

## SECTOR IN-DEPTH

1 JULY 2015

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Austrian banks

# Key Analytical Considerations in Our Rating Actions on Austrian Banks

## Summary

This report summarises the key analytic considerations in coming to our review conclusions for 15 rated Austrian banks<sup>1</sup>, following the implementation of our new bank rating methodology. The review resulted in rating actions on these institutions, as summarised in Exhibit 1 on page two and detailed in the accompanying press releases of 1 July. Our analysis of the Austrian banks focused on three central components of the bank rating methodology:

**Baseline Credit Assessment (BCA).** Our approach to assessing intrinsic standalone credit strength under the new bank methodology includes: (1) a Macro Profile<sup>2</sup> to assess the effect that the geographic spread of a bank's businesses has on its credit fundamentals, and (2) financial factors focused on the key drivers of an institution's solvency and liquidity. The framework for arriving at a BCA also includes explicit qualitative adjustments to reflect bank-specific characteristics beyond an institution's solvency and liquidity.

The BCAs of two of the 15 Austrian banks were upgraded, those of six banks were downgraded, while the remaining seven banks' BCAs remain unchanged. BCA upgrades were driven by derisking, positively affecting asset quality and capitalisation, while BCA downgrades were caused by negative capital and profit effects from equity investments in a sector's central bank as well as exposures to the Russian economy. The average BCA for the Austrian banks is ba2, reflecting their (1) average Macro Profile of "Strong+", (2) an average combined Solvency score of ba2 and average combined Liquidity score of ba1, resulting in an average Financial Profile of ba2, and (3) only sparingly applied negative qualitative adjustments.

**Advanced Loss-Given-Failure (LGF) analysis.** Under the new methodology, we distinguish between the relative loss severity faced by individual creditor classes for banks subject to operational resolution regimes, for which specific legislation provides a reasonable degree of clarity on how a bank's failure could affect depositors and other creditors through the write-down or conversion of capital instruments, or the bail-in of debt. Austrian banks are subject to such an operational resolution regime in the form of the EU's Bank Recovery and Resolution Directive (BRRD). For these banks, we therefore apply an Advanced LGF approach, under which ratings are a function of jurisdiction-specific creditor hierarchies, firm-wide loss rates and a given bank's liability structure. The impact of this LGF analysis on Austrian banks' ratings ranges from plus-two to plus-three notches for senior bank debt and bank deposits.

**Government Support.** In line with the implementation of the BRRD bank resolution legislation, which aims to shift the costs for bank failures to shareholders and creditors, we have either eliminated or lowered our assumptions on the probability of government support for banks based in the European Union. For Austria, in contrast to other EU countries and reflective of government measures implemented since 2014, we assign a low level of support for the senior debt and deposit ratings of its banks. As a consequence, the uplift for ratings on Austrian banks' senior unsecured debt and deposit ratings owing to Austrian government support is zero, with the exception of Kommunalkredit Austria (KA), for which we continue to assign one notch uplift for government support.

Exhibit 1

### Overview of Changes in Austrian Banks' Ratings and Assessments

| Lead Operating Bank          | BAWAG |        | card complete |          | Erste |          | Hypo Tirol* |          | KA   |         |
|------------------------------|-------|--------|---------------|----------|-------|----------|-------------|----------|------|---------|
|                              | FROM  | TO     | FROM          | TO       | FROM  | TO       | FROM        | TO       | FROM | TO      |
| BCA                          | ba1   | baa3   | ba2           | ba2      | ba1   | ba1      | ba3         | ba3      | caa3 | b3      |
| Adjusted BCA                 | ba1   | baa3   | baa3          | ba2      | ba1   | ba1      | ba3         | ba3      | caa3 | b3      |
| CR Assessment LT             | -     | A3(cr) | -             | Baa2(cr) | -     | Baa1(cr) | -           | Baa3(cr) | -    | Ba2(cr) |
| Deposits LT                  | Baa2  | Baa1   | Baa3          | Baa3     | Baa2  | Baa2     | Baa2        | Ba1      | Ba1  | Ba3     |
| Senior Unsecured LT / Issuer | Baa2  | Baa1   | -             | -        | Baa2  | Baa2     | Baa2        | Ba1      | Ba1  | Ba3     |
| Subordinated LT              | Ba2   | Ba1    | -             | -        | Ba2   | Ba2      | B1          | B1       | Ca   | Caa1    |

| Lead Operating Bank          | RBI  |          | RLB NOe |          | RLB OOe |          | RLB Steiermark |          | RLB Tirol |        |
|------------------------------|------|----------|---------|----------|---------|----------|----------------|----------|-----------|--------|
|                              | FROM | TO       | FROM    | TO       | FROM    | TO       | FROM           | TO       | FROM      | TO     |
| BCA                          | ba3  | ba3      | baa3    | ba2      | ba1     | ba1      | baa2           | ba1      | baa2      | baa3   |
| Adjusted BCA                 | ba1  | ba2      | baa3    | ba1      | baa3    | ba1      | baa2           | ba1      | baa2      | baa3   |
| CR Assessment LT             | -    | Baa2(cr) | -       | Baa1(cr) | -       | Baa1(cr) | -              | Baa1(cr) | -         | A3(cr) |
| Deposits LT                  | Baa2 | Baa2     | Baa1    | Baa2     | Baa1    | Baa2     | A3             | Baa2     | A3        | Baa1   |
| Senior Unsecured LT / Issuer | Baa2 | Baa2     | Baa1    | Baa2     | Baa1    | Baa2     | A3             | Baa2     | A3        | Baa1   |
| Subordinated LT              | Ba2  | Ba2      | Ba1     | Ba2      | -       | -        | -              | -        | -         | -      |

| Lead Operating Bank          | RLB Vorarlberg |        | RVS  |        | UBA  |          | VBAG** |        | VLH* |        |
|------------------------------|----------------|--------|------|--------|------|----------|--------|--------|------|--------|
|                              | FROM           | TO     | FROM | TO     | FROM | TO       | FROM   | TO     | FROM | TO     |
| BCA                          | baa2           | baa3   | baa2 | baa3   | ba1  | ba2      | caa3   | caa3   | baa3 | baa3   |
| Adjusted BCA                 | baa2           | baa3   | baa2 | baa3   | ba1  | ba1      | caa3   | caa3   | baa3 | baa3   |
| CR Assessment LT             | -              | A3(cr) | -    | A3(cr) | -    | Baa1(cr) | -      | B3(cr) | -    | A3(cr) |
| Deposits LT                  | A3             | Baa1   | A3   | Baa1   | Baa2 | Baa2     | B2     | Caa1   | A2   | Baa1   |
| Senior Unsecured LT / Issuer | A3             | Baa1   | A3   | Baa1   | Baa2 | Baa2     | B2     | Caa1   | A2   | Baa1   |
| Subordinated LT              | -              | -      | -    | -      | Ba2  | Ba2      | Ca     | Ca     | Ba1  | Ba1    |

Note: Cells in green refer to rating upgrades, cells in red to rating downgrades. \*Hypo Tirol and VLH were part of a separate rating action on 7 May 2015. \*\*VBAG was part of a separate rating action on 15 June 2015.

Source: Moody's Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Baseline Credit Assessment

Our analysis of a bank begins with an assessment of its intrinsic credit strength — as represented by the BCA, which considers the bank's operating environment and its financial performance — to capture its standalone probability of failure. In our new bank rating methodology, the BCA consists of three sub-components:

- » **Macro Profile** (measured on a scale of "Very Strong+" to "Very Weak-") to integrate system-level factors such as economic and institutional strength, event risk, credit and funding conditions, and industry structure into the analysis.
- » **Financial Profile** focused on five solvency- and liquidity-related financial ratios that are predictive of bank failure.
- » **Qualitative Adjustments** to reflect additional bank-specific factors that are less readily attributed to solvency- or liquidity-related drivers, but still contribute to the soundness of an institution.

Exhibit 2 provides an overview of our BCA analysis of the Austrian banks on each of the above factors. The BCAs of these banks range from baa3 to caa3, with an average of ba2. Eight Austrian banks had a BCA change as a result of the rating review (see Highlight Box). The BCAs of Austrian banks reflect their 1) largely moderate asset quality because of elevated non-performing loan exposures, 2) satisfying capitalisation albeit with some tail risk from bank-equity investments, 3) moderate profitability, 4) high market funding dependency and 5) sound liquid resources.

Exhibit 2

### Components of Austrian Banks' BCA Analysis

|                       | SOLVENCY FACTORS |                        |                 |                |         |                |               |                 | LIQUIDITY FACTORS |                         |                  |                          | QUALITATIVE ADJUSTMENTS |                          |                     |
|-----------------------|------------------|------------------------|-----------------|----------------|---------|----------------|---------------|-----------------|-------------------|-------------------------|------------------|--------------------------|-------------------------|--------------------------|---------------------|
|                       | Assigned BCA     | Weighted Macro Profile | Asset Risk      |                | Capital |                | Profitability |                 | Funding Structure |                         | Liquid Resources |                          | Opacity and Complexity  | Business Diversification | Corporate Behaviour |
|                       |                  |                        | Problem Loans % | Assigned Score | TCE %   | Assigned Score | Net Income %  | Tangible Assets | Assigned Score    | Market Funds % Tangible | Assigned Score   | Liquid Assets % Tangible |                         |                          |                     |
| <b>BAWAG</b>          | baa3             | Very Strong -          | 3.8%            | baa3           | 13.6%   | baa1           | 0.6%          | baa2            | 23%               | baa1                    | 19%              | baa2                     | 0                       | 0                        | 0                   |
| <b>RLB Tirol</b>      | baa3             | Very Strong -          | 5.4%            | ba1            | 13.4%   | a3             | 0.2%          | b1              | 69%               | b1                      | 37%              | a1                       | 0                       | 0                        | 0                   |
| <b>RLB Vorarlberg</b> | baa3             | Very Strong -          | 3.5%            | baa2           | 13.1%   | baa2           | 0.3%          | ba2             | 80%               | b2                      | 75%              | aa3                      | 0                       | 0                        | 0                   |
| <b>RVS</b>            | baa3             | Very Strong -          | 5.6%            | ba2            | 11.5%   | baa3           | 0.1%          | ba1             | 54%               | baa2                    | 26%              | baa3                     | 0                       | 0                        | 0                   |
| <b>VLH</b>            | baa3             | Strong +               | 4.4%            | baa3           | 10.6%   | baa2           | 0.3%          | ba1             | 52%               | b1                      | 17%              | baa1                     | 0                       | 0                        | 0                   |
| <b>Erste</b>          | ba1              | Strong                 | 9.1%            | ba3            | 7.7%    | baa3           | -0.3%         | ba3             | 21%               | baa1                    | 30%              | baa2                     | 0                       | 0                        | 0                   |
| <b>RLB OOe</b>        | ba1              | Very Strong -          | 9.3%            | ba2            | 12.2%   | baa2           | 0.1%          | b2              | 55%               | ba1                     | 30%              | baa2                     | 0                       | 0                        | 0                   |
| <b>RLB Steiermark</b> | ba1              | Very Strong -          | 10.5%           | b1             | 14.3%   | a3             | -0.1%         | b2              | 63%               | ba3                     | 38%              | a2                       | 0                       | 0                        | 0                   |
| <b>RLB NOe</b>        | ba2              | Very Strong -          | 6.1%            | baa3           | 10.7%   | ba2            | -0.9%         | b3              | 65%               | ba3                     | 41%              | baa2                     | 0                       | 0                        | 0                   |
| <b>UBA</b>            | ba2              | Strong -               | 9.2%            | b1             | 11.9%   | ba2            | 0.4%          | ba3             | 31%               | ba1                     | 30%              | baa3                     | 0                       | 0                        | 0                   |
| <b>card complete</b>  | ba2              | Very Strong -          | 1.3%            | ba3            | 15.4%   | baa1           | 2.5%          | a2              | 45%               | ba2                     | 6%               | b1                       | 0                       | -1                       | 0                   |
| <b>Hypo Tirol</b>     | ba3              | Strong +               | 12.9%           | b2             | 11.9%   | baa2           | -0.3%         | caa1            | 51%               | caa2                    | 28%              | baa1                     | 0                       | 0                        | 0                   |
| <b>RBI</b>            | ba3              | Moderate +             | 11.3%           | b2             | 10.1%   | ba3            | -0.3%         | ba3             | 31%               | ba2                     | 24%              | baa1                     | 0                       | 0                        | 0                   |
| <b>KA</b>             | b3               | Very Strong -          | 0.7%            | baa2           | 14.3%   | ba1            | 0.0%          | caa1            | 87%               | b3                      | 15%              | b2                       | -2                      | -1                       | 0                   |
| <b>VBAG</b>           | caa3             | Moderate +             | 20.3%           | caa3           | 2.1%    | caa3           | -3.2%         | caa2            | 75%               | caa2                    | 50%              | ba3                      | -1                      | 0                        | 0                   |

Source: Moody's Investors Service

### Focus on the BCA changes for eight Austrian banks

**BAWAG's** upgraded BCA reflects its stronger and higher-quality capital adequacy ratios and an underlying recovery in profitability that have allowed the bank to reduce on-balance sheet risks. It also reflects the banks' significantly strengthened loss-absorption capacity. BAWAG's baa3 BCA is positioned at the low-end of the scorecard range, indicating potential upside over our 12-18 month outlook horizon. This reflects our expectation of further improvements in the bank's financial profile.

The upgrade of **Kommunalkredit Austria's** BCA to b3 reflects the bank's gradual progress in reducing legacy assets without needing to resort to additional capital or liquidity support from its ultimate owner, the Austrian government. KA has improved its risk-weighted capital ratios and returned to modest levels of profitability. The BCA remains constrained by very high single-name concentrations in the bank's public finance and infrastructure lending portfolio, very weak Tangible Common Equity leverage ratios (1.9% as of FYE 2014); and low visibility regarding the development of the bank's standalone financial profile as result of the agreed partial sale of the bank.

The downgrade of **Raiffeisenlandesbank Niederoesterreich-Wien's** (RLB NOe) BCA to ba2 reflects our anticipation of further deterioration in the bank's financial profile, mostly notably with regards to ongoing pressure on RLB NOe's capitalisation and profitability, given its position as the largest shareholder in Raiffeisen Zentralbank Oesterreich AG (RZB; Baa2 negative/Baa2 negative)<sup>3</sup>. RZB owns the majority of Raiffeisen Bank International (RBI), which faces challenges in particular due to its exposures in Eastern Europe and the Commonwealth of Independent States. The rating remains supported by the bank's adequate asset quality and its strong liquidity profile.

The downgrade of **RLB Steiermark's** BCA to ba1 reflects our expectation of further deterioration in the bank's financial profile, most notably with regards to ongoing pressure on its asset quality and profitability with further potential adverse effects on its current solid capitalisation stemming from its position as one of the larger shareholders in RZB.

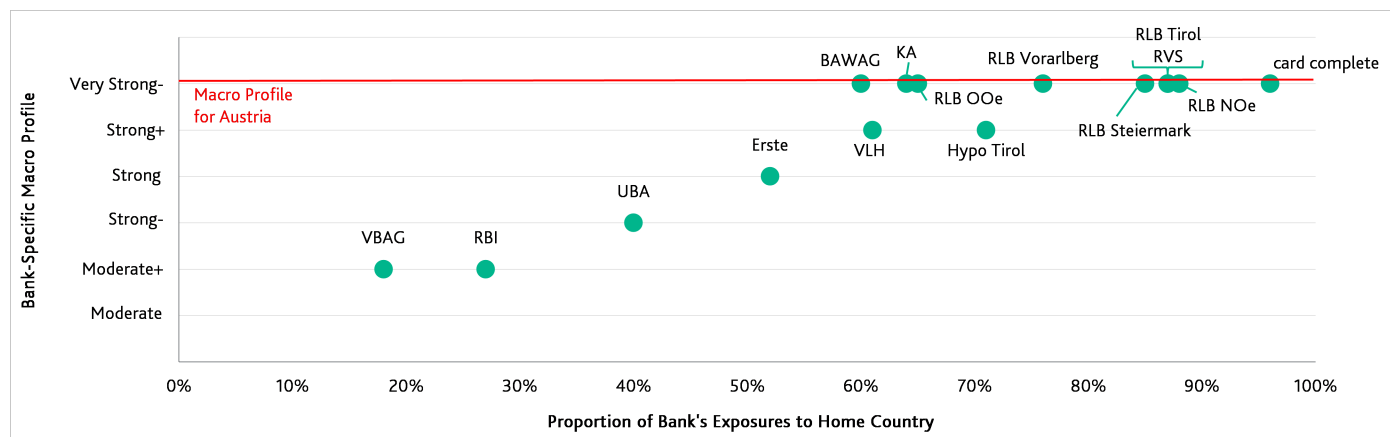
The downgrade of **RLB Tirol's, RLB Vorarlberg's and Raiffeisenverband Salzburg's** (RVS) BCAs to baa3 reflects the banks' exposure to credit pressures in Raiffeisen Bankengruppe Oesterreich (RBG; unrated), posing tail risks for its solvency. The BCAs remains underpinned by the respective banks' improving capitalisation and its solid liquidity.

**UniCredit Bank Austria's** (UBA) BCA downgrade to ba2 indicates deterioration in the operating environment for some of its Central and Eastern European (CEE) operations, which raises risks to capital. Risks are particularly high in relation to UBA's operations in Russia that have been a prominent contributor to group profits in recent years. A deep and extended depression of the Russian economy would imply elevated credit and market risk for UBA.

### Macro Profile

While the majority of Austrian banks' exposures are within their home country, a substantial portion (about one-third) are outside, with concentrations in Central Eastern European (CEE) countries and the Commonwealth of Independent States (CIS). The Macro Profile captures the macroeconomic and sector-level variables to which these banks are exposed across the various jurisdictions in which they operate. Because Austria's "Very Strong-" Macro Profile remains one of the highest ranked globally, non-domestic exposures, particularly those in Eastern European countries and the CIS region, put pressure on the Macro Profile; for some banks this is as much as four notches to "Moderate+" (Exhibit 3).

Exhibit 3  
**Austrian Banks' Macro Profiles Are Impacted By CEE/CIS Exposures**  
 Proportion of Exposures in Home Country vs. Bank-Specific Macro Profile

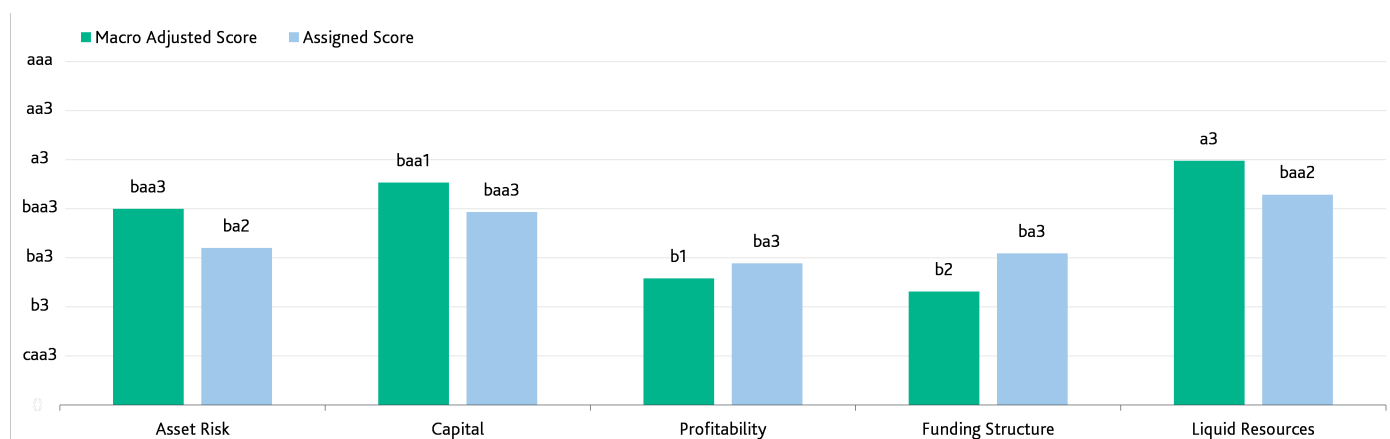


Source: Moody's Investors Service

### Financial Profile

Exhibit 4 shows the average Macro-Adjusted and Assigned scores for the Austrian banks on the Financial Profile sub-factors of asset risk, capital, profitability, funding structure and liquid resources. Each of the sub-factors — which utilise historical financial ratios as a starting point — receive Macro-Adjusted scores, which are calibrated relative to the bank-specific Macro Profile. We then adjust each sub-factor score to reflect other relevant metrics and our forward-looking expectations, resulting in the Assigned scores. We discuss the analytic considerations driving each of the Assigned scores below.

Exhibit 4  
**Financial Profile - Average Factor Scores for Austrian Banks**



Source: Moody's Investors Service

The **Asset Risk** score focuses on problem loans as a percentage of gross loans. The average assigned asset risk score for the Austrian banks is ba2, two notches below the macro-adjusted score of baa3. Our adjustments largely reflect loan concentration risks, particularly sector concentrations, such as financial institutions, but also geographical concentrations and - to a lesser extent - single-name concentrations. Sector concentrations and market risk are more visible for institutions in the Raiffeisen co-operative sector, while geographical concentrations are more common for Austrian commercial banks.

The **Capital** position for Austrian banks as a whole is captured in the average assigned capital factor score of baa3, two notches below the macro-adjusted outcome of baa1. This is particularly driven by stressed capital resilience resulting from the Raiffeisenlandesbanks (RLBs) sizeable equity investments in their central bank RZB, and therefore indirectly RZB's largest asset Raiffeisen Bank International (RBI), which faces challenges in particular due to its exposures in Russia (Ba1 negative)<sup>4</sup> and the Ukraine (Ca negative)<sup>5</sup>. Stressed capital resilience is also the most common reason for adjustment at commercial banks.

Austrian banks' **Profitability** remains moderate, reflecting adjustment to ba3 by one notch from a macro-adjusted outcome of b1. We expect profitability to remain subdued because of elevated loan-loss charges (especially for CEE/CIS exposures), and because of strong competition and low margins within Austria (Aaa stable)<sup>6</sup>.

The **Funding Structure** of most Austrian banks rated by us leans heavily on wholesale (capital market) funding, which we consider more confidence-sensitive and volatile than deposit funding. The average ratio of market funds to tangible banking assets remains very high, at above 50%, which drives our average assigned funding structure score of ba3. While banks that have greater access to deposit funds achieve market funds ratios of close to 20% (in particular Erste and BAWAG), some largely wholesale-dependent banks reach levels as high as 80%.

This high market funding dependence is only partly compensated by Austrian banks' sizeable buffers of **Liquid Resources** (cash and liquid asset reserves), which are available to mitigate a potential loss of less-stable short-term funding. Their average liquid assets to tangible banking assets ratio of about 30% results in an average assigned liquid resources factor score of baa2.

### Qualitative Adjustments

Three qualitative factors beyond those considered in the Financial Profile contribute to the soundness of a financial institution and are considered in determining BCAs: (1) business diversification, (2) opacity and complexity, and (3) corporate behavior.

Generally, qualitative adjustments do not play an important role for Austrian banks; only three banks' Financial Profiles receive qualitative adjustments. For KA and card complete we identified criteria to apply a one-notch downward adjustment for Business Diversification. For KA we added another two notch downward adjustment for Opacity and Complexity. VBAG also received a one-notch downward adjustment for Opacity and Complexity.

### Support and Structural Analysis

The support and structural analysis, which follows the BCA, consists of three separate stages in the following sequence: (1) Affiliate Support, (2) Loss-Given-Failure and (3) Government Support.

#### Affiliate Support

Affiliate support refers to the support that a bank could receive from a parent or cooperative group. In combination with the BCA, our assessment of affiliate support determines a bank's adjusted BCA.

Currently, three Austrian banks' ratings benefit from affiliate support, of which two are from the Austrian Raiffeisen bank sector; RBI and RLB NOe (see below). The remaining bank is UBA, which benefits from one notch of parental support uplift from UniCredit SpA (Baa1 stable/Baa1 stable, ba1).<sup>7</sup> We assume an unchanged "very high" probability of support for UBA based on a proven support track record and UniCredit's unchanged strategic interest in its subsidiary.

#### Raiffeisen sector in Austria: weak fundamentals limit affiliate support

As part of our review of Austrian bank ratings, we have reassessed the Austrian Raiffeisen sector's financial capacity to provide support to its members, based on the co-operative group's combined financial strength. We consider the group's capitalisation as moderate relative to its overall credit profile, which is strongly correlated with its higher-risk CEE/CIS exposures, housed at RBI. Higher capital

would be required to protect the group against likely losses under an adverse scenario. Given the lack of material improvement in the group's capital levels in recent years, our reassessment has resulted in a more limited support capacity than assessed previously.

Furthermore, we have re-assessed the group's renewed Institutional Protection Schemes, which extend to all the group's rated domestic institutions including RZB, but which exclude RBI, which has substantial non-domestic exposure. Nonetheless, RZB's majority ownership of RBI leads us to believe that there is some likelihood that RBI would indirectly benefit from any sector support provided for RZB in case of need.

Because of the constrained capacity of Raiffeisen group's Institutional Protection Scheme, the cross-sector support attributed to RBI has been lowered to "moderate", leading to one notch of affiliate support uplift to ba2 instead of two notches previously. For the six rated Raiffeisenlandesbanks, their adjusted BCAs include an unchanged "very high" probability of sector support and range between baa3 and ba1 (from baa2 and baa3 previously), mostly in line with their standalone BCAs. Only RLB NOe benefits from one notch of affiliate support uplift.

### Loss Given Failure

Our next step is to consider the losses likely to be incurred across the liability structure in order to determine the risks to which creditors are exposed in the event of a bank's failure. Under our Advanced LGF analysis, we rate loss-absorbing debt and capital at the instrument level, allowing for creditor loss discrimination across the liability structure hierarchy and taking into account factors such as firm-wide loss rates, the volume of securities subordinated to a given debt class, and the overall volume of that instrument class.

Our Advanced LGF analysis is particularly relevant for Austrian banks, because they are subject to the EU's Bank Recovery and Resolution Directive (BRRD), a resolution framework under which capital instruments can be written down at the point of non-viability and debt can be bailed-in after a bank is placed into resolution. Our Advanced LGF analysis accounts for both a given firm's capital structure and the order in which losses would be absorbed by holders of equity and debt securities.

### Creditor Hierarchy

Our Advanced LGF analysis employs an assumed creditor hierarchy based on the resolution framework under which a bank operates.<sup>8</sup> Exhibit 5 shows the creditor hierarchies for the EU, in which the Austrian banks primarily operate, with the US and Switzerland creditor hierarchies included for comparison. The main differences between the various liability hierarchies are the positioning of deposits relative to other senior unsecured obligations and the positioning of holding company obligations relative to those of the operating bank.

Exhibit 5

## Loss Given Failure Creditor Hierarchies

| United States                             | EU*                                     |   | Switzerland                             |
|---|---|---|---|
|   | DE JURE                                 | DE FACTO                                |   |
| DEPOSITS                                  | PREFERRED DEPOSITS                      | PREFERRED DEPOSITS                      | PRIVILEGED DEPOSITS                     |
| OPERATIONAL LIABILITIES                   | OPERATIONAL LIABILITIES                 | OPERATIONAL LIABILITIES                 | JUNIOR DEPOSITS                         |
| SENIOR LONG-TERM DEBT (bank)              | JUNIOR DEPOSITS                         | JUNIOR DEPOSITS                         | OPERATIONAL LIABILITIES                 |
| DATED SUBORDINATED DEBT (bank)            | SENIOR LONG-TERM DEBT (bank)            | SENIOR LONG-TERM DEBT (bank)            | SENIOR LONG-TERM DEBT (bank)            |
| JUNIOR SUBORDINATED (bank)                | SENIOR LONG-TERM DEBT (holding company) | SENIOR LONG-TERM DEBT (holding company) | SENIOR LONG-TERM DEBT (holding company) |
| PREFERENCE SHARES (bank)                  | DATED SUB. DEBT (bank)                  | DATED SUB. DEBT (bank)                  | DATED SUB. DEBT (BANK)                  |
| SENIOR LONG-TERM DEBT (holding company)   | DATED SUB. DEBT (holding co)            | DATED SUB. DEBT (holding co)            | DATED SUB. DEBT (holding co)            |
| DATED SUBORDINATED DEBT (holding company) | JUNIOR SUB. (bank)                      | JUNIOR SUB. (bank)                      | JUNIOR SUB. (bank)                      |
| JUNIOR SUBORDINATED (holding company)     | JUNIOR SUB. (holding co)                | JUNIOR SUB. (holding co)                | JUNIOR SUB. (holding co)                |
| PREFERENCE SHARES (holding company)       | PREFERENCE SHARES (bank)                | PREFERENCE SHARES (bank)                | PREFERENCE SHARES (bank)                |
|   | PREFERENCE SHARES (holding co)          | PREFERENCE SHARES (holding co)          | PREFERENCE SHARES (holding co)          |

Note: \* In the EU, "ineligible" — i.e., non-preferred — deposits rank pari passu with senior unsecured debt under a liquidation (de jure), but we believe they may benefit from discretionary preference in a resolution (de facto). We generally assign a 25% probability to the de facto scenario.

Source: Moody's Investors Service

#### Firm-Wide Loss Rate

Our assumed overall firm-wide loss rate in resolution has a major bearing on the loss-given-failure for the Austrian banks' rated instruments. In order to assign a loss rate under our Advanced LGF analysis, we consider asset volatility — using the Macro Profile and historical loss rates — as well as the type of resolution approach that would likely apply (going concern or liquidation).

For EU banks with "Weak" to "Very Weak" Macro Profiles, we typically apply a loss rate of 13% of tangible banking assets. We believe that banks with stronger Macro Profiles are likely to demonstrate lower recovery value volatility and lower losses on assets in an early intervention scenario than for a failed bank, and therefore apply an 8% loss rate for EU banks with Macro Profiles of "Moderate –" or higher. Given that all Austrian banks have a bank-specific Macro Profile between "Moderate+" and "Very Strong–" we apply an 8% loss rate.

#### Resolution Perimeter

In applying Advanced LGF analysis, we establish the appropriate firm balance sheet for what we judge to be the firm's "resolution perimeter." Typically, we expect resolutions to be conducted along national boundaries, since a regulator's authority usually does not extend beyond its borders. In the case of a multi-national banking group, we might divide the consolidated whole into sub-groups according to jurisdiction. We consolidate debt and deposit data within these sub-groups and assume that equivalent creditors at different entities are treated equally.



For each Austrian banking group, we apply Advanced LGF analysis to the aggregated balance sheet for the home country, foreign branches and foreign debt-issuing vehicles. We typically exclude foreign subsidiaries from the parent's resolution perimeter. For the following subsidiaries we apply the LGF analysis of its parent (stated in parentheses): card complete (UBA), RBI (RZB).

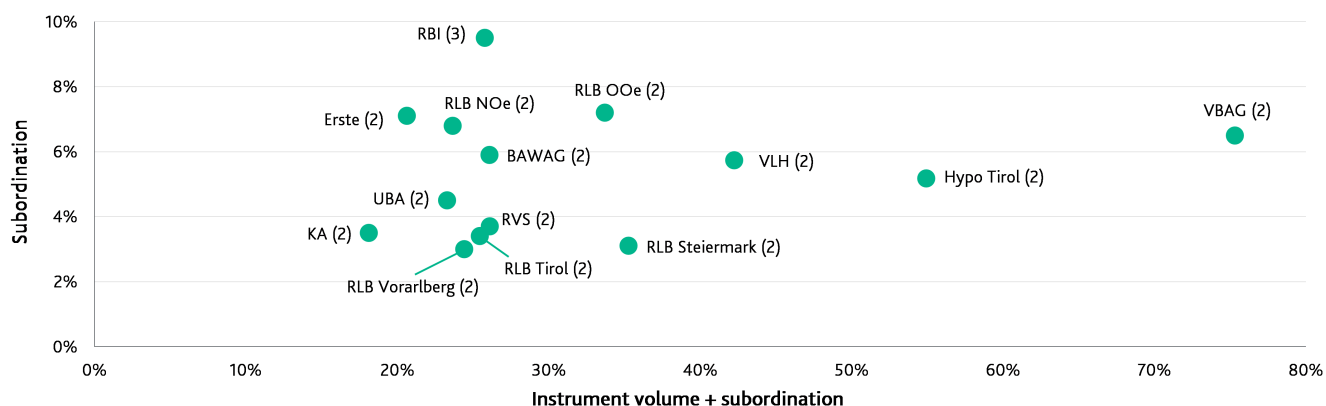
### Liability Structure

The liability structure of each bank today reflects historical funding strategies but will increasingly reflect how a given bank chooses to meet its resolution requirements. Advanced LGF analysis assesses the extent to which the characteristics of a given bank's liability structure change the risk profile of a given instrument, which determines its position relative to the bank's adjusted BCA. This notching differential can vary for the same debt class between different banks and banking systems, reflecting distinctions in the creditor hierarchy, debt class volume and the amount of instruments subordinated to that debt class in each case.

Since Austrian banks have not established any holding company structure, they benefit from high volumes of outstanding long-term senior unsecured bank debt but mostly moderate - albeit increasing - levels of subordinated debt. This structure limits LGF uplift relative to the adjusted BCA to two notches for the senior unsecured bank debt of most Austrian banks, RBI being an exception with three notches (Exhibit 6).

Exhibit 6

#### LGF Uplift for Austrian Banks' Long-Term Senior Unsecured Debt Ratings



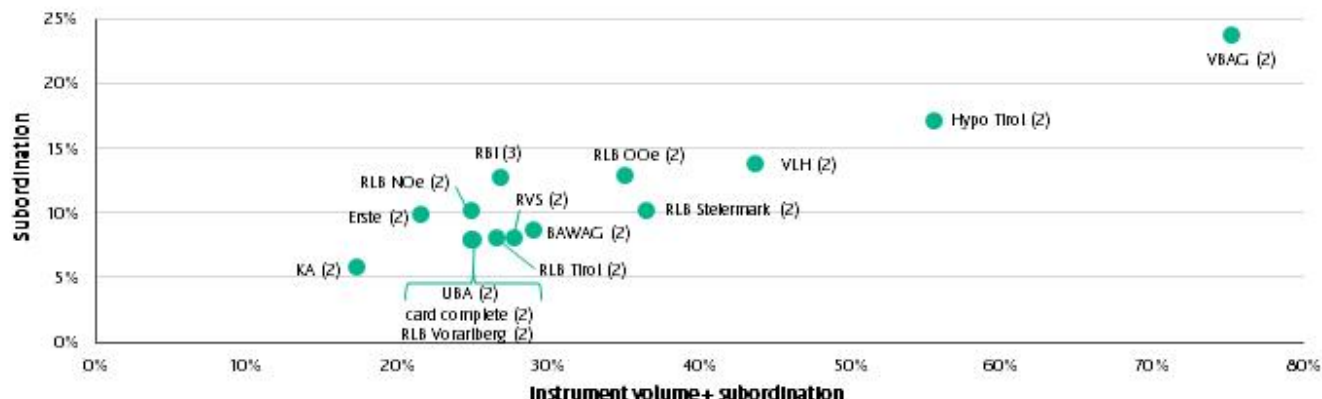
Note: In brackets we show the notches of LGF uplift for each bank's long-term senior unsecured debt ratings. card complete is excluded from this chart because it has neither a senior unsecured debt rating nor an issuer rating. Subordination and instrument volume data shown is the weighted average of de jure and de facto scenarios; this is shown for indicative purposes only.

Source: Moody's Investors Service

In the EU, junior deposits (i.e. large corporate or institutional deposits) rank pari passu with senior unsecured debt in a liquidation, but we believe they may benefit from discretionary preference in a resolution. We assign a 25% probability to this latter (de facto) scenario. This also reflects the probability of a distressed exchange which is more likely to be imposed upon bondholders than depositors. Deposit ratings of Austrian banks benefit from two to three notches of LGF uplift relative to the adjusted BCA, in line with the uplift we assign for senior unsecured debt ratings (Exhibit 7).

Exhibit 7

## LGF Uplift for Austrian Banks' Long-Term Deposit Ratings



Note: In brackets we show the notches of LGF uplift for each bank's long-term deposit ratings. Subordination and instrument volume data shown is the weighted average of the two de jure and de facto scenarios; this is shown for indicative purposes only.

Source: Moody's Investors Service

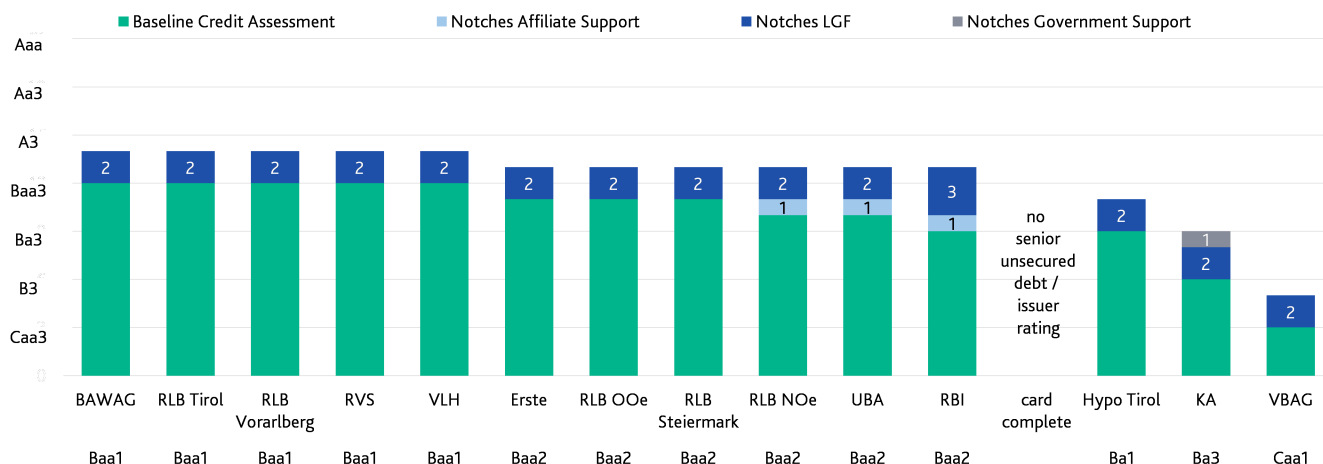
### Government Support

The newly introduced resolution framework in the EU, BRRD, is likely to be used to deal with failing banks. It reflects a decline in the willingness of EU governments to bail out banks and severely restricts the conditions under which authorities can use public monies to fund bank recapitalizations.<sup>9</sup> We expect that most failing banks in the EU will be resolved without governments providing financial support.

With the implementation of bank resolution legislation, we have either eliminated or lowered our assumptions about the probability of government support for the banks in the EU, thereby generally attributing a "moderate" probability of government support to banking groups in the EU that are considered systemically relevant. We have lowered our expectations regarding the degree of support that the Austrian government might provide to a bank in Austria to below the level we assign in other EU countries. The main trigger for this assessment was the early adoption of BRRD in Austria and its recent application to Heta Asset Resolution AG (Heta)<sup>10</sup>, as wind-down institutions are in the scope of the Austrian transposition of BRRD. We believe that the wider scope of the BRRD implementation in Austria and its recent application, triggering a resolution of Heta, illustrates the Austrian government's willingness to apply burden-sharing.

While we consider Erste, UBA and the group of Austrian Raiffeisen co-operative banks to be domestically systemically relevant, we only attribute a "low" probability of Austrian government support, which results in no ratings uplift from government support.

Exhibit 8  
Austrian Banks' Long-Term Senior Unsecured Bank Debt/Issuer Ratings and Their Components



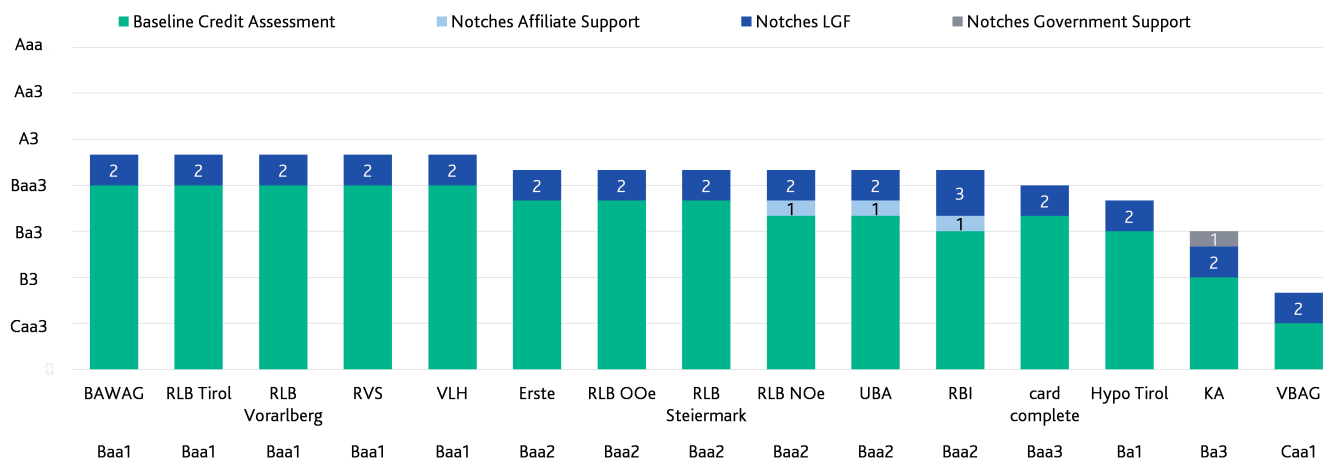
Note: card complete is excluded because it does not have a senior unsecured debt or issuer rating. Ratings shown for RLB Tirol, RLB Vorarlberg, RVS and RLB Steiermark are issuer ratings

Source: Moody's Investors Service

While KA is not considered systemically relevant, we have taken into account that the bank continues to be owned by the Austrian government which, for now, retains discretion over whether to provide liquidity and capital support under the terms of a state-aid ruling by the European Commission issued before the introduction of BRRD.

Exhibits 8 and 9 present a breakdown of Austrian banks' long-term senior unsecured debt and deposit ratings, showing the initial BCA and additional notching for affiliate, LGF and government support.

Exhibit 9  
Austrian Banks' Long-Term Deposit Ratings and Their Components



Source: Moody's Investors Service

## Counterparty Risk Assessment

The newly introduced resolution framework in the EU does not specifically exempt derivatives, counterparty obligations, or contractual commitments arising from a bank's operating functions from the scope of bail-in. Nevertheless, we believe that, in most instances, resolution authorities would exclude these obligations from bail-in to limit market disruptions and contagion risk and preserve the continuity of the bank's key operations and payment flows. This view is reflected in the Counterparty Risk (CR) Assessment that we have introduced as part of our new bank rating methodology.

For Austrian banks, we expect that the operating obligations to which the CR Assessment applies will benefit from the loss absorption that capital and debt instruments provide in the banks' liability structures. As a result, we position operational liabilities above senior debt and junior (uninsured) deposits in the LGF creditor hierarchy (Exhibit 5). Consequently, the CR Assessments of banks to which we apply Advanced LGF benefit from the subordination of both senior debt and junior deposits, resulting in three notches of LGF uplift for the CR Assessments of 15 Austrian banks (Exhibit 10).

Exhibit 10

### Counterparty Risk Assessment for Austrian Banks

|                | Adjusted BCA | LGF Notching | Government Support Notching | Long-Term CR Assessment | Short-Term CR Assessment |
|----------------|--------------|--------------|-----------------------------|-------------------------|--------------------------|
| BAWAG          | baa3         | 3            | 0                           | A3(cr)                  | P-2(cr)                  |
| RLB Tirol      | baa3         | 3            | 0                           | A3(cr)                  | P-2(cr)                  |
| RLB Vorarlberg | baa3         | 3            | 0                           | A3(cr)                  | P-2(cr)                  |
| RVS            | baa3         | 3            | 0                           | A3(cr)                  | P-2(cr)                  |
| VLH            | baa3         | 3            | 0                           | A3(cr)                  | P-2(cr)                  |
| Erste          | ba1          | 3            | 0                           | Baa1(cr)                | P-2(cr)                  |
| RLB NOe        | ba1          | 3            | 0                           | Baa1(cr)                | P-2(cr)                  |
| RLB Steiermark | ba1          | 3            | 0                           | Baa1(cr)                | P-2(cr)                  |
| RLB OOe        | ba1          | 3            | 0                           | Baa1(cr)                | P-2(cr)                  |
| UBA            | ba1          | 3            | 0                           | Baa1(cr)                | P-2(cr)                  |
| card complete  | ba2          | 3            | 0                           | Baa2(cr)                | P-2(cr)                  |
| RBI            | ba2          | 3            | 0                           | Baa2(cr)                | P-2(cr)                  |
| Hypo Tirol     | ba3          | 3            | 0                           | Baa3(cr)                | P-3(cr)                  |
| KA             | b3           | 3            | 1                           | Ba2(cr)                 | NP(cr)                   |
| VBAG           | caa3         | 3            | 0                           | B3(cr)                  | NP(cr)                   |

Source: Moody's Investors Service

## Moody's Related Research

### Rating Methodology

- » [Banks, March 2015 \(179038\)](#)
- » [Bank Rating Methodology: Responses to Frequently Asked Questions - Update, May 2015 \(1002868\)](#)

### Rating Actions

- » [Moody's reviews global bank ratings, March 2015 \(321005\)](#)

### Banking System Outlook

- » [Austria, May 2014 \(166796\)](#)

### Special Comments

- » [French Banks: Key Analytic Considerations in Our Rating Actions on French Banks, June 2015 \(1005720\)](#)
- » [Italian Banks: Key Analytic Considerations in Our Rating Actions on Italian Banks, June 2015 \(1005806\)](#)
- » [German banks: Key Analytic Considerations in Our Rating Actions on German Banks, June 2015 \(1005805\)](#)
- » [Nordics Banks: Key Analytic Considerations in Our Rating Actions on the Large Six Nordic Banks, June 2015 \(1005869\)](#)
- » [Global Investment Banks: Key Analytic Considerations in Our Rating Actions on Global Investment Banks, May 2015, \(1004940\)](#)
- » [How Resolution Frameworks Drive Our Creditor Hierarchies, April 2015 \(1003760\)](#)
- » [Basel III Liquidity and Stable Funding Requirements Are Credit Positive for Banks Despite Compliance Costs, May 2015 \(1002654\)](#)
- » [Bank Resolution Regimes - An Overview of Progress Made to Date \(Presentation\), March 2015 \(179964\)](#)
- » [European Bank Ratings To Reflect Reduced Probability of Government Support, March 2015 \(1002793\)](#)
- » [European Proposal on Minimum Own Funds and Eligible Liabilities Is Credit Positive for Senior Bank Creditors, December 2014 \(177860\)](#)
- » [FSB Proposal Sets High Loss-Absorbing Capacity Bar For G-SIBs, November 2014 \(1000838\)](#)
- » [Reassessing Systemic Support for EU Banks, May 2014 \(170460\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

## Endnotes

- 1 This report includes rated Austrian banks for which we assign a baseline credit assessment. For a full list of banks and instruments affected by the rating actions, please refer to the press releases from 1 July, 15 June and 7 May 2015. The banks included in this report are (abbreviation in parenthesis: BAWAG P.S.K. (BAWAG), card complete Service Bank AG (card complete), Erste Group Bank AG (Erste), Hypo Tirol Bank AG (Hypo Tirol), Kommunalkredit Austria AG (KA), Oesterreichische Volksbanken AG (VBAG), Raiffeisen Bank International AG (RBI), Raiffeisenlandesbank Niederoesterreich-Wien (RLB NOe), Raiffeisenlandesbank Oberoesterreich AG (RLB OOe), Raiffeisen-Landesbank Steiermark AG (RLB Steiermark), Raiffeisen-Landesbank Tirol AG (RLB Tirol), Raiffeisenlandesbank Vorarlberg (RLB Vorarlberg), Raiffeisenverband Salzburg (RVS), UniCredit Bank Austria AG (UBA), Vorarlberger Landes- und Hypothekenbank AG (VLH).
- 2 Please see [Moody's Macro Profiles: A Compendium](#) , 18 March 2015.
- 3 The rating shown is RZB's deposit rating and senior unsecured rating and outlook
- 4 The rating shown is Russia's senior unsecured rating and outlook
- 5 The rating shown is Ukraine's senior unsecured rating and outlook
- 6 The rating shown is Austria's senior unsecured rating and outlook
- 7 The rating shown is UniCredit SpA's deposit rating and senior unsecured rating and outlook, and its baseline credit assessment
- 8 Please see [How Resolution Frameworks Drive Our Creditor Hierarchies](#) , 16 April 2015.
- 9 Please see [European Bank Ratings to Reflect Reduced Probability of Government Support](#) , 17 March 2015.
- 10 Please see [Austrian application of BRRD to wind-down entity Heta sets precedent](#) , 9 March 2015

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