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.

Financials Strengthened Despite Pandemic: The Positive Outlook on VB-Verbund's Long-Term IDR mirrors the trends on Fitch Ratings' risk appetite and asset quality assessments. This reflects Fitch's view that the pandemic has not materially disrupted the gradual strengthening of VB-Verbund's financial profile, now relatively strong for a Viability Rating (VR) of 'bbb'.

Asset Quality Improved: As at larger domestic banks, the 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.

Profitability Recovery 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, even in a continued low-rate environment.

Adequate Capitalisation Despite Repayment: The group's common equity Tier 1 (CET1) ratio is adequate in light of its low risk profile and despite its obligation to repay by end-2023 the EUR100 million still due to the Austrian state. This obligation will constrain the group's earnings retention until full repayment in 2023. The stable trend on the capital score reflects our view that the group will maintain an adequate buffer over its regulatory CET1 requirement of 9.8%.

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 (EUR500 million in 1H21) to comply with its minimum requirement for own funds and eligible liabilities (26.2% of RWAs by end-2024), as well as the requirements of the Supervisory Review and Evaluation Process.

Rating Sensitivities

Economic Setback: A rating downgrade is unlikely in the short term as indicated by the Positive Outlook. However, negative rating pressure could arise from spill-over effects of the war in Ukraine if they severely and durably derail Austria's post-pandemic economic recovery. In this event, rating pressure could reflect lower revenue and higher credit loss expectations than in our base case, especially if we expect the impaired loans ratio to rise above 4%, an operating profit/RWAs ratio below 0.5%, or a CET1 ratio below 11.5% without clear recovery prospects.

Resilient Financial Profile: An upgrade of the IDRs and VR would require resilient asset quality with an impaired loan ratio below 3% over the rating horizon and evidence the group will not loosen its risk appetite and standards after the pandemic. An upgrade would also be contingent on VB-Verbund sustainably maintaining an operating profit/RWAs ratio comfortably above 0.5% and a CET1 ratio above 12.5% following full repayment to the Austrian government.

Ratings

Issuer Ratings	
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	Positive
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (November 2021)

Related Research

Fitch Revises Volksbanken-Verbund's Outlook to Positive; Affirms Long-Term IDR at 'BBB' (September 2021)

Volksbanken-Verbund (September 2021)

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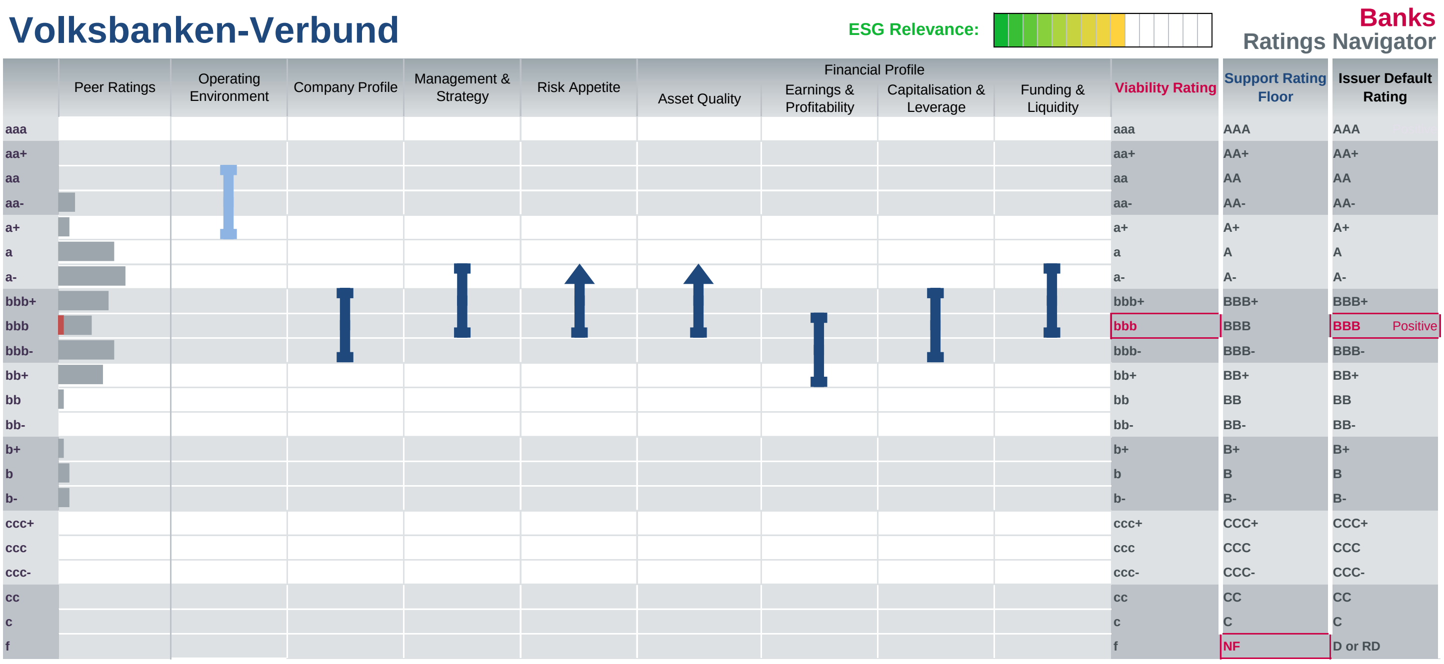
Ratings Navigator



Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colours – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

- ⇧ Positive
- ⇩ Negative
- ⇳ Evolving
- ▫ Stable

Significant Changes

War in Ukraine Will Weaken GDP Growth

Fitch has lowered its growth forecast for Austria to 3.3% from 4.6% for 2022 due to the expected economic spill-overs from Russia's invasion of Ukraine. The uncertain outlook on energy supply still presents a risk to Fitch's revised baseline growth assumptions. Austria sources 80% of its natural gas imports and 18% of its total energy consumption from Russia. Substituting Russian gas in the short term would be difficult and costly.

Fitch expects higher energy and food prices to dampen domestic demand, while exports to Russia, Ukraine and Belarus should all but cease (the share of total goods exports to these three countries is small, at 1.6% of Austria's total exports in 2021). Potential negative effects from supply chain disruptions and higher energy costs on the manufacturing sector will be partially offset by the continued recovery of private consumption following the pandemic. This is amid high household savings and an increase in international tourist arrivals (overnight stays in 2021 were still 50% below their 2019 level).

No Direct Exposure to Russia and Ukraine

The Austrian banking sector's direct exposure to Russia and Ukraine is moderate (2.8% of total exposures at end-2021 according to the European Banking Authority) and largely concentrated at Raiffeisen Bank International. VB-Verbund has no direct loan exposure to Russia, Ukraine or Belarus as it operates exclusively in Austria. The group also focuses on Austrian mass retail customers and micro businesses, which have virtually no ties to Russia and Ukraine. VB-Verbund also does not hold any security investments in these countries.

We therefore believe the group's asset quality is largely insulated from direct effects from the Ukrainian crisis. Indirect effects from a slowdown in economic growth and inflation are likely to weaken loan quality over the next two years, but we still expect the four-year average impaired loans ratio to remain below 3%, which underpins our positive outlook on the asset quality score.

Depletion of Austrian Banking Sector's DPS is Neutral for the Ratings

The failure and subsequent closure in 1Q22 of Sberbank Europe AG, the Austrian subsidiary of Russia's Sberbank, has depleted the paid-in resources of Einlagensicherung Austria, the deposit protection scheme (DPS) of which VB-Verbund is a member. VB-Verbund estimates it will have to bear a cost of EUR58 million through extraordinary contributions to replenish the DPS over the coming years. The amount is equivalent to about 40% of VB-Verbund's four-year average annual operating profit. However, VB-Verbund expects to recover this amount in full once Sberbank Europe has been wound down, which seems realistic in light of Sberbank Europe's favourable ratio of liquid assets to insured deposits at the time of its closure. In addition, the Austrian Financial Market Authority has closed three small DPS members unrelated to VB-Verbund in the past two years. This was due to fraud and severe governance failures. This requires the DPS members, including all banks in the VB-Verbund, to make additional contributions to the DPS until 2024, which Fitch believes is manageable for VB-Verbund.

Record High 2021 Profit Strengthens Capitalisation

VB-Verbund's record-high net income of EUR219 million in 2021 was mainly driven by a net release of provisions for pandemic-driven expected credit losses booked in 2020. Net fee income rose by 6% owing to higher asset management fees. However, loan growth, which was weaker than that of domestic peers due to VB-Verbund's prudent underwriting standards and limited appetite to attract new business during the pandemic, could not offset the pressure from persisting ultra-low interest rates, leading to a slight decline in net interest income.

We expect loan growth to pick up in 2022 as VB-Verbund has sufficient regulatory capital buffers to fund it (its CET1 ratio increased at end-2021 despite the repayment of EUR124 million of government participation rights). Loan demand should remain robust despite rising interest rates. In addition, the new macroprudential measures introduced by Austria's Financial Market Stability Board to tackle accelerating house prices are not particularly constraining. The group's operating expenses were stable in 2021 as higher contributions to the DPS offset the benefits of the strategic cost reduction programme. The group is also envisaging outsourcing some of its IT functions. This could reduce operating expenses to below EUR500 million a year, but we expect the cost-income ratio to remain above 70% in the next two years.

Summary Financials and Key Ratios

	31 Dec 21		31 Dec 20	31 Dec 19	31 Dec 18
	(USDm)	(EURm)	(EURm)	(EURm)	(EURm)
Summary income statement					
Net interest and dividend income	459	406	413	422	420
Net fees and commissions	287	253	239	230	234
Other operating income	19	17	9	78	11
Total operating income	764	676	662	730	664
Operating costs	583	515	512	534	568
Pre-impairment operating profit	181	160	150	196	96
Loan and other impairment charges	-101	-89	126	22	-6
Operating profit	283	250	24	174	102
Other non-operating items (net)	1	1	33	5	21
Tax	36	32	37	31	8
Net income	248	219	20	149	115
Other comprehensive income	10	9	13	-2	-13
Fitch comprehensive income	258	228	33	146	102
Summary balance sheet					
Assets					
Gross loans	24,697	21,837	21,651	21,537	20,795
- Of which impaired	523	463	454	538	633
Loan loss allowances	309	273	364	286	293
Net loans	24,388	21,563	21,287	21,251	20,502
Interbank	290	257	438	431	470
Derivatives	130	115	170	143	127
Other securities and earning assets	2,990	2,644	2,898	2,850	2,718
Total earning assets	27,798	24,579	24,793	24,675	23,817
Cash and due from banks	7,828	6,921	3,944	2,072	1,732
Other assets	673	595	634	750	1,016
Total assets	36,300	32,095	29,370	27,496	26,564
Liabilities					
Customer deposits	25,727	22,747	22,154	21,729	21,555
Interbank and other short-term funding	4,294	3,797	1,884	412	595
Other long-term funding	2,681	2,371	1,972	1,985	1,037
Trading liabilities and derivatives	370	327	504	463	455
Total funding and derivatives	33,072	29,242	26,513	24,589	23,643
Other liabilities	589	521	518	562	940
Preference shares and hybrid capital	246	218	293	316	126
Total equity	2,392	2,115	2,047	2,028	1,855
Total liabilities and equity	36,300	32,095	29,370	27,496	26,564
Exchange rate		USD1 = EUR0.884173	USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057

Source: Fitch Ratings, Fitch Solutions, VB-Verbund

Summary Financials and Key Ratios

	31 Dec 21	31 Dec 20	31 Dec 19	31 Dec 18
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.8	0.2	1.2	0.7
Net interest income/average earning assets	1.7	1.7	1.7	1.8
Non-interest expense/gross revenue	76.1	77.3	73.1	87.1
Net income/average equity	10.5	1.0	7.3	6.4
Asset quality				
Impaired loans ratio	2.1	2.1	2.5	3.0
Growth in gross loans	0.9	0.5	3.6	5.2
Loan loss allowances/impaired loans	59.1	80.2	53.2	46.2
Loan impairment charges/average gross loans	-0.4	0.6	0.1	0.0
Capitalisation				
Common equity Tier 1 ratio	14.4	14.1	12.9	12.1
Fully loaded common equity Tier 1 ratio	14.1	13.5	12.8	12.1
Tangible common equity/tangible assets	4.8	5.9	6.5	6.8
Basel leverage ratio	6.6	7.3	7.5	6.4
Net impaired loans/common equity Tier 1	9.6	4.5	13.2	19.3
Funding and liquidity				
Gross loans/customer deposits	96.0	97.7	99.1	96.5
Liquidity coverage ratio	223.7	194.0	142.1	133.0
Customer deposits/total non-equity funding	78.1	84.2	88.9	92.5
Net stable funding ratio	138.0	141.3	133.5	125.9

Source: Fitch Ratings, Fitch Solutions, VB-Verbund

Sovereign Support Assessment

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		✓	

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.

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.

DISCLAIMER & DISCLOSURES