

FITCH AFFIRMS KOMMUNALKREDIT AT 'A' FOLLOWING EC STATE AID DECISION; WITHDRAWS VR

Fitch Ratings-London/Warsaw-24 July 2013: Fitch Ratings has removed Kommunalkredit Austria's (KA) Long-Term Issuer Default Rating (IDR), Short-Term IDR, Support Rating and Support Rating Floor (SRF) from Rating Watch Negative (RWN) and affirmed the ratings at 'A', 'F1', '1' and 'A' respectively. At the same time, the agency has affirmed KA's Viability Rating (VR) at 'b+' and has simultaneously withdrawn it. A full list of rating actions is at the end of this rating action commentary.

The removal of the RWN on KA's support-driven ratings follows the European Commission's (EC) announcement published on 19 July 2013 that KA's run-off is in line with EC state aid rules. Consequently, the EC will not appoint a divestiture trustee to sell KA and the bank will remain state-owned during the run-off process. As such, short-term downside risks to KA's support-driven ratings have eased and Fitch has decided to remove the RWN.

The withdrawal of KA's VR reflects the fact that KA is now effectively in run-off. As such Fitch no longer considers it possible to provide a meaningful analysis of KA on a standalone basis. This rating action is in line with similar run-off banks across Western Europe.

In line with the EC's decision KA will no longer carry out new lending activities (except the servicing of existing transactions and transactions under offer). KA is permitted to continue with its advisory business (including the activities of the 90% subsidiary Kommunalkredit Public Consulting), as well as to carry out market-based funding activities. The partial sale of business activities is also allowed.

KEY RATING DRIVERS - IDRs, Support Rating, Support Rating Floor and Senior Debt

KA's IDRs are driven solely by Fitch's view that support from KA's 99.78% ultimate owner, the Republic of Austria (AAA/Stable), is extremely probable. Fitch's assessment of support is based on KA's government ownership, strong track record of support from Austrian authorities and Fitch's expectation that timely support would continue to be forthcoming as long as the Republic of Austria owns KA. In addition, the EC decision allows for the provision of capital and liquidity support, if required, from the Austrian state for KA. Moreover, the government has committed itself to maintaining a Basel II Tier 1 ratio of at least 7% in KA as long as the bank's previous owners remain invested in KA's participation capital.

KA's Long-Term IDR has been maintained one notch below KA Finanz AG's IDR (KF; A+/Stable), a public finance bank fully owned by the Austrian state, mainly for the following two reasons: while KF will remain government-owned until the end of the wind-down process, partial sales of business activities are still allowed in the case of KA which means that a creditor could ultimately be allocated to the business activity that is being sold. Secondly, KF relies to a large extent on government-guaranteed funding sources which would make a default of KF more costly for the Austrian government compared with KA, making support for the former marginally more likely.

RATING SENSITIVITIES - IDRs, Support Rating, Support Rating Floor and Senior Debt

KA's support-driven ratings are primarily sensitive to a change in Fitch's view of the ability or propensity of the Austrian government to provide support. There is a clear political intention to ultimately reduce the implicit state support for systemically important banks in Europe, as demonstrated by a series of policy and regulatory initiatives aimed at curbing systemic risk posed by the banking industry. This might result in Fitch revising SRFs downwards in the medium term, although the timing and degree of any change would depend on developments with respect to specific jurisdictions.

While this mostly affects large, systemically relevant banks, it could ultimately also put pressure on

SRFs of government-owned banks.

In addition, the support-driven ratings could be downgraded if the ability, as expressed in the sovereign rating, or propensity of the Republic of Austria to support the bank change.

Following a significant net loss in 2011 due to sizeable impairments on Greek government bond exposures, KA returned to modest profitability in 2012 (pre-tax profit of EUR18.4m; operating return on average equity of 14.8%) supported by one-off gains of bond buy-backs and offset by losses on the disposal of assets in the year. While KA's leverage remained high due to its former public sector lending business model (tangible common equity leverage ratio of 0.86% at end-2012, excluding EUR138.4m participation capital), the bank's capitalisation remained acceptable with a Basel 2.5 Tier 1 ratio of 12.3% at end-2012.

KA, based in Vienna, specialises in municipal and infrastructure-related financing and consultancy services, predominately in Austria, Germany, Switzerland and selected central and eastern European countries. Following the takeover of its predecessor, also called Kommunalkredit (KA Old) by the Republic of Austria, KA Old's strategic, operating business was transferred to KA while non-core assets were transferred to KF and put in orderly wind-down.

The rating actions are as follows:

Long-term IDR: affirmed at 'A'; Rating Watch Negative (RWN) removed; Outlook Stable

Short-term IDR: affirmed at 'F1'; RWN removed

Viability Rating: affirmed at 'b+' and simultaneously withdrawn

Support Rating: affirmed at '1'; RWN removed

Support Rating Floor: affirmed at 'A'; RWN removed

Long-term senior unsecured notes rating: affirmed at 'A'; RWN removed

Short-term senior unsecured notes rating: affirmed at 'F1'; RWN removed

Senior market-linked notes rating: affirmed at 'Aemr'; RWN removed

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Additional information is available at www.fitchratings.com.

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 15 August 2012, and 'Evaluating Corporate Governance', dated 12 December 2012, are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686181

Evaluating Corporate Governance

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=694649

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