

Rating Action: Oesterreichische Volksbanken AG

Moody's downgrades VBAG to Baa1/E+ from Aa3/C-

VBAG's subsidiary Investkredit's BFSR downgraded to E+ and long-term ratings to Baa2

Frankfurt, July 24, 2009 -- Moody's Investors Service today downgraded the bank financial strength rating (BFSR) of Oesterreichische Volksbanken AG (VBAG) to E+ from C-. The long-term senior debt and deposit ratings were downgraded to Baa1 from Aa3 and the subordinated liabilities to Baa2 from A1. All these ratings carry a negative outlook. VBAG's short-term rating was downgraded to Prime-2 from Prime-1. At the same time, Moody's also downgraded VBAG's subsidiary, Investkredit Bank AG (Investkredit), and various hybrid instruments of VBAG and Investkredit, as detailed below.

Moody's affirmed, with a stable outlook, VBAG's Aaa ratings for debt guaranteed by the Republic of Austria. The rating actions conclude the review of VBAG and Investkredit initiated on 17 November 2008.

DOWNGRADE OF BFSR DUE TO ASSET QUALITY PRESSURE AND LACK OF CAPITAL GENERATION CAPACITY

VBAG's downgraded E+ BFSR translates to a Baseline Credit Assessment (BCA) of B1 and reflects Moody's assessment of the bank's overall very strained financial profile. Reported losses for the financial year 2008 of a moderate EUR152 million obscure the much larger losses attributable to VBAG's former public finance subsidiary, Kommunalkredit AG (D/Aa3, on review for downgrade), which was taken over by the Austrian government late last year in a rescue effort. (These losses were, however, partly offset by positive valuation effects on other participations.) VBAG reported further losses of EUR86 million in Q1 2009: although its operations in Central and Eastern Europe (CEE) were still moderately profitable, the Austrian operations incurred losses.

Moody's remains concerned that the economic environment in VBAG's major markets will pose considerable challenges for the bank given its persistently weak performance in its core corporate and real estate operations, which are chiefly carried out in its home Austrian market, while the macroeconomic outlook for CEE has strongly deteriorated. Although, the rating agency recognises the strong retail franchise that the bank has established in its CEE markets, it believes that the anticipated rise in credit charges across all segments cannot be buffered through operating earnings and therefore expects the bank to be loss-making over the next two years at least.

As positive factors, Moody's recognises the bank's strengthened capital base as a result of an injection of EUR1 billion of participation capital from the Republic of Austria and the liquidity support received from the Republic of Austria's guarantee of a EUR3 billion debt issuance programme. VBAG reports a moderate Tier 1 capital ratio of 7.4%. However, the coupon on the fresh capital, which amounts to 9.3% or EUR93 million per year, places a further burden on the bank's profitability. Given VBAG's lack of internal capital generation capacity for the foreseeable future, the possible substantial rise in risk charges and some potential for further impairments emanating from its structured credit portfolio, Moody's remains concerned about the increased probability of additional capital support in the medium term.

Moreover, Moody's observes shortcomings in the effective oversight of group risk and liquidity management as shown by the near collapse of Kommunalkredit in late 2008. However, the rating agency notes that the entity was managed at arms' length, although it understands that other major subsidiaries are more closely integrated into the group-wide risk and liquidity management system. Moody's will continue to closely assess and monitor VBAG's risk management practices going forward.

Overall, Moody's believes that the E+ BFSR better reflects VBAG's profile given its low recurring earnings power and rising provisioning needs related to the challenges posed by the weak economic environment. As a consequence, there is increased pressure on VBAG's capital and a greater likelihood that it will require further outside support in the future.

SENIOR DEBT RATINGS RECEIVE A LARGE UPLIFT FROM PROBABILITY OF SYSTEMIC SUPPORT

VBAG's Baa1 long-term debt and deposit ratings continue to benefit from Moody's assessment of a very high probability of systemic support. The rating agency notes that the dependence of VBAG's investment-grade ratings on systemic support has increased, while at the same time the probability of co-operative support has

decreased.

While Moody's recognises the co-operative sector's strong willingness to support VBAG in the event of need, it views the sector's ability to support VBAG in a severe downturn as rather limited, given the sector's overall size in the Austrian banking system and its limited financial power in relation to the size of VBAG group. The negative outlook on all the ratings reflects the potential downside risk of a more severe than anticipated adverse change in the overall economic environment, which could exert further pressure on VBAG's BFSR and, in turn, on the long-term unsecured debt ratings.

DOWNGRADE OF HYBRID INSTRUMENTS REFLECTS INCREASED RISK OF COUPON LOSSES

1) Moody's downgraded VBAG's participation capital certificates to Caa2 from A3 and the non-cumulative preferred securities issued by OeVAG Finance (Jersey) Ltd to Caa2 from A2. The downgrade reflects the rating agency's expectation of a high likelihood that coupons will not be paid for 2009 and 2010 and a moderate likelihood of a non-payment for 2011 due to a breach of the distributable profit trigger. Moody's believes that VBAG's reserves are not sufficient to compensate for losses in coming years. Coupon payments on the instruments are non-cumulative. With regard to the participation capital certificates, the Unpaid Remuneration Settlement Mechanism (URSM) would allow the bank to pay deferred coupons through the issuance of common shares or other equity-like securities for up to five years. However, since they are subject to the availability of sufficient distributable profits, Moody's does not expect such payments.

2) The rated Upper Tier 2 securities ("Ergaenzungskapitalanleihen") were downgraded to Caa2 from A1 as a result of the high likelihood of two coupon losses for 2009 and 2010 and a moderate likelihood of one coupon loss for 2011. The instruments have a net profit trigger and are non-cumulative.

The outlook on all the hybrid instruments is stable.

DOWNGRADE OF INVESTKREDIT'S BFSR, LONG-TERM AND HYBRID RATINGS

Investkredit's BFSR was downgraded to E+ (BCA of B1) from C-, reflecting Moody's concerns about the bank's profitability and increased risks inherent in its exposure to corporate and real estate markets in Austria and CEE. VBAG's corporate and real estate business is concentrated in Investkredit.

Investkredit's debt and deposit ratings were downgraded to Baa2 from A1. The rating for the subordinated liabilities was downgraded to Baa3 from A2. Both sets of ratings reflect a very high probability of parental support, reflecting Moody's views of the co-operative sector and systemic support. The ratings carry a negative outlook, reflecting the same concerns that lead to the negative outlook on VBAG's ratings. The short-term rating was downgraded to Prime-2 from Prime-1.

Moody's downgraded the ratings of the non-cumulative hybrid securities (Tier 1 instruments) issued by Investkredit's subsidiaries, Investkredit Funding Ltd and Investkredit Funding II Ltd, to Caa1 from A3 as a result of its assessment of a high likelihood of a coupon loss for 2010 and a moderate likelihood of a coupon loss for 2011. With regard to 2009, Moody's believes that Investkredit's reserves might still be sufficient to buffer a loss and pay the coupons; hence, it assumes a moderate likelihood of a deferral.

The rated Upper Tier 2 securities ("Ergaenzungskapitalanleihen") were downgraded to Caa2 from A2, reflecting Moody's view of a high likelihood of coupon deferrals for 2009 and 2010 and a moderate likelihood of a coupon deferral for 2011. The instruments have a net loss trigger and are non-cumulative. The outlook on all the hybrid instruments is stable.

RATING HISTORY AND MOODY'S METHODOLOGIES

Moody's previous rating action on VBAG was on 17 November 2008, when the bank's BFSR was downgraded to C- from C and placed on review for possible downgrade.

The principal methodologies used in rating VBAG and Investkredit are "Bank Financial Strength Ratings: Global Methodology", "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology" as well as "Guidelines for Rating Bank Junior Securities", which can be found on www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating these issuers can also be found in the Credit Policy & Methodologies directory.

With respect to hybrid instruments and subordinated debt, Moody's adds that it has released a Request for Comment entitled, "Moody's Proposed Changes to Bank Subordinated Capital Ratings", dated June 2009. In this comment, the rating agency requested market feedback on potential changes to its bank hybrid rating methodology. Should Moody's implement this revised methodology as proposed, the ratings of VBAG's and Investkredit's instruments will most likely not be affected.

Based in Vienna, Austria, VBAG reported 2008 net losses of EUR152 million and total assets of EUR52.9 billion at the end of the year.

Frankfurt
Dominique Nutolo
Asst Vice President - Analyst
Financial Institutions Group
Moody's Deutschland GmbH
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Frankfurt
Carola Schuler
Managing Director
Financial Institutions Group
Moody's Deutschland GmbH
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

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