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## Research Update:

# Austria-Based Oberbank AG Rated 'A/A-1'; Outlook Stable

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## Research Update:

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## Overview

- As a midsize bank in Austria, Oberbank has weaker diversity than larger rated peers, but we consider this to be offset by its proven stable and strong franchise in core markets, above-average cost efficiency, and strong capitalization.
- The material buffer of loss-absorbing capacity at Oberbank would likely help to protect senior unsecured creditors, since we think that, despite Oberbank's relatively modest size, it would be subject to a bail-in-led resolution if it were to fail.
- We are assigning our 'A/A-1' long- and short-term issuer credit ratings and 'A+/A-1' long- and short-term resolution counterparty ratings to Oberbank.
- The stable outlook reflects our view that Oberbank will maintain its competitive advantage and that expansion in foreign markets will not materially affect the bank's risk profile or its strong capitalization. It also reflects our view that the bank will keep a buffer of additional loss capacity instruments above 5% of our risk-weighted assets metric.

## Rating Action

On Jan. 9, 2019, S&P Global Ratings assigned its 'A/A-1' long- and short-term issuer credit ratings to Austria-based Oberbank AG. The outlook is stable.

We also assigned our 'A+/A-1' long- and short-term resolution counterparty ratings (RCRs) to Oberbank.

## Rationale

With total assets of about €21 billion, Oberbank is a midsize universal bank in Austria with a strong regional focus, mainly in the Upper Austria and Salzburg regions, complemented by supplementary business in some neighboring countries. While Oberbank is relatively small in a broader European context and has significant geographic concentration, our ratings recognize the bank's proven stability and franchise strength in one of the lower-risk European banking markets, as well as its strong capitalization. The ratings also take into account the bank's good efficiency when compared with other banks active in the same region, such as UniCredit Bank Austria, Erste Bank Group AG, the Austrian Landesbanks, or the savings banks in Germany, for example.

The ratings also reflect our view that the bank would most likely be subject to an open bank resolution if it failed, and that it already has a meaningful base of loss-absorbing capacity, upon which we expect it will build. We reflect this buffer though one notch of uplift above our 'a-' assessment of the bank's standalone credit profile (SACP).

Our starting point for the ratings on Oberbank is the 'a-' anchor, which represents our view of the economic environment of the markets where the bank operates and the banking industry risk in Austria.

We regard Oberbank as having an adequate business position, when compared with peers in Austria and European markets with a similar industry risk profile. This assessment balances the bank's limited size and regional and business concentration with its strong regional franchise and sound cost efficiency. We also note its strong track record in delivering sound and stable risk-adjusted profits over the past few decades.

We primarily base our view of Oberbank's capital and earnings as a rating strength on our risk-adjusted capital (RAC) ratio, which we project will be in the 12.5%-13.5% range by year-end 2020, compared with 11.3% as of Dec. 31, 2017. The anticipated increase mainly stems from our expectation of ongoing sound earnings retention over that period, highlighted by an expected dividend payout ratio of 15%-20%, which exceeds the expected annual increase of 3%-4% in our risk-weighted asset (RWA) metric for 2018-2020.

We consider Oberbank's concentration in corporate banking activities--mainly in Austria, and in particular in Upper Austria--as one of the main weaknesses to our assessment. Furthermore, Oberbank's material and concentrated equity participations in Austrian corporates leaves the bank's earnings substantially vulnerable to adverse swings in the local economy in Upper Austria.

While we acknowledge the bank has an established presence in neighboring countries such as Germany, Czech Republic, and Hungary, we still consider the benefits in terms of geographic diversification as limited. Domestic business continues to represent about 85% of net profits. Following the ongoing opening of new branches, mainly in Germany, we expect the share of revenues from German business will increase over the coming years.

The recent expansion in Germany, and in the Austrian regions Lower Austria and Vienna, has contributed to annual customer loan growth of 7.7% since 2017, materially above the industry average in Austria. However, we expect this expansion will slow down, returning to the 5% annual levels that we observed in 2012-2016, partly because some of Oberbank's domestic peers have completed restructuring. That said, we expect growth will remain at the upper end of banks operating in Austria, as Oberbank's lean structure and efficiency give it some advantage compared to peers in the region.

Apart from the abovementioned regional and business concentration risks, we think Oberbank's risk appetite and exposure to unexpected losses compare

favorably with peers'. We consider the bank's risk management to be sound, supported by the bank's nonperforming loan (NPL; 90 days past due) ratio at 2.6% of gross customer loans at end-September 2018. This compares well with the 3.1% NPL ratio we calculate for the consolidated Austrian banking sector when including foreign operations (see "Industry Report Card: The Austrian Banking System Is Likely To Remain Resilient In A Downturn," published Nov. 23, 2018).

We think Oberbank's funding and liquidity benefit from the bank's strong regional franchise in Austria and its proximity to local customers with long-standing relationships that provide it with a stable deposit base--even in times of stress. Customer loans accounted for about 134% of customer deposits at end-September 2018, which is materially weaker than for Erste Group, Raiffeisen Bank, and UniCredit Bank Austria, for example, but remains broadly in line with the wider Austrian market.

Oberbank's liquidity is adequate, in our view. This is demonstrated by the bank's sound liquidity ratio (broad liquid assets to short-term wholesale funding) of at about 1.5x as of Sept. 30, 2018, which compares well with local and global peers. We therefore think it could operate for more than six months without access to market funding in an adverse scenario.

Despite Oberbank's relatively modest size in the context of the wider banking system, as well as its corporate focus, we assess the bank as systemically important in Austria due to its large regional market shares and interconnections with the economy in Upper Austria. If Oberbank failed, we think it would be subject to a bail-in-led resolution aimed at preserving the bank's operations. We also expect that the regulators will impose minimum requirement for own funds and eligible liabilities (MREL) for the bank, which would also support our view of the bank's additional loss absorbing capacity (ALAC)--our measure of the bail-in buffer available for protection of senior creditors in case of resolution.

Our ratings on Oberbank benefit from one notch of uplift above the 'a-' SACP, reflecting our assumption that Oberbank will build a buffer of ALAC-eligible instruments by 2020 that will be comfortably above our threshold of 5% of its RWAs, after an expected 4.9% at year-end 2018. In our projection for the coming two years, we assume ongoing sound earnings retention and the replacement of maturing subordinated instruments.

Although Oberbank's size and diversity are weaker than larger 'A' rated peers', we think that the very low economic risks of its lending portfolio, stability in its core markets, good efficiency, and favorable track record of performance and risk metrics offset its higher geographical and business concentrations. Combined, these factors support our view that Oberbank's creditworthiness is equivalent to that of its 'A' rated peers in Europe.

The 'A+/A-1' RCRs reflect our RCR jurisdiction assessment on Austria, and our review of its relevance for Oberbank. We consider that there is an effective resolution regime in Austria and that if Oberbank were to reach a point of

nonviability, it would be subject to a bail-in-led resolution that would seek to ensure the timely and full payment of senior liabilities. An RCR is a forward-looking opinion of the relative default risk of certain senior liabilities that may be protected from default through an effective bail-in resolution process for the issuing financial institution (see "Resolution Counterparty Ratings Jurisdiction Assessment For Austria Completed," published June 29, 2018).

## Outlook

The stable outlook reflects our expectation that the bank will be able to maintain its competitive advantage and internal capital generation, and that expansion in foreign markets will remain contained and will not weaken the bank's risk profile or deplete its strong capital buffer in the medium term.

The outlook also reflects our view that management will be able to uphold the buffer of ALAC-eligible instruments above 5% of our RWAs, and that the resolution scenario for Oberbank would likely be bail-in-led, as we anticipate for the larger, more systemically important banks in Austria.

### Downside scenario

We would lower the rating if we expected that Oberbank's ALAC buffer was to drop below our 5% threshold for one notch of support, or if we anticipated that the intended resolution strategy for Oberbank could differ from our current expectations. We expect more clarity regarding resolution details and regulatory bail-in buffer thresholds over the course of 2019.

While a more remote scenario, we could also lower the ratings if the bank were hit by tail events or if it pursued strong expansion that led to the deterioration of the capital buffer, with a risk-adjusted capital ratio falling below 10%. Offering more risky products, expanding into regions with higher risks than in Austria, or tail risk in its equity holdings may harm the bank's risk profile or materially increase its capital consumption--this could also lead to a downgrade

### Upside scenario

We consider an upgrade to be a remote scenario. We think Oberbank's strengths are unlikely to compensate for its regional concentrations in revenues and risks to the extent that we would consider raising the ratings, thus bringing Oberbank in line with 'A+' rated peers.

## Ratings Score Snapshot

Issuer Credit Rating	A/Stable/A-1
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SACP	a-
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Anchor	a-
Business Position	Adequate (0)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	+1
ALAC Support	+1
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

## Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- Industry Report Card: The Austrian Banking System Is Likely To Remain Resilient In A Downturn, Nov. 23, 2018
- Resolution Counterparty Ratings Jurisdiction Assessment For Austria Completed, June 29, 2018

- Banking Industry Country Risk Assessment: Austria, May 30, 2018

## Ratings List

New Rating

Oberbank AG

Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/-/-/A-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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