FitchRatings

Banks
Retail & Consumer Banks
Austria

Volksbanken-Verbund

Ratings

Foreign Currency

Long-Term IDR	BBB
Short-Term IDR	F2
Viability Rating	bbb
Support Rating	5
Support Rating Floor	No Floor

Sovereign Risk

Long-Term Foreign-Currency IDR	AA+
Long-Term Local-Currency IDR	AA+
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Key Rating Drivers

Mutual Support Drives Group Ratings: Volksbanken-Verbund (VB-Verbund) is not a legal entity, but a medium-sized network of Austrian cooperative banks, whose cohesion is primarily ensured by their mutual support scheme. VB-Verbund's Issuer Default Ratings (IDRs) apply to each individual member bank, based on Annex 4 of Fitch's *Bank Rating Criteria*.

Intragroup Consolidation Completed: VB-Verbund's ratings reflect the group's strengthened cohesion, underlined by its intragroup consolidation completed in 2019, reduced risk appetite, improved asset quality, as well as its generally stable funding and liquidity profile. The Negative Outlook on VB-Verbund's Long-Term IDR reflects downside risks to our expectations of its relative resilience. A materially slower than expected economic recovery could weigh on the group's earnings and capital materially more than our base case suggests.

Asset Quality to Weaken Moderately: VB-Verbund's predominantly domestic loan book focuses on retail, self-employed and SME clients. The group entered the economic downturn with an impaired loan ratio of 2.1% at end-1H20, which is broadly in line with larger domestic Austria-focused peers. We expect inflows of new impaired loans to increase, mostly in 2021 when the damage from the crisis becomes more apparent. However, we expect asset quality to remain commensurate with the group's 'bbb+' asset quality score through the crisis.

Pandemic Weighs on Profitability: Rising loan impairment charges (LICs) are likely to intensify VB-Verbund's earnings pressure in 2020 and 2021. We expect the four-year average operating profit/risk-weighted assets (RWAs) ratio to remain above 0.5% through the crisis, implying an earnings and profitability score of 'bbb-'. The negative outlook on the score reflects the risk of a deeper than expected recession or a slower economic recovery, which could lead to higher than anticipated credit losses and net losses in the next two years.

Organic Capital Generation Constrained: The group's Common Equity Tier 1 (CET1) ratio of 13.2% at end-1H20 is only adequate in view of the weak profitability prospects. In addition, the group's obligation to repay by end-2023 to the Austrian state the EUR224 million still due after the bailout measures during the crisis a decade ago will constrain its medium-term earnings retention. The negative outlook on the capital score reflects the risk of significant profit erosion from higher-than-expected credit losses in our downside scenario.

Increasingly Diversified Funding: VB-Verbund's funding mix is underpinned by its stable and granular base of retail and small SME deposits. The group has been gradually restoring its access to capital markets through covered bonds, Tier 2 and Additional Tier 1 capital issuances, which increased its total capital ratio to 17.9% at end-1H20 from 12.9% at end-1H17. Volksbank Wien (VBW), the group's central organisation (CO), plans to issue EUR1.2 billion of senior unsecured debt by January 2025 to meet the group's resolution buffer requirement.

Rating Sensitivities

Unexpectedly High Credit Losses: We may downgrade VB-Verbund's ratings if the economic and financial market fallout arising from the pandemic leads to a more severe and prolonged deterioration in profitability or capitalisation than currently envisaged, without credible prospects to restore them over the medium-to-long-term. This could stem from depressed demand or higher-than-expected asset quality deterioration as borrowers struggle to recover.

Limited Rating Upside: A rating upgrade would require VB-Verbund's cost efficiency and operating profitability to improve significantly and sustainably. The VR is unlikely to rise above the 'bbb' category because VB-Verbund's fairly small market share in the generally low-margin, high-cost, Austrian retail banking market results in modest operating profit generation.

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Fitch Affirms Volksbanken-Verbund at 'BBB'; Outlook Negative (September 2020)

Fitch Revises Austria's Outlook to Stable; Affirms at 'AA+' (May 2020)

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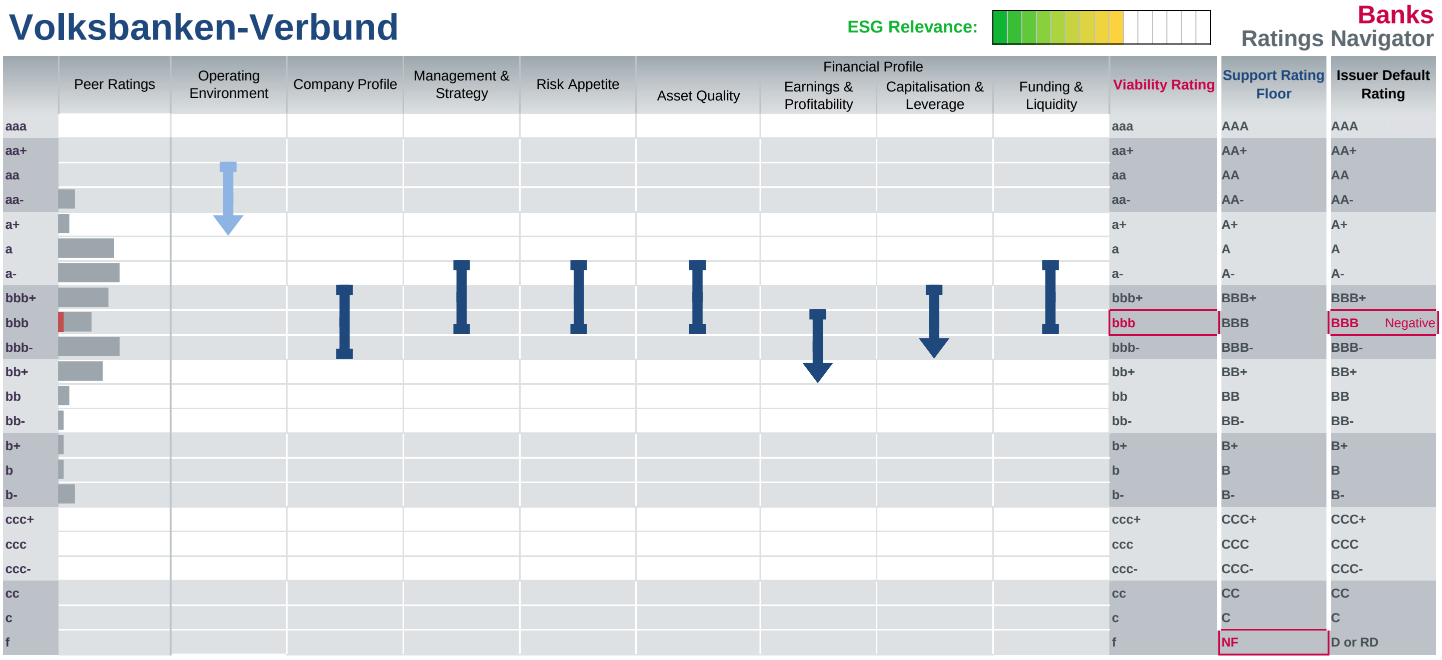
Ratings Navigator



Significant Changes

Uncertain Economic Prospects Drive Negative Rating Outlook

The ultimate economic and financial market implications of the coronavirus pandemic remain unclear, but Fitch considers the risks to Austrian banks' credit profiles to be skewed to the downside. Accordingly, we revised the outlook on the Austrian operating environment score to 'aa-'/Negative from 'aa-'/Stable in April 2020. In the near term, a downgrade of the score appears unlikely in light of the Austrian government's comprehensive support measures, and given the Austrian economy's relative resilience eight months into the pandemic.

The Austrian government has launched large support programmes totalling to 13% of its GDP to support companies and households affected by the crisis. Together with regulatory forbearance for the classification of crisis-driven non-performing loans (NPLs), these programmes have strongly mitigated negative rating migration, RWA inflation and provisioning needs this year. However, credit quality is likely to deteriorate in 2021 as some vulnerable borrowers will not fully recover, and many corporates and SMEs are likely to emerge from the crisis with weaker credit profiles.

Temporary Depletion of DPS is Neutral for Ratings

Since 2019, VB-Verbund has contributed to a nationwide Deposit Protection Scheme (DPS) that replaced the group's former DPS, Volksbank Einlagensicherung eG. The nationwide scheme, which includes all Austrian banks except for Erste Group Bank and the savings banks, had a paid-in endowment of EUR685 million at end-2019, with a medium-term target of 0.8% of its members' covered deposits (EUR179 billion at end-2019). The scheme would reimburse each eligible depositor up to EUR100,000 in the event of insolvency in line with the EU's Deposit Guarantee Schemes Directive. The DPS can only be called on to indemnify VB-Verbund's depositors if the group's mutual support scheme (see next page) fails to ensure the viability of VB-Verbund's members. The vast majority of VB-Verbund's depositors are mass retail clients with no more than EUR100,000 each.

In 2020, the Austrian Financial Market Authority closed two small DPS members unrelated to VB-Verbund, due to fraud and severe governance failures. These closures have resulted in claims of about EUR550 million for the DPS, depleting its paid-in endowment by 80%. VB-Verbund must bear about EUR43 million of this amount through extraordinary contributions to the DPS over the next five years, although recoveries from the two failed banks' insolvency

Bar Chart Legend

Vertical bars – VR range of Rating Factor			
Bar Colors – Influence on final VR			
■	Higher influence		
■	Moderate influence		
■	Lower influence		
Bar Arrows – Rating Factor Outlook			
⇧	Positive	⇩	Negative
⇳	Evolving	▫	Stable

Rated Members of VB-Verbund

Oesterreichische Aerzte- und Apothekerbank AG
Volksbank Kaernten eG
Volksbank Niederoesterreich AG
Volksbank Oberoesterreich AG
Volksbank Salzburg eG
Volksbank Steiermark AG
Volksbank Tirol AG
VOLKSBANK VORARLBERG e.Gen.
VOLKSBANK WIEN AG

Source: Fitch Ratings

proceeds are likely to reduce this amount significantly. To prevent similar contingent liabilities from crystallising in the future, VBW's management is weighing the merits of leaving (subject to regulatory approval) the nationwide DPS and recreating an independent scheme for VB-Verbund's members. We view the implications of the DPS' momentary depletion as well as VB-Verbund's extraordinary contributions and potential exit as neutral for the group's ratings.

Brief Company Summary

Medium-Sized, Domestic Retail-Focused Cooperative Banking Group

VB-Verbund focuses on Austrian retail, self-employed and small SME clients. Its member banks collectively serve about 1.1 million clients 264 branches. The group has modest nationwide retail market shares of 7%-8% on average, but the member banks generally have stronger local franchises and customer loyalty in rural areas.

The group complements its highly standardised product mix with consumer lending and asset-management products from DZ BANK AG Deutsche Zentral-Genossenschaftsbank (AA-/Negative), the German cooperative banking group's central organ CO. The revenue diversification from this outsourcing agreement compensates for VB-Verbund's limited size, which would make it uneconomical to offer these services on its own.

Verbund Contract Strengthens Central Organisation and Governance

Following years of deep restructuring, VB-Verbund is now a highly integrated cooperative banking group. The Verbund (group) contract in force since 2016 entrusts the CO with broad discretionary powers. VBW's management can unilaterally issue binding orders to all or single member banks and impose support measures. The contract ensures the effectiveness of the group's governance, mutual support and organisation by governing the CO's powers, duties and interactions with the member banks.

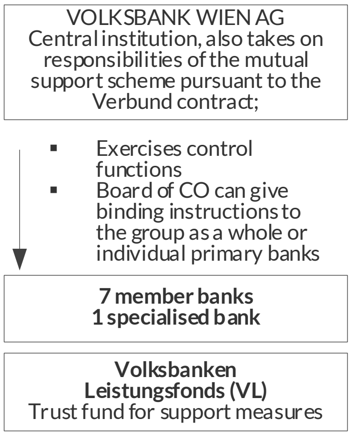
This enables VB-Verbund's recognition as a financial institution group by the Single Resolution Board, although its member banks are legally independent and have no common parent. The Verbund contract makes VBW responsible for the group's adherence to regulatory capital, liquidity and risk management requirements as well as strategic decisions and their implementation, including products and pricing. The member banks are obliged to place their excess liquidity at VBW.

Restructured Mutual Support Scheme Ensures Cohesion and Reactivity

Volksbanken Leistungsfonds (VL), a fund endowed with trust assets to support troubled member banks, became operative in 2016. The CO calculates VL's target endowment based on the member banks' average risk position. We expect the endowment to rise at least to EUR100 million by 2021 from the current EUR90 million. In our view, this should be sufficient to recapitalise member banks other than VBW in a reasonable idiosyncratic stress scenario, but it is unlikely to ensure a substantial line of defence for the group in a systemic crisis.

If the CO estimates that VL is insufficient to cover support needs as these arise, it can call unilaterally for additional contributions from the member banks. The Verbund contract does not cap each member bank's maximum contributions to mutual support measures. The mutual support framework allows the CO's management to impose remedial actions on troubled member banks if early-warning indicators (macroeconomic, market-based or breaches of capital, liquidity, profitability or asset-quality ratios) deteriorate materially. Such interventions are possible without the consent of the bank concerned or preliminary consultation with the group's members. This is rating positive as it increases cohesion, discipline and responsiveness.

Mutual Support and Liquidity Scheme



Source: Fitch Ratings

Summary Financials and Key Ratios

	30 Jun 20 (EURm)	31 Dec 19 (EURm)	31 Dec 18 (EURm)	31 Dec 17 (EURm)
Summary income statement				
Net interest and dividend income	211	422	420	443
Net fees and commissions	117	230	234	237
Other operating income	16	84	11	-1
Total operating income	345	736	664	679
Operating costs	260	534	568	586
Pre-impairment operating profit	85	207	96	94
Loan and other impairment charges	49	22	-6	52
Operating profit	36	180	102	42
Tax	5	31	8	-21
Net income	30	149	115	61
Summary balance sheet				
Gross loans	21,506	21,537	20,795	19,769
- Of which impaired	430	538	633	839
Loan loss allowances	320	286	293	362
Net loans	21,187	21,251	20,502	19,407
Interbank	450	431	470	495
Derivatives	174	143	127	160
Other securities and earning assets	2,988	2,850	2,718	2,541
Total earning assets	24,798	24,675	23,817	22,602
Cash and due from banks	3,410	2,072	1,732	2,001
Other assets	670	750	1,016	720
Total assets	**28,877**	**27,496**	**26,564**	**25,323**
Customer deposits	21,423	21,729	21,555	20,850
Interbank and other short-term funding	2,014	412	595	449
Other long-term funding	1,968	1,985	1,037	1,150
Trading liabilities and derivatives	520	463	455	464
Total funding	25,925	24,589	23,643	22,911
Other liabilities	596	562	940	514
Preference shares and hybrid capital	307	316	126	145
Total equity	2,050	2,028	1,855	1,753
Total liabilities and equity	**28,877**	**27,496**	**26,564**	**25,323**
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	0.5	1.2	0.7	0.3
Net interest income/average earning assets	1.7	1.7	1.8	2.0
Non-interest expense/gross revenue	75.4	72.6	87.1	85.2
Net income/average equity	3.0	7.3	6.4	3.6

Summary Financials and Key Ratios (Cont.)

	30 Jun 20 (EURm)	31 Dec 19 (EURm)	31 Dec 18 (EURm)	31 Dec 17 (EURm)
Asset quality				
Impaired loans ratio	2.1	2.5	3.0	4.2
Growth in gross loans	-0.1	3.6	5.2	2.0
Loan loss allowances/impaired loans	70.8	53.2	46.2	43.1
Loan impairment charges/average gross loans	0.5	0.1	0.0	0.2
Capitalisation				
Common equity Tier 1 ratio	13.2	12.9	12.1	12.4
Tangible common equity/tangible assets	6.7	6.5	6.8	6.7
Basel leverage ratio	7.1	7.5	6.4	6.2
Net impaired loans/common equity Tier 1	7.0	13.2	19.3	29.2
Funding and liquidity				
Loans/customer deposits	100.4	99.1	96.5	94.8
Liquidity coverage ratio	n.a.	143	133.0	138.0
Customer deposits/funding	83.3	88.9	92.5	92.3
Net stable funding ratio	137.9	133.5	125.9	130.0

Source: Fitch Ratings, Fitch Solutions, VB-Verbund

Key Financial Metrics – Latest Developments

Pandemic Drives Increase in Impaired Loans

We expect a strong increase in corporate insolvencies in Austria from January 2021, when the loan moratoria and the corporate tax and social security forbearance measures implemented in March 2020 end. However, we expect VB-Verbund's asset quality to hold up well in 2020 and deterioration to be manageable in 2021 as the government's support to the economy should considerably mitigate credit losses from the pandemic. Consequently, the stable outlook on asset quality reflects our expectation that the 'bbb+' score offers sufficient headroom to absorb a deterioration of VB-Verbund's SME loan quality. This should result in the impaired loans ratio peaking below 4% in 2021 in our base scenario.

VB-Verbund entered the coronavirus crisis after five years of steadily improving asset quality owing to deep restructuring, strong economic conditions in the robust Austrian market, and the group's relatively low-risk business model and prudent underwriting.

Earnings Pressure to Increase Further

We expect VB-Verbund's operating profit to recover in 2021 but to remain below 0.5% of RWAs in 2020 and 2021 as interest rates will remain extremely low and LICs above the last few years' average. The group will continue to pursue structural cost savings after cutting its branch network to 264 and its full-time equivalent staff by 4% in 1H20. However, extraordinary contributions to the DPS could offset further near-term cost reduction efforts. We believe the return of a more benign economic environment after the crisis should enable VB-Verbund to generate an operating profit of about 1% of RWAs, even in a continued low-rate environment.

The group's operating revenue was roughly stable in 1H20 yoy. However, its profitability, which was already under pressure due to the low interest rates before the crisis, further weakened in 1H20. Its operating profit fell sharply to 0.5% of RWAs, as LICs rose to EUR49 million (compared to a net release of EUR4 million in 1H19), mostly driven by management overlays on performing loans.

Risk on Capitalisation

VB-Verbund's CET1 ratio of 13.2% at end-1H20 adequately exceeded its regulatory requirement of 9.85% at end-1Q20. The negative outlook on the capitalisation & leverage score reflects pressure on profitability that could result in greater-than-expected capital erosion in our downside scenario.

The Austrian government was granted a profit participation right (Genussrecht) and a blocking minority (25% plus one share) in VBW as part of the restructuring in 2015. The government will return its stake to VBW's other owners once VB-Verbund has repaid the EUR224 million still outstanding based on a binding schedule until 2023. This repayment obligation will continue to significantly limit organic capital generation in the next few years. This is mitigated by the restriction of dividend payments until the state capital is fully repaid.

Stable Deposits and Good Liquidity

We expect VB-Verbund's funding base to remain stable through the pandemic. We do not expect the envisaged change of DPS to affect the group's depositor confidence and stability.

Stable and granular deposits from households and small SMEs account for 83% of VB-Verbund's total funding mix. The group participated with EUR1.5 billion in the TLTRO III, strengthening its liquidity reserve to EUR7.1 billion at end-1H20 (EUR5.5 billion at end-2019). Its liquidity portfolio is of high quality and consists of central bank deposits, cash, bonds as well as retained covered bonds and represented about 25% of total assets at end-1H20.

State Capital Binding Repayment Schedule
(Cumulative targets by year-end)

2019	EUR75m
2021	EUR200m
2023	EUR300m

Source: Fitch Ratings, VB-Verbund

Sovereign Support Assessment

VB-Verbund's Support Rating and Support Rating Floor 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, which has been in force in Austria since 2015.

Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy		✓	
Size of potential problem		✓	
Structure of banking system		✓	
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)		✓	
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support			✓
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance		✓	
Liability structure of bank		✓	
Ownership		✓	
Specifics of bank failure		✓	

Environmental, Social and Governance Considerations

VB-Verbund's 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, either due to their nature or the way in which they are being managed by the group.

FitchRatings **Volksbanken-Verbund**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Volksbanken-Verbund has 5 ESG potential rating drivers				Overall ESG Scale
Volksbanken-Verbund has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.	key driver	0	issues	5
Governance is minimally relevant to the rating and is not currently a driver.	driver	0	issues	4
	potential driver	5	issues	3
	not a rating driver	4	issues	2
		5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Priniciples for Responsible Investing (PRI) and the Sustainability Accounting Standards Board(SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.