FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades Volksbanken-Verbund to 'BBB+'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 25 Jul 2022: Fitch Ratings has upgraded the Austrian Volksbanken-Verbund's (VB-Verbund) Long-Term Issuer Default Rating (IDR) to 'BBB+' from 'BBB' and Viability Rating (VR) to 'bbb+' from 'bbb'. The Rating Outlook on the Long-Term IDR is Stable. A full list of rating actions is below.

The upgrade reflects VB-Verbund's record of operating under its post-restructuring risk management framework and that asset-quality metrics have remained resilient during the pandemic. Accordingly, we have upgraded VB-Verbund's Risk Profile and Asset Quality scores to 'a-' from 'bbb+'. We have also revised up the group's capitalisation score to 'bbb+' from 'bbb', which we now expect to remain resilient to plausible stress scenarios.

Fitch has withdrawn VB-Verbund's Support Rating and Support Rating Floor as they are no longer relevant to Fitch's coverage following the publication of its updated Bank Rating Criteria on 12 November 2021. In line with the updated criteria, we have assigned VB-Verbund a Government Support Rating (GSR) of 'no support' (ns).

KEY RATING DRIVERS

VB-Verbund is not a legal entity but a medium-sized network of regional cooperative banks, the strong cohesion of which is primarily ensured by their mutual support scheme. VB-Verbund's IDRs apply to each of its member banks, in line with our 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 than higher-rated peers, which results in below-average operating profitability and cost efficiency and somewhat limits the group's financial flexibility. The VR also reflects its 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 in 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, limited pricing power and a lack of geographical diversification.

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

Resilient Asset Quality: As at larger domestic banks, the group's low impaired loans ratio has so far benefited from substantial state support that has helped contain unemployment and corporate defaults during the pandemic. Impaired loans inflows could rise moderately in 2022 as state aid is phased out and as second-order effects from the war in Ukraine materialise. However, we expect the four-year average impaired loans ratio to stay below 3% in the coming years, a level commensurate with the 'a-' score for asset quality.

Profitability Recovers in 2021: VB-Verbund's operating profit/risk-weighted assets (RWAs) rebounded to an exceptionally high 1.8% in 2021 owing to reversals of pandemic-driven loan loss allowances. We expect VB-Verbund to generate an operating profit of about 0.5%-1% of RWAs on a sustained basis. Increasing interest rates are likely to start gradually alleviating the margin pressure that has prevailed in recent years. Together with loan growth, this is likely to support the group's operating income.

Adequate Capitalisation: The group's common equity Tier 1 (CET1) ratio of 14.4% at end-2021 is adequate in light of its low risk profile and offers sufficient headroom over its capital requirement of 9.8% and to repay the EUR100 million still due to the Austrian state by end-2023. The standardised approach for the computation of risk weighted assets will also mitigate the impact of asset quality deterioration on the group's CET1 ratio.

Regulation Drives Funding Diversification: Stable, granular retail and SME deposits accounted for 78% of VB-Verbund's funding at end-2021. The group does not rely on debt markets for funding but has gradually restored its capital market access. It has issued covered bonds, additional Tier 1, Tier 2 and senior non-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 a 'BBB+' Long-Term IDR and reflects 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/RWA 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. Given the bank's post-restructuring strategic plan and business model, we view this as rather unlikely in the near-to-mid-term.

An upgrade would also be contingent on VB-Verbund achieving a further sustainable improvement in operating profitability with an average operating profit/RWA of about 1.5% while maintaining its good asset quality and capitalization.

An upgrade of the Short-Term IDRs is unlikely, as it would require a two-notch upgrade of the funding and liquidity score to 'a'.

No Support Assumed: VB-Verbund's GSR 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, visitwww.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Volksbank Wien AG	LT IDR Upgrade	BBB+ Rating Outlook Stable	BBB Rating Outlook Positive

	ST IDR	F2	Affirmed	F2
Volksbank Salzburg eG	LT IDR	BBB+ Rating Outlook Stable	Upgrade	BBB Rating Outlook Positive
	ST IDR	F2	Affirmed	F2
Volksbank Niederoesterreich AG	LT IDR	BBB+ Rating Outlook Stable	Upgrade	BBB Rating Outlook Positive
	ST IDR	F2	Affirmed	F2
Volksbank Oberoesterreich AG	LT IDR	BBB+ Rating Outlook Stable	Upgrade	BBB Rating Outlook Positive
	ST IDR	F2	Affirmed	F2
Volksbank Tirol AG	LT IDR	BBB+ Rating Outlook Stable	Upgrade	BBB Rating Outlook Positive
	ST IDR	F2	Affirmed	F2

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 12 Nov 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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Volksbank Kaernten eG	EU Issued, UK Endorsed
Volksbank Niederoesterreich AG	EU Issued, UK Endorsed
Volksbank Oberoesterreich AG	EU Issued, UK Endorsed
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Volksbank Steiermark AG	EU Issued, UK Endorsed
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