FitchRatings

Banks
Retail & Consumer Banks
Austria

Volksbanken-Verbund

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*.

Financials Strengthened Despite Pandemic: The Outlook revision to Positive from Negative on VB-Verbund's Long-Term IDR in September 2021 follows a similar revision of the risk appetite and asset quality trends, and a stabilisation of the previously negative trends for earnings and capitalisation. This reflects our view that the pandemic has not materially disrupted the gradual strengthening of the financial profile underlying VB-Verbund's Viability Rating (VR) of 'bbb'.

Asset Quality Improved During Crisis: Similar to larger domestic peers, VB-Verbund's low non-performing loans (NPL) ratio has so far benefited from substantial state support, containing unemployment and corporate defaults during the crisis. NPL inflows could rise temporarily if moderately in 2022, as state aid is phased out and damages from the pandemic become more apparent. However, we expect the average NPL ratio to stay below 3% in the coming years.

Low Risk Appetite: The group's robust asset quality also benefits from its lending focus on domestic retail, self-employed and SME clients, conservative underwriting standards, good loan collateralisation and low concentrations. This should mitigate any deterioration in asset quality when state aid is scaled back.

Profitability Recovery in 2021: VB-Verbund remained profitable in 2020 despite exceptionally high loan impairment charges (LICs) and muted loan growth due to the pandemic. Its operating profit/risk-weighted assets (RWAs) ratio rebounded in 1H21 to exceptionally high 1.7% owing to large model-driven LIC reversals as the economic environment continues to improve. The deterioration in credit risks expected in 2020 had not materialised at end-1H21.

Adequate Capital Despite Repayment: The common equity Tier 1 (CET1) ratio is adequate in light of its low risk profile and its obligation to repay by end-2023 the EUR224 million still due to the Austrian state. This will constrain the group's earnings retention until full repayment in 2023. The stable trend on the capital score reflects our view the group will maintain an adequate buffer over its regulatory CET1 requirement of 9.76%.

Regulation Drives Funding Diversification: Stable, granular retail and SME deposits comprised 77% of VB-Verbund's total funding at end-1H21. It does not rely on debt markets for funding but has gradually restored capital markets access, issuing (together with covered bonds) additional Tier 1, Tier 2 and senior non-preferred (EUR500 million in 1H21) notes to comply with its minimum requirement for own funds and eligible liabilities (26.2% of RWAs, by 2025) and from the Supervisory Review and Evaluation Process.

Rating Sensitivities

Economic Setback: A downgrade of the IDRs and VR is unlikely in the short term as indicated by the positive outlook. Rating pressure could arise in the longer term from materially, durably weakening asset quality, earnings and capitalisation, with an NPL ratio above 4%, an operating profit/RWAs 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, over the rating horizon with an NPL ratio below 3%, and evidence the group will not loosen its prudent risk appetite and standards after the crisis. An upgrade would also be contingent on VB-Verbund sustainably maintaining an operating profit/RWAs comfortably above 0.5% and a CET1 ratio above 12.5% following full repayment to the Austrian government.

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

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

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

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

Global Economic Outlook (September 2021)

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Ratings Navigator

Volksbanken-Verbund

ESG Relevance:

Banks
Ratings Navigator

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		✓	

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

Significant Changes

Austrian Operating Environment Stabilised in 1H21 as Pandemic Risks Subside

Large state programmes to support companies and households affected by the pandemic, and regulatory forbearance for the classification of crisis-driven loan payment holidays and NPLs have strongly mitigated Austrian banks' negative rating migration, RWAs inflation, and provisioning needs since 2Q20. The extensive use of furlough schemes since 2Q20 has protected household income and contained the rise in the unemployment rate to 5.4% at end-2020. This has strongly supported borrowers' ability to service their loans.

After a 6.6% GDP contraction in 2020, the economy has regained strong momentum in 1H21 as restrictions are being eased and vaccination progresses. However, Fitch expects weaker GDP growth in Austria (2.5%) in 2021 than in the eurozone (4.7%) as the important tourism sector remains underperforming. This year's skiing season was almost entirely lost due to the pandemic, weighing on private consumption and service exports. Last year's winter season was only moderately affected by the pandemic and tourism rebounded strongly in the summer of 2020.

Brief Company Summary

Medium-Sized, Domestic Retail-Focused Cooperative Banking Group

VB-Verbund focuses on Austrian retail, self-employed and small SME clients. Its member banks collectively serve about one million clients. The group has modest retail market shares of 7%-8% on average in the fairly small Austrian market, but the member banks generally have stronger local franchises underpinned by solid customer loyalty in rural areas.

The group complements its highly standardised product mix with consumer lending and asset-management products from DZ Bank GmbH (AA-/Stable), the German cooperative banks' central organisation (CO). The revenue diversification from this outsourcing agreement mitigates VB-Verbund's limited size, which would make it uneconomical to offer these services on its own.

Verbund Contract Strengthens Central Organisation and Governance

After years of deep restructuring, VB-Verbund is now a highly integrated cooperative banking group steered by its CO, Volksbank Wien (VBW). The Verbund (group) contract in force since 2016 entrusts the CO with broad discretionary powers. VBW's management can unilaterally issue binding orders to any member banks and impose support measures.

The contract ensures the effectiveness of the group's governance, mutual support and organisation by governing the CO's powers, duties and interactions with the member banks. This enables VB-Verbund's recognition as a financial institution group by the Single Resolution Board, although its member banks are legally independent and have no common parent. The Verbund contract makes VBW responsible for the group's adherence to regulatory capital, liquidity and risk management requirements as well as strategic decisions and their implementation, including products and pricing. The member banks must place their excess liquidity at VBW.

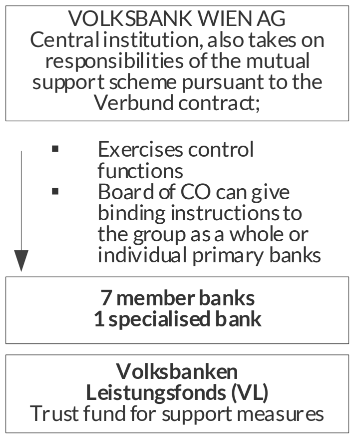
Restructured Mutual Support Scheme Ensures Cohesion and Reactivity

Volksbanken Leistungsfonds (VL), a fund endowed with trust assets to support troubled member banks, became operative in 2016. The VL's target endowment of EUR100 million is fully paid-in and was calibrated by the CO based on the member banks' average risk position. In our view, this should be sufficient to recapitalise member banks other than VBW in a reasonable idiosyncratic stress scenario, but it is unlikely to ensure a substantial line of defence for the group in a systemic crisis.

If the CO estimates that VL is insufficient to cover support needs, it can call unilaterally for additional contributions from the member banks. The Verbund contract does not cap each member bank's maximum contributions to mutual support measures.

The mutual support framework allows the CO's management to impose remedial actions on troubled member banks if early-warning indicators (macroeconomic, market-based or breaches of capital, liquidity, profitability or asset quality ratios) deteriorate materially. Such interventions are possible without the consent of the bank concerned or preliminary consultation with the group's members. This is rating positive as it increases cohesion, discipline and responsiveness.

Mutual Support and Liquidity Scheme



Source: Fitch Ratings

Key Latest Developments

Asset Quality Improved in 1H21; Major Deterioration Unlikely

We expect that some more vulnerable micro and small SME borrowers, notably in the tourism and accommodation sectors, will not fully recover once state support measures are lifted, and some corporates and SMEs are likely to emerge from the crisis with durably weaker credit profiles. However, VB-Verbund is in a favourable position to absorb the resulting asset quality pressure. This is because the group entered the coronavirus crisis after five years of steadily improving asset quality owing to deep restructuring, strong economic conditions in the robust Austrian market, and the group's relatively low-risk business model and prudent lending standards. In addition, we do not expect pressure on VB-Verbund's mortgage loans, given their robust collateralisation and mortgage borrowers' strong payment behaviour.

Reversal of Impairments Support Profitability Recovery in 2021

VB-Verbund's pre-tax profit rose to EUR115 million in 1H21 from EUR36 million yoy. The group will continue to pursue structural cost savings after cutting its number of branches to 242 and its full-time equivalent staff by 2% in 1H21. The group's business model focusing on lending to domestic SMEs and households proved resilient in the current crisis. We expect VB-Verbund, excluding provision releases, to be able to generate an operating profit of about 0.5%-1% of RWAs on a sustained basis, even in a continued low-rate environment.

Capitalisation Benefits from Regulatory Relief

VB-Verbund's capitalisation improved in 2020, as the focus on SME lending led to a significant decrease in RWAs owing to regulatory relief (specifically the 'CRR2 quick fix' and the 'SME supporting factor'). IFRS 9 transitional rules temporarily increase the group's capital ratios. The Austrian government was granted a profit participation right (Genussrecht) and a blocking minority (25% plus one share) in VBW as part of the restructuring in 2015.

The government will return its stake to VBW's other owners once VB-Verbund repays the EUR224 million still outstanding based on a binding schedule until 2023. This repayment will continue to significantly limit capital generation in the next few years. This is mitigated by the restriction of dividend payments until the state capital is fully repaid. We expect the group to maintain a CET1 ratio sustainably above 12.5% following the repayment to the Austrian state.

Funding Stable Through the Pandemic

The group increased its TLTRO funding by EUR2 billion to EUR3.5 billion in 1H21, strengthening its liquidity reserve to EUR7 billion at end-1H21 (EUR5.5 billion at end-2019). Its liquidity portfolio is of high quality and consists of central bank deposits, cash, bonds and retained covered bonds, representing about 22% of total assets at end-1H21.

State Capital Binding Repayment Schedule
(Cumulative targets by year-end)

2019	EUR75m
2021	EUR200m
2023	EUR300m

Source: Fitch Ratings, VB-Verbund

Summary Financials and Key Ratios

	30 Jun 2021 EURm	31 Dec 2020 EURm	31 Dec 2019 EURm	31 Dec 2018 EURm
Summary Income Statement				
Net interest and dividend income	198	413	422	420
Net fees and commissions	128	239	230	234
Other operating income	10	9	78	11
Operating costs	254	512	534	568
Loan and other impairment charges	-32	126	22	-6
Operating profit	114	24	174	102
Other non-operating items (net)	1	33	5	21
Tax	23	37	31	8
Net income	93	20	149	115
Summary Balance Sheet				
Gross loans	21,491	21,651	21,537	20,795
- of which impaired	387	454	538	633
Loan loss allowances	330	364	286	293
Interbank and derivatives	400	608	574	597
Other securities and earning assets	2,683	2,898	2,850	2,718
Cash and due from banks	6,983	3,944	2,072	1,732
Other assets	597	634	750	1,016
Total assets	**31,823**	**29,370**	**27,496**	**26,564**
Customer deposits	22,196	22,154	21,729	21,555
Interbank and other short-term funding	3,976	1,884	412	595
Other long-term funding	2,398	1,972	1,985	1,037
Trading liabilities and derivatives	338	504	463	455
Other liabilities	563	518	562	940
Preference shares and hybrid capital	228	293	316	126
Total equity	2,123	2,047	2,028	1,855
Total liabilities and equity	**31,823**	**29,370**	**27,496**	**26,564**
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.7	0.2	1.2	0.7
Net interest income/average earning assets	1.6	1.7	1.7	1.8
Non-interest expense/gross revenue	75.2	77.3	73.1	87.1
Net income/average equity	9.0	1.0	7.3	6.4
Asset quality				
Impaired loans ratio	1.8	2.1	2.5	3.0
Loan loss allowances/impaired loans	85.3	80.2	53.2	46.2
Loan impairment charges/average gross loans	-0.3	0.6	0.1	0.0
Capitalisation				
Common equity Tier 1 ratio	14.5	14.1	12.9	12.1
Fully loaded common equity Tier 1 ratio	13.9	13.5	12.8	12.1
Basel leverage ratio	6.6	7.3	7.5	6.4
Net impaired loans/common equity Tier 1	2.9	4.5	13.2	19.3
Funding and liquidity				
Loans/customer deposits	96.8	97.7	99.1	96.5
Liquidity coverage ratio	238.7	194.0	142.1	133.0
Net stable funding ratio	148.5	141.3	133.5	125.9

Source: Fitch Ratings, Fitch Solutions, VB-Verbund

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
not a rating driver	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference
GHG Emissions & Air Quality	1	n.a.	n.a.
Energy Management	1	n.a.	n.a.
Water & Wastewater Management	1	n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.
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

E Scale: 5, 4, 3, 2, 1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
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
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
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy
Employee Wellbeing	1	n.a.	n.a.
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

S Scale: 5, 4, 3, 2, 1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Operational implementation of strategy	Management & Strategy
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
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy

G Scale: 5, 4, 3, 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.