Moody's Investors Service

Credit Opinion: Österreichische Volksbanken AG

Global Credit Research - 18 Dec 2009

Vienna, Austria

Ratings

Category	**Moody's Rating**
Outlook	Negative
Bank Deposits	Baa1/P-2
Bank Financial Strength	E+
Issuer Rating	Baa1
Senior Unsecured	Baa1
Senior Subordinate -Dom Curr	Baa2
Jr Subordinate -Dom Curr	Caa2
Preferred Stock -Dom Curr	Caa2
Other Short Term -Dom Curr	P-2
Investkredit Bank AG	
Outlook	Negative
Bank Deposits	Baa2/P-2
Bank Financial Strength	E+
Senior Unsecured	Baa2
Subordinate -Dom Curr	Caa2
Jr Subordinate -Dom Curr	Caa2
OEVAG Finance (Jersey) Limited	
Outlook	Stable
Bkd Preferred Stock	Caa2
Investkredit Funding II Limited	
Outlook	Stable
Preferred Stock	Caa1

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Key Indicators

Oesterreichische Volksbanken AG

	[1]**2009**	[2]**2008**	**2007**	**2006**	**2005**	[3]**Avg.**
Total assets (EUR billion)	**52.69**	**52.92**	**78.64**	**67.43**	**54.80**	[4]**19.67**
Total capital (EUR billion)	**5.04**	**4.24**	**4.40**	**4.66**	**3.54**	[4]**22.89**
Return on average assets	**-0.35**	**-0.29**	**0.46**	**0.43**	**0.54**	**0.33**
Recurring earnings power [5]	**0.55**	**-0.02**	**0.46**	**0.50**	**0.42**	**0.42**
Net interest margin	**1.29**	**1.19**	**1.00**	**0.90**	**0.96**	**1.16**
Cost/income ratio (%)	**68.36**	**101.39**	**70.00**	**64.23**	**76.63**	**77.66**
Problem loans % gross loans	**--**	**4.89**	**4.04**	**1.84**	**--**	**3.59**
Tier 1 ratio (%)	**9.99**	**7.14**	**7.05**	**7.71**	**7.33**	**7.85**

[1] As of June 30. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Compound annual growth rate. [5] Preprovision income % average assets.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of E+ to Österreichische Volksbanken - AG (ÖVAG), which translates into a baseline credit assessment (BCA) of B1. ÖVAG is the central institution of the Austrian cooperative banks (Volksbanken). The rating takes into account low expected profitability, the bank's strong reliance on market funds, weak control functions within the group, significant pressure on asset quality and capital in the medium term, and the fact that the Republic of Austria (rated Aaa) currently supports the bank with capital and funding. The rating also reflects its strengthened capital base, its good franchise value in Austria and also it business and geographic diversification given its banking operations in Austria and Central and Eastern European (CEE). The rating also reflects the benefits and support deriving from the bank's owners, the Austrian co-operative banks.

The long-term global local currency (GLC) deposit rating of ÖVAG is Baa1. It benefits from a very high probability of support provided by the Austrian cooperative sector (Österreichischer Volksbanken-Sektor, Genossenschafts-Verband, ÖGV, not rated). Moody's also views the probability of systemic support for ÖVAG as very high based on its position as the fourth largest bank in Austria. Moreover, together with other local cooperative banks, ÖVAG is an important player in the retail and SME market. ÖVAG's GLC deposit rating of Baa1 thus enjoys a six-notch uplift from its B1 BCA.

Credit Strengths

- Stable and strong banking franchise in Austria

- Good diversification (geographic and segment) via its subsidiaries operating in Austria and CEE

- Support and benefits deriving from its owners and the Republic of Austria

Credit Challenges

- Concentration risk in the real estate sector

- Weak profitability

- Weak asset quality

- Heavy reliance on less stable market and interbank funding

- Realising synergies among banking subsidiaries

- Integrating and improving risk management and corporate governance in its subsidiaries

- Significant foreign currency lending among its banking operations in CEE

Rating Outlook

The outlook on the BFSR as well as on the debt and deposit ratings is negative.

What Could Change the Rating - Up

Positive pressure on the bank's ratings could result from a sustained improvement in its financial performance, along with significant asset quality improvement, a decrease in capital markets funding reliance and a strengthening of its risk culture.

What Could Change the Rating - Down

Negative pressure on the BFSR could be triggered by a breach of capital regulatory requirements or severe liquidity constraints.

A downgrade of the deposit rating could be triggered by a lower BCA and/or (ii) any change in our perception of (i) ÖVAG's strategic importance to their main shareholderor (ii) extraordinary commitment of the Republic of Austria.

Recent Results and Company Events

ÖVAG's ratings were downgraded to E+/Baa1/P-2 from C-/Aa3/P-1 on 24 July, 2009. The downgrade of ÖVAG 's BFSR to E+ reflects our assessment of the bank's very strained financial profile. The downgrade of the long-term bank deposit and senior debt ratings reflects the lower BFSR.

On 17 November, 2008 ÖVAG's BFSR was downgraded to C- from C, while deposit ratings were affirmed. The outlook for all ratings was changed to reflect this downgrade. The downgrade of the BFSR to C- had been prompted by (i) the de-merger of Kommunalkredit Group - the group's then public lending subsidiary - and its impact on ÖVAG's fundamentals; (ii) the group's heavy reliance on market and interbank funding; and (iii) ÖVAG's exposure to the CEE real estate market.

Please see respective press releases for further details on these rating actions.

For the first nine months of 2009, the bank reported a net loss of EUR 487 million (Q3 2008: profit of EUR 30 million), given a strong decrease in net interest income (-44%) and commission income (-22%). In addition, risk provisions and losses from financial investments increased to EUR 833 million from EUR 246 million in the equivalent period of 2008. The majority of credit risk provisions derive from the bank's corporate and CEE segments. The bank expects to report a loss for the full - year 2009.

During the credit crisis, ÖVAG encountered substantial liquidity and asset quality issues, which resulted in the following measures from the Republic of Austria: i) transfer of Kommunalkredit group - the bank's then specialized public lender to the Republic of Austria in Q4 2008 - following severe capital and liquidity shortcomings (comprehensive EUR 584 million negative impact on YE 2008 results); ii) capital increase of EUR 1 billion from the Republic of Austria in Q2 2009; iii) issue of EUR 3 billion in government guaranteed bonds in Q1 2009 and Q3 2009.

DETAILED RATING CONSIDERATIONS

Detailed considerations for ÖVAG´s ratings are as follows:

Moody's assigns a BFSR of E+ to ÖVAG, which translates into a BCA of B1. ÖVAG is the central institution of Volksbanken. The rating takes into account low expected profitability, the bank's strong reliance on market funds, weak control functions within the group, significant pressure on asset quality and capital in the medium term, and the fact that the Republic of Austria (rated Aaa) currently supports the bank with capital and funding. The rating also reflects its strengthened capital base, its good franchise value in Austria and also its business and geographic diversification given its banking operations in Austria and Central and Eastern European (CEE). The rating also reflects the benefits and support deriving from the bank's owners, Volksbanken.

Bank Financial Strength Rating

As a point of reference, the assigned BFSR is two notches below the outcome of Moody's bank financial strength scorecard.

Qualitative Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

ÖVAG is the fourth largest bank in Austria in terms of assets and has an overall market share of around 5% of the domestic market. It acts as the central institution for the local co-operative banks and as a commercial bank itself. Together with the Volksbanken, ÖVAG has a sound domestic franchise, particularly in retail banking and small- and medium-sized enterprises (SMEs), which the Volksbanken group has been able to defend reasonably well in recent years.

In 2005 ÖVAG's market position in corporate lending, real estate and public finance was considerably strengthened by its acquisition and integration of Investkredit Bank AG (Investkredit, Baa2/P-2/E+), a specialised lender to Austrian medium-sized companies and a real estate financier. Subsequently all corporate and real estate activities of ÖVAG have been transferred to Investkredit. Together with Investkredit, ÖVAG also acquired the bank's subsidiary Kommunalkredit Austria (Kommunalkredit, Baa1/P-2/E), Austria's then largest public sector lender. Following severe capital and liquidity shortcomings at Kommunalkredit in Q408, the bank was however transferred to the Republic of Austria.

ÖVAG is one of the three largest lenders to corporates and the real estate sector in Austria. The merger with Investkredit provided ÖVAG with a better critical mass in order to offer a wider range of products and services to clients and to raise synergy potential in terms of revenues as well as costs.

The bank has sizable operations outside Austria, mainly in CEE, where it has grown through both acquisitions and organic growth over the past 10 years. ÖVAG's CEE franchise stretches across nine countries, each in which the bank owns subsidiaries. These local banks have good market positions in their home countries and focus on retail and SME lending primarily. At H1 2009, ÖVAG's loan book was geographically split as follows: Austria 37%, Romania 17%, Czech Republic 15%, Hungary 11%, Slovenia 9%, Poland 6%, Slovenia 4%.

ÖVAG recently sold the limited franchise it had in retail banking in Austria via some subsidiaries in Vienna and Linz. It also sold a bank (Ärztebank) that focuses on doctors and similar professionals in the health sector, and IMMO Bank, its housing construction specialist to the cooperative banks. However, together with its local cooperatives, the sector has a good presence in the retail as well as the SME market.

The overall score for the bank's franchise value is D.

Factor 2: Risk Positioning

Trend: Neutral

ÖVAG is owned by the Austrian co-operative banks - 58.2% (not rated), DZ Bank AG - 25% (rated C-/A3), Victoria Lebensversicherungs AG - 10% (rated Aa3, part of Munich Reinsurance Company, rated Aa3), Raiffeisen Zentralbank Oesterreich AG - 6.1% (rated A1/D+), and others (0.7%).

We consider the risk management and control system of ÖVAG to be weak, especially in regards to the complexity and diversity of the bank's operations. Significant deficiencies have been revealed during the financial crisis, which ultimately resulted in economic losses for the bank and various emergency counter-measures during 2008 and 2009 by the Republic of Austria.

The bank releases complete audited reports under IFRS on a semi-annual basis, as well as quarterly trading updates. Management also provides sufficient insight into the business and financial performance of the bank. The bank displays sizeable risks related to borrower and industry concentrations. We are also cautious over the large portion of the more risky foreign currency lending in CEE.

Liquidity management is weak, given its strong reliance on market and interbank funding. About 74% of the bank's total market funds expire in the next four years (by YE 2013). The bank issued EUR 3 billion in government guaranteed bonds in 2008 and 2009 under the government guaranteed bond program for Austrian banks (Interbankmarktstärkungsgesetz). We note, that EUR 3 billion is the maximum amount the bank can issue under the government sponsored programme. The bank's market risk appetite is relatively lowThe score of E reflects Moody's view on the bank's risk positioning.

Factor 3: Regulatory Environment

Trend: Neutral

All Austrian banks are subject to the same score on the regulatory environment. This factor does not address bank-specific issues; instead, it evaluates whether regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control.

Factor 4: Operating Environment

Trend: Neutral

In general, this factor is also common to all Austrian banks, i.e. Moody's assigns an A- score for the overall operating environment. However, ÖVAG's operating environment score has been adjusted to B- since this better reflects the bank's geographical diversification given its operations in Austria and CEE.

Quantitative Factors (50%)

Factor 5: Profitability

Trend: Weakening

For 2008 and the first nine months of 2009, the bank reported an operating loss on account of high risk provisions, the negative income from financial investments,and the negative P&L impact of the transfer of Kommunalkredit to the Republic of Austria (comprehensive EUR 584 negative impact on YE 2008 results). The bank expects to report a loss for the full year 2009.

The group's risk-weighted profitability has been more or less stable in the years prior to 2008, but lags somewhat behind that of its Austrian peers, particularly when compared to other banks with large CEE operations.

Net interest income remains the bank's dominant revenue source, accounting for around 75% of its total operating income. We note that in terms of geographical diversification and business segments, ÖVAG's revenues and pre-tax profits are well diversified.

The score for profitability is E+, with a weakening trend.

Factor 6: Liquidity

Trend: Neutral

ÖVAG's own liquidity is enhanced by the liquidity provided to the bank by the local cooperative banks. ÖVAG has a comfortable level of liquid assets, which accounted for 35% of total assets at H1 2009. The bank transferred about half of its securities portfolio to loans and receivables and held-to-maturity book under IAS 39 at YE 2008.

Overall, we consider the bank's liquidity management is weak, given its strong reliance on market and interbank funding. Please see also the Risk Positioning section for further details.

The score for liquidity is D-.

Factor 7: Capital Adequacy

Trend: Weakening

Following the capital increase of EUR 1 billion in Q1 2009 by the Austrian government ÖVAG's Tier 1 ratio stood at 9.99% in June 2009, up from 7.14% at YE 2008. Common stock thus increased from EUR 340 million to EUR 1.340 billion. Taking into account the relatively high proportion of non-core Tier-1 capital and the bank's risk profile, capital adequacy is modest.

The score for capital adequacy is D+, with a weakening trend.

Factor 8: Efficiency

Trend: Weakening

The cost/income ratio deteriorated significantly in 2008, although this was due to a very low level of income given trading and risk provisioning losses. At H1 2009, the bank's cost - to - income ratio was 67%, weaker than 59% in 2007 and that recorded historically.

The score for efficiency is C, with a weakening trend.

Factor 9: Asset Quality

Trend: Weakening

Asset quality is weak and has been one of the main drivers for the bank's poor performance in 2008 and 2009. We anticipate further significant risk charges given the weak economic operating environment and industry and borrower concentrations, which again highlight the relative weakness of ÖVAG's risk culture and controls. We are also cautious over the large portion of the more risky foreign currency lending in CEE, which accounted for 61% of the total lending at H1 2009.

Overall, the score for asset quality is D, with a weakening trend.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of Baa1 to ÖVAG. This rating is supported by the bank's BCA of B1 as well as by the creditworthiness of its underlying support providers: the Austrian cooperative sector and the Aaa Local Currency Deposit Ceiling of Austria.

Moody's views the probability of support being provided to ÖVAG by the cooperative banks as very high, based on the financial strengths and the structural cohesiveness of Volksbanken. The structural cohesiveness of Volksbanken is exemplified by the multiple operational and financial links between the various member banks in addition to established managerial structures, which ensure a high level of consensus on both strategic and operational issues. In order to underpin the cohesiveness of the sector, there is a strong support mechanism in place, which consists of a joint support agreement and several support funds that are available to help members in the event of financial distress.

We also view the probability of systemic support for the bank as high, since ÖVAG together with the Volksbanken play an important role in the Austrian banking sector as a financial service provider to corporate and retail clients as well as to the public sector. The country support guideline for Austria is medium. There is a very good track record of systemic support being provided to the Austrian banking system historically. However, we believe that market practice is becoming increasingly important, and also note the fragmented nature of the Austrian banking system, in which most banks have only a limited market share. Going forward we therefore view the Medium Country Support Guideline as appropriate.

Notching Considerations

In line with Moody's notching guidelines published in November 2009, ÖVAG's subordinated debt, is rated at Baa2, which is one - notch below the bank's senior debt rating. Upper Tier 2 debt and preferred shares are rated Caa2.

Foreign Currency Deposit Rating

Moody's foreign currency deposit ratings for ÖVAG are Baa1/Prime-1.

Foreign Currency Debt Rating

Moody's foreign currency debt ratings for ÖVAG are Baa1/Prime-1.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model 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

Österreichische Volksbanken AG

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						D	
Factor: Franchise Value						D	Improving
Market Share and Sustainability				x			
Geographical Diversification			x				
Earnings Stability					x		
Earnings Diversification [2]							
Factor: Risk Positioning						E	Neutral
Corporate Governance [2]					x		
- Ownership and Organizational Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management			x				
- Risk Management					x		
- Controls	x						
Financial Reporting Transparency			x				
- Global Comparability	x						
- Frequency and Timeliness			x				
- Quality of Financial Information			x				
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management				x			
Market Risk Appetite		x					
Factor: Operating Environment						A	Neutral
Economic Stability	x						
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						D	
Factor: Profitability						E+	Neutral
PPP % Avg RWA - Basel II				1,45%			
Net Income % Avg RWA - Basel II					-0,60%		
Factor: Liquidity						D-	Neutral
(Mkt funds-Liquid Assets) % Total Assets					25,96%		
Liquidity Management				x			
Factor: Capital Adequacy						D+	Neutral
Tier 1 ratio (%) - Basel II			7,14%				
Tangible Common Equity / RWA - Basel II				3,99%			
Factor: Efficiency						C	Improving
Cost/income ratio			58,67%				
Factor: Asset Quality						D	Neutral
Problem Loans % Gross Loans			3,59%				
Problem Loans % (Equity + LLR)					51,15%		
Lowest Combined Score (15%)						D-	

Economic Insolvency Override						**Neutral**	
Aggregate Score						**D**	
Assigned BFSR						**E+**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral

Moody's Investors Service

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Director and Shareholder Affiliation Policy."