

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, the strong cohesion of which is primarily ensured by their 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. This results in below-average operating profitability and cost efficiency, and limits the group's financial flexibility. The VR also reflects the group's low-risk profile, resilient asset quality, adequate capitalisation, as well as 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, 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, conservative underwriting standards, good loan collateralisation, and granular exposures with very low concentrations.

Resilient Asset Quality: As at larger domestic banks, the group's low impaired-loans ratio has so far benefited from a resilient economy as well as substantial state support that has helped to contain unemployment and corporate defaults. Impaired loans inflows could rise moderately in 2023 as a result of the economic downturn, rising interest rates and high inflation. However, we expect the four-year average impaired loans ratio to stay below 3% in the medium term.

Resilient Profitability: We expect VB-Verbund to generate an operating profit of up to 1% of risk-weighted assets (RWAs) on a sustained basis. Increasing interest rates will gradually alleviate margin pressure. Together with loan growth, this will support the group's operating income. However, profitability could temporarily fall below this level in the coming quarters as a challenging operating environment in Austria could lead to higher loan-impairment charges (LICs), which may be only partially offset by higher revenue from rising interest rates.

Adequate Capitalisation: The group's common equity Tier 1 (CET1) ratio of 14.2% at end-2022 is adequate in light of its low risk profile and offers sufficient headroom over its capital requirement of 9.8%. The standardised approach for the calculation of RWAs will also mitigate the impact of asset-quality deterioration on the group's CET1 ratio.

Regulation Drives Funding Diversification: Stable, granular retail and SME deposits accounted for approximately 80% of VB-Verbund's funding at end-2022. The group does not rely on debt markets for funding, but has established a capital market access by issuing covered bonds, additional Tier 1, Tier 2 and senior non-preferred debt to comply with its minimum requirement for own funds and eligible liabilities (26.5% of RWAs by end-2024).

Ratings

Foreign Currency

Long-Term IDR	BBB+
Short-Term IDR	F2

Viability Rating	bbb+
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Government Support Rating	ns
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Sovereign Risk

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 Upgrades Volksbanken-Verbund to 'BBB+'; Outlook Stable \(July 2022\)](#)

[Fitch Affirms Austria at 'AA+'; Outlook Negative \(March 2023\)](#)

[Global Economic Outlook \(March 2023\)](#)

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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 a downgrade 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 revenue bases without weakening the bank's risk profile. Fitch views this as unlikely in the near to medium term, given the bank's post-restructuring strategic plan and business model.

An upgrade would also be contingent on VB-Verbund achieving a further sustainable improvement in operating profitability with an average operating profit/RWAs of about 1.5% while maintaining its good asset quality and capitalisation.

An upgrade of the Short-Term IDRs is unlikely, as it would require a two-notch upgrade of the funding and liquidity score to 'a'.

Significant Changes from Last Review

Profitability Benefits from Higher Interest Rates

VB-Verbund's pre-impairment operating profit rose by 35% in 2022, supported by an improved net interest income of EUR468 million (EUR406 million in 2021), following higher interest rates in the eurozone. The group's operating expenses decreased to EUR500 million in 2022 from EUR515 million in 2021, in line with the long-term cost reduction plan. VB-Verbund's 2022 operating profit/RWAs of 1.3% remained below the level recorded in 2021, which was supported by reversals of pandemic-driven loan-loss allowances, but it compares favourably with the long-term average of below 1%.

Full and Early Repayment of Government Participation Rights

VB-Verbund's stable performance in recent years enabled the early repayment of the last outstanding tranche (EUR100 million, 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, 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.

Stable Funding and Liquidity

The group has a stable funding and liquidity profile, which we view as resilient in light of the recent market developments affecting the banking sector. The group has a granular deposit base, supported by its local branch networks.

Its liquidity coverage ratio decreased to 165% by end-2022 from a high 224% at end-2021, due to partial repayment of the TLTRO III funding and valuation losses of the high-quality liquid assets portfolio. The LCR still remained well above the regulatory requirements as well as the net stable funding ratio, which was 135% at end-2022.

Ratings Navigator

Volksbanken-Verbund							ESG Relevance: 	Banks Ratings Navigator		
Operating Environment	Business Profile	Risk Profile	Financial Profile				Implied Viability Rating	Viability Rating	Government Support Rating	Issuer Default Rating
			Asset Quality	Earnings & Profitability	Capitalisation & Leverage	Funding & Liquidity				
	20%	10%	20%	15%	25%	10%				
aaa							aaa	aaa	aaa	AAA
aa+							aa+	aa+	aa+	AA+
aa							aa	aa	aa	AA
aa-							aa-	aa-	aa-	AA-
a+							a+	a+	a+	A+
a							a	a	a	A
a-							a-	a-	a-	A-
bbb+							bbb+	bbb+	bbb+	BBB+ Sta
bbb							bbb	bbb	bbb	BBB
bbb-							bbb-	bbb-	bbb-	BBB-
bb+							bb+	bb+	bb+	BB+
bb							bb	bb	bb	BB
bb-							bb-	bb-	bb-	BB-
b+							b+	b+	b+	B+
b							b	b	b	B
b-							b-	b-	b-	B-
ccc+							ccc+	ccc+	ccc+	CCC+
ccc							ccc	ccc	ccc	CCC
ccc-							ccc-	ccc-	ccc-	CCC-
cc							cc	cc	cc	CC
c							c	c	c	C
f							f	f	ns	D or RD

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).

Financials

Financial Statements

	31 Dec 22		31 Dec 21	31 Dec 20	31 Dec 19
	Year end (USDm)	Year end (EURm)	Year end (EURm)	Year end (EURm)	Year end (EURm)
Summary income statement					
Net interest and dividend income	499	468	406	413	422
Net fees and commissions	272	255	253	239	230
Other operating income	-7	-7	17	9	78
Total operating income	764	716	676	662	730
Operating costs	533	500	515	512	534
Pre-impairment operating profit	231	216	160	150	196
Loan and other impairment charges	33	31	-89	126	22
Operating profit	197	185	250	24	174
Other non-operating items (net)	-73	-69	1	33	5
Tax	2	2	32	37	31
Net income	123	115	219	20	149
Other comprehensive income	17	16	9	13	-2
Fitch comprehensive income	139	131	228	33	146
Summary balance sheet					
Assets					
Gross loans	23,882	22,391	21,837	21,651	21,537
- Of which impaired	449	421	463	454	538
Loan loss allowances	293	275	273	364	286
Net loans	23,589	22,116	21,563	21,287	21,251
Interbank	131	123	257	438	431
Derivatives	318	298	115	170	143
Other securities and earning assets	2,812	2,636	2,644	2,898	2,850
Total earning assets	26,850	25,173	24,579	24,793	24,675
Cash and due from banks	3,705	3,473	6,921	3,944	2,072
Other assets	616	578	595	634	750
Total assets	31,170	29,224	32,095	29,370	27,496
Liabilities					
Customer deposits	23,577	22,105	22,747	22,154	21,729
Interbank and other short-term funding	1,933	1,812	3,797	1,884	412
Other long-term funding	2,275	2,133	2,371	1,972	1,985
Trading liabilities and derivatives	321	301	327	504	463
Total funding and derivatives	28,106	26,351	29,242	26,513	24,589
Other liabilities	464	435	521	518	562
Preference shares and hybrid capital	235	220	218	293	316
Total equity	2,366	2,218	2,115	2,047	2,028
Total liabilities and equity	31,170	29,224	32,095	29,370	27,496
Exchange rate		USD1 = EUR0.93756	USD1 = EUR0.884173	USD1 = EUR0.821963	USD1 = EUR0.89015

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+/ 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

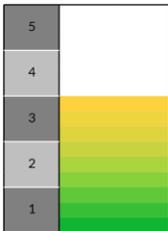
The colours indicate the weighting of each KRD in the assessment.

■ Higher influence
 ■ Moderate influence
 ■ Lower influence

VB-Verbund's GSR reflects 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

Overall ESG

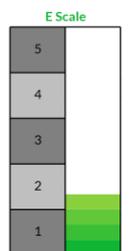


How relevant are E, S and G issues to the overall credit rating?

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.

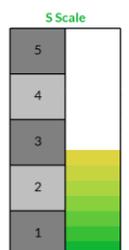
Environmental (E)

General Issues	Score	Impact	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	Business Profile (incl. Management & governance); Risk Profile; Asset Quality



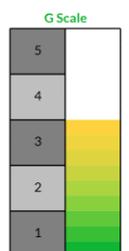
Social (S)

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



Governance (G)

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



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