FitchRatings

Fitch Affirms BAWAG P.S.K. at 'A-'; Outlook Stable

Fitch Ratings - Frankfurt am Main - 27 January 2020:

Fitch Ratings has affirmed BAWAG P.S.K.'s (BAWAG) Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook, Short-Term IDR at 'F1' and Viability Rating (VR) at 'a-'.

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
BAWAG P.S.K.	LT IDR A- ● Affirmed	A- ●
	ST IDR F1 Affirmed	F1
	Viability a- Affirmed	a-
	Support 5 Affirmed	5
	Support Floor NF Affirmed	NF
subordinated	LT BBB+ Affirmed	BBB+
Senior preferred	LT A- Affirmed	A-
subordinated	LT AA- Affirmed	AA-
Senior preferred	LT AA- Affirmed	AA-

Key Rating Drivers

BAWAG's ratings reflect its healthy financial profile and the well-controlled execution of its growth strategy as well as effective risk management and fairly conservative risk appetite.

Extensive due diligence and M&A expertise have so far adequately mitigated the execution risks arising from multiple, albeit mostly small, acquisitions in the past few years. Management has also demonstrated its ability to integrate several acquisitions simultaneously. Corporate governance remains sound and benefits from the withdrawal of a dominant private equity shareholder with whom the bank jointly invested in selected projects or portfolios when an opportunity arose.

BAWAG's asset quality benefits from its conservative risk appetite in its domestic Austrian market and in Germany, an increasingly important core market where it has been rapidly growing through acquisitions. Its non-performing loans (IFRS 9 Stage 3 loans) ratio of 2.6% at end-1H19 is likely to be close to its cyclical low after years of strong economic conditions.

BAWAG's international business (excluding Germany) accounts for over one-fifth of the bank's lending and includes real estate and corporate loans, and manageable exposure to higher-risk leveraged finance and non-performing loan financing. The bank's appetite for highly rated collateralised loan obligations (CLOs) as lending surrogate is also notable. These activities reflect the bank's opportunistic behaviour in search for yield, but also contribute to diversify its credit exposure by country and asset class. Risk management appears effective.

The level and stability of BAWAG's performance compare well with peers and benefit from tight cost control, efficient processes and pricing discipline. Its higher-risk international real estate and corporate lending and targeted growth in higher-yielding asset classes such as consumer lending play an important role in upholding its sound interest margins in an increasingly adverse interest rate environment. Legal risks arising from the City of Linz's lawsuit against BAWAG remain moderate, as even the worst possible outcome for BAWAG would be manageable in light of the bank's earnings.

BAWAG's common equity Tier 1 (CET1) ratio solidly exceeds its regulatory requirements. It fell to pro forma 13% at end-3Q19, taking into account a EUR400 million share buyback in 4Q19. Management has earmarked excess capital above its 12%-13% CET1 ratio target range for organic growth, acquisitions and profit distribution through dividends and share buybacks. We view this target as adequate, given the financial flexibility that arises from the bank's sound recurring profitability.

The 'F1' Short-Term IDR is the higher of the two options possible for a 'A-' Long-Term IDR, which reflects Fitch's view of BAWAG's stable liquidity and funding reflected in a 'a' score. The bank's solid funding structure is underpinned by a large and stable customer deposit base and increasingly diversified wholesale market access. We expect future issuance of subordinated capital to be at BAWAG Group level, the holding company, although BAWAG P.S.K. should remain the main issuing entity for senior secured and senior unsecured debt. BAWAG plans to issue up to EUR1.5 billion of senior non-preferred (SNP) and preferred notes by end-2022 in addition to the EUR0.5 billion issued in 2019 to comply with its minimum requirement for own funds and eligible liabilities (MREL).

BAWAG's senior preferred notes' rating is equalised with the bank's Long-Term IDR because the bank's available buffer of qualifying junior and SNP debt is not large enough to warrant a one-notch uplift of the senior preferred debt rating.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Rating and Support Rating Floor (SRF) reflect our view that the EU's Bank Recovery and Resolution Directive (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.

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.

STATE-GUARANTEED DEBT

BAWAG's state-guaranteed senior preferred and Tier 2 debt ratings reflect our understanding that the Austrian Postsparkassen Act (Postsparkassen-gesetz), on which the guarantee is based, does not oblige the government to honour the guarantee on first demand. We believe there is an extremely high probability that the federal government would fully reimburse grandfathered creditors, should the guarantee be triggered by a default of BAWAG. However, in our opinion, there is no certainty that a reimbursement would be carried out on a timely basis. To reflect this uncertainty, the ratings are not derived from the Austrian sovereign rating (AA+/Positive). Instead, they are notched up three times from BAWAG's Long-Term IDR of 'A-'. The three-notch uplift reflects the outstanding recovery prospects arising from the guarantee.

RATING SENSITIVITIES

IDRS, VR AND SENIOR PREFERRED DEBT

An upgrade of the ratings would require a 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.

Future acquisitions could put negative pressure on the ratings 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 ratings could arise from excessive growth putting pressure on the bank's currently sound 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 financing of 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 senior non-preferred notes exists to protect senior preferred debt from default in case of failure.

SUPPORT RATING AND SUPPORT RATING FLOOR

An 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 Tier 2 notes' rating is sensitive to changes in BAWAG's VR as well as to a wider notching from the VR, which could arise if Fitch sees 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. On 15 November 2019 Fitch published an Exposure Draft of its Bank Rating Criteria, which included proposals to alter the notching of certain debt securities. If the final Bank Rating Criteria are in line with the Exposure Draft, BAWAG's Tier 2 debt ratings could be downgraded by one notch to 'BBB'.

STATE-GUARANTEED DEBT

The state-guaranteed senior preferred and Tier 2 notes are sensitive to changes to the bank's Long-Term IDR. They are also sensitive to a multi-notch downgrade of Austria's Long-Term IDR, and to potential changes to the relevant legislation, in particular the Postsparkassen Act. In addition, they are sensitive to timely execution of the guarantee by the sovereign in a scenario in which BAWAG would be unable to honour its obligations.

ESG Considerations

Unless otherwise stated the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

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Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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