MOODY'S
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Credit Opinion: Raiffeisenlandesbank Vorarlberg

Global Credit Research - 19 Aug 2015

Bregenz, Austria

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Issuer Rating	Baa1
ST Issuer Rating	P-2

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Key Indicators

Raiffeisenlandesbank Vorarlberg (Unconsolidated Financials)[1]

	[2]**12-14**	[3]**12-13**	[3]**12-12**	[3]**12-11**	[3]**12-10**	**Avg.**
Total Assets (EUR billion)	**6.5**	**6.7**	**6.7**	**6.9**	**6.5**	[4]**0.0**
Total Assets (USD billion)	**7.8**	**9.2**	**8.8**	**8.9**	**8.7**	[4]**-2.6**
Tangible Common Equity (EUR billion)	**0.3**	**0.3**	**0.2**	**0.2**	**0.2**	[4]**9.2**
Tangible Common Equity (USD billion)	**0.3**	**0.4**	**0.3**	**0.3**	**0.3**	[4]**6.4**
Problem Loans / Gross Loans (%)	**3.5**	**2.0**	**1.7**	**1.6**	**2.0**	[5]**2.2**
Tangible Common Equity / Risk Weighted Assets (%)	**13.1**	**12.9**	**9.9**	**9.4**	**9.1**	[6]**13.1**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**13.7**	**7.5**	**7.7**	**7.2**	**8.9**	[5]**9.0**
Net Interest Margin (%)	**0.5**	**0.4**	**0.4**	**0.4**	**0.5**	[5]**0.4**
PPI / Average RWA (%)	**0.7**	**0.6**	**0.4**	**0.6**	**0.8**	[6]**0.7**
Net Income / Tangible Assets (%)	**0.3**	**0.9**	**0.2**	**0.2**	**0.2**	[5]**0.4**
Cost / Income Ratio (%)	**73.7**	**73.6**	**77.5**	**71.4**	**65.4**	[5]**72.3**
Market Funds / Tangible Banking Assets (%)	**80.0**	**79.8**	**79.6**	**78.7**	**80.0**	[5]**79.6**
Liquid Banking Assets / Tangible Banking Assets (%)	**74.9**	**78.1**	**77.1**	**78.9**	**79.5**	[5]**77.7**
Gross Loans / Total Deposits (%)	**29.7**	**25.4**	**25.6**	**22.8**	**21.7**	[5]**25.0**

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

On 1 July 2015, we downgraded Raiffeisenlandesbank Vorarlberg's (RLB Vorarlberg) long-term ratings to Baa1, with a negative outlook. The downgrade reflects the (1) one-notch downgrade of the bank's baseline credit assessment (BCA) to baa3; (2) subsequent downgrade of its adjusted BCA to baa3, incorporating "very high" affiliate support, which results in no uplift from Raiffeisen Banking Group (RBG, unrated); (3) two notches of uplift resulting from our Advanced Loss Given failure (LGF) analysis; and (4) removal of government support uplift.

The downgrade of RLB Vorarlberg`s BCA to baa3 reflects the bank's exposure to credit pressures in the wider RBG group, which implies some degree of tail risk for its solvency, despite improving capitalisation and the bank's solid liquidity.

For RLB Vorarlberg, our LGF analysis indicates a very low loss-given-failure for senior unsecured debt and deposits, leading to a two-notch ratings uplift for RLB Vorarlberg's wholesale deposits from its baa3 adjusted BCA.

RATING DRIVERS

- Subdued profitability, with some dependence on Raiffeisen Zentralbank Oesterreich AG's (RZB, deposits Baa2 negative/issuer rating Baa2 negative) earnings;

- Improved, satisfactory capitalisation

- Sound asset quality supported by conservative provisioning policy

- Sound liquidity supported by diversified funding sources including retail deposits

- Senior creditors benefit from a large volume of outstanding debt, as well as subordinated instruments in the unlikely event of resolution (LGF analysis).

RATING OUTLOOK

The outlook for RLB Vorarlberg's long-term rating is negative.

The Raiffeisen sector's financial strength is a limiting factor on RLB Voarlberg's individual creditworthiness. The group's major downsizing and restructuring plan, which it intends to implement until end-2017 with the aim of strengthening capital and reducing tail risks, could place further downward pressure on Raiffeisen Bank International's (RBI, deposits Baa2 negative/senior unsecured Baa2 negative, BCA ba3) already-weakened standalone credit profile. Therefore, the negative outlook we have assigned to the long-term senior ratings reflects the overall challenges for the sector.

WHAT COULD CHANGE THE RATING - UP

As the negative outlook reflects, there is currently no upward rating pressure. Upward pressure for RLB Vorarlberg's long-term ratings could arise from a sustainable capital-generation capacity through improved profits, an improvement of RBG's capitalisation and a higher subordination of debt in our LGF analysis.

WHAT COULD CHANGE THE RATING - DOWN

Downward pressure on the bank's credit profile could result from a deterioration in the commercial and financial profile of the Raiffeisen sector in Austria, a material erosion in RLB Vorarlberg's local market share, or a deterioration in profitability, efficiency and asset quality. Any evidence of a further increase in the bank's exposure to the real-estate sector, or equity participations which appear to affect the existing risk profile, could also exert downwards pressure on the bank's BCA. Furthermore, an unexpected deviation from the bank's prudent liquidity and capital management could have a negative rating impact.

DETAILED RATING CONSIDERATIONS

SUBDUED PROFITABILITY, WITH SOME DEPENDENCE ON RZB'S EARNINGS

RLB Vorarlberg's BCA is constrained by the bank's significant investments in RZB (the bank's stake was at 4.48% at year-end 2014) relative to its overall size and to other Raiffeisen-affiliated entities and its indirect investment in RBI. Although we acknowledge the indirect benefits from the geographic diversification of the Austrian Raiffeisen sector, the bank's limitation to its home region reflects a comparatively narrow geographical focus on Vorarlberg and adjacent regions in Germany and Switzerland.

RLB Vorarlberg's Profitability Score of ba2 is commensurate with the business and function the bank undertakes; therefore, the bank's drivers for income (on a pre-tax level) remain focused on its retail and SME business, treasury activities and its income from sector participations (2014: EUR12.8 million, mainly from RZB). In 2014, RLB Vorarlberg reported a net income of EUR18.0 million (2013: EUR62.2 million; 2012: EUR14.3 million) under audited local GAAP. Net interest income increased to EUR30.4 million (2013: EUR24.4 million; 2012: EUR22.9 million).

The bank's overall net interest margin of 40bps in recent years is low, although it is also a reflection of the bank's central role and the institutional liquidity arrangements with the local sector banks. The pressure on the net interest margin is reflected in the bank's recurring earnings power, as expressed by pre-provision income as a percentage of average risk-weighted assets (RWA), which remained at a low 0.7% in 2014 (2013:0.6%; 2012: 0.4%; 2011: 0.6%). RLB Vorarlberg's cost-to-income ratio remains elevated at about 74% in 2014, which reflects the pressure on earnings and high operating expenses.

With total assets of EUR6.5 billion, RLB Vorarlberg is one of the smaller Raiffeisenlandesbanken in Austria, with operations mainly in the State of Vorarlberg. RLB Vorarlberg is majority-owned by 23 local co-operative banks (Kreditgenossenschaften) in the region, for which the bank is the central institute. In Vorarlberg, the regional co-operative sector has a sizeable market share in retail banking and SME banking.

IMPROVED, SATISFACTORY CAPITALISATION

We note positively RLB Vorarlberg's solid economic and regulatory capital and the absence of hybrid capital instruments. In our view, the bank's capitalisation should be able to withstand a softening of the economic environment without adversely changing its financial profile. The assigned Capital Score of baa2 takes into account the tail risks related to RBI, but also its leverage.

However, the bank's capitalisation reflects the relatively low regulatory risk weightings of its assets and does not fully capture the moderate 2014 balance-sheet leverage, which stood at 3.9% (Tier 1 leverage of Basel III). In 2014, RLB Vorarlberg reported a Tier 1 ratio of 12.6% Basel III (2013: 12.0% Basel II) based on Tier 1 capital of EUR271 million (2013: EUR257 million) and RWA of EUR2,157 million (2013: EUR2,135 million).

SOUND ASSET QUALITY SUPPORTED BY CONSERVATIVE PROVISIONING POLICY

We acknowledge the bank's low level of problem loans and its historically conservative, though declining, provisioning levels, which have enabled it to protect its capitalisation so far. The bank's problem loan ratio for 2014 increased to 3.5% (2013: 2.0%; 2012: 1.7%).

RLB Vorarlberg's Asset Risk Score of baa2 reflects (1) high single-name concentration risk and sector concentration risk to financial institutions, the latter mainly because of its role as a central institute for the regional Raiffeisen banks, which are significantly exposed to the Swiss franc; (2) high levels of related-party lending (lending to group companies); and (3) some participation, market and earnings risk as a result of its stake in RZB.

RLB Vorarlberg has a sizeable portfolio of unquoted equity participations, largely related to the Raiffeisen sector, which we view as a source of potential risk; however, we acknowledge the strategic fit of these investments for the sector. The portfolio carries sizeable hidden reserves according to local GAAP. However, given uncertainties about the liquidity and marketability of such assets in periods of stress - especially for assets that have similar characteristics, such as holdings in financial companies - these potential profit cushions are of limited value as long as they are unrealised.

Excluding the sector banks, RLB Vorarlberg has a high borrower concentration, as the top 20 exposures account for more than 120% of Tier 1 capital.

SOUND LIQUIDITY SUPPORTED BY DIVERSIFIED FUNDING SOURCES INCLUDING RETAIL DEPOSITS

As the central institute for the local Raiffeisen banks in Vorarlberg, RLB Vorarlberg has access to diversified funding sources including sector funds (EUR1.6 billion in 2014) and own issuances (EUR1.6 billion). These funds are complemented by deposits (EUR0.9 billion) and interbank funding (EUR2.0 billion to credit institutes outside the sector), as reflected in the assigned Funding Score of b2. The bank has expanded its portfolio of highly rated fixed-income securities, most of which are eligible for collateral required by central banks, therefore providing some additional flexibility for liquidity management, as visible in the aa3 Liquidity Score.

The loan-to-deposit ratio has slowly increased in the last years to reach 144% in 2014 (123% in 2013; 119% in

2012) due to the combined effect of a slight decrease of deposits and a slight increase of loans. However, the bank's ratio is still at a lower absolute level than its peers. The bank's market funding ratio remains high, at 80% in 2014, which reflects the bank's defined role of collecting funds from the primary banks and other sector banks.

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

Austrian banks operate in Austria's (Aaa stable) strong economic environment, with a robust institutional and legal framework, sound government finances, and a low susceptibility to adverse events. Despite rising house prices, private sector debt is low and declining, which supports credit conditions. High levels of domestic and foreign customer deposits benefit the Austrian banks' funding. Austria's largest banks rely on wholesale capital markets to fund parts of their CEE lending, but their reliance has lessened over the last 12 months. 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 RBG, the Austrian Raiffeisen sector, to be very high due to RLB Vorarlberg'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 reassessed the Austrian Raiffeisen sector's financial capacity to provide support to its members, based on the co-operative group's combined financial strength. We consider the Group's capitalisation as moderate relative to its overall credit profile, which is focused on -- and therefore strongly correlated with -- its higher-risk CEE/CIS exposures, 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. RBG cross-sector support currently results in no rating uplift to RLB Vorarlberg's BCA.

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

RLB Vorarlberg 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.

We believe that RLB Vorarlberg`s 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 from the adjusted BCA. The resulting Preliminary Rating Assessments are set out below.

GOVERNMENT SUPPORT

With the implementation of bank resolution legislation, we has either eliminated or lowered our assumption about the probability of government support for the banks in the EU, thereby generally attributing a "moderate" probability of government support to banking groups in the EU which are considered systemically relevant. While we consider the group of Austrian Raiffeisen co-operative banks to be systemically relevant, we now only attributes a "low" probability of Austrian government support -- from mostly "high" previously - in light of the precedent set by triggering a resolution of Heta. We believes that the wider scope of the BRRD implementation in Austria and its recent application illustrates the Austrian government's willingness to apply burden-sharing. Our assessment of a "low" probability of support results in no government support uplift for Raiffeisen sector banks' senior debt and deposit ratings, including those of RLB Vorarlberg.

About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Raiffeisenlandesbank Vorarlberg

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						
Problem Loans / Gross Loans	3.5%	a2	←→	baa2	Sector concentration	Market risk
Capital						
TCE / RWA	13.1%	a1	←→	baa2	Nominal leverage	Stress capital resilience
Profitability						
Net Income / Tangible Assets	0.3%	ba2	←→	ba2		
Combined Solvency Score		a3		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	80.0%	caa3	←→	b2	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	74.9%	aa1	←→	aa3	Intragroup restrictions	
Combined Liquidity Score		ba2		baa3		

Financial Profile	**baa3**

Qualitative Adjustments	**Adjustment**
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	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	Baa1

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.

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