FitchRatings

Volksbanken-Verbund

Update

Banks
Retail & Consumer Banks
Austria

Ratings

Foreign Currency	
Long-Term IDR	BBB+
Short-Term IDR	F2
Viability Rating	bbb+
Government Support Rating	ns

Sovereign Risk (Austria)	
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	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Key Rating Drivers

Cooperative Banking Group: The Austrian Volksbanken-Verbund (VB-Verbund) is not a legal entity, but a medium-sized network of regional cooperative banks, with Volksbank Wien AG (VBW) acting as the central organisation. The group's strong cohesion is primarily ensured by its 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', which results in below-average operating profitability and cost efficiency, and ultimately limits the group's financial flexibility. The VR also reflects the group's robust capitalisation, and good liquidity and funding profile.

Financials Underpin Business Profile: VB-Verbund has a solid 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 businesses. The group's business profile is constrained by its moderate size and regional focus, resulting in limited diversification and pricing power.

Risk Appetite in Real Estate: The group's risk profile benefits from a focus on core products, lending to a well-known customer base with a focus on domestic retail, self-employed and SME clients and long-term relationships. However, the group's risk profile is increasingly affected by weak domestic real estate markets, primarily commercial real estate.

Asset Quality Deterioration: The group's impaired loans ratio increased to about 3.4% at end-1H24, reflecting rising defaults in the corporate and commercial real estate segments. We expect further inflows of impaired loans in 2H24 as a result of a still-weak economy and continued risks in real estate markets, which drives our negative outlook on VB-Verbund's asset quality score. We expect VB Verbund's NPL ratio to peak at above 5% at end-2024, and to remain at that level in 2025 before improving.

Loan Losses Dampens Profitability: VB-Verbund's operating profit/risk-weighted assets (RWAs) ratio (1H24: 1.0%, annualised) has reduced significantly (2023: 2.4%) despite an adequate operating business in the first six months. It reflects a material rise in loan impairment charges (LICs), which we expect to rise further towards year-end. This has led us to revise our 2024 forecast for VB Verbund's operating profit/RWAs to below 1%.

Adequate Capitalisation: The group's common equity Tier 1 (CET1) ratio (end-1H24: 15.1%) is robust for its risk profile and offers adequate headroom over its regulatory capital requirements. The standardised approach for the calculation of RWAs also mitigates the impact of asset quality deterioration on the group's CET1 ratio. We expect VB-Verbund to maintain a CET1 ratio around 15% in the medium term, which underpins our stable outlook on capitalisation.

Broadening Funding Franchise: VB-Verbund is primarily funded by stable, granular retail and SME deposits resulting in a loans/deposits ratio of consistently around 100%. Its capital market franchise beyond covered bonds has increased due to regulatory requirements for the issuance of minimum requirement for own funds and eligible liabilities. This included two Tier 2 debt issues in 2024 and a green benchmark bond in 2023. VB-Verbund's liquidity profile is solid and underpinned by a large amount of instantly available liquidity at end-1H24.

Applicable Criteria

Bank Rating Criteria (March 2024)

Related Research

Fitch Affirms Volksbanken-Verbund at 'BBB+'; Outlook Stable (June 2024)

Fitch Affirms Austria at 'AA+'; Outlook Stable (July 2024)

Global Economic Outlook (September 2024)

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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 below 0.5% of RWAs, or a CET1 ratio below 11.5% without clear recovery prospects. The Short-Term IDRs are sensitive to downgrades 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 revenues bases without negatively affecting the bank's risk profile. This would strengthen VB-Verbund's business profile, as indicated by a sustainable improvement in average operating profit/RWAs of at least 1.5%, while maintaining its good asset quality and capitalisation.

An upgrade of the Short-Term IDR to 'F1' would require a two-notch upgrade of the funding and liquidity score to 'a'.

Significant Changes from Last Review

Real Estate Drives Asset Quality Deterioration in 1H24

VB-Verbund's impaired loan ratio notably deteriorated in 1H24 to about 3.4% after having risen already by about 80bp to 2.7% in 2023. This is due to negative market performance in various segments of the group's EUR7.7 billion commercial real estate (CRE) exposure, as for other domestically focused banks in Austria. VB-Verbund's CRE financing is purely domestic, with a focus on residential property (EUR3.4 billion).

The CRE portfolio has been particularly affected by sharp interest rate increases, cost inflation in 2023, and a supply–demand imbalance, aggravating refinancing risks in the sector. CRE developers, to which the group is more exposed than peers, fared poorly.

We expect tensions in Austrian real estate markets and developers' weak performance to prevail for longer than initially expected, well into 2025. This means that non-performing exposures will remain high. An improvement in sentiment could slowly materialise upon further interest rate cuts by the ECB in 2025, which would trigger higher market confidence and liquidity.

Weaker Corporate Segment

The group's portfolio of corporates and small and medium-sized enterprises, which comprises about a third of customer loans, also performed below expectations, particularly the tourism sector. Weak economic growth and a rising number of corporate insolvencies in Austria (up 26% yoy) could put further pressure on the segment's asset quality.

Expectations on Financial Metrics Revised

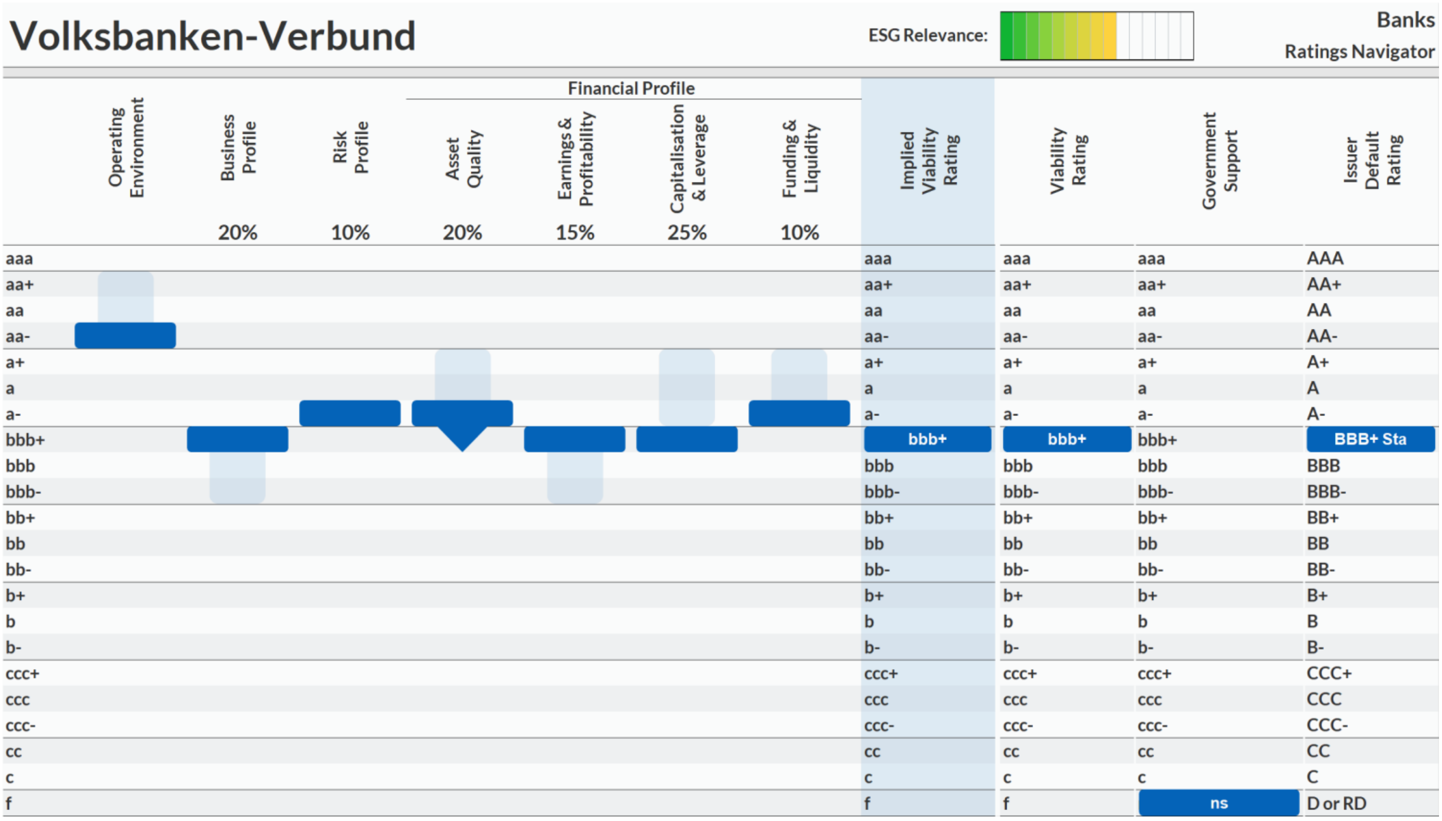
We have revised our forecasts for VB-Verbund's asset quality and profitability for 2024 and 2025. We now expect the bank's impaired loans ratio to increase to just above 5% at end-2024 and to remain broadly stable at that level in 2025. However, the four-year average gross impaired loans ratio should remain below 5% because the gross impaired loans ratio and LICs should improve materially from 2026 as real estate objects are completed and sold.

Results in the first half of the year indicate VB-Verbund's 2024 profitability is likely to be materially below its solid 2023 results. LICs rose to EUR84 million (2023: EUR65 million), despite an adequate level of operating income in 1H24. We expect loan losses in the real estate sector will further increase LICs. Operating costs are set to rise due to inflation effects (up 10% yoy in 1H24), and we believe the operating profit/RWAs ratio could fall to 0.6% for 2024, recovering only slightly to around 1.0% in 2025.

Stable Capitalisation and Funding

VB-Verbund's CET1 ratio (end-1H24: 15.1%; end-2023: 15.3%) is in line with that of peers and commensurate with the bank's risk profile. Customer deposits remained the group's most important funding source, accounting for 87% at end-1H24 (EUR22.8 billion), and having grown by EUR600 million in 1H24, with an ongoing preference for term money. We expect both capitalisation and funding and liquidity to be less affected by the recent weakening of asset quality and profitability.

Ratings Navigator



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’ implied category score due to the following adjustment reason: internal capital generation and growth (negative).

Financials

Financial Statements

	30 Jun 24 1st half (USDm)	30 Jun 24 1st half (EURm)	31 Dec 23 12 months (EURm)	31 Dec 22 12 months (EURm)	31 Dec 21 12 months (EURm)
Summary income statement					
Net interest and dividend income	351	327	705	468	406
Net fees and commissions	151	140	262	255	253
Other operating income	-20	-18	-2	-7	17
Total operating income	482	449	966	716	676
Operating costs	305	284	536	500	515
Pre-impairment operating profit	177	165	430	216	160
Loan and other impairment charges	90	84	65	31	-89
Operating profit	87	81	365	185	250
Other non-operating items (net)	–	–	0	-69	1
Tax	9	9	39	2	32
Net income	78	72	326	115	219
Other comprehensive income	15	14	33	16	9
Summary balance sheet					
Assets					
Gross loans	25,098	23,358	23,068	22,391	21,837
– Of which impaired	–	–	629	421	463
Loan loss allowances	443	412	330	275	273
Net loans	24,655	22,946	22,738	22,116	21,563
Interbank	213	198	234	123	257
Derivatives	258	241	271	298	115
Other securities and earning assets	3,783	3,521	3,229	2,636	2,644
Total earning assets	28,909	26,905	26,472	25,173	24,579
Cash and due from banks	3,494	3,252	3,435	3,473	6,921
Other assets	708	659	575	578	595
Total assets	33,111	30,815	30,482	29,224	32,095
Liabilities					
Customer deposits	24,456	22,761	22,180	22,105	22,747
Interbank and other short-term funding	175	163	212	1,812	3,797
Other long-term funding	4,481	4,170	4,329	2,133	2,371
Trading liabilities and derivatives	257	240	294	301	327
Total funding and derivatives	29,370	27,334	27,015	26,351	29,242
Other liabilities	955	889	708	435	521
Preference shares and hybrid capital	2	2	219	220	218
Total equity	2,784	2,591	2,540	2,218	2,115
Total liabilities and equity	33,111	30,815	30,482	29,224	32,095
Exchange rate		USD1 = EUR0.930665	USD1 = EUR0.912742	USD1 = EUR0.937559	USD1 = EUR0.884173

Source: Fitch Ratings, Fitch Solutions, Volksbanken-Verbund

Key Ratios

	30 Jun 24	31 Dec 23	31 Dec 22	31 Dec 21
Ratios (%; annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.0	2.4	1.3	1.8
Net interest income/average earning assets	2.5	2.7	1.9	1.7
Non-interest expense/gross revenue	63.4	55.6	69.7	76.1
Net income/average equity	5.7	13.8	5.3	10.5
Asset quality				
Impaired loans ratio	3.4	2.7	1.9	2.1
Growth in gross loans	1.3	3.0	2.5	0.9
Loan loss allowances/impaired loans	–	52.4	65.4	59.1
Loan impairment charges/average gross loans	0.7	0.3	0.1	-0.4
Capitalisation				
Common equity Tier 1 ratio	15.1	15.3	14.2	14.4
Fully loaded common equity Tier 1 ratio	15.1	15.2	14.0	14.1
Tangible common equity/tangible assets	8.1	8.2	7.3	4.8
Basel leverage ratio	7.3	8.1	7.4	6.6
Net impaired loans/common equity Tier 1	–	12.8	7.2	9.6
Funding and liquidity				
Gross loans/customer deposits	102.6	104.0	101.3	96.0
Liquidity coverage ratio	184.3	192.6	164.9	223.7
Customer deposits/total non-equity funding	84.0	82.3	84.1	78.1
Net stable funding ratio	135.2	135.0	135.4	138.0

Source: Fitch Ratings, Fitch Solutions, Volksbanken-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 'no support' Government Support Rating reflects Fitch's view that the EU's resolution framework is likely to require senior creditors participating in losses ahead of a bank receiving sovereign support.

Environmental, Social and Governance Considerations

FitchRatings **Volksbanken-Verbund**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Volksbanken-Verbund has 5 ESG potential rating drivers

- Volksbanken-Verbund has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
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	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
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	5
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	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1	n.a.	n.a.	2
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	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	5
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	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

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.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3'means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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