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KA Finanz AG

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Table Of Contents

Credit Highlights

Outlook

Rationale

Key Statistics

Related Criteria

Related Research

KA Finanz AG

Credit Highlights

Issuer Credit Rating

AA+/Stable/A-1+

Key strengths	Key risks
Almost-certain likelihood of extraordinary government support from Austria, KA Finanz AG's sole owner.	Negative equity from accelerated portfolio runoff measures requires offsetting via government support.
A direct €8.2 billion refinancing agreement with government-owned Abbaumanagementgesellschaft des Bundes (ABBAG), with €3.2 billion provided as of June 30, 2022.	Reliance on the government to close funding and liquidity gaps in case of need.
Critical public policy role for the wind-down of the former Kommunalkredit Austria AG's nonstrategic assets.	

The wind-down of KA Finanz is on track to be completed by year-end 2023. KA Finanz has held non-bank status since September 2017. In 2021, its wind-down was accelerated, with completion now targeted by year-end 2023. This was made possible by KA Finanz's outperformance of the initially submitted wind-down plan, which was facilitated by a positive market environment and high investor demand in the past. The preponed wind-down will furthermore reduce uncertainty about future market developments and lower administrative expenses, in our view. We project KA Finanz will continue to post structural losses in 2022 and 2023, which we expect will be covered by the loss-absorbing tranche from the Austrian government through state-owned company, ABBAG. We understand that this support mechanism will remain in place over the accelerated wind-down plan and deem the tranche sufficient to cover further losses until the end of the runoff term. While KA Finanz is not unaffected by the heightened volatility in the current market environment, we note that it has no direct or indirect exposure to Ukraine and Russia and only low exposure to Central and Eastern Europe.

The 'AA+' rating on KA Finanz reflects our expectation of support from Austria (AA+/Stable/A-1+) if needed. In the event of financial difficulties, S&P Global Ratings believes that KA Finanz will be supported by its owner, which will maintain its provide funding, including loss-absorbing tranches. We recently revised the outlook on the sovereign to stable from positive to reflect our view of rising risks to economic performance emanating from further potential stress in energy supply, in particular in relation to gas supply (see "Austria Outlook Revised To Stable From Positive On Rising Economic Risks; 'AA+/A-1+' Ratings Affirmed," published Aug. 26, 2022, on RatingsDirect). As a result, we also revised the outlook on KA Finanz to stable from positive (see "KA Finanz Outlook Revised To Stable From Positive After Outlook Revision On Austria; 'AA+/A-1+' Ratings Affirmed," published Aug. 30, 2022).

Outlook

The stable outlook on KA Finanz reflects that on Austria. Any rating action on Austria would prompt a similar rating action on KA Finanz.

Any weakening of KA Finanz's role for and link to Austria could cause us to take a negative rating action on the wind-down entity. However, we do not anticipate any adverse changes. We believe that the almost-certain likelihood of government support will not change at least over the next two years.

Rationale

We equalize our ratings on KA Finanz with the ratings on its sole owner and support provider, Austria. This reflects our opinion that there is an almost-certain likelihood that the Austrian government would provide timely and sufficient extraordinary support to KA Finanz in case of financial distress. KA Finanz's business model is based entirely on Austria's interest in an orderly wind-down of its contingent liabilities from the troubled former Kommunalkredit Austria.

We base our view on the entity's:

- Critical role as a key government policy tool to stabilize the banking system and minimize potential long-term losses to taxpayers through the orderly wind-down of the noncore assets of the former Kommunalkredit Austria; and
- Integral link with the Austrian government because of full ownership by the government and the credible government-support mechanism, in case of need.

We have no doubts regarding the Austrian government's propensity to support KA Finanz. We believe the government has sufficient financial resources to do so, and do not consider government support subject to transition risk.

We do not expect KA Finanz's ownership status or the state-support mechanism will weaken. We expect the entity's public policy role as a wind-down entity will continue until this task is complete, because we believe an accelerated wind-down could not be easily or more efficiently undertaken by a private entity, given its advanced stage.

We expect Austria will remain supportive of KA Finanz and that the implemented EU Bank Recovery and Resolution Directive does not affect its willingness or ability to support the entity as a wind-down entity.

KA Finanz was established in 2009 with the aim of avoiding disturbance in the financial markets. As part of its restructuring, the former Kommunalkredit Austria was separated into two independent entities: Kommunalkredit Austria and KA Finanz. The new Kommunalkredit Austria was reprivatized in September 2015.

KA Finanz operates as a nonbank wind-down unit according to section 162 of the Austrian Bank Recovery and Resolution Act since the lapse of its banking license in 2017, and is supervised by the Austrian Financial Market

Authority. The entity's nonbank status allows for an accelerated 10-year wind-down plan which was preponed to 2023. KA Finanz is not subject to regulatory capital requirements and only has to comply with a reduced scope of the banking regulatory framework.

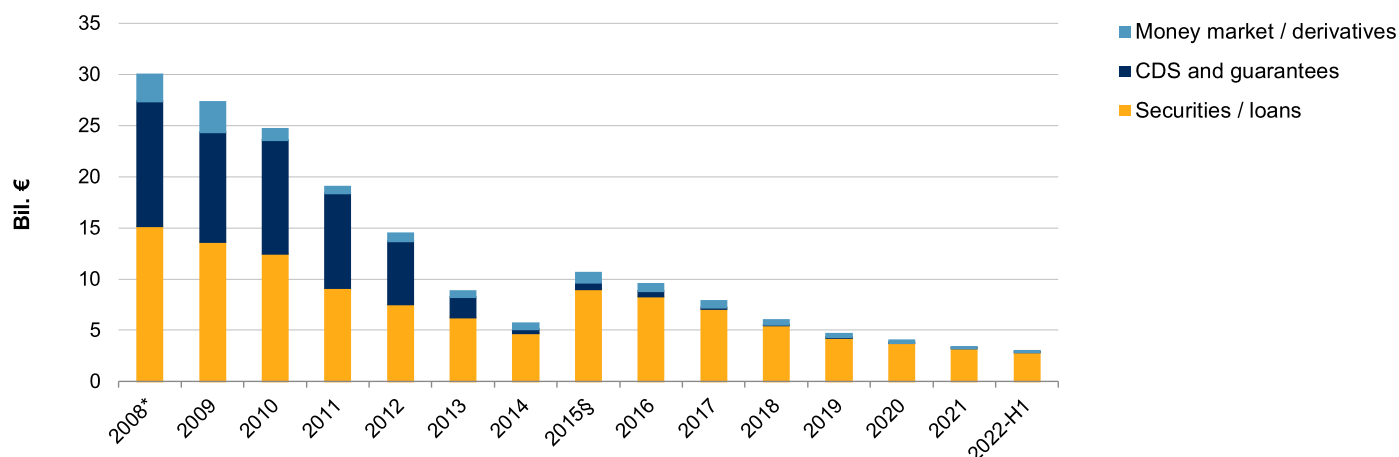
We expect KA Finanz will continue to receive government support over the accelerated runoff term. In its relations with KA Finanz, the Austrian government acts through a state-owned company, ABBAG, which provides a funding framework of up to €8.2 billion. This framework includes a loss-absorbing tranche of €988 million, which covers operating and wind-down losses exceeding KA Finanz's equity base. This loss-absorption mechanism was triggered for the first time in 2018, when KA Finanz's equity was depleted. We expect the remaining capacity of the loss-absorbing tranche to be sufficient to cover further losses until the end of the runoff term.

The wind-down is on track to be completed by year-end 2023, with a fraction of KA Finanz's original exposures remaining. As of June 2022, KA Finanz had assets of €3.4 billion, reflecting a material progress in the wind-down of assets. Overall, exposures have fallen by 90% since the restructuring process started in 2008 (see chart 1). The main measure of the balance-sheet runoff remains asset sales, with €21.9 billion in positions sold in total since 2008, followed by accelerated redemptions of €9.7 billion.

Chart 1

KA Finanz Has Materially Reduced Its Exposures Since 2008

Development of KA Finanz's exposures



*As of Nov. 28, 2008. §Merger with the non-privatized part of Kommunalkredit Austria AG in September 2015.

CDS--Credit default swaps. Source: KA Finanz, S&P Global Ratings.

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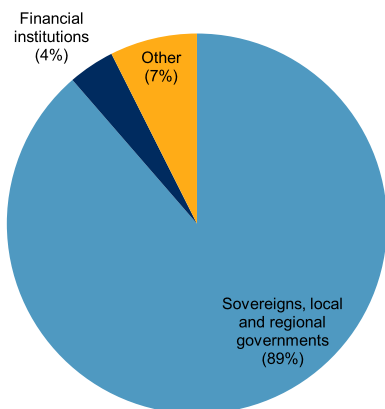
We expect KA Finanz's asset quality will remain strong. As of June 2022, there were no nonperforming loans (NPL) on the entity's book thanks to the previous reduction of exposure to higher-risk geographies and the ongoing decrease of complexity.

As of end-2021, KA Finanz's asset base included predominantly exposures to the public sector (88.6% of total) and the

eurozone (91.8%), which translates into generally high portfolio quality (see charts 2 and 3). Exposure to non-European countries was substantially reduced over the past 1.5 years, among others through the sale of exposures to Mexico, Qatar, and Canada, and the sale of the U.S. securities portfolio. As of end-2021, 97.3% of exposures were investment-grade with roughly 86% rated 'AA' or higher. Although KA Finanz's portfolio is highly concentrated, with the top 20 exposures accounting for 95.6% of the total in June 2022, the low-risk nature of the assets mitigates this risk, in our view.

Chart 2

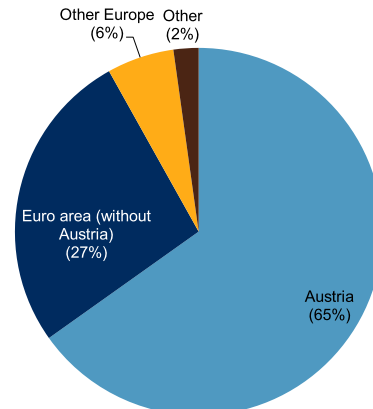
KA Finanz's Portfolio Is Tilted Toward Local And Regional Governments...
Breakdown of exposures by sector as of Dec. 31, 2021



Data as of December 2021. Other includes public-sector entities and quasi-public enterprises.
Source: KA Finanz, S&P Global Ratings.
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Chart 3

...Particularly In Austria And The Eurozone
Breakdown of exposures by geography



Data as of Dec. 2021. Source: KA Finanz, S&P Global Ratings.
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We expect KA Finanz will post structural losses for 2022 and beyond. The entity has posted negative net operating profit of about €172 million in 2021, which resulted predominantly from the net valuation adjustments and realizations from the market values of receivables or securities being wound down. We expect the entity will post structural losses for 2022 and 2023, which will be covered by reductions in the repayment obligations toward ABBAG. Current high valuation volatility amid stressed capital markets poses downside risks, in our view. That said, we note that KA Finanz has so far successfully outperformed its original wind-down plan, despite difficult market conditions.

Since 2017, KA Finanz's capital market funding has been gradually replaced by funding provided by ABBAG. As of June 30, 2022, funding by ABBAG amounted to €3.2 billion while KA Finanz's capital markets legacy funding was only €0.2 billion.

We expect KA Finanz's remaining covered bond, loans, and private placements will continue to be honored and redeemed at their full nominal value on the relevant due dates, while we assume that remaining subordinated debt and private placements maturing after the 10-year wind-down period will eventually be redeemed.

Key Statistics

Table 1

KA Finanz AG--Key Figures					
	--Year-ended Dec. 31--				
(Mil. €)	2022*	2021	2020	2019	2018
Adjusted assets	3,446.7	3,603.2	5,288.2	6,565.3	7,222.0
Customer loans (gross)	2,769.7	2,655.1	3,366.3	3,868.0	4,802.1
Adjusted common equity	27.0	0.0	0.0	0.0	0.0
Operating revenues	19.7	94.0	116.0	3.8	(1.0)
Noninterest expenses	18.8	120.7	131.3	23.8	23.7
Core earnings	27.0	(171.9)	(69.9)	(49.9)	(245.3)

*Data as of June 30.

Table 2

KA Finanz AG--Business Position					
	--Year-ended Dec. 31--				
(%)	2022*	2021	2020	2019	2018
Total revenues from business line (mil. €)	19.7	265.9	195.6	81.6	215.1
Other revenues/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on average common equity	400.0	N.M.	N.M.	N.M.	(200.0)

*Data as of June 30. N.M.--Not meaningful.

Table 3

KA Finanz AG--Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2022*	2021	2020	2019	2018
Adjusted common equity/total adjusted capital	100.0	N.M.	N.M.	N.M.	N.M.
Net interest income/operating revenues	37.7	17.2	13.5	323.9	(1,649.8)
Fee income/operating revenues	(2.1)	(1.4)	(8.1)	(398.1)	1,769.9
Market-sensitive income/operating revenues	(0.0)	1.4	(2.6)	(1.0)	(1.5)
Cost to income ratio	95.3	128.4	113.2	625.2	(2,342.8)
Preprovision operating income/average assets	0.1	(0.6)	(0.3)	(0.3)	(0.3)
Core earnings/average managed assets	1.5	(3.9)	(1.2)	(0.7)	(2.9)

*Data as of June 30. N.M.--Not meaningful.

Table 4

KA Finanz AG--Risk Position					
	--Year-ended Dec. 31--				
(%)	2022*	2021	2020	2019	2018
Growth in customer loans	4.3	(21.1)	(13.0)	(19.5)	(18.5)
Total managed assets/adjusted common equity (x)	127.8	N.M.	N.M.	N.M.	N.M.
New loan loss provisions/average customer loans	(2.1)	4.8	1.5	0.7	4.1

Table 4

KA Finanz AG--Risk Position (cont.)					
(%)	--Year-ended Dec. 31--				
	2022*	2021	2020	2019	2018
Gross nonperforming assets/customer loans + other real estate owned	0.0	0.0	0.0	0.0	0.0

*Data as of June 30. N.M.--Not meaningful.

Table 5

KA Finanz AG--Funding And Liquidity					
(%)	--Year-ended Dec. 31--				
	2022*	2021	2020	2019	2018
Core deposits/funding base	93.3	93.9	85.6	71.0	73.8
Customer loans (net)/customer deposits	89.7	81.3	77.0	85.8	93.4
Long-term funding ratio	96.5	96.8	95.7	90.1	91.5
Stable funding ratio	105.9	113.9	128.8	130.1	115.2
Short-term wholesale funding/funding base	3.6	3.2	4.3	9.9	8.5
Broad liquid assets/short-term wholesale funding (x)	3.3	5.8	6.4	3.4	2.8
Broad liquid assets/total assets	11.3	17.6	26.8	32.4	22.7
Broad liquid assets/customer deposits	12.7	19.4	32.4	47.1	31.9
Net broad liquid assets/short-term customer deposits	5,202.3	9,453.4	760.3	709.5	1,808.9
Short-term wholesale funding/total wholesale funding	53.8	51.6	29.9	34.0	32.5

*Data as of June 30.

Related Criteria

- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- KA Finanz Outlook Revised To Stable From Positive After Outlook Revision On Austria; 'AA+/A-1+' Ratings, Aug. 30, 2022
- Austria Outlook Revised To Stable From Positive On Rising Economic Risks; 'AA+/A-1+' Ratings Affirmed, Aug. 26, 2022
- Banking Industry Country Risk Assessment: Austria, July 13, 2022
- KA Finanz Outlook Revised to Positive After Same Action On Austria; 'AA+/A-1+' Ratings Affirmed, March 1, 2022

- Austria Outlook Revised To Positive On Budgetary Consolidation Prospects; 'AA+/A-1+' Ratings Affirmed, Feb. 25, 2022
- KA Finanz AG, Nov. 19, 2021

Ratings Detail (As Of November 18, 2022)*

KA Finanz AG

Issuer Credit Rating	AA+/Stable/A-1+
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Issuer Credit Ratings History

30-Aug-2022	AA+/Stable/A-1+
01-Mar-2022	AA+/Positive/A-1+
11-Sep-2017	AA+/Stable/A-1+

Sovereign Rating

Austria	AA+/Stable/A-1+
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*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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