FitchRatings

Banks
Retail & Consumer Banks
Austria

Volksbanken-Verbund

Update

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 Ratings' 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 – driven by the pandemic – to our expectation 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's impaired loan ratio of 2.1% at end-2020 is broadly in line with larger domestic Austria-focused peers. We expect inflows of new impaired loans to increase, mostly in 2H21 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 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 & 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, ultimately, net losses this year and next.

Organic Capital Generation Constrained: The group's common equity Tier 1 (CET1) ratio of 14.1% at end-2020 is 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 bail-out 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 from the pandemic 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. In recent years, 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 19.2% at end-2020 from 12.9% at end-1H17. Volksbank Wien, the group's central organisation, 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 could downgrade VB-Verbund's ratings if the economic and financial markets fall-out from the pandemic leads to a more severe and prolonged deterioration in profitability or capitalisation than currently envisaged without credible prospects of restoring them in 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 profit to improve significantly and sustainably. The Viability Rating is unlikely to rise

Ratings

Foreign Currency	
Long-Term IDR	BBB
Short-Term IDR	F2
Viability Rating	bbb
Support Rating	5
Support Rating Floor	NF

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

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

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

Fitch Affirms Austria at 'AA+'; Outlook Stable (May 2021)

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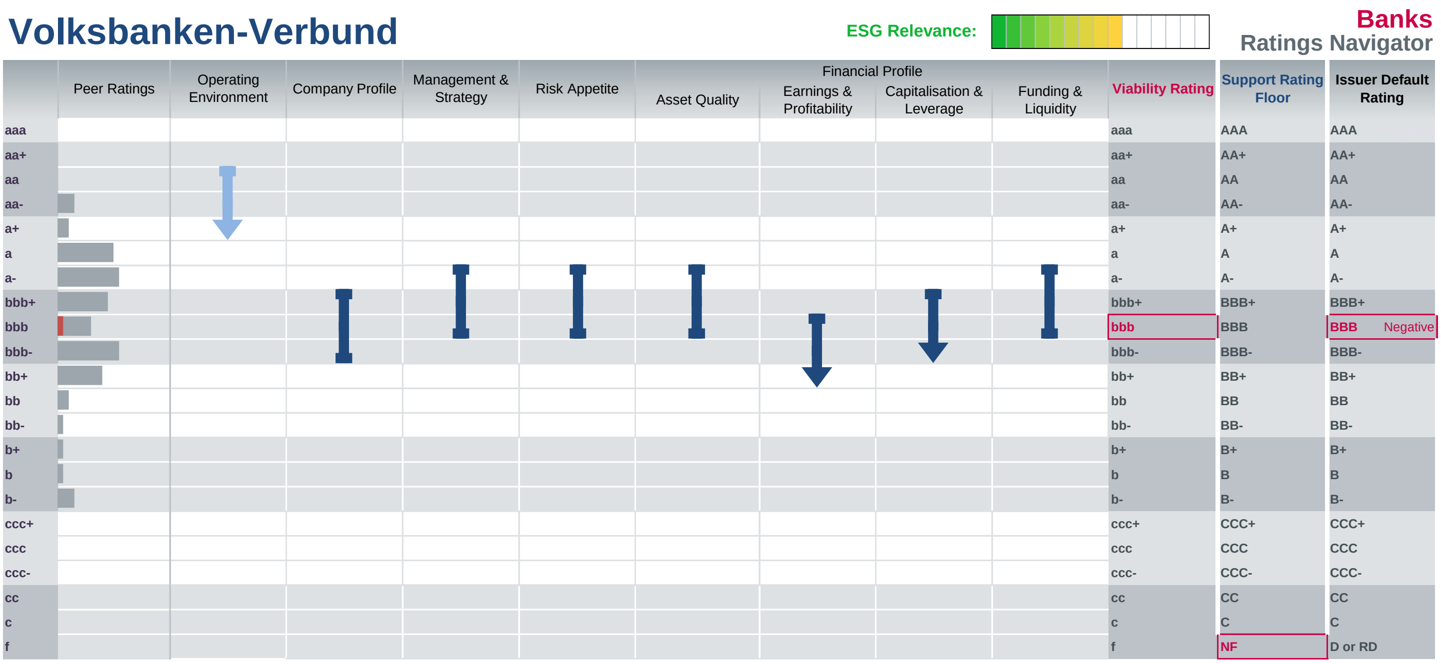
above the 'bbb' category because VB-Verbund's fairly small market share in the generally low-margin, high-cost, Austrian retail and SME banking market leads to modest operating profits.

Ratings Navigator



Significant Changes

Pandemic Drives Increase in LICs in 2020

VB-Verbund’s operating profit, which was already under pressure due to low interest rates pre-crisis, fell sharply to 0.2% of RWAs in 2020 despite roughly stable operating revenue, as LICs rose to EUR126 million from EUR22 million in 2019, mostly driven by management overlays on performing loans. The impaired loans ratio even improved to 2.1% at end-2020 (2.5% at end-2019). The net income benefitted from a one-off gain of EUR32 million from the sale of its headquarters. The group's CET1 ratio of 14.1% at end-2020 adequately exceeded its regulatory requirement of 9.85%.

We expect VB-Verbund’s operating profit to recover in 2021 but to remain below 0.5% of RWAs 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 7% in 2020. However, extraordinary contributions to the DPS will temporarily undermine 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.

Temporary Depletion of Austrian Banking Sector’s DPS Is Neutral for the 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 VB-Verbund’s mutual support scheme fails to ensure the viability of its members. The vast majority of the group’s depositors are mass retail clients with less 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

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

claims of about EUR550 million on the DPS, depleting its paid-in endowment by 80%. VB-Verbund must bear EUR43 million of this amount through extraordinary contributions to the DPS over the next five years, although recoveries from the two failed banks' insolvency proceeds are likely to eventually reduce this amount significantly. To prevent similar contingent liabilities from crystallising in the future, VB-Verbund'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 DPS' momentary depletion as well as VB- Verbund's extraordinary contributions and potential exit as neutral for the group's ratings.

Summary Financials and Key Ratios

	31 Dec 2020	31 Dec 2019	31 Dec 2018	31 Dec 2017
	EURm	EURm	EURm	EURm
Summary Income Statement				
Net interest and dividend income	413	422	420	443
Net fees and commissions	239	230	234	237
Other operating income	9	78	11	-1
Total operating income	662	730	664	679
Operating costs	512	534	568	586
Pre-impairment operating profit	150	196	96	94
Loan and other impairment charges	126	22	-6	52
Operating profit	24	174	102	42
Other non-operating items (net)	33	5	21	-1
Tax	37	31	8	-21
Net income	20	149	115	61
Summary Balance Sheet				
Gross loans	21,651	21,537	20,795	19,769
- of which impaired	454	538	633	839
Loan loss allowances	364	286	293	362
Net loans	21,287	21,251	20,502	19,407
Interbank	438	431	470	495
Derivatives	170	143	127	160
Other securities and earning assets	2,898	2,850	2,718	2,541
Total earning assets	24,793	24,675	23,817	22,602
Cash and due from banks	3,944	2,072	1,732	2,001
Other assets	634	750	1,016	720
Total assets	**29,370**	**27,496**	**26,564**	**25,323**
Customer deposits	22,154	21,729	21,555	20,850
Interbank and other short-term funding	1,884	412	595	449
Other long-term funding	1,972	1,985	1,037	1,150
Trading liabilities and derivatives	504	463	455	464
Total funding	26,513	24,589	23,643	22,911
Other liabilities	518	562	940	514
Preference shares and hybrid capital	293	316	126	145
Total equity	2,047	2,028	1,855	1,753
Total liabilities and equity	**29,370**	**27,496**	**26,564**	**25,323**

Summary Financials and Key Ratios

	31 Dec 2020	31 Dec 2019	31 Dec 2018	31 Dec 2017
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	0.2	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	77.3	73.1	87.1	85.2
Net income/average equity	1.0	7.3	6.4	3.6
Asset quality				
Impaired loans ratio	2.1	2.5	3.0	4.2
Growth in gross loans	0.5	3.6	5.2	2.0
Loan loss allowances/impaired loans	80.2	53.2	46.2	43.1
Loan impairment charges/average gross loans	0.6	0.1	0.0	0.2
Capitalisation				
Common equity Tier 1 ratio	14.1	12.9	12.1	12.4
Fully loaded common equity Tier 1 ratio	13.5	12.8	12.1	12.3
Tangible common equity/tangible assets	5.9	6.5	6.8	6.7
Basel leverage ratio	7.3	7.5	6.4	6.2
Net impaired loans/common equity Tier 1	4.5	13.2	19.3	29.2
Funding and liquidity				
Loans/customer deposits	97.7	99.1	96.5	94.8
Liquidity coverage ratio	194.0	142.1	133.0	138.0
Customer deposits/funding	84.2	88.9	92.5	92.3
Net stable funding ratio	141.3	133.5	125.9	130.0

Source: Fitch Ratings, Fitch Solutions, 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.

Credit-Relevant ESG Derivation

Volksbanken-Verbund has 5 ESG potential rating drivers

- 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.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
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

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

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.

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.