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CREDIT OPINION

20 November 2017

Update

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RATINGS

Raiffeisenlandesbank Vorarlberg

Domicile	Austria
Long Term Debt	Not Assigned
Long Term Deposit	Baa1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Raiffeisenlandesbank Vorarlberg

Update following recent rating affirmation

Summary

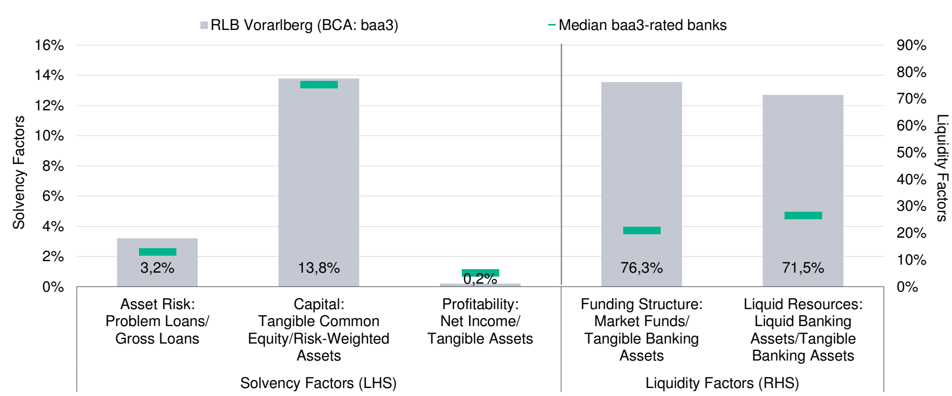
On 3 November 2017, we affirmed Raiffeisenlandesbank Vorarlberg's (RLB Vorarlberg) Baa1 deposit and issuer ratings. The rating affirmation was based on our affirmation of RLB Vorarlberg's Baseline Credit Assessment (BCA) at baa3, which takes into account the bank's sound and broadly stable asset-risk and capital metrics, as well as its solid and stable funding structure. These strengths, combined with improved prospects for profitability, in principle indicate potential for a BCA above the assigned baa3.

At the same time, however, the BCA remains constrained by (1) the weak operating environment and therefore modest profitability; (2) the risks relating to its sector concentrations and participations, in particular the large ownership stake in Raiffeisen Bank International AG (RBI; A3 stable/A3 stable, ba1[1]); and (3) the high degree of correlation within the sector resulting from the very high mutualist support commitment.

The Baa1 ratings reflect (1) the bank's baa3 BCA; (2) its baa3 Adjusted BCA, which incorporates very high affiliate support from Raiffeisen Banking Group (RBG), but results in no uplift from the baa3 BCA; and (3) the result of our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution, adding two notches of rating uplift to RLB Vorarlberg's issuer and deposit ratings from its baa3 Adjusted BCA.

Exhibit 1

Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

» RLB Vorarlberg's capitalisation is sound, especially when taking into account the bank's additional reserves not fully included in its regulatory capital ratios.

» Notwithstanding some deterioration in 2016, the quality of the bank's core lending book remains sound and superior to its peers'.

» RLB Vorarlberg's large liquidity buffer and access to sector funds mitigate funding risks.

» Senior creditors benefit from a large volume of outstanding debt, and therefore a very low loss given failure, in the unlikely event of resolution.

Credit challenges

» The bank's risk profile is strongly influenced by non-lending risks, in particular its large stake in the sector's central institution, RBI.

» RLB Vorarlberg's profitability is modest and volatile, with some dependence on contributions from RBI.

Rating outlook

» The outlook on RLB Vorarlberg's ratings is stable, reflecting our expectation that the bank will be able to sustain, if not further improve, its satisfactory capitalisation and sound asset quality.

» The Raiffeisen sector's financial strength remains a limiting factor on RLB Vorarlberg's individual creditworthiness. Further progress in the RBI Group's ongoing downsizing and restructuring plan will likely further improve RBI's fundamentals. However, RBI's large size and higher-risk profile relative to the domestic Raiffeisen sector will probably continue to constrain individual member banks' BCAs to the low-investment-grade level during 2017-18.

Factors that could lead to an upgrade

» The bank's ratings could be upgraded if (1) stronger fundamentals justify an upgrade of the BCA; and (2) RBG's financial strength improves, such that it raises or removes the current rating constraints, or even results in affiliate support uplift. In addition, the ratings may benefit from additional rating uplift, as assessed in our Advanced LGF analysis. However, the latter would require materially higher subordinated instruments.

» We would consider upgrading the BCA if the bank demonstrates that it can sustain superior asset-quality metrics and improve profits to raise its capital generation capacity. In addition, a stronger leverage ratio could exert upward pressure.

Factors that could lead to a downgrade

» A downgrade could be prompted if (1) weakening fundamentals warrant a downgrade of the bank's BCA and, at the same time, RBG's fundamentals were to weaken to a level that the downgrade cannot be offset by higher affiliate support; (2) the BCA of RBG is downgraded, because this would raise the current constraints for RLB Vorarlberg's BCA; and (3) changes to the bank's liability structure prompt a weaker result from our LGF analysis.

» Negative pressure on the BCA could result from a material weakening of RLB Vorarlberg's profitability and capital ratios or indications of materially rising asset risks.

Key indicators

Exhibit 2

Raiffeisenlandesbank Vorarlberg (Unconsolidated Financials) [1]

	12-16[2]	12-15[2]	12-14[2]	12-13[3]	12-12[3]	CAGR/Avg.[4]
Total Assets (EUR billion)	6.1	6.3	6.5	6.7	6.7	-2.3[5]
Total Assets (USD billion)	6.4	6.8	7.8	9.2	8.8	-7.6[5]
Tangible Common Equity (EUR billion)	0.3	0.3	0.3	0.3	0.2	7.1[5]
Tangible Common Equity (USD billion)	0.3	0.3	0.3	0.4	0.3	1.3[5]
Problem Loans / Gross Loans (%)	3.3	2.9	3.5	2.0	1.7	2.7[6]
Tangible Common Equity / Risk Weighted Assets (%)	13.8	14.5	13.1	13.6	9.9	13.8[7]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	15.2	12.2	13.7	7.6	7.7	11.3[6]
Net Interest Margin (%)	0.5	0.5	0.5	0.4	0.4	0.4[6]
PPI / Average RWA (%)	0.6	0.9	0.7	0.6	0.4	0.7[7]
Net Income / Tangible Assets (%)	0.2	0.3	0.3	0.9	0.2	0.4[6]
Cost / Income Ratio (%)	75.5	69.4	73.7	73.6	77.5	73.9[6]
Market Funds / Tangible Banking Assets (%)	76.3	77.0	77.0	79.8	79.6	78.0[6]
Liquid Banking Assets / Tangible Banking Assets (%)	71.5	74.4	75.7	78.5	77.1	75.5[6]
Gross Loans / Due to Customers (%)	165.4	154.1	144.5	123.4	119.1	141.3[6]

[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] May include rounding differences due to scale of reported amounts. [5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [6] Simple average of periods presented for the latest accounting regime. [7] Simple average of Basel III periods presented.

Source: Moody's Financial Metrics

Profile

With total assets of €6.1 billion as of December 2016, RLB Vorarlberg is one of the smaller of the eight Raiffeisenlandesbanken in Austria. RLB Vorarlberg is majority-owned by 21 local primary credit co-operatives in the region, for which the bank is the central institution. In Vorarlberg, the regional co-operative sector has sizeable market shares in retail banking and in lending to small and medium-sized corporates.

RLB Vorarlberg is a direct shareholder in RBI, the Austrian Raiffeisen sector's central institution, holding a 2.9% share, which implies a material indirect exposure to the Central and Eastern European banking markets. Traditionally, RLB Vorarlberg has partly relied on income derived from participations. The bank's financial reporting is based on local GAAP.

Detailed rating considerations

RLB Vorarlberg's capitalisation is sound, taking into account additional reserves

RLB Vorarlberg's ratings are underpinned by sound and stable solvency metrics, in particular satisfactory capital buffers. RLB Vorarlberg reported a 13.0% Common Equity Tier 1 capital ratio as of year-end 2016, slighty below the 13.3% reported a year earlier, under the Capital Requirements Regulation and Directive (CRR/CRD IV). The ratio benefitted from a mild increase in CET1 capital to €275 million, which, however, was more than offset by a 4% increase in risk-weighted assets (RWA) in 2016. The bank reported a weaker leverage ratio than its Raiffeisenlandesbanken peers, as reflected in its 4.1% regulatory Tier 1 leverage ratio as of year-end 2016 (2015: 4.0%).

That said, RLB Vorarlberg has substantial additional capital resources stemming from (1) fully taxed reserves under Austrian local GAAP[2], which we understand stood at €61 million as of December 2016; and (2) hidden reserves on its participation portfolios. Portions of the local GAAP reserves were included in the bank's €71 million Tier 2 capital as of December 2016. If the bank were to report under IFRS, the respective amounts would be attributed to its CET1 capital. Adjusted for the Austrian GAAP reserves, the CET1 ratio was 15.8% as of year-end 2016, slightly above that of its Austrian peers.

At the same time, RLB Vorarlberg faces various risks to capital, specifically from (1) its highly concentrated equity investments, and (2) evolving regulation that could result in higher RWA over the next year. The €148 million (mostly indirect) stake in the former RZB as of year-end 2016 represented a very large concentration in the context of the bank's €275 million CET1 capital. To take account of the related risk, we simulate a partial impairment of the bank's stake in the former RZB, as well as on other participations, which we discount from its adjusted tangible common equity (for example, including Local GAAP reserves), and adjust the Capital score accordingly. Prospective changes in RWA, which could weaken the bank's regulatory capital ratios, could result from adjustments to the currently applicable (and relatively favourable) risk weightings for participations, in the context of the targeted harmonisation of risk weights under Basel III. Regulatory aspects aside, we expect RLB Vorarlberg to gradually build further capital buffers.

The aspects of current buffers and risks to capital are reflected in the a1 Capital score.

Asset quality is sound, and modest nonperforming loans are supported by adequate provisioning

RLB Vorarlberg has one of the lowest problem loan ratios in the Austrian banking market, which illustrates its conservative underwriting. The bank's problem loan ratio rose mildly during 2016 to 3.3% from 3.0% a year earlier, but remained sound. Provisioning levels are prudent.

In addition to its €148 million participation in the former RZB, RLB Vorarlberg has a €30 million portfolio of unquoted equity participations. These participations are largely related to the Raiffeisen sector, and we acknowledge the strategic fit for the bank. We understand that the portfolio carries substantial hidden reserves according to local GAAP. Although these cannot be, and are also not intended to be, realised, the hidden reserves imply a valuable buffer against value erosion in its participations portfolio, thereby protecting the income statement from potential losses.

RLB Vorarlberg's Asset Risk score is baa2. This score includes adjustments for the bank's high single-borrower and sector concentrations.

RLB Vorarlberg's profitability is modest and partly dependent on dividends

RLB Vorarlberg's BCA is constrained by the bank's dependence on returns from its significant investment in RBI, formerly RZB, which has been the reason for considerable (underlying) profit volatility in recent years. At the same time, the bank reported relatively stable net profits, which was possible either due to offsetting effects or through transfers to reserves under local GAAP.[3] Such transfers principally understate the true profit, and we note positively that during the three years to 2016, the bank consistently made transfers to reserves, thereby adding to its loss-absorption buffers.

RLB Vorarlberg reported a very modest net profit for 2016 of €10.9 million (2015: €17.9 million). However, adjusted for a substantial €14.8 million transfer to local GAAP reserves (2015: €9.0 million), the result was €25.7 million. That said, the 2016 result was relatively weak at the operating level, and, in the context of several large one-off effects, we believe that the reported €10.9 million net result only mildly understates the bank's underlying profit for the year.

» Core revenue was under pressure. Net interest income, and fee and commission income declined by 8.5% and 4.5%, respectively, because net interest returns from treasury and interbank activities weakened owing to the low interest rate environment and a weaker securities business, with clients weighed on fee income. This resulted in a reduced operating result before risk charges of €16.0 million (2015: €19.8 million).

» The one-off items include first-time accounting effects following a legal change to Austrian local GAAP, reporting standards that aim to enhance transparency. These accounting effects resulted in gains of €6.6 million under risk provisions and another €17.6 million in positive tax effects. The total €24.2 million positive accounting effect was more than offset by a €10.8 million one-off contribution to the Austrian stabilisation fund and the above-mentioned €14.8 million transfer to fully taxed local GAAP reserves. Adjusted for these one-off effects, net profit was €12.3 million.

In 2017, we expect pressure on the bank's operating revenue to persist. That said, RLB Vorarlberg recently embarked on a cost-saving programme that aims to offset further pressure on revenue and, over time, to result in higher profits and capital retention.

The bank's Profitability score of ba3 reflects its modest net profit relative to its total assets, as well as the limited potential of raising profits from its core banking operations in 2017.

The bank's sound liquidity mitigates funding risks, additionally supported by access to sector funds and retail deposits

As the central institution for the local Raiffeisen banks in Vorarlberg, RLB Vorarlberg has access to diversified funding sources, including sector funds (€1.37 billion in 2016) and own issuances (€1.38 billion). These funds are complemented by deposits (€887 million) and interbank funding (€2.1 billion from banks outside the sector). The bank's market fund ratio remained stable at a high 76% as of year-end 2016. However, the mitigation of funding risk implied by the bank's access to sector funds is reflected in the assigned Funding score of b2.

RLB Vorarlberg has a relatively liquid balance sheet, considering that its loan book only represents 24% of its total assets, with the remainder mostly comprising interbank claims (35%) and securities investments (35%). The bank's large portfolio of highly rated fixed-income securities, most of which are eligible for collateral required by central banks, therefore provides ample flexibility in its liquidity management, as reflected in the a1 Liquidity score.

RLB Vorarlberg's ratings are supported by its Macro Profile of Strong+

RLB Vorarlberg's Macro Profile is Strong+, at the same level as the Strong+ Macro Profile for the Government of Austria (Aa1 stable[4]) because the bank's assets are primarily generated in its home market.

Austria's Strong+ Macro Profile reflects the country's stable 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, further supporting the credit conditions. Our Macro Profile also takes into account the banking sector's high market fragmentation, low fee income generation and intense competition for domestic business.

Support and structural considerations

Affiliate support

We consider the likelihood of support from RBG, the Austrian Raiffeisen sector, very high owing to RLB Vorarlberg's regional importance to the sector. This support materially reduces the probability of default because 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 assess the Austrian Raiffeisen sector's financial capacity to provide support to its members based on the co-operative group's combined financial strength. Although their combined financial strength has recently improved, we still consider RBG's capitalisation moderate relative to its overall credit profile, which is strongly correlated with its higher-risk Central and Eastern European exposures, housed at RBI. The sector's limited support capacity implies a constraint to the possible uplift included in member banks' ratings. Member banks with BCAs of baa3 or higher therefore do not benefit, in terms of rating uplift, from our very high support assumption for the group of Raiffeisenlandesbanken. Accordingly, RBG's cross-sector support currently results in no rating uplift for RLB Vorarlberg.

Loss Given Failure analysis

RLB Vorarlberg is subject to the EU Bank Recovery and Resolution Directive, which we consider 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 and 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 deposits are likely to face very low loss given failure, resulting in two notches of rating uplift from the baa3 Adjusted BCA.

» RLB Vorarlberg's senior obligations (which the issuer rating speaks to) are also likely to face very low loss given failure, resulting in two notches of rating uplift from the baa3 Adjusted BCA.

Government support

In contrast to banks in other EU countries and reflective of government measures in Austria implemented since 2014, we assign a low level of support for the senior debt and deposit ratings of Austrian banks. As a consequence, we do not include any beneficial rating impact for government support in RLB Vorarlberg's issuer and deposit ratings despite the strong national market shares and systemic relevance of the Raiffeisen sector as a whole to the country's banking system.

Counterparty Risk Assessment (CR Assessment)

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails, and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

RLB Vorarlberg's CR Assessment is positioned at A3(cr)/P-2(cr).

The bank's CR Assessments are positioned three notches above the baa3 Adjusted BCA, based on the buffer against default provided to the senior obligations represented by the CR Assessment, by more subordinated instruments, primarily senior unsecured debt. To determine the CR Assessment, we focus purely on subordination, taking no account of the volume of the instrument class.

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 methodology and scorecard factors

Exhibit 3

Raiffeisenlandesbank Vorarlberg

Macro Factors		
Weighted Macro Profile	**Strong +**	**100%**

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	3.3%	a3	←→	baa2	Sector concentration	
Capital						
TCE / RWA	13.8%	a2	←→	a1	Nominal leverage	Stress capital resilience
Profitability						
Net Income / Tangible Assets	0.2%	b1	←→	ba3	Earnings quality	
Combined Solvency Score		baa1		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	76.3%	caa3	←→	b2	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	71.5%	aa1	←→	a1	Asset encumbrance	
Combined Liquidity Score		ba2		ba1		
Financial Profile				baa2		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				--		
Scorecard Calculated BCA range				baa2-ba1		
Assigned BCA				baa3		
Affiliate Support notching				--		
Adjusted BCA				baa3		

Balance Sheet	**in-scope (EUR million)**	**% in-scope**	**at-failure (EUR million)**	**% at-failure**
Other liabilities	4,068	66.9%	4,159	68.3%
Deposits	886	14.6%	796	13.1%
Preferred deposits	656	10.8%	623	10.2%
Junior Deposits	230	3.8%	173	2.8%
Senior unsecured bank debt	948	15.6%	948	15.6%
Equity	183	3.0%	183	3.0%
Total Tangible Banking Assets	6,085	100%	6,085	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Assessment	21.4%	21.4%	21.4%	21.4%	3	3	3	3	0	a3 (cr)
Deposits	21.4%	3.0%	21.4%	18.6%	2	3	2	2	0	baa1
Senior unsecured bank debt	21.4%	3.0%	18.6%	3.0%	2	2	2	2	0	baa1

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a3 (cr)	0	A3 (cr)	--
Deposits	2	0	baa1	0	Baa1	Baa1
Senior unsecured bank debt	2	0	baa1	0	Baa1	Baa1

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
RAIFFEISENLANDESBANK VORARLBERG	
Outlook	Stable
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

Source: Moody's Investors Service

Endnotes

1 The ratings shown are RBI's deposit rating and outlook, its senior unsecured debt rating and outlook, and its BCA.

2 Fully taxed local GAAP reserves, based on § 57(1) of the Austrian Legal Banking Act, are deducted from gross loans and therefore not disclosed as reserves.

3 In accordance with §57(1) of the Austrian Legal Banking Act, such fully taxed reserves under Austrian local GAAP are labelled loan-loss provisions and booked under risk charges in the income statement. Economically, however, the transfers represent allocations of net profits to capital reserves.

4 The rating shown is the sovereign bond rating and outlook.

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