FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Volksbanken-Verbund at 'BBB+'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 07 Jul 2023: Fitch Ratings has affirmed Austrian Volksbanken-Verbund's (VB-Verbund) Long-Term Issuer Default Rating (IDR) at 'BBB+' with a Stable Outlook and Viability Rating (VR) at 'bbb+'. A full list of rating actions is below.

KEY RATING DRIVERS

The Austrian VB-Verbund is not a legal entity but a medium-sized network of regional cooperative banks with Volksbank Vienna acting as the central organisation. The Verbund's strong cohesion is primarily ensured by their mutual support scheme.

VB-Verbund's IDRs apply to each of its member banks, in line with Fitch's criteria for rating banking structures backed by mutual support mechanisms.

The group's Long-Term IDR is driven by its VR. The latter reflects VB-Verbund's smaller domestic franchise and less diverse business model compared with higher-rated peers, which results in below-average operating profitability and cost efficiency and ultimately limits the group's financial flexibility. The VR also reflects the group's low-risk profile, resilient asset quality, adequate capitalisation as well as good liquidity and funding profile.

Stable Business Profile: VB-Verbund has a solid post-restructuring record of operating a retail-oriented cooperative franchise focused on the domestic market. Its business model generates stable revenues from traditional commercial banking and does not rely on volatile business. However, the group is constrained by its small size and regional focus, limited pricing power and lack of geographical diversification.

Low Risk Appetite: The group's robust asset quality benefits from its lending focus on domestic retail, self-employed and SME clients and deep customer knowledge. Its moderate risk profile reflects conservative underwriting standards, good loan collateralisation and granular exposures with very low concentrations.

Robust Asset Quality: The group's impaired loans ratio (1.9% at end-2022) has remained low, in line with its peers, despite headwinds from the war in Ukraine and overall slower economic growth. Impaired loans inflows are likely to rise moderately in 2023 and 2024 as a result of the economic downturn, rising interest rates and high inflation. We expect loan-impairment charges (LICs) to be concentrated in SME lending sensitive to higher rates and energy prices, while asset quality in retail mortgage lending should remain strong, despite an elevated share of variable-rate loans. However, we expect the four-year average impaired loans ratio to stay below 3% in the medium term

Resilient Profitability: VB-Verbund's adequate operating profit/risk-weighted assets (RWAs) of 1.3% is below the exceptionally high 1.8% in 2021 which benefitted from the reversals of pandemic-driven loan loss allowances. We expect VB-Verbund to generate a sustainable operating profit above 1% of RWAs through the cycle. We believe the group will benefit from higher interest rates, which could be partly offset by higher LICs and weaker loan growth, reflecting a challenging operating environment in Austria.

Adequate Capitalisation: The group's common equity Tier 1 (CET1) ratio of 14.2% at end-2022 is adequate in light of its low risk profile and offers ample headroom over its capital requirement. The standardised approach for the calculation of RWAs also mitigates the impact of asset quality deterioration on the group's CET1 ratio. The score also reflects the group's solid leverage ratio of 7.4% end-2022. We expect the group to maintain a CET1 ratio above 14% in the medium term.

Regulation Drives Funding Diversification: The group has a stable, granular retail and SME deposit franchise, which accounted for 80% of VB-Verbund's funding at end-2022. This limits reliance on debt markets for funding where we believe its franchise is weaker than peers, as VB-Verbund is a less frequent issuer. However, VB-Verbund has successfully restored its capital market access post-restructuring through the covered bonds market and issuance of junior instruments. VB-Verbund regularly issues senior preferred debt to comply with its minimum requirement for own funds and eligible liabilities (26.5% of RWAs by end-2024).

VB-Verbund's and the member banks' Short-Term IDRs of 'F2' correspond to the lower option mapping to the 'BBB+' Long-Term IDR, due to Fitch's assessment of VB-Verbund's funding and liquidity of 'bbb+'.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Pressure on the ratings could arise from a durable and material deterioration in asset quality, earnings and capitalisation, with an impaired loans ratio above 4%, operating profit/RWAs below 0.5% or a CET1 ratio below 11.5% without clear recovery prospects. The Short-Term IDRs are sensitive to a downgrade of the Long-Term IDRs in conjunction with a deterioration of the group's funding and liquidity profile.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of the IDRs and VR would require a significantly stronger franchise, including more diversified customer, funding and revenues bases without negatively affecting the bank's risk profile. This would strengthen VB-Verbund's business profile, as indicated by a sustainable improvement in average operating profit/RWAs of at least 1.5% while maintaining its good asset quality and capitalisation.

An upgrade of the Short-Term IDR to 'F1' would require a two-notch upgrade of the funding and liquidity score to 'a'.

No Support Assumed: VB-Verbund's GSR of 'no support' reflects Fitch's view that the EU's resolution framework is likely to require senior creditors participating in losses, if necessary, instead or ahead of a bank receiving sovereign support.

An upgrade of VB-Verbund's GSR would require a positive change in the sovereign's propensity to support banks. Fitch believes this is highly unlikely in light of the prevailing regulatory environment.

VR ADJUSTMENTS

The capitalisation & leverage score of 'bbb+' is below the 'a' category implied score due to the following adjustment reason: Internal capital generation and growth (negative).

The funding & liquidity score of 'bbb+' is below the 'a' category implied score due to the following adjustment reason: Non-deposit funding (negative).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the 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 on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Volksbank Wien AG	LT IDR	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2	Affirmed	F2
Volksbank Salzburg eG	LT IDR	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2	Affirmed	F2
Volksbank Niederoesterreich AG	LT IDR	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Stable

	ST IDR	F2 Affirmed	F2
Volksbank Oberoesterreich AG	LT IDR	BBB+ Rating Outlook Stable Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2 Affirmed	F2
Volksbank Tirol AG	LT IDR	BBB+ Rating Outlook Stable Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2 Affirmed	F2

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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