# FITCH AFFIRMS BAWAG P.S.K. AT 'A-'; OUTLOOK STABLE

Fitch Ratings-London/Frankfurt-01 August 2018: Fitch Ratings has affirmed BAWAG P.S.K.'s Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook, Short-Term IDR at 'F1' and Viability Rating (VR) at 'a-'. A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

IDRS, VR AND SENIOR PREFERRED DEBT

BAWAG's IDRs and senior preferred debt rating are driven by its VR, which reflects our view of the bank's strong financial profile and management's successful record in implementing the bank's post-restructuring stabilisation and expansion strategy. The ratings also reflect the bank's effective risk management and fairly conservative risk appetite, which includes a focus on high-quality assets in highly developed markets.

The ratings also factor in BAWAG's intention to remain acquisitive in the medium term. This carries heightened execution risk and may negatively affect the bank's profitability and capitalisation. However, BAWAG's strong risk control framework and integration of several bolt-on acquisitions in the last three years adequately mitigate these risks, and we expect future growth to be well-controlled.

BAWAG's asset quality is strong, with a stable non-performing loan (NPL) ratio at around 2% in the last three years (as per the bank's calculation; gross exposure perspective). Half of total loans are to retail clients, while the rest are mostly to large corporates (with the bank's international business) and the public sector. BAWAG is expanding its presence in Germany, where it plans to launch its online consumer loan offering. However, it will take time for the consumer finance franchise to achieve a size and revenue contribution that significantly mitigates the high competitive pressure in the bank's small home market of Austria and in the German corporate banking market. BAWAG's appetite for assets that we view as inherently higher-risk such as investments in collateralised loan obligations (CLOs) and performing and non-performing loans via asset-backed structures is mitigated, in our view, by the strong risk controls in place.

BAWAG's performance compares well with domestic peers' and is supported by a strong focus on cost control, efficient processes and pricing discipline. The early termination of the cooperation with the Austrian Post in December 2017 will support cost control by accelerating the restructuring of BAWAG's branch network, which is targeted for completion by 2021. The full costs for the separation and restructuring were booked in 2017.

BAWAG's capital ratios are solid, helped by strong earnings and capital strengthening measures, including the issuance of EUR300 million Additional Tier 1 capital in April 2018. As a result, the bank's pro-forma fully loaded total capital ratio increased to ca. 16.9% (including interim profit) at end-1Q18 from 15.2% at end-2017, which compares favourably with domestic peers'. Fitch expects BAWAG to maintain its fully loaded common equity tier 1 ratio (14% at end-1Q18) above the management target of 12%. Part of the excess capital above this target is to be used to fund organic growth and acquisitions, as well as profit distribution (including special dividends and share buybacks), which the bank resumed in 2016. The bank is also working to reduce the density of risk-weighted assets, which will further strengthen regulatory capital ratios.

BAWAG's senior preferred notes' rating is equalised with its Long-Term IDR because the bank's available buffer of qualifying junior and senior non-preferred (SNP) debt is not large enough to warrant a one-notch uplift of the senior preferred debt rating. The SNP debt class was introduced in

Austrian law in July 2018 by transposing the revision of the EU's Bank Recovery and Resolution Directive (BRRD) agreed in December 2017. BAWAG plans to issue about EUR500 million in SNP notes to ensure its compliance with its minimum requirement for own funds and eligible liabilities by end-2019. Under the revised Austrian resolution regime, BAWAG's senior unsecured debt issued prior to July 2018 ranks pari passu with any future senior preferred debt issuance and senior to any future SNP issuance.

The 'F1' Short-Term IDR is the higher of the two Short-Term IDRs possible for an 'A-' Long-Term IDR, which reflects Fitch's view of BAWAG's solid liquidity and funding. The bank's solid funding structure is underpinned by a large and stable customer deposit base - which accounts for 70% of total liabilities - and increasingly diversified wholesale market access. BAWAG also benefits from its established brand and strong retail franchise in Austria.

SUPPORT RATING AND SUPPORT RATING FLOOR (SRF)
The Support Rating and SRF reflect our view that the BRRD and Single Resolution Mechanism provide a resolution framework that is likely to require senior creditors participating in losses, if necessary, instead, or ahead, of a bank receiving sovereign support. In addition, we do not factor in any support from BAWAG's owners because Fitch generally considers that support from financial investors, while possible, cannot be relied upon.

SUBORDINATED DEBT
BAWAG's Tier 2 subordinated debt is rated one notch below the VR to reflect below-average recovery prospects. These securities are subordinated to all senior unsecured creditors. No notching is applied for incremental non-performance risk because there is no coupon flexibility prior to non-viability and the notes would only be written down once the point of non-viability is reached.

RATING SENSITIVITIES
IDRS, VR AND SENIOR PREFERRED DEBT
The Long-Term IDR is sensitive to changes to the VR.

An upgrade of the VR would require a longer record of resilient earnings and sound asset quality through the economic cycle including amid more adverse market conditions. An upgrade would also require a successful expansion and diversification of BAWAG's asset base, particularly the establishment of a solid franchise in the bank's targeted international markets, while maintaining a conservative risk appetite and a focus on retail banking.

Over the longer term, future acquisitions could put negative pressure on the VR if they erode capitalisation and profitability significantly for a longer period or result in unexpectedly high operational or integration risks, or if we believe that future acquisitions are no longer well-controlled or are beyond current risk appetite and management expertise.

More generally, a downgrade of the VR could arise from excessive growth significantly undermining internal capital generation and putting pressure on the bank's currently robust capital ratios, or deterioration in the bank's risk profile or material increase in risk appetite. This could include significant growth in asset classes that we view as inherently higher-risk such as investments in CLOs and performing and non-performing loans via asset-backed structures.

A downgrade of the Short-Term IDR could be triggered by a downgrade of BAWAG's Long-Term IDR or a weakening of the bank's funding and liquidity.

The senior preferred notes' rating is sensitive to a change in the Long-Term IDR. Fitch could also notch up the rating of BAWAG's senior preferred notes by one notch above the Long-Term IDR once a sufficiently large buffer of qualifying junior debt and SNP notes exists to protect senior preferred debt from default in case of failure.

SUPPORT RATING AND SRF
Any upgrade of the Support Rating and upward revision of the SRF would be contingent on a positive change in the sovereign's propensity to provide support. This is highly unlikely, in our view, in light of the regulatory regime in place since the implementation of BRRD.

SUBORDINATED DEBT
The subordinated notes' rating is sensitive to changes in BAWAG's VR. It is also sensitive to a wider notching from the VR, which could arise if Fitch expects an increase in the probability of non-performance of the subordinated debt relative to the probability of failure of the bank, or if our view of the subordinated notes' recovery prospects changes negatively.

The rating actions are as follows:

BAWAG P.S.K.
Long-Term IDR: affirmed at 'A-'; Outlook Stable
Short-Term IDR: affirmed at 'F1'
Viability Rating: affirmed at 'a-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Senior preferred notes: affirmed at 'A-'
Tier 2 subordinated debt: affirmed at 'BBB+'

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 22 Jun 2018)