MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Kommunalkredit Austria to Baa3/P-3/E from Baa1/P-2/E+; outlook stable

Global Credit Research - 02 Feb 2012

Subordinated debt downgraded to Ba2, on review for downgrade

Frankfurt am Main, February 02, 2012 -- Moody's Investors Service has today downgraded the standalone bank financial strength rating (BFSR) of Kommunalkredit Austria AG (KA) to E from E+, mapping to Caa1 on Moody's long-term scale (previously B2). Concurrently, KA's senior debt and deposit ratings were downgraded by two notches to Baa3 from Baa1. The outlook on these ratings is stable. In addition, the short-term rating was downgraded to Prime-3 from Prime-2.

The rating actions follow rising expectations that exposures to the Greek sovereign will require write downs exceeding those previously anticipated.

The rating agency also downgraded KA's rating for senior subordinated debt to Ba2 from Baa2, which reflects the downgrade of the senior debt ratings as well as a wider notching of two (instead of one) from its fully supported senior debt ratings. The Ba2 subordinated debt rating remains on review for downgrade, because it is under pressure from the rising risk that government support for this type of debt instrument may not be available in future cases of bank support. Moody's initiated the review of these debt instruments on 29 November 2011; please also see the press release, "Moody's reviews European banks' subordinated, junior and Tier 3 debt for downgrade".

RATING RATIONALE

BFSR DOWNGRADE REFLECTS MAJOR SETBACK IN KA's RECOVERY AND DIMINISHED CAPITAL, POST-GREEK WRITE DOWN

The BFSR downgrade to E reflects Moody's expectations that KA will need to write down the lion's share of its exposure to Greece in its 2011 results. Following a EUR31 million write-down in H1 2011, the remaining exposure on KA's books was EUR204 million as reported by the bank as of June 2011, which represented roughly 50% of its EUR 411 million Tier 1 capital. From the latest developments in the negotiations of a private sector participation in the restructuring of Greek debt, Moody's considers that a write down to 30% of the notional value of bonds cannot be ruled out.

Moody's does not expect the full write-down to be charged against capital, considering that the bank (i) still has fully-taxed reserves available to offset the effect; and (ii) can absorb losses of up to EUR30 million per year its income statement. Nonetheless, the rating agency expects KA to post a three-digit million loss for the year 2011, which would considerably reduce KA's regulatory capitalisation and diminish its earlier loss-absorption capacity.

In the current situation of weakening sovereign credit quality in Europe, the yet-unresolved debt crisis of Greece and elevated funding costs for wholesale funded banks, the expected impairment of and valuation losses on KA's exposures to the more pressured countries in Europe's periphery is considered a major setback for the fragile recovery of KA's franchise. The capital buffer afforded by the reported 15.5% Tier 1 ratio as of June 2011 was planned to be deployed for new underwriting in KA's core operations of project and infrastructure finance. With a material reduction of this ratio, KA will likely adopt a very prudent approach to its capital management and the development of its franchise.

SENIOR DEBT RATINGS STILL UNDERPINNED BY VERY HIGH PROBABILITY OF SYSTEMIC SUPPORT

The downgrade of KA's long-term debt and deposit ratings to Baa3 and its short-term rating to Prime-3 reflects the downgrade of its standalone BFSR. At the same time, these ratings continue to benefit from Moody's assessment of a very high probability of systemic support. At the Baa3 level, the fully supported senior debt ratings continue to include seven notches of support uplift from the Caa1 standalone credit strength (mapped from the E BFSR).

The very high support has been demonstrated by the rescue and takeover of the bank by the Republic of Austria, which owns almost 100% of KA's capital. At the same time, the Baa3/Prime-3 ratings better reflect the uncertainty about KA's future as a standalone viable entity, as well as the absence of unconditional and irrevocable guarantees by the Austrian government.

Ba3 SUB-DEBT RATING PARTLY REFLECTS WIDER NOTCHING; REMAINS ON REVIEW DUE TO WEAKENING SUPPORT

The three-notch downgrade to Ba2 of KA's senior subordinated debt rating partly reflects a wider notching of two, instead of one, from the bank's fully supported senior debt ratings. The revised rating remains on review for downgrade as it is under pressure from the rising risk that government support for Lower Tier 2 instruments may not be available in future cases of bank rescue actions in Europe, considering legal changes that the EU plans to implement for all its member states.

The focus of the ongoing review includes considerations for a complete removal of systemic support from senior subordinated debt ratings in Austria, which follows on from the removal of systemic support from such ratings in other systems including Denmark, UK, Ireland, and Germany. Also refer to Moody's report "Moody's to re-assess government support in bank sub debt ratings globally" published February 2011.

STABLE OUTLOOK REFLECTS EXPECTATION OF SUPPORT IN THE CONTEXT OF THE ONGOING DEBT CRISIS

The stable outlook on KA's E BFSR reflects that this rating is now positioned at the low end of the BFSR rating scale. The stable outlook on its Baa3 long-term ratings reflects the rating agency's view that, in the context of the ongoing sovereign debt crisis, the Republic of Austria will probably not risk further disruption of the financial system by allowing a state-owned bank to default on its senior debt.

WHAT COULD CHANGE THE RATINGS UP/DOWN

The outlook on the E BFSR is stable. However, the E BFSR could be remapped to a lower level on the long-term scale from the current Caa1 level, if there is further erosion of KA's capitalisation and/or KA has limited access to debt capital markets for an extended period. A lower remapping within the Caa rating category could have an immediate effect on the long-term ratings.

Moody's also notes the potential for a large rating migration if the probability of government support declines. The rating agency will therefore very closely monitor the state's commitment towards the entity and its timetable for withdrawing its support.

Moody's considers the upside potential for the BFSR to be limited at this stage. Positive pressure on the BFSR would require a track record of sustainable profits, sound liquidity and risk management, as well as a sustainable solution for the euro area debt crisis and improving investor confidence. An upgrade of the Baa3 long-term senior debt and deposit ratings could be triggered by an upgrade of the BFSR or a stronger commitment by the Austrian government, in particular an explicit guarantee for the bank's obligations, which however, is not expected.

The methodologies used in this rating were Bank Financial Strength Ratings: Global Methodology published in February 2007, Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology published in March 2007, and Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt published in November 2009. Please see the Credit Policy page on www.moodys.com for copies of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides relevant regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides relevant regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides relevant regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

The rating has been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

Information sources used to prepare the rating are the following : parties involved in the ratings, public information, and confidential and proprietary Moody's Investors Service information.

Moody's considers the quality of information available on the rated entity, obligation or credit satisfactory for the purposes of issuing a rating.

Moody's adopts all necessary measures so that the information it uses in assigning a rating is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Moody's Investors Service may have provided Ancillary or Other Permissible Service(s) to the rated entity or its related third parties within the two years preceding the credit rating action. Please see the special report "Ancillary or other permissible services provided to entities rated by MIS's EU credit rating agencies" on the ratings disclosure page on our website www.moodys.com for further information.

Please see the ratings disclosure page on www.moodys.com for general disclosure on potential conflicts of interests.

Please see the ratings disclosure page on www.moodys.com for information on (A) MCO's major shareholders (above 5%) and for (B) further information regarding certain affiliations that may exist between directors of MCO and rated entities as well as (C) the names of entities that hold ratings from MIS that have also publicly reported to the SEC an ownership interest in MCO of more than 5%. A member of the board of directors of this rated entity may also be a member of the board of directors of a shareholder of Moody's Corporation; however, Moody's has not independently verified this matter.

Please see Moody's Rating Symbols and Definitions on the Rating Process page on www.moodys.com for further information on the meaning of each rating category and the definition of default and recovery.

Please see ratings tab on the issuer/entity page on www.moodys.com for the last rating action and the rating history.

The date on which some ratings were first released goes back to a time before Moody's ratings were fully digitized and accurate data may not be available. Consequently, Moody's provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website www.moodys.com for further information.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Katharina Barten
VP - Senior Credit Officer
Financial Institutions Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Carola Schuler
MD - Banking
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454