FitchRatings

Banks
Retail & Consumer Banks
Austria

Volksbanken-Verbund

Key Rating Drivers

The Austrian Volksbanken-Verbund (VB-Verbund) is not a legal entity, but a medium-sized network of regional cooperative banks, with Volksbank Wien AG (VBW) acting as the central organisation. The Verbund group's strong cohesion is primarily ensured by the mutual support scheme. VB-Verbund's Issuer Default Ratings (IDRs) apply to each of its member banks, in line with Fitch Ratings' criteria for rating banking structures backed by mutual support mechanisms.

The group's Long-Term IDR is driven by its Viability Rating (VR). The latter reflects VB-Verbund's smaller domestic franchise and less diverse business model compared to 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, and 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 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 (end-2022: 1.9%) has remained low, in line with its peers, despite challenges posed by 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, as this is sensitive to higher rates and energy prices, while asset quality in retail mortgage lending should remain strong despite an elevated shared of variable-rate loans. However, we expect the four-year average impaired loans ratio to stay below 3% over the next two years.

Resilient Profitability: VB-Verbund's adequate operating profit/risk-weighted assets (RWAs) ratio of 1.3% has fallen from exceptionally high levels (2021: 1.8%) in 2021, due to the reversals of pandemic-driven loan loss allowances. We expect VB-Verbund to generate a sustainable operating profit of over 1% of risk-weighted assets (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 (end-2022: 14.2%) is adequate in light of its low risk profile and offers ample headroom over its capital requirement of 9.8%. The standardised approach for the calculation of RWAs also mitigates the impact of asset quality deterioration on the group's CET1 ratio. Our assessment also reflects the group's solid leverage ratio (end-2022: 7.4%). We expect the Verbund to maintain a CET1 ratio over 14% in the medium term.

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

Ratings

Foreign Currency	
Long-Term IDR	BBB+
Short-Term IDR	F2
Viability Rating	bbb+
Government Support Rating	ns

Sovereign Risk (Austria)	
Long-Term Foreign-Currency IDR	AA+
Long-Term Local-Currency IDR	AA+
Country Ceiling	AAA

Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Local-Currency IDR	Negative

Applicable Criteria

Bank Rating Criteria (September 2022)

Related Research

Fitch Affirms Volksbanken-Verbund at 'BBB+'; Outlook Stable (July 2023)

Fitch Affirms Austria at 'AA+'; Outlook Negative (March 2023)

Global Economic Outlook (June 2023)

Analysts

Roger Schneider
+49 69 768076 242
roger.schneider@fitchratings.com

Justus Roppertz
+49 69 768076 232
justus.roppertz@fitchratings.com

Rating Sensitivities

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

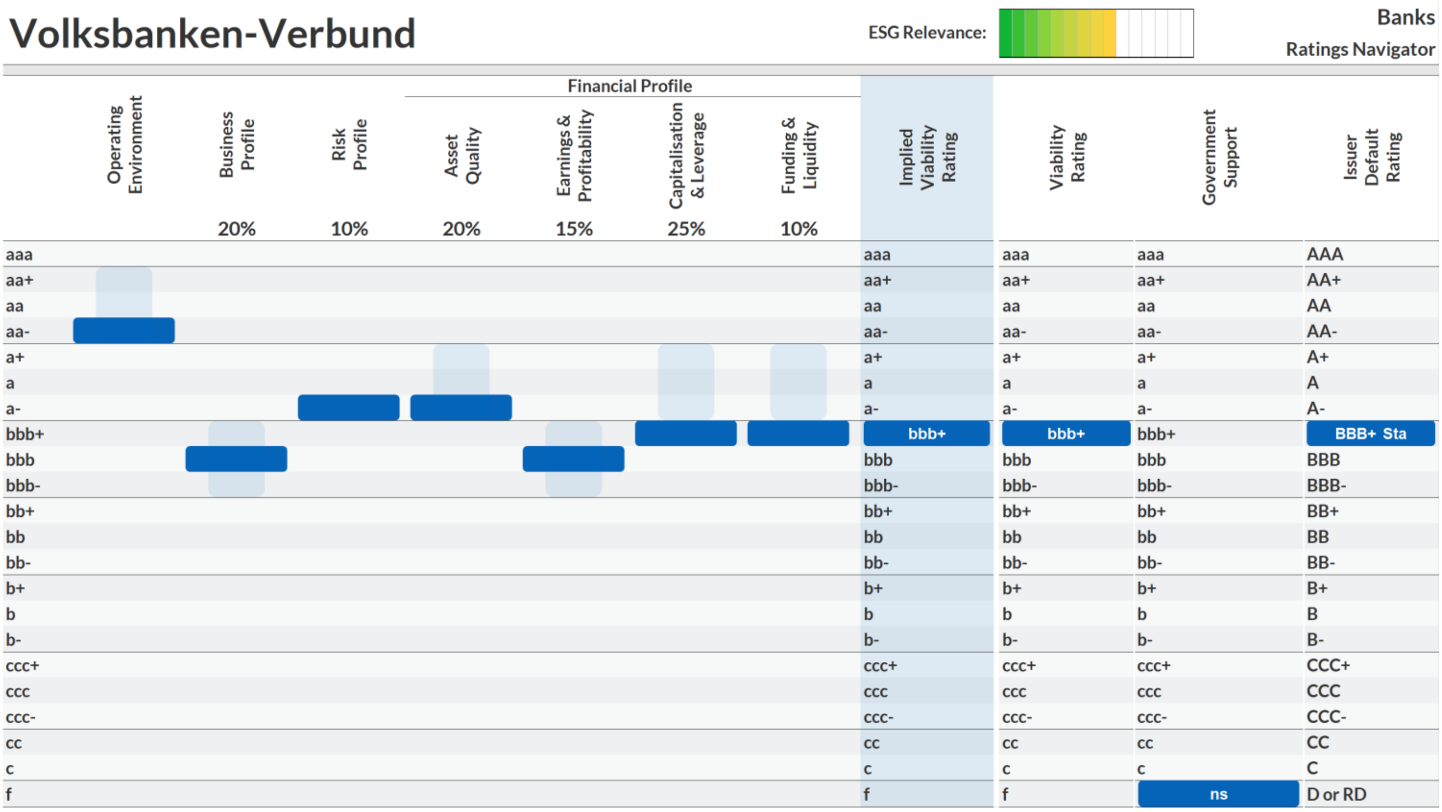
Pressure on the ratings could arise from a durable and material deterioration in asset quality, earnings and capitalisation, with an impaired loans ratio above 4%, operating profit/RWAs below 0.5%, or a CET1 ratio below 11.5% without clear recovery prospects. The Short-Term IDRs are sensitive to downgrades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

Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

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).

Company Summary and Key Qualitative Factors

Operating Environment

Continued Dependence on Russian Gas

Fitch expects that economic growth in Austria in 2023 will be close to stagnation at 0.4%, representing a moderate improvement from the previous forecast of -0.3%. This follows a strong 5% GDP expansion in 2022, which exceeded the eurozone performance of 3.5%. The ongoing dependence on Russian gas leaves Austria exposed to Russia turning off supply, or domestic or international political pressures to phase out long-term contracts at a potentially substantial fiscal cost.

Business Profile

Medium-Sized, Domestic Retail-Focused Cooperative Banking Group

VB-Verbund focuses on Austrian retail, self-employed and small clients. Its member banks collectively serve about one million clients. The group has modest retail market shares in the fairly small Austrian market, but the member banks generally have strong 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, the German cooperative banks' central organisation. Revenue diversification from this outsourcing agreement mitigates VB-Verbund's limited size, which would make it uneconomical for the individual banks to offer these services on their own. We expect the group's increasing focus on sustainability financing to underpin its business profile.

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 central organisation, VBW. The Verbund (group) contract in force since 2016 entrusts the central organisation with broad discretionary powers. VBW's management can unilaterally issue binding orders to all or single member banks, and impose support measures. The contract ensures the effectiveness of the group's governance, mutual support and organisation by governing the central organisation'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, and strategic decisions and their implementation, including products and pricing. The member banks must place their excess liquidity at VBW.

Full and Early Repayment of Government Participation Rights

VB-Verbund's recent stable performance has enabled the early repayment of the last outstanding tranche (EUR100 million in 2022, included in other non-operating expenses in the Financial Statements below) of the participation right of Austria, which was agreed to be repaid by end-2023. With the early repayment, all requirements resulting from the state aid proceedings of 2015 have been fulfilled, and the EU Commission confirmed the closure of the proceedings at end-January 2023.

Following the closure of state aid proceedings and the completion of its long-term restructuring project, VB-Verbund is no longer subject to restrictions on its business and growth objectives. Nevertheless, we expect the group's strategy to remain focused on its core domestic businesses.

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. 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 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 as these arise, 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 central organisation'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.

Risk Profile

The restructuring process has enhanced VB-Verbund's risk profile, which we now view as robust in light of the simplified retail-focused business model. Risk controls strongly benefit from the centralised risk-management functions at VBW, the standardised product offering, and the simplified organisational structure. The group has also enhanced its internal data quality and monitoring tools in recent years, which makes day-to-day management and reporting more effective.

Structural interest rate risk in the member banks' banking books is VB-Verbund's main source of market risk, primarily driven by the mismatch between its mainly short-term deposits and its long-term mortgage loans. This is mitigated by the fact that, similar to its Austrian peers, the majority of retail loans in the group's bank book carry variable rates. Fitch believes that, after several years of new mortgage lending predominantly at fixed rates, higher interest rates are causing a gradual shift back towards variable lending.

Financial Profile

Asset Quality

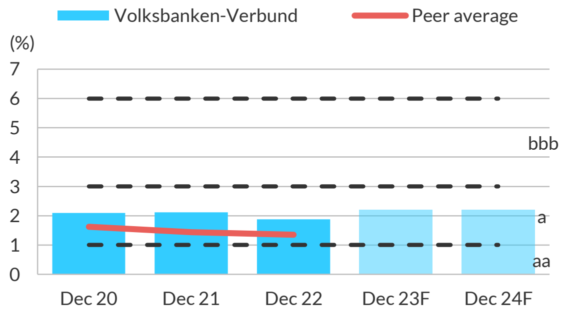
Asset Quality Resilient Against A Weaker Economic Outlook

VB-Verbund's asset quality improved moderately in 2022 despite the negative implications of the Ukraine war, including higher energy prices and inflation. The group's impaired loans ratio dropped to 1.9% at end-2022 (end-2021: 2.1%. Half of VB-Verbund's EUR22.4 billion loan book is loans to SME clients, which are well diversified by sector – although with some concentration in construction and housing. Residential mortgage loans are the main component of the group's EUR8.9 billion loan portfolio to retail customers.

To reflect macroeconomic uncertainties, the stock of Stage 1 and Stage 2 risk provisions has been increased by 27% (2022: EUR150 million), built up by way of model adjustments and overlays. This follows the EUR89 million release of provisions in 2021. Post-model adjustments of EUR24 million, formed in 2020 and 2021 due to the pandemic, were released at the end of 2022.

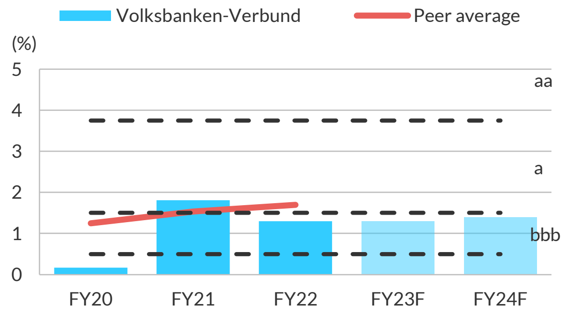
We expect VB-Verbund's fairly low-risk business model and prudent lending standards to mitigate asset quality pressure from economic disruptions. In addition, we do not expect pressure on the quality of VB-Verbund's mortgage loans, given their robust collateralisation and mortgage borrowers' strong payment behaviour.

Impaired Loans/Gross Loans



Source: Fitch Ratings, Fitch Solutions, banks

Operating Profit/Risk-Weighted Assets



Source: Fitch Ratings, Fitch Solutions, banks

Earnings and Profitability

Profitability Benefits from Higher Interest Rates

VB-Verbund's earnings rely on fairly undiversified revenue streams, with a high reliance on net interest income (NII). The group's cost base is acceptable for a branch-based operating model, in our view, but is less competitive than that of larger peers, despite recent improvements. We expect VB-Verbund to achieve an operating profit/RWAs ratio of over 1% over the next two years, which is commensurate with the group's low-risk co-operative banking model.

VB-Verbund's pre-impairment operating profit rose by 35% in 2022, supported by an improved NII (2022: EUR468 million; 2021: EUR406 million). Following higher interest rates in the eurozone, margins for new lending have increased, and the banking book could be repriced quickly due to the substantial amount of variable-rate loans.

The group's operating expenses decreased once again to EUR500 million in 2022 (2021: EUR515 million), in line with the long-term cost-reduction plan. VB-Verbund's 2022 operating profit/RWAs ratio of 1.3% remained below 2021 levels, which was supported by reversals of pandemic-driven loan-loss allowances. It is close to the long-term average (slightly above 1%).

Capital and Leverage

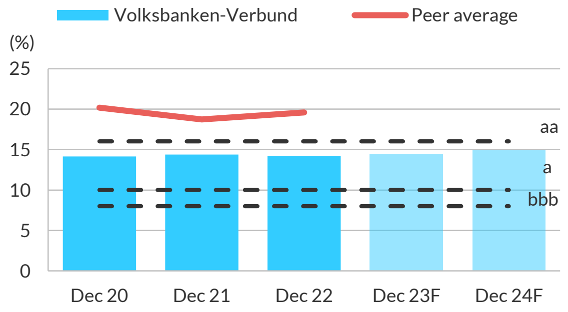
Adequate Capitalisation

VB-Verbund's capitalisation improved over the years, despite the repayment of EUR300 million government participation rights. VB-Verbund's CET1 and total capital ratios both decreased slightly at end-2022, mainly reflecting higher RWAs due to loan growth. The government's participation allowed restricted returns paid to the group's shareholders. Fitch expects adherence to prudent dividend pay-outs in the next few years, consolidating the capital adequacy position in light of the economic downturn.

The group's strong Basel leverage ratio (7.4%) reflects the use of the standardised approach to calculate RWA and is better than that of most peers.

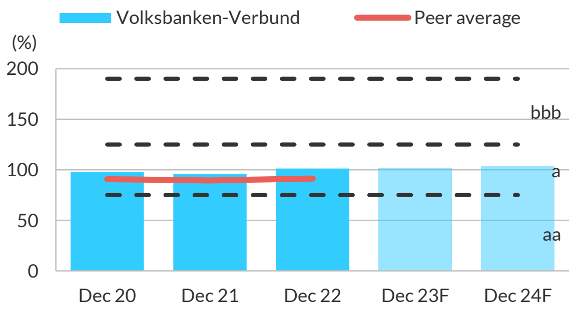
We expect the group to maintain a CET1 ratio above 14% in the medium term, well above regulatory requirements.

CET1 Ratio



Source: Fitch Ratings, Fitch Solutions, banks

Gross Loans/Customer Deposits



Source: Fitch Ratings, Fitch Solutions, banks

Funding and Liquidity

Stable Funding and Liquidity

We view the group's stable funding and liquidity profile as resilient in light of the recent market developments affecting the banking sector. The group's local branch networks support its granular deposit base.

The decrease in the liquidity coverage ratio (end-2022: 165%; end-2021: 224%) was due to partial repayment of the TLTRO III funding. The liquidity coverage ratio and the net stable funding ratio (end-2022: 135%) were still well above regulatory requirements. The liquidity portfolio is of high quality, in our view, consisting of central bank deposits, cash, bonds and retained covered bonds.

Additional Notes on Charts

The forecasts in the charts in this section reflect Fitch's forward view on the bank's core financial metrics per Fitch's Bank Rating Criteria. They are based on a combination of Fitch's macro-economic forecasts, outlook at the sector level and company-specific considerations. As a result, Fitch's forecasts may materially differ from the guidance provided by the rated entity to the market.

To the extent Fitch is aware of material non-public information with respect to future events, such as planned recapitalisations or merger and acquisition activity, Fitch will not reflect these non-public future events in its published forecasts. However, where relevant, such information is considered by Fitch as part of the rating process.

Black dashed lines represent indicative quantitative ranges and implied scores for Fitch's core financial metrics for banks operating in the environments that Fitch scores in the 'aa' category. Light-blue columns represent Fitch's forecasts.

Peer average includes Erste Group Bank AG (VR: a), Corner Banca SA (bbb+), de Volksbank N.V. (a-), Raiffeisen Group (a+). Latest average does not include Genossenschaftliche FinanzGruppe.

Financials

Financial Statements

	31 Dec 22 Year end (EURm)	31 Dec 21 Year end (EURm)	31 Dec 20 Year end (EURm)	31 Dec 19 Year end (EURm)
Summary income statement				
Net interest and dividend income	468	406	413	422
Net fees and commissions	255	253	239	230
Other operating income	-7	17	9	78
Total operating income	716	676	662	730
Operating costs	500	515	512	534
Pre-impairment operating profit	216	160	150	196
Loan and other impairment charges	31	-89	126	22
Operating profit	185	250	24	174
Other non-operating items (net)	-69	1	33	5
Tax	2	32	37	31
Net income	115	219	20	149
Summary balance sheet				
Assets				
Gross loans	22,391	21,837	21,651	21,537
- Of which impaired	421	463	454	538
Loan loss allowances	275	273	364	286
Net loans	22,116	21,563	21,287	21,251
Interbank	123	257	438	431
Derivatives	298	115	170	143
Other securities and earning assets	2,636	2,644	2,898	2,850
Total earning assets	25,173	24,579	24,793	24,675
Cash and due from banks	3,473	6,921	3,944	2,072
Other assets	578	595	634	750
Total assets	29,224	32,095	29,370	27,496
Liabilities				
Customer deposits	22,105	22,747	22,154	21,729
Interbank and other short-term funding	1,812	3,797	1,884	412
Other long-term funding	2,133	2,371	1,972	1,985
Trading liabilities and derivatives	301	327	504	463
Total funding and derivatives	26,351	29,242	26,513	24,589
Other liabilities	435	521	518	562
Preference shares and hybrid capital	220	218	293	316
Total equity	2,218	2,115	2,047	2,028
Total liabilities and equity	29,224	32,095	29,370	27,496

Source: Fitch Ratings, Fitch Solutions, VB-Verbund

Key Ratios

	31 Dec 22	31 Dec 21	31 Dec 20	31 Dec 19
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.3	1.8	0.2	1.2
Net interest income/average earning assets	1.9	1.7	1.7	1.7
Non-interest expense/gross revenue	69.7	76.1	77.3	73.1
Net income/average equity	5.3	10.5	1.0	7.3
Asset quality				
Impaired loans ratio	1.9	2.1	2.1	2.5
Growth in gross loans	2.5	0.9	0.5	3.6
Loan loss allowances/impaired loans	65.4	59.1	80.2	53.2
Loan impairment charges/average gross loans	0.1	-0.4	0.6	0.1
Capitalisation				
Common equity Tier 1 ratio	14.2	14.4	14.1	12.9
Fully loaded common equity Tier 1 ratio	14.0	14.1	13.5	12.8
Tangible common equity/tangible assets	7.3	4.8	5.9	6.5
Basel leverage ratio	7.4	6.6	7.3	7.5
Net impaired loans/common equity Tier 1	7.2	9.6	4.5	13.2
Funding and liquidity				
Gross loans/customer deposits	101.3	96.0	97.7	99.1
Liquidity coverage ratio	164.9	223.7	194.0	142.1
Customer deposits/total non-equity funding	84.1	78.1	84.2	88.9
Net stable funding ratio	135.4	138.0	141.3	133.5

Source: Fitch Ratings, Fitch Solutions, VB-Verbund

Support Assessment

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	a+ to a-
Actual jurisdiction D-SIB GSR	ns
Government Support Rating	ns
Government ability to support D-SIBs	
Sovereign Rating	AA+/ Negative
Size of banking system	Neutral
Structure of banking system	Neutral
Sovereign financial flexibility (for rating level)	Neutral
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Neutral
Government propensity to support bank	
Systemic importance	Neutral
Liability structure	Neutral
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

VB-Verbund's Government Support Rating 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.

Environmental, Social and Governance Considerations

FitchRatings **Volksbanken-Verbund**

Banks
Ratings Navigator

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	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	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 Principles 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.

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	Business Profile (incl. Management & governance); Risk Profile	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; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

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.

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

SOLICITATION & PARTICIPATION STATUS

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.

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