MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Hypo Alpe-Adria-Bank International AG's public-sector covered bonds

Global Credit Research - 24 Feb 2014

Frankfurt am Main, February 24, 2014 -- Moody's Investors Service has today downgraded the ratings of Hypo Alpe-Adria-Bank International AG's (the issuer/HAA; not rated) guaranteed public-sector covered bonds to Aa2 on review for downgrade from Aaa. The downgrade of the guaranteed covered bonds follows the downgrade of the guaranteed senior unsecured debt ratings of HAA to Baa2 on review for downgrade from A1.

At the same time, Moody's has downgraded the issuer's unguaranteed public-sector covered bonds to A3 on review direction uncertain from Aa2 on review direction uncertain. The unguaranteed covered bonds' downgrade is primarily driven by the lack of transparency towards their future positioning in case of HAA's resolution.

For more details on HAA please refer to our press release (https://www.moodys.com/research/Moodys-downgrades-Hypo-Alpe-Adrias-guaranteed-debt-ratings-ratings-placed--PR_292479), published on 14 February 2014.

RATINGS RATIONALE

--- GUARANTEED PUBLIC-SECTOR COVERED BONDS

The guaranteed public-sector covered bonds benefit from the statutory deficiency guarantee of the Austrian federal state of Carinthia. Previously, the ratings of HAA's guaranteed public-sector covered bonds reflected Moody's view that it was appropriate to look through the issuer to the provider of the deficiency guarantee in determining the anchor point for Moody's covered bond analysis.

However, recent discussions on the future of HAA have revealed that the Austrian government is willing to consider outcomes that might greatly reduce the value of the deficiency guarantee to ensure full and timely payment of interest and principal. To reflect the increased risk, Moody's has ceased applying full credit substitution for the guaranteed covered bonds benefitting from Carinthia's statutory support.

--- UNGUARANTEED COVERED BONDS

The downgrade of the unguaranteed covered bonds reflects the lack of transparency towards the future positioning of these debt instruments. The European Commission's state aid approval from 3 September 2013 requires Austria to explore how best to wind down the bank's restructuring unit. Moody's believes it is likely that the covered bonds will form part of a wind-down entity that does not have a banking licence and which will benefit from support by the Austrian government. However, government officials have publically stated that taxpayer costs are a concern. Consequently, the A3 rating of the unguaranteed covered bonds reflects the implied risk to bondholders if alternatives to the wind-down solution are explored.

Please note that on 19 September 2013, Moody's released a Request for Comment, requesting market feedback in which it proposes an adjustment to the anchor point it uses in its covered bond analysis. If the revised Credit Rating Methodology is implemented as proposed, the Credit Ratings of the covered bonds may be affected. Please refer to Moody's Request for Comment, titled "Approach to Determining the Issuer Anchor Point for Covered Bonds" for further details regarding the implications of the proposed Credit Rating Methodology changes on Moody's Credit Ratings https://www.moodys.com/research/Approach-to-Determining-the-Issuer-Anchor-Point-for-Covered-Bonds--PBS_SF342448.

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a timely payment indicator (TPI) framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the issuer's probability of default (measured by the issuer's rating); and (2) the stressed losses on the cover pool assets following issuer default.

The cover pool losses for HAA's covered bonds are 44.8%. This is an estimate of the losses Moody's currently models if HAA defaults. Moody's splits cover pool losses between market risk of 33.2% and collateral risk of 11.6%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 21.2%.

The over-collateralisation (OC) in the cover pool is 338%, of which HAA provides 38.5% on a "committed" basis. The minimum OC level consistent with the rating targets is 46%, of which the issuer should provide 25.5% in a "committed" form. These numbers show that Moody's is only partially relying on "uncommitted" OC in its expected loss analysis for HAA.

All numbers in this section are based on Moody's most recent modelling based on data, as per 30 September 2013. The current level of OC is an exception to this, being based on data as per 31 December 2013.

The cover pool losses are an estimate of the losses Moody's currently models if the relevant issuer defaults. Moody's splits cover pool losses between market risk and collateral risk. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from the cover pool assets' credit quality. Moody's derives collateral risk from the collateral score.

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which indicates the likelihood that the issuer will make timely payments to covered bondholders if the issuer defaults. The TPI framework limits the covered bond rating to a certain number of notches above the issuer's rating. For HAA's guaranteed and unguaranteed covered bonds, Moody's has assigned a TPI of "High".

FACTORS THAT WOULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING

The issuer's credit strength is the main determinant of a covered bond rating's robustness. The TPI Leeway measures the number of notches by which Moody's might downgrade the issuer's rating before the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "High", the TPI Leeway for the guaranteed covered bonds is 1 notch. This implies that Moody's might downgrade the covered bonds because of a TPI cap, if it downgrades the guaranteed senior unsecured debt below Baa3, all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain limited circumstances, such as (1) a sovereign downgrade negatively affecting both the issuer's senior unsecured rating and the TPI; (2) a multiple-notch downgrade of the issuer; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in July 2012. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this rating action, and whose ratings may change as a result of this rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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