MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Kommunalkredit Austria's Baa3/P-3 ratings

Global Credit Research - 21 May 2013

Subordinated debt downgraded to Ca from Caa2, prompted by lower baseline credit assessment of caa3

Frankfurt am Main, May 21, 2013 -- Moody's Investors Service has today affirmed at Baa3 the senior unsecured debt and deposit ratings of Kommunalkredit Austria AG (KA). At the same time, the rating agency lowered KA's baseline credit assessment (BCA) to caa3 from caa1 and affirmed the corresponding E standalone bank financial strength rating (BFSR). In turn, the lowering of the BCA prompted the downgrade of the bank's senior subordinated debt rating to Ca from Caa2.

The short-term rating was affirmed at Prime-3 and the outlook on the long-term debt ratings remains stable. All other ratings carry no outlook.

The rating actions follow official reports on 16 May 2013 that the Austrian government (Aaa, negative) -- KA's majority stakeholder -- had suspended all efforts to divest its stake in KA, and instructed the bank to discontinue new underwriting. In Moody's view this development implies the imminent orderly unwinding of KA. Divestment of the government's stake in KA by end-June 2013 was a compensation measure for state aid agreed between the European Commission (EC) and the Austrian government in 2011. Moody's says that the lowering of the BCA reflects KA's challenges of franchise impairment following the unsuccessful privatisation, potentially constrained access to debt capital markets, and the likelihood of weaker profitability.

RATINGS RATIONALE

AFFIRMATION OF THE Baa3 SENIOR DEBT RATINGS RECOGNISES CONTINUED HIGH GOVERNMENT SUPPORT COMBINED WITH EXPECTATIONS OF LIMITED ADDITIONAL COSTS FOR TAXPAYERS

The affirmation of KA's long and short-term debt and deposit ratings at Baa3/P-3 reflects the agency's view that the Austrian government, which owns almost 100% of KA's capital, will support the bank to the extent required to ensure an orderly unwinding process. This expectation is underpinned by the Austrian's government's track record of supporting Austrian banks, as well as its continued commitment to financial market stability. At the Baa3 level, the fully supported senior debt ratings include nine notches of support uplift from the caa3 BCA.

In addition, Moody's says that an orderly unwinding of the bank -- whereby senior bond holders and depositors will not be required to participate in the sharing of losses, as may be required -- may have preferable economic aspects in contrast to other, less protective solutions. This view takes into account certain aspects of KA's risk profile, including (1) the bank's loss-absorption capacity in the form of Tier 1 capital and reserves, totaling roughly EUR325 million as of December 2012; and (2) the relatively low risk of the bank's asset profile. Whilst Moody's does not rule out that KA may require funding support, it takes the view that an orderly unwinding could, at least under Moody's central scenario, be accomplished with limited, if any, additional capital needs. This aspect could provide an additional incentive for the government to maintain its supportive stance towards KA's senior bondholders.

THE LOWERING OF KA'S BCA TO caa3 REFLECTS FRANCHISE IMPAIRMENT AND POTENTIAL FUNDING CONSTRAINTS

The lowering of the BCA to caa3 from caa1 reflects Moody's view that KA's franchise is impaired, following a preliminary agreement between the Austrian government and the EC that new loan underwriting by KA is to be discontinued with immediate effect. The rating agency understands that this was required when the government halted its efforts to divest its stake in the bank. The discontinuation of new underwriting in effect implies that KA's core lending business is now subject to gradual unwinding. Moody's believes that this scenario is conducive to the lower BCA of caa3.

In addition, the rating agency expects adverse implications for KA's profitability and, potentially, for its access to debt capital markets. In the absence of new lending, the earlier targets of improving the bank's quality of earnings over time cannot be met, even if some revenue streams remain sufficiently resilient to cover costs for several years. However, Moody's expects that an unwinding will, at some point, lead to revenue erosion that cost savings cannot offset, partly because of declining economies of scale. Regarding KA's access to (and costs of) market funds, the rating agency says that it does not rule out adverse effects that could lead to requirements of intermittent funding support, which further constrains the caa3 BCA.

At the same time, Moody's recognises that this may be somewhat offset by the prospect of the Austrian government maintaining its majority stake for the foreseeable future. This aspect, however, is factored into the support considerations that Moody's incorporates into the senior debt ratings.

THE Ca SUB-DEBT RATING REFLECTS THE LOWER BCA AND NO SUPPORT FOR THIS CLASS OF DEBT

The two-notch downgrade to Ca of KA's senior subordinated (Lower Tier 2) debt rating reflects Moody's view that in the context of KA's unwinding, subordinated debtholders face elevated levels of risk given the now higher likelihood that KA might need external support at some point.

Irrespective of current legislation (that does not include a bail-in regime, but which Moody's believes can be altered as required to facilitate any desired burden sharing), subordinated creditors are at risk if future losses were to materially exceed expectations in a downside scenario for KA's earnings, credit losses and capital.

KA's Ca rating for Lower Tier 2 instruments are positioned one notch below its adjusted BCA, which is caa3.

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

The stable outlook on KA's Baa3 long-term ratings reflects the rating agency's view that in the context of the ongoing sovereign debt crisis, the Republic of Austria is unlikely to risk further disruption of the financial system by allowing a relatively small state-owned bank to default on its senior obligations.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Moody's might lower the BCA further from caa3, if (1) KA faces fast erosion of its capital because of high credit losses that materially exceed current expectations; and (2) KA has no access to debt capital markets for an extended period, leading to distress. A lowering of the BCA below the caa category could have an immediate effect on the long-term ratings.

Moody's also notes the potential for rating migration if the probability of government support declines and will therefore monitor the state's commitment towards KA. However, Moody's does not expect that the government will withdraw its support for KA for the foreseeable future.

Moody's considers that upwards ratings momentum is limited, given its expectation that the discontinuation of underwriting and KA's unwinding is final. An upgrade of the Baa3 long-term senior debt and deposit ratings could be triggered by a stronger commitment from the Austrian government, in particular an explicit guarantee for the bank's obligations, which, however, Moody's also does not expect.

The principal methodology used in this rating was Moody's Consolidated Global Bank Rating Methodology published in June 2012. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain 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 certain 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 certain 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.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this rating action, and whose ratings may change as a result of this rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

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.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit 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