FITCH AFFIRMS LARGE AUSTRIAN BANKS FOLLOWING PEER REVIEW

Fitch Ratings-Frankfurt/London-16 March 2016: Fitch Ratings has affirmed the Long-term Issuer Default Ratings (IDRs) of Erste Group Bank AG and UniCredit Bank Austria AG at 'BBB+' with Stable Outlooks and their Viability Ratings (VRs) at 'bbb+'. Volksbanken-Verbund's (VB-Verbund) Long-term IDR has been affirmed at 'BB+' with a Positive Outlook and its VR at 'bb+'. Fitch has also affirmed the Long-term IDRs of VB-Verbund's member banks at 'BB+' with Positive Outlooks. A full list of rating actions is at the end of this rating action commentary.

The rating actions follow Fitch's periodic review of the major Austrian banks. The affirmations reflect the Austrian banking sector's generally solid operating environment and Erste and Bank Austria's adequate flexibility to deal with recurring challenges in heterogeneous CEE markets. Bank Austria's ratings also reflect our expectation that the announced transfer of its CEE business to its parent UniCredit S.p.A. (UC; BBB+/Stable/bbb+) will have neutral implications for its risk profile and does not affect UC's high propensity to support its Austrian subsidiary.

KEY RATING DRIVERS - IDRs, VRs AND SENIOR DEBT RATINGS

Erste and VB-Verbund's IDRs are based on their standalone profiles as reflected by their VRs. Bank Austria's Long-term IDR is equalised with UC's and at the same level as its VR.
Erste and Bank Austria's identical VRs reflect primarily comparable business models and risk profiles resulting from similar positioning in Austria and in diverse CEE markets, although Bank Austria's CEE presence is currently broader. The VRs also reflect our view that both banks' flexibility to deal with recurring but evolving challenges in CEE is adequate but not strong.

Erste's ratings benefit from its strong and diversified franchise in its core Austrian, Czech, Slovakian and Romanian markets, overall adequate asset quality and solid capitalisation, funding and liquidity. Erste's profitability has been improving thanks to loan impairment charges that are extremely low in Austria and declining in CEE, but is still burdened by regulatory costs and persistently low interest rates.

Bank Austria's VR factors in our expectation that the bank will emerge from its restructuring that will transfer its CEE subsidiaries to its parent UC with a significantly narrower, more focused business model, but that the implications for its risk profile are likely to be broadly neutral. Bank Austria is likely to become a purely domestic bank by end-2016, which will considerably reduce its geographic diversification and business scope. However, we expect the downsized bank to benefit from its focus on domestic assets in light of the solid operating environment in Austria, which is considerably more developed and resilient than most CEE economies in which the bank has been operating so far.

VB-Verbund's VR reflects the considerable risk reduction achieved via the spin-off of its former central institution, immigon portfolioabbau ag, which concentrated most of the group's impaired legacy assets. As a result, we estimate that the group's non-performing loan (NPL) ratio improved from almost 13% at end-2013 to just below 5% at end-2015. The group's member banks are in the process of merging into eight regional and two specialised banks by end-2017 from a total of 47 at mid-2015. We believe that the process is well-controlled, but the scope of the ongoing restructuring gives rise to significant execution risk in the short term.

The Positive Outlook on VB-Verbund's Long-term IDR reflects our view that the process will significantly and sustainably improve the group's efficiency. We also expect the overhauled framework contract between the new central institution and the member banks to strengthen the group's governance and the cohesion among its members.

We view the three large Austrian banks' NPL and reserve coverage ratios as adequate and their volumes of non-impaired forborne loans as moderate. Asset quality still varies considerably by country but has been generally converging over the past year.

Erste's asset quality has improved rapidly over the past two years, notably thanks to large NPL sales, but remains very weak in Romania, Hungary and Croatia. Its consolidated NPL ratio fell to 7.1% at end-2015 from 9.6% at end-2013, due to intensive workout and NPL sales, especially in Romania, and recovering loan growth. We believe that the risk of large NPL inflows has fallen in Erste's main markets, although some uncertainties remain in Romania.

The spin-off of Bank Austria's CEE business will strongly relieve the bank's asset quality and we expect its NPL ratio to decrease to a mid-single digit level upon completion of the transfer. The CEE segment's NPL ratio was 11.8% at end-2015, down from 12.4% yoy. Across CEE the trends were mixed, with clear negative developments in Russia, where we currently see the biggest risk, Ukraine and Croatia. In Austria, the NPL ratio decreased to 5.1% at end-2015, and asset quality benefits from the borrower-friendly environment.

VB-Verbund now operates almost exclusively in the robust Austrian market and its loan book consists predominantly of lower-risk retail and small SME clients. Its asset quality remains moderately weaker than that of large, highly rated European cooperative banks. However, its overhauled risk management practices should enable gradual convergence with these peers.

Erste's profit contributions from the individual CEE markets were far more balanced in 2015 than in previous years as Romania and Hungary are stabilising, although these two markets still create some uncertainty for medium-term profits. The Czech unit's share of group pre-tax profit declined accordingly despite the unit's still strong performance in absolute terms. Net profit from Austria benefited from exceptionally low risk costs, which we deem unsustainable through the cycle, but also from loan growth and decreasing funding costs.

We expect that Bank Austria's performance after the spin-off of its CEE operations will be driven by its corporate business, which in our view has been moderately profitable across the cycle, and the low-margin retail operations in Austria. This is likely to result in less earnings volatility but also weaker internal capital generation. Bank Austria's CEE business is currently suffering from a fairly modest (but still reasonable) performance in Russia and one-off charges in various other CEE countries. The sale of its heavily loss-making Ukrainian subsidiary announced in January 2016 is providing sizeable relief ahead of the spin-off of the remainder of the CEE business. However, CEE has historically contributed the majority of Bank Austria's profits.

We expect VB-Verbund's ongoing restructuring to result in weak profitability in 2016. Performance should recover to sufficient but moderate levels in the longer term, given the saturated Austrian market and the bank's efforts.

Cost pressure for all banks in the peer group is likely to remain high in the medium term due to high recurring regulatory costs in Austria (bank levies and contributions to the new resolution and deposit protection funds), the risk of new harsher regulation for banks in CEE countries and investment needs to adapt to the changing regulatory and competitive landscapes.

The three banks' adequate risk-adjusted capitalisation progressed during 2015 and is broadly in line with general market expectations for universal banks. The high regulatory risk weights, driven by Erste and Bank Austria's CEE assets and VB-Verbund's use of the standardised approach, result in solid leverage ratios. However, their CEE portfolios expose Erste, and particularly Bank Austria, to foreign exchange and RWA volatility. This will be reduced significantly at Bank Austria after the spin-off of the CEE portfolio.

Erste's internal capital generation turned positive in 2015 after two negative years, allowing a strengthening of its phased-in CET1 ratio to 12.3% at end-2015 from 10.6% yoy. As a result, the bank already fulfils its fully-loaded Pillar 2 requirements. We expect capitalisation to improve gradually on the back of resilient operating profit, adequate retained earnings supported by modest growth, and manageable risk costs.

Bank Austria's phased-in CET1 ratio improved more moderately, to 11% at end-2015. As CEE has historically contributed the majority of Bank Austria's profits we expect weaker through the cycle internal capital generation after the planned spin-off of the CEE portfolio.

VB-Verbund's capitalisation is acceptable but it will need the cost savings from the primary banks' mergers to strengthen its internal capital generation before it repays the EUR300m state capital of its former troubled central institution.

Erste and Bank Austria have strengthened their local deposit franchises in CEE and maintain large unencumbered liquidity buffers. Their wholesale funding needs are limited. Erste's funding benefits strongly from its leading retail deposit franchises in Austria, the Czech Republic and Slovakia. In addition, the three peers have large Austrian retail deposit franchises which are particularly resilient and not subject to FX volatility. Intragroup funding needs in Croatia and Romania have declined substantially in recent years but remain material.

We expect UC to maintain solid funding and liquidity and comfortable capital buffers at Bank Austria as it is likely to continue to issue in the markets.

KEY RATING DRIVERS - SUPPORT RATINGS AND SUPPORT RATING FLOORS
Erste and VB-Verbund's Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on full extraordinary state support. This is driven by the EU's Bank Recovery and Resolution Directive (BRRD), which has been fully transposed, with its bail-in tool, into Austrian law, effective from 1 January 2015.

Bank Austria's Support Rating reflects our view that the planned transfer of its CEE subsidiaries and its 41% stake in its Turkish unit to UC, where the group's CEE activities will be centralised, does not affect UC's high propensity to support its Austrian subsidiary.

RATING SENSITIVITIES - IDRs, VRs AND SENIOR DEBT RATINGS
Erste and VB-Verbund's IDRs and Erste's senior debt ratings are sensitive to the same factors as their VRs. Bank Austria's IDRs and senior debt ratings are equalised with UC's IDRs and are at the same level as its VR. Therefore, a downgrade of UC's Long-term IDR would not immediately result in a downgrade of Bank Austria's IDRs, unless Bank Austria's VR also changes. An upgrade of UC's Long-term IDR would result in an upgrade of Bank Austria's IDRs.

Erste's VR could come under pressure if its earnings prospects or asset quality deteriorate as a result of changes in market conditions or adverse political actions in Romania, Hungary or Croatia. Conversely, an upgrade of its VR would require better risk adjusted returns across CEE resulting from normalised regulatory, political and risk costs leading to sustainably higher profits in these three countries (even though their mid-term contribution to group profits is likely to remain modest). Continued efforts to further raise the Austrian savings banks' cost efficiency will also be important to limit the downside risk to Erste's capital generation, for which it largely relies on CEE.

Bank Austria's VR could come under pressure if UC targets a more aggressive financial profile than we currently expect. A downgrade could also arise from a failure to address a deterioration of the domestic retail business' performance. Bank Austria's VR is limited on the upside in light of the narrow geographic diversification and increasingly wholesale focus of is future business model. This is likely to constrain the VR within the 'bbb' category, even if the bank significantly improves the performance of its retail business.

The Positive Outlook on VB-Verbund's Long-term IDR reflects the ongoing consolidation of its member banks and a high likelihood that it will be upgraded, possibly by up to two notches, once the execution risk of the consolidation plan has sufficiently receded. Downside risk to the VR and IDRs could come from a failure to achieve the necessary cost savings from the restructuring or from a severe downturn in Austria's economy or from the group's inability to repay the state capital as scheduled, none of which we expect.

RATING SENSITIVITIES - SUPPORT RATINGS AND SUPPORT RATING FLOORS
Any upgrade of Erste and VB-Verbund's Support Ratings and an upward revision of their Support Rating Floors would be contingent on a positive change in the sovereign's propensity to provide support to the bank. This is highly unlikely in light of the new regulatory environment, in our view.

An upgrade of Bank Austria's Support Rating would be contingent on an upgrade of UC's Long-Term IDR. A downgrade could occur if we perceived a decrease in UC's propensity to support, which we deem highly unlikely in the foreseeable future. A scenario in which the downsized Bank Austria's role in the group becomes less important could result in a downgrade of the Support Rating.

The rating actions are as follows:

Erste Group Bank AG
Long-term IDR: affirmed at 'BBB+'; Outlook Stable
Short-term IDR: affirmed at 'F2'
Viability Rating: affirmed at 'bbb+'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Senior unsecured notes: affirmed at 'BBB+'/'F2'
Market-linked securities: affirmed at 'BBB+emr'
Lower Tier 2 debt: affirmed at 'BBB'
Erste Finance (Delaware) LLC: USD10bn CP programme guaranteed by Erste: affirmed at 'F2'

UniCredit Bank Austria AG
Long-term IDR: affirmed at 'BBB+'; Outlook Stable
Short-term IDR: affirmed at 'F2'
Viability Rating: affirmed at 'bbb+'
Support Rating: affirmed at '2'
Senior unsecured notes: affirmed at 'BBB+'
EMTN programme: affirmed at 'BBB+'/'F2'

VB-Verbund
Long-term IDR: affirmed at 'BB+'; Outlook Positive
Short-term IDR: affirmed at 'B'
Viability Rating: affirmed at 'bb+'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'

The IDRs of VB-Verbund's members listed below have been affirmed at 'BB+'/Positive/ 'B' in line with VB-Verbund's IDRs and are sensitive to the same drivers as VB-Verbund's IDRs:

start:bausparkasse e.Gen. Genossenschaft mit beschraenkter Haftung
Bank fuer Aerzte und Freie Berufe AG
Volksbank, Gewerbe- und Handelsbank Kaernten AG
IMMO-BANK AG
Oesterreichische Apothekerbank eG
SPARDA-BANK AUSTRIA Nord eGen
SPARDA-BANK AUSTRIA Sued eGen
Volksbank Bad Goisern eingetragene Genossenschaft
Volksbank Bad Hall e.Gen.
Volksbank Eferding - Grieskirchen reg.Gen.m.b.H.
Volksbank Enns - St.Valentin eG
Volksbank Feldkirchen eG
Volksbank Kaernten Sued e.Gen.
Volksbank Kufstein-Kitzbuehel eG
Volksbank Landeck eG
Volksbank Marchfeld e.Gen.
Volksbank Niederoesterreich AG
Volksbank Niederoesterreich Sued eG
Volksbank Oberes Waldviertel reg.Gen.m.b.H.
Volksbank Oberkaernten reg.Gen.m.b.H.
Volksbank Oberndorf reg.Gen.m.b.H.
Volksbank Oberoesterreich AG
Volksbank Obersteiermark eGen
Volksbank Oetscherland eG
Volksbank Salzburg eG
Volksbank Steiermark Mitte AG
Volksbank Steirisches Salzkammergut reg.Gen.m.b.H.
Volksbank Suedburgenland eG
Volksbank Sued-Oststeiermark e.Gen.
Volksbank Tirol Innsbruck - Schwaz AG
Volksbank Voecklabruck-Gmunden e.Gen.
Volksbank Vorarlberg e. Gen.
Volksbank Weinviertel e.Gen.
Volksbank Wien AG
Waldviertler Volksbank Horn reg.Gen.m.b.H.

The IDRs of VB-Verbund's following member banks have been affirmed at 'BB+'/Positive/'B' and withdrawn as a result of their merger into other rated members of the group:
Volksbank Alpenvorland e.Gen.
Volksbank Donau-Weinland reg.Gen.m.b.H.
Volksbank Fels am Wagram e.Gen.
Volksbank Obersdorf - Wolkersdorf - Deutsch-Wagram e. Gen.
Volksbank Ost reg.Gen.m.b.H.
Volksbank Ried im Innkreis eG
Volksbank Schaerding, Altheim Braunau
Volksbank Tullnerfeld eG

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Applicable Criteria
Global Bank Rating Criteria (pub. 20 Mar 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501