Fitch Ratings

Fitch Affirms VB-Verbund at 'BBB'; Outlook Stable

Fitch Ratings - Frankfurt am Main - 24 January 2020:

Fitch Ratings has affirmed Volksbanken-Verbund's (VB-Verbund) Long-Term Issuer Default Rating (IDR) at 'BBB' with a Stable Outlook and Viability Rating (VR) at 'bbb'. A full list of rating actions is at the end of this rating action commentary.

Key Rating Drivers

IDR AND VR

Fitch assigns "group" ratings to VB-Verbund and the individual primary banks in line with our criteria for rating banking structures backed by mutual support mechanisms (Annex 4 of the Bank Rating Criteria). VB-Verbund is not a legal entity but a medium-sized network of cooperative banks, whose cohesion is primarily ensured by their mutual support scheme.

The affirmation of VB-Verbund's VR and IDRs and the member banks' IDRs reflects the group's strengthened cohesion, underlined by the completed intragroup consolidation in 2018, reduced risk appetite, improving asset quality, stabilised but modest performance and generally stable funding and liquidity profile. Capitalisation is only adequate and earnings retention capacity is expected to be modest in the medium term, due to the group's obligation to repay profit participation rights granted to the state by end-2023.

VB-Verbund focuses on Austrian retail, self-employed and SME clients, resulting in a predominantly domestic loan book. Non-performing loans (NPL; IFRS 9 Stage 3 loans) accounted for 3% of gross loans at end-2018, which is broadly in line with larger domestic Austria-focused peers. The NPL ratio reported by the group (which includes off-balance sheet items) decreased to 2.5% at end-1H19 (vs. 2.7% at end-2018). Management aims to keep the NPL ratio sustainably below 3% (based on its own definition), which we view as realistic thanks to strengthened risk management data and tools and the group's fairly prudent risk appetite.

VB-Verbund's profitability has stabilised and considerably improved after several years of legacy-related losses and restructuring costs. The group broke even in 2017 and the positive trend continued in 2018 and 1H19, driven by business growth, much lower risk charges and positive one-offs (in particular, gains from the sale of non-core foreign subsidiaries). We expect further improvement, supported by the bank's further cost-savings measures to reduce the cost/income ratio to 60% from 85% in the medium term. The intense competition in Austrian retail banking is likely to constrain long-term profitability.

Capitalisation is only adequate. The common equity Tier 1 (CET1) ratio stood at 12.7% at end-1H19. VB-Verbund has initiated capital-enhancing measures to retain a sufficient buffer over its increased regulatory capital requirements and mitigate regulatory risk-weight inflation. The group's obligation to repay to the government by end-2023 the EUR225 million still due from the bailout measures received during the crisis a decade ago will constrain its medium-term earnings retention. However, we view management's target of a minimum CET1 ratio of at least 12.25% as realistic and adequate.

VB-Verbund's funding mix is underpinned by a stable and granular retail and small SME deposit base. The group has gradually been restoring its access to capital markets through covered bonds and Tier 2 capital issuances, as well as most recently Additional Tier 1 capital notes (EUR220 million in 1H19). VB-Verbund's total capital ratio increased to 17.9% at end- 1H19 from 14.7% at end-1H17.

The Single Resolution Board has yet to communicate its minimum requirement for own funds and eligible liabilities (MREL) to the group, but we expect the relatively large junior debt buffer to cover a potential subordination requirement. We also expect Volksbank Wien (VBW), the group's central institution, to increase issuance of senior unsecured debt to fulfil regulatory requirements.

VB-Verbund's and the member banks' Short-Term IDRs of 'F2' correspond to the higher option mapping to a 'BBB' Long-Term IDR and reflects Fitch's assessment of VB-Verbund's funding and liquidity.

SUPPORT RATING AND SUPPORT RATING FLOOR

VB-Verbund's Support Rating and Support Rating Floor (SRF) reflect Fitch's view that senior creditors can no longer rely on full extraordinary state support. This is driven by the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism, which provide a resolution framework that is likely to require senior creditors participating in losses, if necessary, instead, or ahead , of a bank receiving sovereign support.

RATING SENSITIVITIES

IDRS AND VR

Fitch believes that an upgrade of the group's IDRs and VR, and of the member banks' IDRs would be contingent on VB-Verbund achieving a significant and sustainable improvement in cost efficiency and operating profitability. The VR is unlikely to rise above the 'bbb' category over the rating horizon, because of VB-Verbund's modest operating profit generation, also driven by a fairly small market share in the generally low-margin, high-cost Austrian retail banking market. The member banks' IDRs are equalised with and sensitive to the same drivers as VB-Verbund's IDRs.

The Short-Term IDRs are sensitive to deterioration in the funding and liquidity profile.

A downgrade of the IDRs and VR could result from a failure to achieve sufficient cost savings and maintain pricing discipline. This could constrain profitability and challenge the group's ability to service the profit participation rights as scheduled, which could also occur if earnings deteriorate as a result of a severe downturn in Austria's economy. However, we view none of these scenarios as likely.

SUPPORT RATING AND SRF

An upgrade of VB-Verbund's Support Ratings and upward revision of the SRF would be contingent on a positive change in the sovereign's propensity to support the bank. This is highly unlikely in light of the prevailing regulatory environment, in our view.

ESG Considerations

Unless otherwise stated the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Volksbank Wien AG	LT IDR BBB Affirmed		BBB
	ST IDR F2 Affirmed		F2
Volksbank Salzburg eG	LT IDR BBB Affirmed		BBB
	ST IDR F2 Affirmed		F2
Volksbank Niederoesterreich AG	LT IDR BBB Affirmed		BBB
	ST IDR F2 Affirmed		F2
Volksbank Oberoesterreich AG	LT IDR BBB Affirmed		BBB
	ST IDR F2 Affirmed		F2
Volksbank Tirol AG	LT IDR BBB Affirmed		BBB
	ST IDR F2 Affirmed		F2
Volksbank Vorarlberg e. Gen.	LT IDR BBB Affirmed		BBB
	ST IDR F2 Affirmed		F2
Volksbanken-Verbund	LT IDR BBB Affirmed		BBB
	ST IDR F2 Affirmed		F2
	Viability bbb Affirmed		bbb
	Support 5 Affirmed		5
	Support Floor NF Affirmed		NF
Volksbank Steiermark AG	LT IDR BBB Affirmed		BBB

	ST IDR F2 Affirmed		F2
Volksbank Kaernten eG	LT IDR BBB Affirmed		BBB
	ST IDR F2 Affirmed		F2
Oesterreichische Aerzte- und Apothekerbank AG	LT IDR BBB Affirmed		BBB
	ST IDR F2 Affirmed		F2

Additional information is available on www.fitchratings.com

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Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)

Short-Term Ratings Criteria (pub. 02 May 2019)

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Solicitation Status
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