Credit Rating Announcement 15 November 2017

# Scope assigns AA+ to Bank Burgenland's Austrian mortgage-covered bonds, Outlook Stable

## Covered bond ratings reflect the strong protection by the cover pool and the good credit quality of the issuer.

Scope Ratings (Scope) has today assigned a AA+ with Stable Outlook to the mortgage-covered bonds issued by Austria's HYPO-BANK BURGENLAND Aktiengesellschaft (Bank Burgenland). The ratings are driven by the credit quality of the bank, further enhanced by:

1. fundamental credit support factors, which provide four notches uplift above the bank's credit quality and provide a floor against a cover pool deterioration; and
2. overcollateralisation which fully mitigates credit and markets risks under stressed assumptions, supporting a seven-notch rating differentiation between the covered bonds and the bank.

## Covered bond rating anchored by bank's good credit quality

Scope's credit view on Bank Burgenland reflects a well-established and profitable banking franchise. The bank has been a fully owned subsidiary of Grazer Wechselseitige Versicherung AG (Grawe) since 2006 and is the controlling financial institution within the 'Grawe banking group', which consolidates several banks and financial subsidiaries under a multi-brand strategy. Bank Burgenland itself is a regionally focused bank, mainly active in the state of Burgenland and bordering areas, including Vienna and Styria. The bank offers comprehensive retail and corporate banking services. Other entities within the group provide asset management services to Grawe as well as to external customers, allowing the group to reduce dependence on interest income and to diversify its revenue and customer base.

Bank Burgenland's asset quality is adequate, and its financial results have been improving gradually since its takeover by Grawe. The bank exhibits a conservative funding and liquidity profile as well as prudent capitalisation – also reflecting the parent's acceptance to retain earnings within the bank rather than upstream them to the parent. Scope's credit view on the bank also reflects the concentration risk and limited growth potential in its home market. Parental support was not directly factored into the rating due to the lack of a formalised and enforceable guarantee commitment by Grawe.

## Legal framework and resolution regime assessment provides first stage of credit differentiation

Fundamental credit support factors provide the covered bond rating a four-notch uplift above Scope's credit view on the bank. Two notches of uplift are driven by the agency's analysis of the Austrian covered bond legal framework, which meets all provisions relevant to establishing and maintaining a high-quality cover pool

that remains available after the issuer's potential insolvency. Scope notes that under its methodology the covered bond framework just meets the minimum standards, as the framework remains relatively vague on best practice regarding liquidity or risk management.

Two other notches are due to issuer- and country-specific benefits provided by the resolution regime as well as the systemic importance of covered bonds in Austria. This reflects the covered bonds' exclusion from bail-in in a hypothetical scenario of the bank experiencing regulatory intervention. Scope also has provided one additional notch to reflect the combination of i) a moderate likelihood that regulators are, in a resolution scenario, more likely to restructure the issuer as a going concern using available tools; and ii) the increasing systemic importance of covered bonds in Austria; but offset in part by iii) the bank's limited prominence as covered bond issuer. The latter is currently unlikely to fully sustain a covered bond issuer-driven support.

## Cover pool provides strong rating support

The covered bond ratings reflect the strong cover pool support provided by a generous overcollateralisation of 389% (based on whole loan balances). This fully mitigates the moderate credit risk of the cover pool and the market risks.

The strong protection against final losses is evidenced by an average eligible cover pool LTV of 47.4%, which is low and well seasoned. The fully domestic and wider Vienna area-focused cover pool is geared towards SMEs, followed by private individuals and residential housing-focused corporates. High overcollateralisation and relatively fast amortisation are sufficient to pay outstanding covered bonds on time and in full in a run-down scenario. Based on whole loan balances (whole loan cover pool balances of EUR 910.4m) an overcollateralisation of about 40% supports the current rating uplift.

## Stable Outlook

The Stable Outlook on the covered bonds reflects the expected stable credit performance of both the bank and its mortgage assets. Scope's Outlook reflects its expectation that the issuer will maintain its prudent risk management and that further diversification of its funding structure will not adversely impact the covered bonds' maturity profile. The agency expects that Bank Burgenland will remain willing and able to continuously provide the overcollateralisation needed to support the very strong credit quality of the covered bonds.

The covered bond rating incorporates the maximum uplift provided by cover pool support. The covered bond rating could therefore be impacted directly by changes to Scope's credit view and Outlook on the issuer.

## Rating-change drivers

The covered bond rating could be affected positively by a further improvement in the bank's financial results and by more stable profitability. A positive review of fundamental support factors could also be prompted by improvements in: the bank's prominence as covered bond issuer; the funding product's importance to the Austrian market; and increasing cohesiveness and cooperation between all relevant stakeholders.

Deterioration in the bank's credit quality will directly affect the covered bond rating or Outlook. Such rating changes could be driven by a deterioration in the bank's risk profile, profitability and prudential metrics. Excessive increases in the cover pool's risk could reduce cover pool support; but Scope does not currently expect such an outcome. At present, these risks are also mitigated by available overcollateralisation.

Fundamental support factors effectively provide a floor for the covered bond rating. Credit-negative changes to the cover pool's risk profile would at most result in a three-notch downgrade.

## Notes

Scope has today published a rating report which provides the detailed analysis for the covered bond rating. The rating report is freely available on www.scoperatings.com or under the following **LINK**.

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### Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings AG.

The rating analysis has been prepared Karlo Fuchs, Executive Director. Responsible for approving the rating: Guillaume Jolivet, Managing Director

The rating was first assigned by Scope on 15 November 2017.

### Methodology

The principle methodology applicable for the covered bond rating is the 'Covered Bond Rating Methodology', published July 2017. Scope also applied the principles listed in the 'Rating Methodology for Counterparty Risk in Structured Finance Transactions', published August 2017, and the 'General Structured Finance Rating Methodology', published August 2017.
For the credit assessment of the issuer Scope also applied the principles contained in the "Bank Rating Methodology" dated May 2017. All documents are available on www.scoperatings.com

Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's definition of default as well as definitions of rating notations can be found in Scope's public credit rating methodologies on www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

### Stress testing & cash flow analysis

No stress testing was performed.

In the determination of the cover pool supported rating uplift Scope performed a cash flow analysis to determine an expected loss for the covered bonds. The cash flow analysis uses as starting point the scheduled cash flows of the cover assets and covered bonds. Scope has applied rating distance-dependant stresses to simulate the impact of increasing credit and market risks to these cash flows. The cash flow analysis also incorporates the impact of stressed asset sales or other variables such as changing prepayment speeds or servicing costs.

### Solicitation, key sources and quality of information

The rated entity participated in the rating process.

The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity, third parties and Scope internal sources.

Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.

Prior to publication, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds on which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

### Potential conflicts

Please see www.scoperatings.com. for a list of potential conflicts of interest related to the issuance of credit ratings.

### Conditions of use / exclusion of liability



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Scope Ratings AG is part of the Scope Group with headquarters in Berlin and offices in Frankfurt, London, Madrid, Milan and Paris. As the leading European credit rating agency, the company specialises in the analysis and ratings of financial institutions, corporates, structured finance, project finance and public finance. Scope Ratings offers a credit risk analysis that is opinion-driven, forward-looking and non-mechanistic – an approach which adds to a greater diversity of opinions for institutional investors. Scope Ratings is a credit rating agency registered in accordance with the EU rating regulation and operating in the European Union with ECAI status.

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