MOODY'S
INVESTORS SERVICE

Credit Opinion: Raiffeisenlandesbank Vorarlberg

Global Credit Research - 12 Feb 2016

Bregenz, Austria

Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	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

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 / Due to customers (%)	**144.5**	**123.4**	**119.1**	**103.6**	**116.6**	[5]**121.4**

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 Raiffeisenlandesbank Vorarlberg (RLB Vorarlberg) 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 Vorarlberg'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 Raffeisen 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 Vorarlberg's BCA reflects the bank's sound asset quality, improving and satisfactory capitalisation as well as its strong liquidity. The BCA also takes into account RLB Vorarlberg's subdued profitability, which is dependent on earnings from RLB Vorarlberg's share-holdings in Raiffeisen Zentralbank Oesterreich AG (RZB, deposits Baa2 negative/issuer Baa2 negative) and therefore the associated tail risks regarding the bank's solvency.

RATING DRIVERS

- Subdued profitability, with some dependence on RZB's earnings

- Improved, satisfactory capitalisation

- Sound asset quality supported by conservative provisioning policy

- Sound liquidity supported by diversified funding sources including retail deposits

- RLB Vorarlberg's ratings are supported by its Macro Score of Very Strong-

RATING OUTLOOK

The outlook for RLB Vorarlberg'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 Vorarlberg's profit generation and stability party 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.

Upward pressure for RLB Vorarlberg'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 Vorarlberg's issuer and/or deposit ratings.

WHAT COULD CHANGE THE RATING - DOWN

Downward pressure on RLB Vorarlberg'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 a material erosion in RLB Vorarlberg's local market share; (2) a deterioration in the bank's profitability and efficiency; or (3) further weakening of its 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 investment in RZB relative to its overall size (as well as its total shareholdings in other Raiffeisen-affiliated entities), implying a considerable indirect investment in RBI. The bank's stake in RZB stood at 4.48% at year-end 2014. 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 the adjacent regions in Germany and Switzerland.

The bank's income drivers (on a pre-tax level) remain focused on its retail and small and medium-sized enterprises (SMEs) 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 0.4% in recent years is low, although it is also a reflection of the bank's central role in the group 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 approximately 74% in 2014, which reflects the pressure on earnings and high operating expenses. All factors together result in a Profitability score of ba2.

IMPROVED, SATISFACTORY CAPITALISATION

We note positively RLB Vorarlberg's solid economic and regulatory capital, and the absence of hybrid capital instruments. The bank's capitalisation should be able to withstand a softening of the economic environment without adversely changing its financial profile. In addition, the assigned Capital score of baa2 takes into account the tail risks related to RBI, but also the bank's T1 leverage ratio of 3.9% in 2014.

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 capital 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) its 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) its high levels of related-party lending, i.e., 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 for RLB Vorarlberg's profitability and therefore its capital generation capacity. We acknowledge the strategic fit of these investments for the sector, and 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-customer deposit ratio has slowly increased since 2011 to reach 144% in 2014 (123% in 2013; 119% in 2012) owing 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-

As an Austrian bank, RLB Vorarlberg 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 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 owing to RLB Vorarlberg's vital regional importance to the sector. This support materially reduces the probability of default as the co-operative group's 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. 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 cross-sector support currently results in no uplift for RLB Vorarlberg.

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.

RLB Vorarlberg'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. 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 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 Vorarlberg, to be systemically relevant, we now only attribute a low probability of Austrian government support. This results in no government support uplift for RLB Vorarlberg's senior debt and deposit ratings.

Issuer Profile

With total assets of EUR6.5 billion, RLB Vorarlberg is one of the smaller Raiffeisenlandesbanks (central regional institutions of the Group) in Austria, with operations mainly in the State of Vorarlberg. RLB Vorarlberg is majority-owned by 23 local co-operative banks 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.

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

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