FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms BAWAG at 'A-'; Withdraws Ratings

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Fitch Ratings - Frankfurt am Main - 30 Oct 2020: Fitch Ratings has affirmed BAWAG's Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook and Viability Rating (VR) at 'a-'.

Fitch has simultaneously withdrawn BAWAG's ratings for commercial reasons

KEY RATING DRIVERS

IDRs, VR and SENIOR PREFERRED (SP) DEBT

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. The ratings also reflect BAWAG's franchise, which lacks the breadth of its larger Austrian and international peers.

BAWAG's asset quality benefits from its conservative risk appetite in its domestic Austrian market and in Germany, a core market where it has been growing through acquisitions. Its impaired loans ratio of 2.7% at end-3Q20 is likely to rise over the next two years, driving the four-year average impaired loans ratio beyond the 3% threshold that implies an asset quality score in the 'a' range at end-2021. 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 international business (excluding Germany) accounts for over a 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 a lending surrogate is also notable. These activities reflect the bank's opportunistic behaviour in search for yield, but also help 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 maintaining its sound interest margins in an increasingly adverse interest rate environment.

We believe the bank's resilient pre-impairment profits constitute a solid buffer against higher expected credit losses even in a downside scenario. BAWAG booked EUR179 million provisions for credit losses in 9M20, 44% of which was related to general reserves for Stage 1 and Stage 2 loans, primarily reflecting the revised macroeconomic assumptions, under which BAWAG applied the adverse ECB euro area scenario.

BAWAG's common equity Tier 1 (CET1) ratio of 14% at end-3Q20 after deduction of the 2019 and 9M20 dividend accruals comfortably exceeds its regulatory requirements. Following the anticipation of the change in the Pillar 2 requirement composition, BAWAG reduced its medium-term CET1 ratio target to 12.25% from 13.00% and issued EUR175 million Additional Tier 1 and EUR200 million Tier 2 instruments to fill the Pillar 2 requirement bucket and create additional risk-weighted asset capacity.

We view this target as adequate, given the financial flexibility that arises from the bank's sound recurring profitability. Management has earmarked excess capital above this target for organic growth, acquisitions and profit distribution through dividends and share buybacks.

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 funding and liquidity score of 'a'. The bank's robust 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 the level of the holding company BAWAG Group, although BAWAG P.S.K. should remain the main issuing entity for senior secured and senior unsecured debt. BAWAG plans to issue up to EUR1.5billion 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.

BAWAG's SP debt is rated at the same level as the Long-Term IDR because we expect BAWAG to include preferred instruments in its resolution buffer. Moreover, the buffer of SNP and more junior debt is not large enough to warrant a one-notch uplift of the SP debt.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

The SR and 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 to participate in losses, if necessary, instead, or ahead, of a bank receiving sovereign support.

SUBORDINATED DEBT

BAWAG's Tier 2 subordinated debt is rated two notches below the VR to reflect below-average recovery prospects. The notching reflects our expectation that the bank will not maintain buffers of Tier 2 and additional Tier 1 debt exceeding 10% of risk-weighted assets. These securities are subordinated to all senior unsecured creditors. No notching is applied for incremental non-performance risk because there is no coupon flexibility before 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 SP 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+/Stable). 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

Rating sensitivities are no longer relevant as BAWAG's ratings have been withdrawn.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Following the withdrawal of ratings for BAWAG, Fitch will no longer be providing the associated ESG Relevance Scores.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
BAWAG P.S.K.	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
	LT IDR	WD	Withdrawn	A- Rating Outlook Stable

ENTITY/DEBT	RATING			PRIOR
	ST IDR	F1	Affirmed	F1
	ST IDR	WD	Withdrawn	F1
	Viability	a-	Affirmed	a-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

BAWAG P.S.K.	EU Issued

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