FitchRatings

Banks
Retail & Consumer Banks
Austria

Volksbanken-Verbund

Update

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 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, resilient asset quality, adequate capitalisation, and good liquidity and funding profile.

Stable 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 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 increased to 2.7% at end-2023 (end-2022: 1.9%), reflecting pressure from its commercial real estate exposure. Impaired loans inflows could rise further in 2024 and 2025 as a result of economic weakness and high interest rates.

We expect loan-impairment charges (LICs) to be concentrated in SME lending and real-estate, as these sectors remain sensitive to higher rates and energy prices, while asset quality in retail mortgage lending should remain strong despite a heightened share 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 operating profit/risk-weighted assets (RWAs) ratio of 2.4% at end-2023 is significantly stronger than its historic average. We believe financial results will moderate as we expect interest rates to decline, in combination with higher LICs and weakening loan growth, reflecting a challenging operating environment in Austria.

Adequate Capitalisation: The group's common equity Tier 1 (CET1) ratio (end-2023: 15.3%) is adequate in light of its low risk profile, offering ample headroom over its minimum requirement of 9.7%. 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-2023: 8.1%). 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 non-equity funding at end-2023, 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	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (March 2024)

Related Research

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

Fitch Affirms Austria at 'AA+'; Outlook Stable (February 2024)

Global Economic Outlook (March 2024)

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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'.

Significant Changes from Last Review

Solid Operational Performance; CRE Drives Asset Quality

VB-Verbund's total operating income rose by 35% year-on-year in 2023, supporting exceptionally strong financial performance. VB-Verbund's net interest margin also increased greatly, in line with most banks in Austria, as material parts of the loan book are based on variable rates. Fee income rose a further 3% from last year's high level.

These improvements were partly offset by far higher LICs (up 52%), reflecting a weak economic environment, and the particularly negative developments in VB Verbund's commercial real estate (CRE) exposure in 4Q23, weakening the group's asset quality. Consequently, VB-Verbund' s impaired loan ratio rose by about 80bp to 2.7%. VB-Verbund's CRE exposure overall comprises about 30% of its loan book, but about two-thirds of this segment relates to multi-tenant and lower-risk social housing. We believe that the sector could be vulnerable to a further deterioration this year and next, but expect the bank's impaired loan ratio to remain below 3%.

Improved Capitalisation

VB-Verbund's improved capitalisation was mainly due to the group's solid profitability and a conservative distribution policy, offsetting inflating risk-weighted assets primarily due to negative rating migration. Its CET1 ratio (end-2023: 15.3%; end-2022: 14.2%) is robust and broadly in line with peers'. VB-Verbund's regulatory capital requirements will be mostly unchanged in 2024, as its Pillar 2 requirement will decrease by 25bp to 2.25%, while its O-SIIB buffer will increase by 15bp, on a consolidated level, to 0.9%.

VB-Verbund issued debt in the capital markets to optimise its capital structure, including issuance of a benchmark Tier 2 bond, fully placed by VB Vienna in March 2024. Customer deposits have held steady in 2023, but, a significant shift took place across the Austrian banking sector, from sight deposits, which fell by almost 15%, over to term deposits and certificates. However, VB-Verbund still has a substantial total amount of sight deposits (EUR17.6 billion), representing about 80% of the group's customer deposits. VB-Verbund's liquidity position was strong, with the liquidity coverage ratio consistently above 150% throughout 2023.

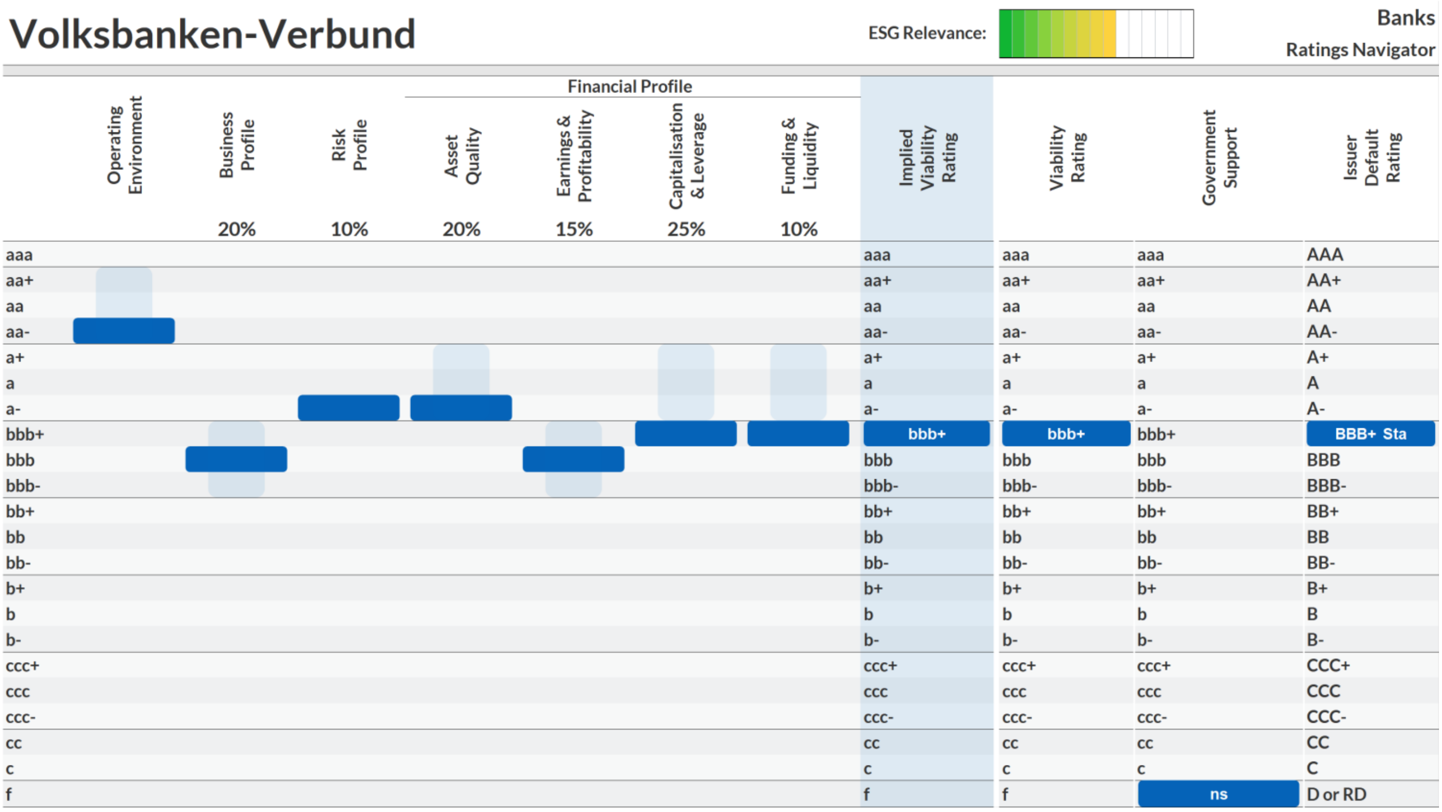
New Medium-Term Business Targets

Following VB-Verbund's improved performance in recent years and the good 2023 results, the group set itself more ambitious medium-term targets and aims to reach a cost/income ratio of below 65% (average of 70% over the past three years), maintain a minimum CET1 ratio of at least 16%, and keep the gross impaired loan ratio below 3%. We view these targets as reasonable and achievable. The group's return on equity target (after taxes) of more than 5.5% is moderate compared to peers, but we believe it matches its lower risk profile well.

Resolution Strategy Simplification

VB-Verbund implemented a revised resolution strategy. We understand that, in cooperation with the SRB, a structural simplification concept has been established to make operations more effective in a resolution scenario. Based on this concept, VB Vienna would become prime shareholder of the group ahead of its failure, hence facilitating asset transfers. VB-Verbund's MREL ratio – including combined buffer requirements – is set at 23.4%, becoming binding at end-2024, without any subordination requirement. VB-Verbund had already exceeded this target at end-2023.

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' implied category score due to the following adjustment reason: internal capital generation and growth (negative).

The funding & liquidity score of 'bbb+' is below the 'a' implied category score due to the following adjustment reason: non-deposit funding (negative).

Financials

Financial Statements

	31 December 2023		31 December 2022	31 December 2021	31 December 2020
	12 months (USDm)	12 months (EURm)	12 months (EURm)	12 months (EURm)	12 months (EURm)
Summary Income statement					
Net interest and dividend income	773	705	468	406	413
Net fees and commissions	287	262	255	253	239
Other operating income	-2	-2	-7	17	9
Total operating income	1,058	966	716	676	662
Operating costs	587	536	500	515	512
Pre-impairment operating profit	471	430	216	160	150
Loan and other impairment charges	71	65	31	-89	126
Operating profit	400	365	185	250	24
Other non-operating items (net)	0	0	-69	1	33
Tax	42	39	2	32	37
Net income	357	326	115	219	20
Summary balance sheet					
Assets					
Gross loans	25,273	23,068	22,391	21,837	21,651
– Of which impaired	689	629	421	463	454
Loan loss allowances	361	330	275	273	364
Net loans	24,912	22,738	22,116	21,563	21,287
Interbank	256	234	123	257	438
Derivatives	297	271	298	115	170
Other securities and earning assets	3,537	3,229	2,636	2,644	2,898
Total earning assets	29,002	26,472	25,173	24,579	24,793
Cash and due from banks	3,763	3,435	3,473	6,921	3,944
Other assets	630	575	578	595	634
Total assets	33,396	30,482	29,224	32,095	29,370
Liabilities					
Customer deposits	24,300	22,180	22,105	22,747	22,154
Interbank and other short-term funding	232	212	1,812	3,797	1,884
Other long-term funding	4,743	4,329	2,133	2,371	1,972
Trading liabilities and derivatives	322	294	301	327	504
Total funding and derivatives	29,598	27,015	26,351	29,242	26,513
Other liabilities	776	708	435	521	518
Preference shares and hybrid capital	240	219	220	218	293
Total equity	2,782	2,540	2,218	2,115	2,047
Total liabilities and equity	33,396	30,482	29,224	32,095	29,370
Exchange rate		USD1 = EUR0.912742	USD1 = EUR0.937559	USD1 = EUR0.884173	USD1 = EUR0.821963

Source: Fitch Ratings, Fitch Solutions, Volksbanken-Verbund

Key Ratios

	31 December 2023	31 December 2022	31 December 2021	31 December 2020
Ratios (%; annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	2.4	1.3	1.8	0.2
Net interest income/average earning assets	2.7	1.9	1.7	1.7
Non-interest expense/gross revenue	55.6	69.7	76.1	77.3
Net income/average equity	13.8	5.3	10.5	1.0
Asset quality				
Impaired loans ratio	2.7	1.9	2.1	2.1
Growth in gross loans	3.0	2.5	0.9	0.5
Loan loss allowances/impaired loans	52.4	65.4	59.1	80.2
Loan impairment charges/average gross loans	0.3	0.1	-0.4	0.6
Capitalisation				
Common equity Tier 1 ratio	15.3	14.2	14.4	14.1
Fully loaded common equity Tier 1 ratio	15.2	14.0	14.1	13.5
Tangible common equity/tangible assets	8.2	7.3	4.8	5.9
Basel leverage ratio	8.1	7.4	6.6	7.3
Net impaired loans/common equity Tier 1	12.8	7.2	9.6	4.5
Funding and liquidity				
Gross loans/customer deposits	104.0	101.3	96.0	97.7
Liquidity coverage ratio	192.6	164.9	223.7	194.0
Customer deposits/total non-equity funding	82.3	84.1	78.1	84.2
Net stable funding ratio	135.0	135.4	138.0	141.3

Source: Fitch Ratings, Fitch Solutions, Volksbanken-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+/ Stable
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.

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.

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.