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Vienna Insurance Group Proposed Subordinated Fixed-To-Floating-Rate Notes Rated 'A-'; Existing 2005 Notes Raised To 'A-'

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FRANKFURT (Standard & Poor's) July 9, 2013--Standard & Poor's Ratings Services today assigned its 'A-' long-term issue rating to the proposed subordinated fixed-to-floating-rate notes to be issued by Austria-based Vienna Insurance Group AG Wiener Versicherung Gruppe (VIG; A+/Stable/--), the operating holding company of the Vienna Insurance Group. The rating is subject to our review of the final terms and conditions.

At the same time, we raised the issue ratings on two existing subordinated fixed-to-floating-rate notes issued by VIG in 2005 to 'A-' from 'BBB+'.

The rating on the proposed notes incorporates our methodology for junior subordinated debt issues, which leads us to rate them two notches below the long-term counterparty credit rating on VIG.

The rating is based on our understanding that holders of the proposed notes will be subordinated to VIG's senior creditors and that VIG has the option of deferring interest from the previous 12-month period under the following conditions:

- That no dividend, other distribution, or payment in respect of any class of shares has been agreed upon in the most recent ordinary general meeting of shareholders; or
- That there was no repurchase of shares of any class of the issuer for cash.

Furthermore, we note that interest deferral is mandatory if a solvency event has occurred. Ahead of the implementation of Solvency II, a solvency event might be triggered in a situation in which the coupon payments exceed the local GAAP profit of the issuer. This trigger is required by the Austrian Insurance Supervision Act for the issue to receive regulatory solvency credit. However, we regard such a risk of mandatory coupon deferral as highly remote, owing to VIG's local GAAP unrealized investment gains. We regard these gains as substantial and resilient to stressful conditions. We would expect unrealized gains to be easily converted into realized investment gains at the management's discretion.

Our upgrade of the 2005 notes is based on our reassessment of the likelihood of such a mandatory deferral being triggered given the scale and expected utilization of unrealized investment gains.

We understand that the proposed notes will have a tenor of 30.5 years, but will be callable at the option of the issuer 10.5 years after issuance and on any quarterly interest payment date thereafter. The coupon is fixed until the first call date. After that, the interest rate will convert into a floating-rate coupon with a step-up of 100 basis points above the initial credit spread, and will be payable quarterly.

We expect to classify the notes as having "intermediate equity content" under our hybrid capital criteria. We include securities of this nature, up to a maximum of 25%, in our calculation of total adjusted capital, which forms the basis of our consolidated risk-based capital analysis of insurance companies. Such inclusion is subject to the notes being considered eligible for regulatory solvency treatment and the aggregate amount of included hybrid capital not exceeding the total eligible for regulatory solvency treatment.

We understand that VIG plans to issue these instruments to take advantage of current financing conditions. Including this transaction, we estimate that the group's financial leverage (debt plus hybrid capital, divided by the sum of economic capital available, debt, and hybrid capital) will increase but remain relatively conservative at about 20%. We will continue to monitor the leverage of the group, in particular in view of our treatment of the company as an operating holding company under our criteria. We currently have a zero-notch differential between VIG AG and the ratings on the group's rated core operating subsidiary. We expect the fixed-charge coverage (EBITDA divided by senior and subordinated debt interest) to be about 7x-9x over 2013-2015.

RELATED RESEARCH AND CRITERIA

- Insurers: Rating Methodology, May 7, 2013
- Group Rating Methodology, May 7, 2013
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments , Feb. 9, 2010

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