

MOODY'S

INVESTORS SERVICE

CREDIT OPINION

14 December 2020

Update

 Rate this Research

RATINGS

Raiffeisenbank Austria d.d.

Domicile	Zagreb, Croatia
Long Term CRR	Baa2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Baa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Raiffeisenbank Austria d.d.

Update following rating action, driven by change to sovereign ceiling

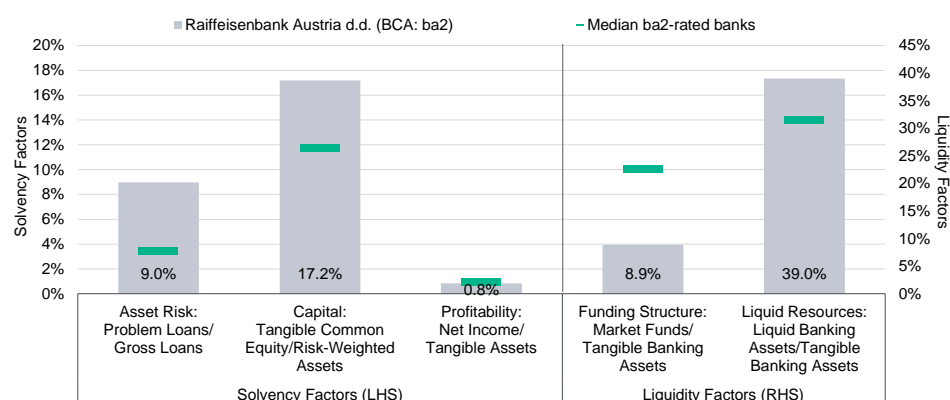
Summary

[Raiffeisenbank Austria d.d.](#)'s (RBA) Baa2/P-2 deposit ratings incorporate the bank's standalone Baseline Credit Assessment (BCA) of ba2; our assumption of a high probability of parental support from [Raiffeisen Bank International AG](#) (RBI, A3 stable, baa3¹), resulting in a one-notch rating uplift for RBA's ba1 Adjusted BCA; and two notches of rating uplift to the bank's deposit rating following the application of our Advanced Loss Given Failure (LGF) analysis.

The BCA of ba2 reflects RBA's stable deposit-based funding structure and good liquidity buffers at around 40% of total assets; and strong capitalisation, with an equity-to-assets ratio of 13.4% in 2019, which provides a buffer to absorb unexpected credit losses. These strengths are moderated by the difficult macroeconomic environment, which is worsened by the global spread of the coronavirus, which will strain the bank's profitability and asset-quality metrics, with nonperforming loans (NPLs) accounting for 5.4% of gross loans as of December 2019. For 2020, we expect RBA to break even, while NPLs will likely double from the current level over the next two years. RBA's BCA also reflects high legal risks, as a Croatian Supreme Court decision allows consumers who borrowed in Swiss francs and suffered losses as a result of the unilateral change of interest rates and currency depreciation to sue banks for compensation.

Exhibit 1

Rating Scorecard - Key financial ratios



These are our [Banks](#) methodology scorecard ratios. Asset risk and profitability reflect the weaker of either the three-year average or the latest annual figure. Capital is the latest reported figure. Funding structure and liquid resources reflect the latest fiscal year-end figures.

Source: Moody's Investors Service

Credit strengths

- » Stable deposit-based funding and high liquidity buffers
- » High capital buffers
- » Our assessment of a high probability of parental support in case of need
- » Our very low LGF assessment for deposits

Credit challenges

- » Deteriorating operating conditions, which will strain asset-quality and profitability metrics
- » High legal risks following a Supreme Court decision that allows borrowers of Swiss francs loans to sue banks

Outlook

RBA's stable rating outlook balances its stable funding, high liquidity and robust capital buffers, against a difficult macro environment and asset-quality and profitability pressures. The stable outlook is also aligned with the stable outlook on the sovereign rating.

Factors that could lead to an upgrade

Upward pressure on RBA's rating can result from improvements in the operating environment and the sovereign's credit risk profile, combined with a recovery in the bank's asset-quality and profitability metrics.

Factors that could lead to a downgrade

Downward pressure on RBA's rating would be triggered by a significant deterioration in the bank's asset-quality and profitability metrics, larger-than-expected litigation costs, a weakening of the sovereign's credit profile, or a decline in RBA's parent bank's capacity or willingness to provide support in case of need.

Key indicators

Exhibit 2

Raiffeisenbank Austria d.d. (Consolidated Financials) [1]

	12-19 ²	12-18 ²	12-17 ²	12-16 ²	12-15 ²	CAGR/Avg. ³
Total Assets (HRK Million)	36,844.0	35,165.0	34,178.0	35,364.0	35,058.0	1.2 ⁴
Total Assets (USD Million)	5,558.0	5,426.1	5,513.0	4,935.0	4,984.3	2.8 ⁴
Tangible Common Equity (HRK Million)	4,529.0	4,178.0	4,398.0	4,592.0	4,049.0	2.8 ⁴
Tangible Common Equity (USD Million)	683.2	644.7	709.4	640.8	575.7	4.4 ⁴
Problem Loans / Gross Loans (%)	5.4	8.4	13.1	19.8	16.3	12.6 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	17.2	16.6	17.4	17.4	14.7	16.7 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	20.1	29.2	40.5	57.7	53.8	40.3 ⁵
Net Interest Margin (%)	2.5	2.5	2.6	2.8	2.9	2.7 ⁵
PPI / Average RWA (%)	2.4	2.3	2.6	3.1	2.7	2.6 ⁶
Net Income / Tangible Assets (%)	1.2	0.8	0.6	1.5	-0.4	0.7 ⁵
Cost / Income Ratio (%)	62.9	64.1	60.7	56.1	61.4	61.1 ⁵
Market Funds / Tangible Banking Assets (%)	8.9	7.3	10.9	12.9	13.2	10.6 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	39.0	42.5	41.4	40.3	36.2	39.9 ⁵
Gross Loans / Due to Customers (%)	78.9	71.1	83.6	88.4	95.6	83.5 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Profile

Raiffeisenbank Austria d.d. (RBA) is the fifth-largest bank in Croatia, with an estimated market share of 8% of total assets. As of December 2019, the bank reported consolidated total assets of HRK36.8 billion (€4.9 billion) and operated 63 branches with 1,794 employees. RBA provides banking and factoring services to corporates, small and medium-sized enterprises (SMEs), and commercial and retail clients. It also offers leasing and consulting services via its subsidiary companies.

Detailed credit considerations

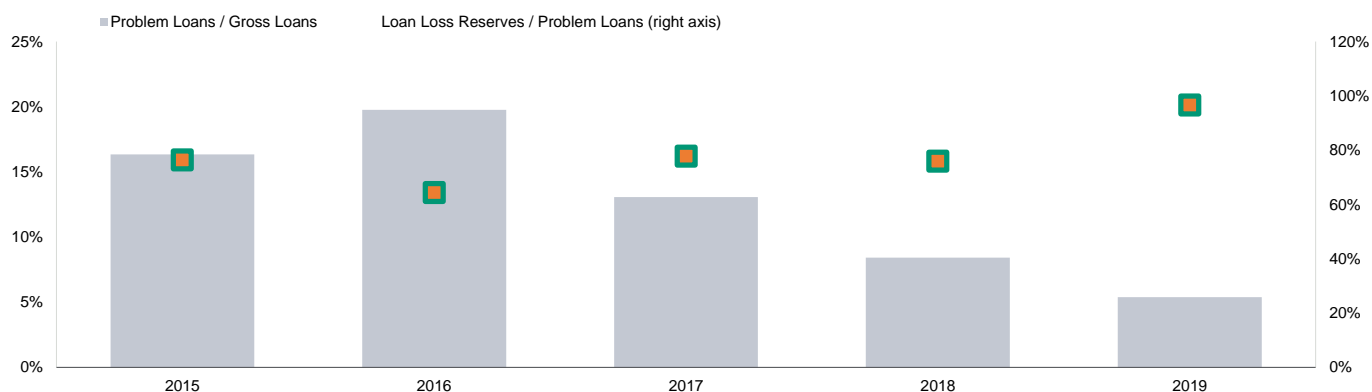
High asset risks remain a key challenge for the bank

The NPL-to-gross loan ratio stood at 5.4% as of December 2019, declining steadily from 19.8% in 2016. Improved risk management, deleveraging by local corporates, NPL recoveries and the sale of NPL portfolios (NPL sales amounted to HRK233 million in 2019) have been the main drivers for the improvement. RBA has also implemented IFRS 9, with provisioning coverage at 97% as of December 2019.

Despite the improvements, asset risks remain high primarily because the coronavirus pandemic is placing renewed strain on the bank's asset quality, specifically on the broader hospitality sector and on consumption-related businesses. Despite deleveraging, corporate debt levels also remain high (around 56% of GDP), while bankruptcy proceedings and out-of-court settlements are still ineffective. We expect the NPL level to double from the current level, but to remain well below the peak in the previous crises.

Exhibit 3

High asset risk, although NPL levels have been declining



Sources: Moody's Financial Metrics and RBA's consolidated financial statements

Similar to regulators around the world, the Croatian National Bank has allowed the postponement of loan repayments without classification as restructured or defaulted. The moratorium is for six months, but can extend to 12 months for companies in the tourism industry. However, this may only delay recognition of problem loans rather than prevent an ultimate rise in NPLs as the economy emerges from the crisis. Clients' opt-in to the moratorium has been modest, ranging from around 11% for retail clients to just under 40% for SMEs, but the strain on the loan portfolio is already evident with a significant migration of loans from Stage 1 to Stage 2.

RBA also has high exposures to Croatian government bonds and T-bills, primarily as part of its liquid assets. These exposures are estimated at around 117% of the bank's Tier 1 capital and link RBA's BCA with the government rating, because RBA's operations are almost exclusively conducted in Croatia.

Profitability metrics have historically been moderate and will be significantly strained in 2020-21

RBA has historically maintained a modest earnings-generating capacity, reflecting its high cost base (with operating expenses at 2.8% of total assets and a cost-to-income ratio of 62.9% in 2019); modest business growth opportunities, with gross loans declining by 7% during 2015-19; and declining margins, partly the result of a low interest rate environment.

For 2019, the bank reported bottom-line profit of HRK421 million, up by 49% from the level a year earlier, mainly because of much lower provisioning charges (0.1% of gross loans compared with 1.1% in 2018) and a drop in the effective tax rate (around 3%, against a tax rate of 18%), and translating into a return on assets of 1.2%.

For 2020 and 2021, we expect a significant deterioration in profitability metrics, primarily driven by subdued business generation, rising provisioning requirements and potentially higher litigation losses related to Swiss franc loans. Cost reduction and digitalisation initiatives will only partly mitigate risks. We expect Croatia's economy to suffer from the coronavirus pandemic because the tourism industry will be hit hard by the slowdown in consumption and travel in 2020. For 2020 and 2021, we forecast real GDP growth of -8.6% and 5.0%, respectively, also taking into consideration the rising unemployment and worsening confidence indices.

With regard to litigation losses, consumers who borrowed in Swiss francs and suffered losses as a result of the currency depreciation or banks' unilateral change of interest rates can individually sue banks for compensation. The monetary impact on RBA is difficult to establish, because it will partly depend on the number of consumers that will sue the bank, most of whom have already repaid their loans. We expect the impact to be significant, but manageable. As of September 2020, accumulated provisions stood at €31 million.

Exhibit 4

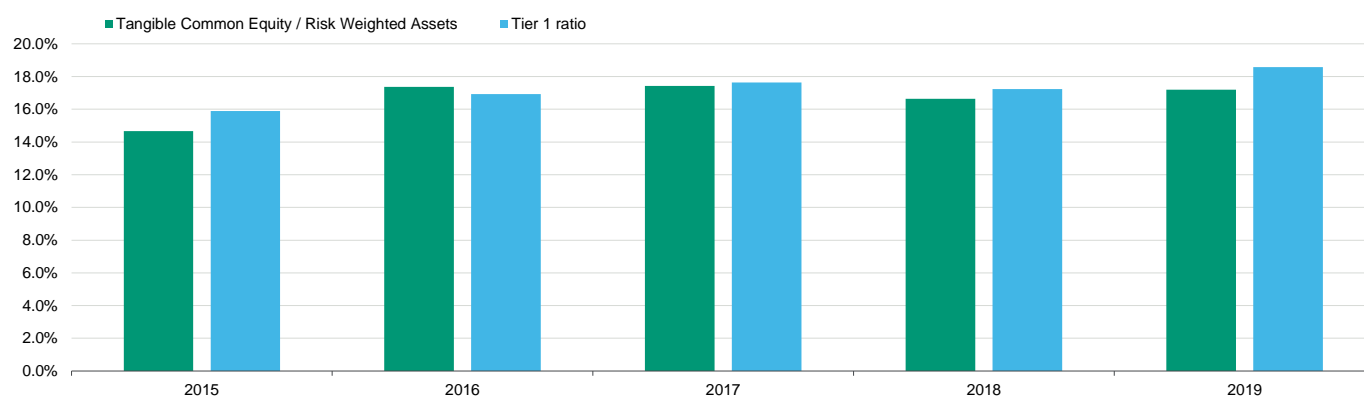
Modest earnings-generating capacity

Sources: Moody's Financial Metrics and RBA's consolidated financial statements

Solid capital buffers with strong loss-absorbing capacity

With a tangible common equity-to-adjusted risk-weighted assets ratio of 17.2% as of year-end 2019, RBA has a significant capacity to absorb unexpected losses, which is a credit strength. We expect RBA's capital buffers to remain strong as the Croatian National Bank requested banks to retain their 2019 profit, although some strain may arise if litigation losses and provision requirements are higher than currently projected. During 2019, RBA replaced its existing €60 million Tier 2 capital with a €40 million Tier 1 instrument and a €20 million Tier 2 instrument, both maturing in 2029. Both instruments are held by RBI.

Exhibit 5

High capital buffers are a credit strength

Sources: Moody's Financial Metrics and RBA's consolidated financial statements

The regulators are currently working on establishing banks' minimum requirements for own funds and eligible liabilities (MREL). For RBA, we estimate the MREL target to be around 27%-30%, with the subordination target at around 20%. RBA, as a subsidiary of RBI that is likely to be subject to a resolution approach of multiple points of entry (MPE), will have to issue its own MREL liabilities. We expect RBA to meet these new requirements by utilising some of its excess capital buffers; undertaking risk-weighting optimisation initiatives; attracting eligible deposits from customers; and tapping the local capital market for MREL-eligible instruments, such as senior non-preferred instruments. Raising new debt instruments in a country where the debt capital market remains shallow can be difficult. Therefore, we will continue to monitor this issue as more information becomes available.

Stable deposit funding and high liquidity

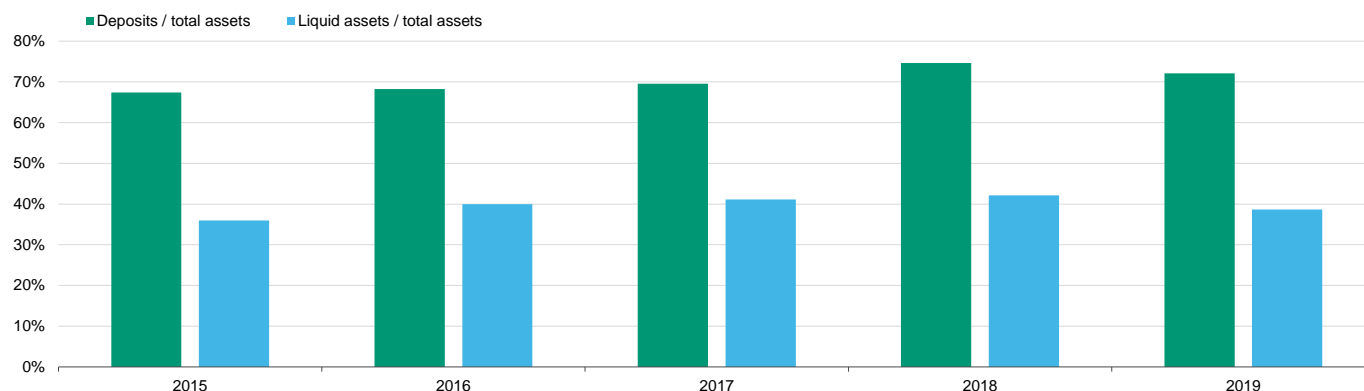
RBA maintains a solid and stable deposit franchise. It sources funding from retail, corporate, SMEs and institutional clients, and recorded a 1% deposit growth in 2019. We expect higher deposit growth in 2020, driven by investors' "flight to safety", given volatile market conditions and negative euro interest rates. RBA has limited reliance on market funding, with borrowings of HRK1,995 million as of December 2019, which accounted for 5.4% of total assets, down from 20% in 2012. These borrowings mainly include parent-bank exposures, interbank exposures and an HBOR loan.

RBA also maintains high liquidity buffers, with cash and interbank balances accounting for 21% of total assets, and an additional 21% of total assets invested in securities, mainly government bonds. The liquidity coverage ratio was 139% in 2019, with the net stable funding ratio at 171%, while the group maintained sizeable unencumbered assets available for collateralised funding.

Authorities and regulators have also responded to the currently difficult operating conditions by reducing the minimum reserve requirement rate to 9% from 12%, while the Croatian National Bank has established a €2 billion precautionary currency swap line with the European Central Bank, to be activated if needed; this will act as a mitigant to the risks related to the high level of eurorisation in deposits (76%).

Exhibit 6

Stable deposit funding and high liquidity



Sources: Moody's Financial Metrics and RBA's consolidated financial statements

ESG considerations

In line with our general view for the banking sector, RBA has a low exposure to environmental risks. See our [environmental risk heat map](#) for further information. We believe banks face moderate social risks; see our [social risk heat map](#) for further information.

However, Croatian banks, including RBA, face rising legal risks related to populist legislative propositions, such as challenging banks' decisions to disperse Swiss franc loans to their clients. In fact, Supreme Court decisions ruled that related clauses — such as the unilateral change of interest rates and a Swiss franc foreign-exchange clause — were "null and void" as consumers were unfairly treated and not fully informed of the risks, and eventually suffered significant losses. This is leading to both reputational and monetary damages for affected banks. Michael Mueller, the previous CEO of RBA, resigned from his position in January 2020, following an RBA tender seeking the services of a PR company in relation to the Swiss franc loan issue, which attracted negative publicity and caused reputational damage to the bank. In the case of RBA, we capture the near-term crystallisation of these risks by applying downward adjustments to the Capital and Profitability scores.

Governance is highly relevant for RBA, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for RBA, we do not highlight any particular governance issues, given its appropriate risk management framework. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Affiliate support

We believe that there is a high probability of support from the bank's parent bank, RBI. Our assessment is based on RBI's 100% stake in RBA, its strong operational support and supervision, and the subsidiary's use of the Raiffeisen logo and name. RBA has a high strategic fit in RBI and the Raiffeisen group. Hence, the risk of the parent disposing off its subsidiary is low. We consider both RBA and the Croatian market important to RBI's operations, and RBI is highly likely to support its Croatian subsidiary, if necessary. This assessment results in one notch of rating uplift from a BCA of ba2 to an Adjusted BCA of ba1.

Loss Given Failure (LGF) analysis

RBA operates in Croatia, which is a member of the [European Union](#) (EU, Aaa stable). Croatian banks are subject to the EU Bank Recovery and Resolution Directive, which we consider to be an operational resolution regime. In accordance with our methodology for rating banks globally, we apply our Advanced LGF analysis, which takes into account the risks faced by the different debt and deposit classes across the liability structure if the bank enters resolution. We assume a residual tangible common equity of 3%, post-failure losses of 8% of tangible banking assets, a 25% runoff in junior wholesale deposits and a 5% runoff in preferred deposits. We assign a 25% probability to deposits being preferred to senior unsecured debt and assume 26% (EU average) of junior deposits over total deposits. These are in line with our standard assumptions.

Our LGF analysis indicates a very low loss given failure for deposits, reflecting the likely reduction in expected loss because of the loss absorption provided by the substantial volume of deposits, translating into two notches of uplift from the bank's Adjusted BCA of ba1.

Government support considerations

The implementation of BRRD in the EU, which was also transposed into the local Croatian law, indicates a low likelihood of government support for RBA. This assumption, combined with the Croatian government's limited capacity to provide support beyond its Ba1 rating, results in no further rating uplift above the Preliminary Rating Assessment. Therefore, RBA's deposit ratings are set at Baa2.

Foreign currency (FC) deposit ratings

We have recently upgraded the bank's FC deposit rating to Baa2 from Ba2, following the change in the relevant country ceiling to A2 from Ba2. FC deposit ratings are therefore no longer constraint by the relevant ceiling.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

RBA's CRRs are positioned at Baa2/P-2, constrained at two notches above the government rating, in accordance with our Banks rating methodology. RBA's Counterparty Risk (CR) Assessment is positioned at Baa3(cr)/P-3(cr), constrained at one notch above the government rating, in accordance with our Banks rating methodology.

Rating methodology and scorecard factors

Exhibit 7

Raiffeisenbank Austria d.d.

Macro Factors

Weighted Macro Profile **Moderate** **100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	9.0%	b2	↓↓	b2	Expected trend	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	17.2%	baa1	↔	baa2	Expected trend	Stress capital resilience
Profitability						
Net Income / Tangible Assets	0.8%	ba2	↓↓	b2	Return on assets	Expected trend
Combined Solvency Score		ba2		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	8.9%	baa3	↔	baa3	Expected trend	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	39.0%	baa3	↔	baa3		
Combined Liquidity Score		baa3		baa3		
Financial Profile				ba2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Ba1		
BCA Scorecard-indicated Outcome - Range				ba1 - ba3		
Assigned BCA				ba2		
Affiliate Support notching				1		
Adjusted BCA				ba1		
Balance Sheet		in-scope (HRK Million)	% in-scope	at-failure (HRK Million)	% at-failure	
Other liabilities		8,210	22.5%	10,919	29.9%	
Deposits		26,561	72.7%	23,852	65.3%	
Preferred deposits		19,655	53.8%	18,672	51.1%	
Junior deposits		6,906	18.9%	5,179	14.2%	
Equity		1,096	3.0%	1,096	3.0%	
Total Tangible Banking Assets		35,867	100.0%	36,541	100.0%	

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional	Preliminary
	Instrument	Sub-ordination	Instrument	Sub-ordination	De Jure	De Facto	Notching Guidance vs. Adjusted BCA	LGF notching	Notching	Rating Assessment
Counterparty Risk Rating	19.0%	19.0%	19.0%	19.0%	3	3	3	2	0	baa2
Counterparty Risk Assessment	19.0%	19.0%	19.0%	19.0%	3	3	3	1	0	baa3 (cr)
Deposits	19.0%	3.0%	19.0%	4.8%	2	2	2	2	0	baa2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	2	0	baa2	0	Baa2	Baa2
Counterparty Risk Assessment	1	0	baa3 (cr)	0	Baa3(cr)	
Deposits	2	0	baa2	0	Baa2	Baa2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

Ratings

Exhibit 8

Category	Moody's Rating
RAIFFEISENBANK AUSTRIA D.D.	
Outlook	Stable
Counterparty Risk Rating	Baa2/P-2
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa3(cr)/P-3(cr)
PARENT: RAIFFEISEN BANK INTERNATIONAL AG	
Outlook	Stable
Counterparty Risk Rating	A3/P-2
Bank Deposits	A3/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Senior Unsecured	A3
Subordinate	Baa3
Pref. Stock Non-cumulative -Dom Curr	Ba3 (hyb)

Source: Moody's Investors Service

Endnotes

1 The ratings shown here are RBI's deposit rating and BCA.

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