

Global Credit Research - 12 Feb 2016

Austria

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits -Dom Curr	Baa1/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating	Baa1
ST Issuer Rating	P-2

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Key Indicators

Raiffeisen-Landesbank Tirol AG (Unconsolidated Financials)[1]

	[2]12-14	[3]12-13	[3]12-12	[3]12-11	[3]12-10	Avg.
Total Assets (EUR billion)	7.1	7.3	7.1	7.4	7.2	[4]-0.4
Total Assets (USD billion)	8.6	10.1	9.3	9.5	9.6	[4]-2.9
Tangible Common Equity (EUR billion)	0.4	0.4	0.4	0.4	0.4	[4]3.3
Tangible Common Equity (USD billion)	0.5	0.5	0.5	0.5	0.5	[4]0.7
Problem Loans / Gross Loans (%)	5.4	4.4	4.3	6.2	6.8	[5]5.4
Tangible Common Equity / Risk Weighted Assets (%)	13.4	12.7	11.9	11.2	10.8	[6]13.4
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	24.0	20.6	21.5	32.7	38.1	[5]27.4
Net Interest Margin (%)	0.8	0.8	0.8	0.8	0.8	[5]0.8
PPI / Average RWA (%)	1.4	1.3	1.3	1.4	1.3	[6]1.4
Net Income / Tangible Assets (%)	0.3	0.2	0.2	0.2	0.2	[5]0.2
Cost / Income Ratio (%)	59.9	62.8	59.5	57.8	58.5	[5]59.7
Market Funds / Tangible Banking Assets (%)	68.6	70.8	70.0	73.3	73.6	[5]71.3
Liquid Banking Assets / Tangible Banking Assets (%)	37.0	38.6	40.6	39.0	59.7	[5]43.0
Gross loans / Due to customers (%)	147.5	153.7	156.6	181.3	191.5	[5]166.1

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; LOCAL GAAP [3] Basel II; LOCAL GAAP [4] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [5] LOCAL GAAP reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & LOCAL GAAP reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

We assign Raiffeisen-Landesbank Tirol AG (RLB Tirol) Baa1 long-term deposit and issuer ratings with a negative outlook. The bank's short-term deposit and issuer ratings are Prime-2. We also assign a A3(cr)/Prime-2(cr) Counterparty Risk Assessment.

RLB Tirol's Baa1 long-term deposit and issuer ratings reflect (1) the bank's baseline credit assessment (BCA) of baa3; (2) its adjusted BCA of baa3 that incorporates very high affiliate support from the mutual Raiffeisen Banking Group (the Group, unrated), which, however results in no rating uplift owing to the Raiffeisen group's limited internal support capacity; (3) two notches of uplift from the adjusted BCA resulting from our advanced Loss Given Failure (LGF) analysis which indicates a very low loss-given-failure for senior unsecured debt and deposits; and (4) our low government support assumption, which results in no additional rating uplift.

RLB Tirol's BCA reflects the bank's average asset quality as indicated by persistent credit concentrations and deteriorating non-performing loans (NPLs) as well as its improving capitalisation and strong liquidity. The BCA also takes into account the tail risks associated with RLB Tirol's share-holdings in Raiffeisen Zentralbank Oesterreich AG (RZB, deposits Baa2 negative/issuer Baa2 negative).

RATING DRIVERS

- Satisfactory capitalisation ratios
- Weak profitability owing to a high degree of low-margin interbank activities
- Diversified funding sources, including retail deposits, which support the bank's liquidity profile
- Average asset quality indicators, albeit with persistent credit concentrations to intra-group counterparties and the regional economy
- RLB Tirol's ratings are supported by its Macro Score of Very Strong-

RATING OUTLOOK

The outlook for RLB Tirol's long-term ratings is negative, reflecting the challenges of the Raiffeisen group, which constitute a limiting factor for the bank's individual creditworthiness. The Raiffeisen group's ongoing downsizing and restructuring exercise bears execution risk, and failure to strengthen capital and reduce tail risks by end-2017 according to the restructuring plan could place further downward pressure on the Eastern European lender Raiffeisen Bank International (RBI, deposits Baa2 negative/senior unsecured Baa2 negative, BCA ba3). RLB Tirol's profit generation and stability partly depends on RBI's performance and therefore Raiffeisen group's success in stabilising the group.

WHAT COULD CHANGE THE RATING - UP

As the negative outlook reflects, there is currently no upward rating pressure on RLB Tirol's long-term ratings.

Upward pressure for RLB Tirol's issuer and deposit ratings could arise from a higher BCA, which would require a sustainable capital-generation capacity through improved profits and an improvement of the Group's capitalisation.

Furthermore, alterations in the bank's liability structure could change the amount of uplift provided by our advanced LGF analysis. This would lead to a higher notching from the bank's adjusted BCA in the event of significant issuance of subordinated debt instruments, thereby affecting RLB Tirol's issuer and/or deposit ratings.

WHAT COULD CHANGE THE RATING - DOWN

Downward pressure on RLB Tirol's long-term ratings could arise from a lowering of the bank's BCA and/or a reduction in uplift as a result of our advanced LGF.

Factors which could exert downwards pressure on the bank's BCA include (1) a deterioration in the commercial and financial profile of the Raiffeisen sector in Austria and/or an erosion of RLB Tirol's local market share; (2) a deterioration of the bank's capitalisation; (3) a further decrease of its asset quality; (4) a continual weakening of its recurring earnings power and levels of operating efficiency; and/or (5) an increase of its risk appetite.

DETAILED RATING CONSIDERATIONS

SATISFACTORY CAPITALISATION RATIOS

RLB Tirol reported a satisfactory Tier 1 capital ratio of 12.2% in 2014 (2013: 12.2%; 2012: 11.4%). The capital consists almost exclusively of common equity, and therefore the bank reports a total capital ratio of 13.2% as of year-end 2014.

According to our internal stress test, the bank has a sufficient capital buffer to absorb a severe deterioration in its loan book. However, significant risks could arise from the bank's sizeable counterparty and regional concentrations through its share-holdings in RZB, especially during periods of regulatory change and economic uncertainty.

The bank's investment in RZB, with a 5.64% stake, plays a prominent role relative to its overall size, with respective dividends contributing around one third of RLB Tirol's pre-provision income (PPI). RZB's earnings contribution plays a prominent role and operates largely outside of RLB Tirol's control. The tail risks related to the sector are a key driver for the bank's assigned Capital score of a3.

The bank maintains investments in a portfolio of unquoted equity participations, which are largely related to the Raiffeisen sector. We view these investments as a potential source of significant risk because of their potential negative effect on net income and therefore capital generation capacity. The portfolio carries substantial hidden reserves, according to local GAAP. However, given these assets' limited liquidity and marketability, these potential profit cushions are of limited value as long as they are unrealised.

WEAK PROFITABILITY DUE TO A HIGH DEGREE OF LOW-MARGIN INTERBANK ACTIVITIES

At the end of 2014, RLB Tirol reported a stable net income/tangible asset ratio of 0.3% and a PPI/average risk weighted assets ratio of 1.4%. Half of the bank's net revenue of EUR108 million (2014, based on local GAAP) was generated from net interest income and approximately 20% from fee and commission income. Income from investments, primarily from the bank's share in RZB, contributed another 16%. This earnings mix has been relatively stable in recent years and almost unchanged since 2008, although RLB Tirol's net interest income has somewhat increased in proportion, which we reflect in our assigned Profitability score of b1.

The bank operates in the challenging operating environment of its competitive and mature home market. RLB Tirol's franchise value is constrained by the bank's limitation on its home region of Tyrol and the adjacent regions in southern Germany and northern Italy, a comparatively narrow geographical focus.

Furthermore, its role as a central institute for the local Raiffeisen banks limits its overall net interest margin and will likely prevent any significant improvement without changing its risk profile. PPI dropped to EUR42 million in 2014 from EUR44 million per annum since 2009, illustrating the bank's stable income sources but also its limited growth potential.

We consider the bank's cost-to-income ratio of 59.9% in 2014 (2013: 62.8%; 2012: 59.5%; 2011: 57.8%) to be weak, given its wholesale-based franchise, particularly in an international comparison, although it is better than its domestic peers. It partly reflects that its earnings-generating power is constrained by the bank's geographical focus and low economies of scale. Therefore, effective cost management will be crucial for the bank to ensure sufficient income without compromising its risk profile. However, given the changing operating environment and higher cost of regulation, room to manoeuvre is limited and we therefore expect stable performance at best.

DIVERSIFIED FUNDING SOURCES, INCLUDING RETAIL DEPOSITS, WHICH SUPPORT THE BANK'S LIQUIDITY PROFILE

Diversified funding sources characterise RLB Tirol's liquidity profile. The bank provides treasury and central clearing functions to the local primary credit co-operatives, which results in interbank funding (primarily intra-group and intra-sector) constituting the main contribution to the bank's total funding, representing approximately 53.5% in 2014. Following this funding source, deposits of retail customer amount to 25.7% of total liabilities, driving the Funding score to b1.

Customer deposits are also an important and stable source of funding for RLB Tirol. The loan-to-customer deposit ratio of 147.5% in 2014 implies that the bank has an above-average reliance on wholesale funds compared to its domestic peers.

RLB Tirol has a portfolio of highly rated fixed-income securities, which are mainly repo eligible with the central bank or other counterparties. This portfolio provides flexibility for liquidity management purposes, and we consider

that under a stressed scenario with disrupted market access, the bank could still rely on adequate liquidity reserves from sector funds and repo eligible securities; we reflect this in our Liquidity score of a1.

AVERAGE ASSET QUALITY INDICATORS, ALBEIT WITH PERSISTENT CREDIT CONCENTRATIONS TO INTRA-GROUP COUNTERPARTIES AND THE REGIONAL ECONOMY

RLB Tirol reported a problem loan ratio of 5.4% for 2014 (2013: 4.4%; 2012: 4.3% and 2011: 6.2%) with a conservative provisioning policy that makes use of regular charges allowable under local GAAP for general provisions. Lending activities to commercial customers, predominantly small and medium-sized enterprises, account for approximately 73% of the loan book and primarily target customers in Tyrol and southern Germany, the bank's extended core market. RLB Tirol has no direct exposures to Central and Eastern Europe, unlike other Austrian banks, and has reduced its corporate lending activities to bordering northern Italy to a fraction of its loan book.

Market conditions in the Tyrolean export industry and the region's tourism sector have been stable and improving respectively over recent years. However, a prolonged period of adverse macroeconomic conditions, coupled with a more marked slowdown in the tourism sector, or a flawed downturn of the region's main export segments (manufacturing, trade and logistics), could exert significant pressure on the bank's asset quality metrics. Despite an environment of persistently low economic growth, we expect the bank's asset quality to remain satisfactory, as visible in the ba1 Asset Risk score.

Credit concentrations are high and mainly reflect the bank's exposure to the Tyrolean economy, its treasury function for the wider RLB Tirol group and the Raiffeisen sector in Austria. The bank's corporate borrower concentration is high compared with its Tier-1 capital because of Raiffeisen-sector-related assets.

RLB TIROL'S RATINGS ARE SUPPORTED BY ITS MACRO SCORE OF VERY STRONG-

As an Austrian bank, RLB Tirol benefits from a strong economic environment with a robust institutional and legal framework, sound government finances, and a low susceptibility to adverse events, as reflected in its assigned Very Strong- Macro Profile. Despite rising house prices, private sector debt is low and declining, supporting credit conditions. The bank's funding profile benefits from high levels of domestic and foreign-customer deposits. Our Macro Profile also takes into account the banking sector's high market fragmentation, low fee-income generation and intense competition for domestic business.

NOTCHING CONSIDERATIONS

AFFILIATE SUPPORT

We consider the likelihood of support from the Group, the Austrian Raiffeisen sector, to be very high due owing to RLB Tirol's vital regional importance to the sector. This support materially reduces the probability of default as the co-operative group cross-sector support mechanism aims to stabilise its members by avoiding a bail-in or any form of loss-participation by creditors.

We assessed the Austrian Raiffeisen sector's financial capacity to provide support to its members, based on the co-operative group's combined financial strength. The Group's capitalisation is moderate relative to its overall credit profile, which is focused on, and therefore strongly correlated with, its higher-risk exposures to Central Eastern Europe and the Commonwealth of Independent States, which are housed at RBI. Higher capital would be required to protect the sector against likely losses under an adverse scenario. Given the lack of material improvement of the Austrian Raiffeisen sector's capital levels in recent years, our reassessment has resulted in a more limited support capacity than assessed previously. As such, the Group's cross-sector support currently results in no uplift for RLB Tirol.

LGf ANALYSIS: SENIOR CREDITORS BENEFIT FROM LARGE VOLUME OF BOTH OUTSTANDING DEBT AND SUBORDINATED INSTRUMENTS IN THE UNLIKELY EVENT OF RESOLUTION

RLB Tirol is subject to the EU Bank Resolution and Recovery Directive (BRRD), which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred to senior unsecured debt. These metrics are in line with our standard assumptions.

RLB Tirol's senior unsecured debt and deposits are likely to face very low loss-given-failure. This assumption is based on (1) the loss absorption provided by subordinated debt and, potentially, by senior unsecured debt if

deposits are treated preferentially in a resolution; and (2) the substantial volume of senior unsecured debt itself. This results in a Preliminary Rating Assessment two notches above the adjusted BCA.

GOVERNMENT SUPPORT

With the implementation of the BRRD, we have either eliminated or lowered our assumptions regarding the probability of government support for EU banks. We have since generally attributed a moderate probability of government support to EU banking groups that are considered systemically relevant. However, we have lowered our expectations regarding the degree of support that the Austrian government might provide to a bank in Austria to below the level we assign in other EU countries. The main trigger for this assessment was the early adoption of the BRRD in Austria and its recent application to Heta Asset Resolution AG (Heta; Carinthian-state-guaranteed senior unsecured debt Ca developing). We consider that the wider scope of the BRRD implementation in Austria and its recent application illustrates the Austrian government's willingness to apply burden-sharing.

Although we consider the group of Austrian Raiffeisen co-operative banks, including RLB Tirol, to be systemically relevant, we now only attribute a low probability of Austrian government support. This results in no government support uplift for RLB Tirol's senior debt and deposit ratings.

Issuer Profile

With total assets of EUR7.1 billion as of year-end 2014, RLB Tirol is one of the smallest Raiffeisenlandesbanks (central regional institutions of the Group) in Austria, and has its major operations in the Austrian Federal State of Tyrol. RLB Tirol is indirectly majority owned by 73 local co-operative banks for which the bank is the central institute and provides a wide variety of services and products. RLB Tirol also offers banking services to private customers and corporates mainly in the Tyrolean area.

About Moody's Bank Scorecard

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Rating Factors

Raiffeisen-Landesbank Tirol AG

Macro Factors	
Weighted Macro Profile	Very Strong -

Financial Profile						
Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
<i>Problem Loans / Gross Loans</i>	5.4%	baa2	← →	ba1	Sector concentration	Market risk
Capital						
<i>TCE / RWA</i>	13.4%	a1	← →	a3	Stress capital resilience	
Profitability						
<i>Net Income / Tangible Assets</i>	0.2%	b1	← →	b1		
Combined Solvency Score		baa2		baa3		
Liquidity						
Funding Structure						

<i>Market Funds / Tangible Banking Assets</i>	68.6%	caa1	← →	b1	Market funding quality	
Liquid Resources <i>Liquid Banking Assets / Tangible Banking Assets</i>	37.0%	aa3	← →	a1	Asset encumbrance	Intragroup restrictions
Combined Liquidity Score		ba1		baa3		

Financial Profile

baa3

Qualitative Adjustments

Business Diversification
Opacity and Complexity
Corporate Behavior

Adjustment

0
0
0

Total Qualitative Adjustments

0

Sovereign or Affiliate constraint

Aaa

Scorecard Calculated BCA range

baa2 - ba1

Assigned BCA

baa3

Affiliate Support notching

0

Adjusted BCA

baa3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	2	0	baa1	0	Baa1	

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