

**Rating Action: Moody's confirms Heta, upgrades Hypo Tirol and Pfandbriefbank (Oesterreich)**

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Global Credit Research - 12 Oct 2016

Frankfurt am Main, October 12, 2016 -- Moody's Investors Service has today taken rating actions on three Austrian financial institutions following the announcement by Kaerntner Ausgleichszahlungs-Fonds (KAF, backed senior secured rating Aa1 stable) on 10 October 2016 that the required two-third acceptance rate was comfortably met for its renewed tender offer for Heta Asset Resolution AG's (Heta) senior unsecured and subordinate debt obligations, which benefit from a grandfathered statutory guarantee of the regional State of Carinthia (B1 with developing outlook).

Consequently, Moody's has taken the following rating actions:

--- Confirmation of Heta's Ca senior unsecured debt rating and of its C subordinate debt rating, all guaranteed by the State of Carinthia.

--- Upgrade of Hypo Tirol Bank AG's (Hypo Tirol) deposit ratings to Baa3/Prime-3 from Ba1/Not-Prime and of its long-term debt ratings to Baa3 from Ba1. Moody's further upgraded Hypo Tirol's standalone baseline credit assessment (BCA) and adjusted BCA to ba2 from ba3, and its Counterparty Risk Assessment (CR Assessment) to Baa2(cr)/Prime-2(cr) from Baa3(cr)/Prime-3(cr). Hypo Tirol's backed long-term senior unsecured debt and deposit ratings were upgraded to Baa1 from Baa2 while its backed short-term deposit ratings of Prime-2 were affirmed.

--- Upgrade of Pfandbriefbank's (Oesterreich) AG's (Pfandbriefbank) backed senior unsecured debt ratings to Baa3 from Ba1.

The long-term senior unsecured and deposit ratings of the entities affected by today's rating action carry a stable outlook.

Today's rating action concludes the rating review initiated on 23 May 2016 on all three entities' ratings.

Further, Heta's Austrian government-guaranteed subordinated debt rating of Aa1 is unaffected by today's rating action.

Please refer to the end of this press release for a list of all affected ratings.

#### RATINGS RATIONALE

##### -- CONFIRMATION OF HETA'S DEFICIENCY-GUARANTEED RATINGS

The confirmation of Heta's deficiency-guaranteed Ca-rated senior unsecured debt rating and C-rated subordinate debt rating reflects Moody's unchanged assessment that the expected losses for each liability class remain in the 35%-65% and the greater-than-65% range, respectively. This assessment takes into account a compensatory payment for Carinthia's deficiency guarantee undertaken by KAF, which is 10.97 percentage points for both debt classes. These ratings relate to creditors who have not accepted the KAF's renewed tender offer (so-called "hold-outs") and thus will only benefit from an orderly wind-down of Heta's assets, which is not expected before end-2023. KAF, a public-sector special purpose entity established under the regional law of the State of Carinthia, is offering Heta creditors to swap their Heta debt into a zero-coupon debt issuance which is backed by a full, direct, unconditional and irrevocable guarantee provided by the Government of Austria (Aa1, stable).

On 10 April 2016, the Austrian Financial Market Authority (FMA) imposed several resolution measures on Heta, including a bail-in of liabilities. The FMA's emergency administrative decision ("Mandatsbescheid") reduced the face value of Heta's senior unsecured liabilities to 46.02%, while the entity's subordinated liabilities had been written down to zero. In addition, the regulator canceled interest payments and extended the maturity of all affected liabilities until 31 December 2023, effectively rolling over the payment moratorium that the regulatory body ordered in March 2015.

The stable outlook on Heta's deficiency-guaranteed senior unsecured debt rating reflects Moody's views that any cash payback for hold-out creditors will not be known before Heta's orderly wind-down is concluded until end-2023, which goes beyond the outlook horizon.

#### -- UPGRADE OF HYPO TIROL'S BCA AND RATINGS

The upgrade of Hypo Tirol's BCA to ba2 from ba3 reflects the significant reduction of downside risks related to Hypo Tirol's contingent liabilities resulting from its joint and several liability shared with fellow members of Pfandbriefbank.

In addition, owing to a reversal of impairments and reserves held against its exposure to Heta, Moody's expects Hypo Tirol to benefit from a sizable one-off profit, which will support Hypo Tirol's efforts to further strengthen its capitalisation. At the same time, the exchange of Hypo Tirol's illiquid Heta claims into a liquid zero bond issued by KAF helps the bank further improve its overall liquidity profile ahead of the bank's concentrated debt maturities in 2017.

Hypo Tirol's stable rating outlook reflects the rating agency's expectation that a significant change in the bank's liability structure as a result of the upcoming maturity of large portions of its backed senior unsecured debt in 2017 will have a net neutral effect on the bank's ratings. Moody's expects a successful completion of the refinancing operations predominantly through covered bond issuance and the use of excess liquidity to put upward pressure on the bank's BCA, mostly because of a reduced market funding dependence and a smoothed debt maturity profile. At the same time, the rating agency expects the bank to make additional progress in the work-out of its Italian legacy non-performing loan (NPL) portfolio.

The reduction of senior unsecured funding components will, however, compress significantly the currently still comfortable buffer of senior unsecured instruments, which will put pressure on the bank's Advanced LGF notching results that could partly offset upward pressure on the bank's standalone credit profile.

#### -- UPGRADE OF PFANDBRIEFBANK'S RATINGS

The upgrade reflects Moody's assessment that the debt exchange exerts upward pressure on Pfandbriefbank's supporting member banks' creditworthiness from which Pfandbriefbank's ratings are derived. The upward pressure results from lower-than-previously expected losses imposed on their direct and indirect Heta debt exposure based on the debt exchange which reduces tail risk related to Pfandbriefbank support.

Pfandbriefbank's rating continues to be purely based on the member banks' creditworthiness and does not include uplift from public-sector entities, reflecting the track record of lack of commitment by several federal states to honour their obligations under the existing joint and several liability framework.

Given its business profile as a poorly capitalised issuing vehicle for its member banks, i.e., the Austrian Landeshypothekenbanken or their legal successors, Pfandbriefbank relies fully on the performance of its concentrated assets to service its liabilities. The Heta moratorium in March 2015 therefore impaired its liquidity and solvency. Pfandbriefbank came under stress after the regulator in Austria imposed a payment moratorium on the liabilities of Heta to which Pfandbriefbank had a EUR1.2 billion exposure as of March 2015. Pfandbriefbank's liabilities are grandfathered under a statutory joint and several guarantee from member banks and their former guarantors, i.e. the relevant Austrian federal states, according to Austrian federal law.

The stable outlook on Pfandbriefbank's senior backed debt ratings reflects Moody's assessment on the supporting Austrian Landeshypothekenbanken credit quality.

#### WHAT COULD CHANGE THE RATINGS UP/DOWN

##### Heta Asset Resolution AG

Upward ratings pressure on Heta's Carinthian-state-guaranteed senior unsecured and subordinated debt ratings could result from Moody's assessment of a higher-than-currently anticipated recovery rate for each debt class during the orderly wind-down of Heta.

Moody's would consider downgrading Carinthian-state-guaranteed senior unsecured debt ratings if the expected loss assumption on these instruments were higher than currently expected.

##### Hypo Tirol Bank AG

An upgrade of Hypo Tirol's long-term debt and deposit ratings could result from an upgrade of its standalone BCA, whereas a downgrade could be driven by the anticipated change in the bank's funding profile which may put downward pressure on the results of Moody's Advanced LGF analysis.

Hypo Tirol's BCA may be upgraded if: (1) following the bank's refinancing of its concentrated 2017 debt maturities, its funding profile is more evenly spread out than presently and less dependent on confidence-sensitive market funding sources; and/or (2) the bank continues to make solid progress in the reduction of its Italian NPL exposures.

Hypo Tirol's Advanced LGF analysis may result in reduced uplift if following the refinancing of backed senior unsecured maturities, the amount of equal-ranking debt for remaining senior unsecured creditors and wholesale depositors declined beyond the rating agency's current expectations.

#### Pfandbriefbank (Oesterreich) AG

An upgrade could result from: (1) a strengthening of the member banks' credit profiles; or (2) a clarification of the legal obligations of the Austrian federal member-states under the guarantee framework, to the extent that this removes any doubts over the full, unconditional liability of all parties to support Pfandbriefbank in a timely fashion. A downgrade could result from a deterioration of the member banks' credit profiles.

#### LIST OF AFFECTED RATINGS

The following ratings were upgraded:

..Issuer: Pfandbriefbank (Oesterreich) AG

...Backed Senior Unsecured Ratings, to Baa3 from Ba1, outlook changed to Stable from Rating Under Review

..Issuer: Hypo Tirol Bank AG

...Adjusted Baseline Credit Assessment, to ba2 from ba3

...Baseline Credit Assessment, to ba2 from ba3

...Long Term Counterparty Risk Assessment, to Baa2(cr) from Baa3(cr)

...Short Term Counterparty Risk Assessment, to P-2(cr) from P-3(cr)

...Long Term Bank Deposit Ratings, to Baa3 from Ba1, outlook changed to Stable from Rating Under Review

...Short Term Bank Deposit Ratings, to P-3 from NP

...Senior Unsecured Rating, to Baa3 from Ba1, outlook changed to Stable from Rating Under Review

...Senior Unsecured MTN Rating, to (P)Baa3 from (P)Ba1

...Subordinate MTN Rating, to (P)Ba3 from (P)B1

...Backed Long Term Bank Deposit Ratings, to Baa1 from Baa2, outlook changed to Stable from Rating Under Review

...Backed Senior Unsecured Ratings, to Baa1 from Baa2, outlook changed to Stable from Rating Under Review

...Backed Senior Unsecured MTN Rating, to (P)Baa1 from (P)Baa2

...Backed Subordinate Rating, to Ba1 from Ba2

...Backed Senior Subordinate Rating, to Ba1 from Ba2

...Backed Subordinate MTN Rating, to (P)Ba1 from (P)Ba2

The following rating was affirmed:

..Issuer: Hypo Tirol Bank AG

...Backed Short-Term Bank Deposit Ratings, at P-2

The following ratings were confirmed:

..Issuer: Heta Asset Resolution AG

.... Carinthian-state-guaranteed Senior Unsecured Debt Ratings at Ca, outlook changed to Stable from Rating Under Review

.... Carinthian-state-guaranteed Subordinate Debt Ratings, at C

Not Affected:

..Issuer: Heta Asset Resolution AG

.... Austrian government-guaranteed Subordinate Debt Rating at Aa1

Outlook Actions:

..Issuer: Heta Asset Resolution AG

.... Outlook, changed to Stable from Rating Under Review

..Issuer: Hypo Tirol Bank AG

.... Outlook, changed to Stable from Rating Under Review

..Issuer: Pfandbriefbank (Oesterreich) AG

.... Outlook, changed to Stable from Rating Under Review

#### PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Bank published in January 2016. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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