0255270380): affirmed at 'B'

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Additional information is available on www.fitchratings.com

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