FitchRatings

RATING ACTION COMMENTARY

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

Thu 06 Jun, 2024 - 7:02 AM ET

Fitch Ratings - Frankfurt am Main - 06 Jun 2024: Fitch Ratings has affirmed the Austrian Volksbanken-Verbund's (VB-Verbund) Long-Term Issuer Default Rating (IDR) at 'BBB+' and its Viability Rating (VR) at 'bbb+'. The Rating Outlook on the Long-Term IDR is Stable. A full list of rating actions is below.

KEY RATING DRIVERS

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 group's strong cohesion is primarily ensured by its 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 VBVerbund's smaller domestic franchise and less diverse business model than 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, reasonably resilient asset quality, robust capitalisation, and good liquidity and funding profile.

Financials Underpin Business Profile: VB-Verbund has a solid 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 businesses. The group's business profile is constrained by its moderate size and regional focus, resulting in limited diversification and pricing power. However, VB-Verbund's financial metrics including improved earnings in 2023 underpin its business profile score.

Low Risk Appetite: The group's risk profile benefits from a focus on core products, lending to a well-known customer base with a focus on domestic retail, self-employed and SME clients and long-term relationships. Its moderate risk profile reflects conservative underwriting standards, good loan collateralisation and granular exposures with very low loan concentrations.

Asset Quality Deterioration: The group's impaired loans ratio increased to 2.7% at end-2023, due primarily to rising defaults in the commercial real estate segment. We expect further impaired loan inflows in 2024 as a result of a still weak economy, continued high interest rates and vulnerable real estate markets, which drives our negative outlook on VB-Verbund's asset quality score. We expect asset quality in retail mortgage lending to be less affected although debt serving capacity is an increasing constraint for consumers and SMEs.

Structural Profitability Improvement: VB-Verbund's operating profit of 2.4% risk-weighted assets (RWAs) ratio at end-2023 is materially stronger than its historical average and was driven by a significant rise in net interest income (NII). We expect some reduction in NII in 2024 as liabilities continue to reprice. We also expect higher operating expenses and loan impairment charges as the weak economy weighs on profitability in 2024 and 2025. However, after its restructuring we believe that VB-Verbund can generate a sustainable operating profit of around 1.5% of RWAs through the cycle. This underpins our stable outlook for VB-Verbund's earnings and profitability score.

Adequate Capitalisation: The group's common equity Tier 1 (CET1) ratio (end-2023: 15.3%) is robust for its low risk profile and offers ample headroom over its regulatory capital requirements. The standardised approach for the calculation of RWAs also mitigates the impact of asset quality deterioration on the group's CET1 ratio. Our assessment of VB Verbund also reflects the group's solid leverage ratio (end-2023: 8.1%). We expect VB Verbund to maintain a CET1 ratio over 15% in the medium term, which underpins our stable outlook on its captialisation score.

Broadening Funding Franchise: VB Verbund is primarily funded by stable, granular retail and SME deposits resulting in a loans/deposits ratio of consistently around 100%. Its capital market franchise beyond covered bonds has increased due to regulatory requirements for the issuance of minimum requirement for own funds and eligible liabilities (MREL). This included a Tier 2 debt issue in 2024 and a green benchmark bond in 2023. VB Verbund's liquidity profile is solid and underpinned by around EUR6.5 billion instantly available liquidity at end-2023, equivalent to more than 20% of its balance sheet.

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 below 0.5% of RWAs, 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 of at least 1.5% of RWAs, while maintaining its good asset quality and capitalisation.

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

No Support Assumed: VB Verbund's 'no support' Government Support Rating (GSR) reflects Fitch's view that the EU's resolution framework is likely to require senior creditors participating in losses 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 implied 'a' category score due to the following adjustment reason: internal capital generation and growth (negative).

Sources of Information

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

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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. 15 Mar 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Oesterreichische Aerzte- und Apothekerbank AG	EU Issued, UK Endorsed
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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