FitchRatings

Fitch Affirms KA Finanz at 'BBB+'; Withdraws Kommunalkredit Austria's Ratings

Fitch Ratings-Frankfurt/London-02 October 2015: Fitch Ratings has affirmed KA Finanz AG's (KF) Long-term Issuer Default Rating (IDR) at 'BBB+' with a Stable Outlook. Fitch has withdrawn the 'BBB+'/Stable Long-term IDR of KF's former sister bank, Kommunalkredit Austria AG (KA). The agency has also affirmed KA's senior debt that has been transferred to KF at 'BBB+'. KA's senior debt that has been transferred to KA New, a newly incorporated bank, has been downgraded to 'BB' and 'BBemr' from 'BBB+' and 'BBB+emr', respectively, removed from Rating Watch Negative (RWN) and subsequently withdrawn. Fitch does not rate KA New.

A full list of rating actions is at the end of this rating action commentary.

The rating actions result from the spin-off under Austria's demerger legislation of certain business operations of KA and all of its subsidiaries to KA New, and the merger of the remainder of KA (KA Residual) into KF on 26 September 2015. As the old KA has ceased to exist as a legal entity, its ratings have been withdrawn.

EUR4.5bn of assets have been transferred to KA New and a proportionate volume of KA's outstanding liabilities was also transferred. KA Residual's total assets of EUR6.7bn were merged into KF along with the remaining liabilities. The downgrade prior to withdrawal of the rated debt transferred to KA New reflects the Financial Markets Holding Company of the Republic of Austria's (FIMBAG) sale of its 99.78% in the new bank to a private sector consortium on 28 September 2015, which means that Fitch no longer considers it likely that repayment of these issues would benefit from sovereign support. The debt ratings have been withdrawn for commercial reasons.

KEY RATING DRIVERS - KF's IDRs, SUPPORT RATING AND SUPPORT RATING FLOOR (SRF)
The affirmations of KF's ratings reflect Fitch's view of the high likelihood of support from the Republic of Austria (AA+/Stable/F1+), the bank's sole owner. The government has stated that it intends to remain KF's sole shareholder until the bank's wind-down is completed.

Fitch's assessment of the remaining high likelihood of state support for KF is driven by qualitative factors, primarily the bank's state ownership, Austria's commitment and some flexibility to provide support to KF.

The EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) are now sufficiently progressed to provide a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support. The BRRD has been fully implemented (including its bail-in tool) into Austrian law with effect from 1 January 2015.

Although KF is subject to the BRRD, Fitch believes that it will not be applied to the bank as long as its orderly wind-down progresses in line with plans agreed with the European Commission's (EC) state aid authorities. However, KF's ratings reflect the fact that, although unlikely, the bank may be required to take resolution measures, potentially including some bail-in of senior creditors, should events transpire that mean that state aid is required beyond that already approved by the EC.

Austria's approach to KF's wind-down was clearly formulated at an early stage, consistently executed since the inception of the bank's wind-down plan and is progressing ahead of expectation. We do not expect KF to suffer major losses in the foreseeable future under reasonable stress assumptions. In our view, these characteristics significantly and positively differ from the aggressive resolution measures imposed by the Austrian authorities to resolve Heta Asset Resolution AG (Heta).

Our ratings factor in assumptions around a potential decrease in the Austrian state's propensity to provide support for wind-down banks in general since 2014 and following measures taken against Heta, which include a 15-month moratorium on Heta's debt payments since March 2015. However, we differentiate the Heta case, where measures taken were driven by the government's clear intention to impose a large-scale burden sharing on Heta's senior creditors following the large scale and highly volatile development of Heta's losses.

An important consideration in our assumptions around Austria's commitment to support KF is substantial funding guarantees provided to KF by the Austrian government, which were increased after the start of Heta's moratorium. KF issued EUR1bn of state-guaranteed five-year notes in July 2015 and the guaranteed volume issued under its commercial paper programme (CP) was increased to EUR3.5bn from EUR3.0bn in September 2015.

As part of the EC state aid decisions, the Austrian government is committed to maintaining a Tier 1 ratio of 7% for KF. We understand from management that this commitment (and the EC's state aid decision) is unaffected by the merger of KA Residual's assets and liabilities into KF. KF has received net EUR2bn in state support, including EUR1bn in 2011 following Greece-driven losses, and a shareholder contribution of EUR350m in 2013 that allowed the bank to comply with Basel III regulations while actively reducing risk-weighted assets. KF maintained a total capital ratio of 20.5% and a CET1 ratio of 14.8% at end-1H15. We understand from KF that the merger of KA Residual will only moderately affect these ratios.

Fitch expects that KF will need no additional capital for the foreseeable future, given the nature of its remaining assets which are systematically running off. Concentration in KF's public sector-focussed portfolio remains high but is rapidly declining, increasingly mitigating the risk of significant single losses.

Depending on the magnitude of any credit losses that may arise and the speed of asset disposal and run-off, further capital injections by the Austrian government could, in Fitch's view, become necessary. Should this be the case, Fitch believes that the Austrian government's propensity to provide capital and/or funding support to KF remains high, even if additional capital requirements proved to be substantial.

KF benefits from substantial funding guarantees from Austria. These guarantees are large in absolute terms and, assuming full utilisation of the CP programme, amounted to about one-third of KF's total assets post-merger. In our view, this represents a strong incentive for the authorities to provide additional support, if required, to protect their investment until the banks' assets are wound down. Moreover, we understand from management that the EC state aid decisions would allow a substantial increase of the volume of state-guaranteed debt.

Fitch does not assign a Viability Rating to KF because the bank is a wind-down institution whose business model would not be viable without external support.

KEY RATING DRIVERS - RATINGS OF KA's SENIOR DEBT MERGED INTO KF
The affirmation at 'BBB+' of KA's debt merged into KF reflects our view that KF now drives these notes' risk profile. Since the merger, KF has become KA's legal successor and retains all rights and obligations attached to this status. Therefore, we have aligned the notes' ratings with KF's Long-term IDR and senior debt ratings.

KEY RATING DRIVERS - RATINGS OF KA's SENIOR DEBT TRANSFERRED TO KA NEW
The downgrade prior to withdrawal of senior debt transferred to KA New to 'BB' and 'BBemr' reflects our view that KA New is highly unlikely to benefit from support from Austria and that support from its owners, albeit possible, cannot be relied upon. The rating of the senior debt transferred to KA New primarily reflected KA New's company profile, including start-up characteristics that will necessitate the build-up of a sustainable standalone franchise in the next few years. Fitch does not rate KA New.

We believe that KA New is highly unlikely to benefit from sovereign support in light of its private ownership and small size, given Austria's full implementation of BRRD and the government's recent track-record of not supporting larger issuers. The new owner, Gesona Beteiligungsverwaltung GmbH, is a special purpose vehicle owned by a consortium of English Interritus Limited and Irish Trinity Investments Limited, managed by London-based asset manager Attestor Capital LLP. Fitch does not usually factor in support from private equity investors into its ratings as their ability or commitment to fully support creditors typically cannot be relied upon. The remaining 0.22% of KA New's shares continues to be held by the Association of Austrian Municipalities.

KA New has announced that it will focus on infrastructure financing at the early stages of projects' life cycles, which suggests a monoline, wholesale business model. As a result, we expect the bank's balance sheet to be increasingly exposed to the construction phase of the projects as it ramps up new business in the medium term. Because infrastructure projects are not cash-generating during the early stage of their life cycle, this strategy would result in a high-risk profile if it is not mitigated by structural features or guarantees from public sector entities.

The long-standing expertise and extensive relationships of KA's management with the Austrian public sector are positive rating considerations and should enable it to mitigate KA New's exposure to project finance risk. KA New's opening balance sheet shows robust asset quality (with 98% of total exposures rated investment grade, 61% rated 'AA' or above and an NPL ratio of 0%). It also has a matched asset/liability profile and a comfortable capital buffer, with a CET1 ratio and a total capital ratio (both pro-forma) of 19.0% and 26.2%, respectively, on 1 January 2015.

However, we expect KA New's maturing legacy assets to be gradually replaced by significantly riskier infrastructure finance assets. In addition, KA New may need some time to restore a viable franchise after several years of very modest new business generation at KA, especially since 2013, when the EC's state aid agreement banned new business generation. KA New will also need to re-establish in the medium term a standalone funding profile, which unlike KA's, will not benefit from implicit state support.

The ratings of the notes transferred to KA New have been subsequently withdrawn for commercial reasons.

RATING SENSITIVITIES

KF's IDRs, SENIOR DEBT RATINGS, SUPPORT RATING AND SRF

KF's ratings (including the ratings of KA's senior debt merged into KF) will remain primarily sensitive to Austria's ability and propensity to provide support. Fitch does not believe that Austria's ability to support KF will diminish materially as long as the sovereign rating remains in the 'AA' category.

KF's ratings are also sensitive to the bank's progress with its orderly wind-down in accordance with the plan agreed with the EC. In light of the bank's solid risk profile, we do not expect the assets and liabilities acquired from KA to pose a significant threat to KF's wind-down.

However, a negative deviation from the wind-down plan would likely trigger a fresh state aid review and heighten the likelihood of the EC and/or the Single Resolution Board requiring more stringent measures, which could include burden-sharing for senior creditors. This scenario could be driven by large single credit losses that would mean KF requiring further state support, although this is unlikely given that KF's (and KA Residual's) concentration risk has declined significantly in recent years.

KF's SUBORDINATED LOWER TIER 2 DEBT

The performing subordinated lower Tier 2 debt securities issued by KF have been affirmed at 'B' to reflect a bespoke analysis of the risks of non-performance and loss severity risks in the absence of a VR or alternative rating that could act as an anchor, The rating factors in the still material credit risk for the bank if state support is excluded and lack of financial flexibility for subordinated instruments, which we would expect to be bailed in if additional state support was required to accompany orderly wind down, facilitated by BRRD legislation.

In deriving the rating Fitch stresses the bank's net operating income forecasts and credit exposures and compares the related potential losses with available capital buffers to determine the potential need for further extraordinary state support.

There is upside potential for the subordinated lower Tier 2 debt rating should KF's wind-down progress significantly with capital being retained at the same time. Downside pressure arises from the risk of the instruments being bailed-in if new state aid is required. Should these instruments be bailed in, then loss severity would likely be high, which could result in a downgrade to 'CC' or 'C'.

KF's JUNIOR SUBORDINATED DEBT

KF's junior subordinated debt rating of 'C' reflects the deferral of coupon payments and Fitch's view that payments are unlikely to be resumed given that KF is in wind-down. Fitch does not expect that this instrument will become performing and therefore sees no upside for the instruments' ratings.

KF's GUARANTEED DEBT

The Long-term rating of KF's EUR1bn government-guaranteed senior notes (XS1270771006) and the Short-term rating of KF's EUR3.5bn government-guaranteed commercial paper programme have been affirmed at 'AA+' and 'F1+', respectively, and reflect the state guarantee supporting the notes and the programme and Fitch's view that Austria will honour its sovereign guarantees. The ratings have the same sensitivities as the sovereign's IDRs.

The rating actions are as follows:

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Kommunalkredit Austria AG (KA)

Long-term IDR: withdrawn

Short-term IDR: withdrawn

Support Rating: withdrawn

Support Rating Floor: withdrawn

Debt issuance programme: withdrawn

Short-term senior unsecured notes: withdrawn

KA's Long-term senior unsecured notes transferred to KF: affirmed at 'BBB+'.

The following notes are affected: XS1072804484, XS1003354252, XS0235597068, XS1020014608, XS1016032457, XS1040273267, AT0000329859 XS0255439803, XS0981809584, XS0247759094, XS1048251091, XS1055031139, XS1013581274 and CH0025370906.

KA's Long-term senior unsecured notes transferred to KA New: downgraded to 'BB' from 'BBB+', removed from RWN and withdrawn.

The following notes are affected: XS0238189657, XS0238190150, XS0234510930, XS0236347240, XS0238071228, XS0241451581, XS0186736228, XS0187975262, XS0363735712, XS0252593198, XS0171595183, XS0214564972, XS0192480977, XS0163624504, XS0104786263, XS0212470149, XS0213230047, XS0215865287, XS0218474533, XS0252786669, XS0221102840, XS0222391632, XS0243179354, XS0157911958, XS0161439954, XS0162167398, XS0169415659, XS0170583123, XS0190871409, XS0201565115, XS0214981812, XS0243771218, XS0253410236, XS0184959376, XS0205974701, XS0169321832, XS0170243702, XS0172801986, XS0173644724, XS0189430183, XS0215839019, XS0238702400, XS0306952598.

KA's Long-term senior unsecured market-linked notes transferred to KA New: downgraded to 'BBemr' from 'BBB+emr', removed from RWN and withdrawn.
The following notes are affected: XS0233055424, XS0169312179, XS0172124603, XS0193213393, XS0230962002, XS0340901908, XS0158079540, XS0158239680, XS0164432394, XS0166841121, XS0162912934, XS0167712016, XS0167426864, XS0168578317, XS0170112519, XS0171468746, XS0185849568.

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+'
Government-guaranteed Long-term senior unsecured notes: affirmed at 'AA+'
Short-term senior unsecured notes: affirmed at 'F2'
Subordinated lower tier 2 debt (XS0257275098, AT0000441209, XS0185015541, XS0144772927 and XS0255270380): affirmed at 'B'
Junior subordinated debt (XS0284217709 and XS0270579856): affirmed at 'C'
Debt issuance programmes: affirmed at 'BBB+'/'F2'
Commercial paper and certificates of deposit programmes: affirmed at 'F2'
Government-guaranteed commercial paper programme: affirmed at 'F1+'

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Applicable Criteria
Global Bank Rating Criteria (pub. 20 Mar 2015)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501)

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