MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Hypo Alpe Adria's guaranteed subordinated debt ratings to C and Ca

Global Credit Research - 20 Jun 2014

Reflects government's draft law that voids the deficiency guarantee on subordinated debt maturing until 30 June 2019

Frankfurt am Main, June 20, 2014 -- Moody's Investors Service has today taken rating actions on Hypo Alpe-Adria-Bank International AG (HAA) following the Austrian government's proposal to enact legislation to allow it to bail-in the bank's subordinated debt holders and void the State of Carinthia's (A2 stable) deficiency guarantees that apply to parts of HAA's debt. This concludes the ratings review initiated on 14 February 2014 and extended on 23 May 2014.

Specifically, Moody's has downgraded HAA's:

--- Previously-guaranteed subordinated debt (maturing on or before 30 June 2019) to C from B3

--- Subordinated debt maturing after 30 June 2019, which continues to benefit from a deficiency guarantee from Carinthia, to Ca (negative) from B3

--- Senior debt that continues to benefit from a deficiency guarantee from Carinthia to Caa1 (negative) from Ba1

At the same time, Moody's affirmed the Aaa rating, with a stable outlook, of the EUR1 billion subordinated debt guaranteed by the Austrian Government and issued in December 2012.

RATINGS RATIONALE

On 11 June 2014, the Austrian government published a draft law that paves the way for the nationalised Austrian lender HAA to be transferred to an unregulated wind-down institution later this year, at which point its banking license will be revoked. If enacted, the law will allow the wind-down entity to be recapitalised through the full write down of all subordinated debt maturing on or before 30 June 2019, notwithstanding the existence of a deficiency guarantee issued by the State of Carinthia, which the law will declare null and void. Moody's expects the draft legislation to be enacted over the coming weeks.

--SUBORDINATED DEBT MATURING UNTIL 30 June 2019 DOWNGRADED TO C FROM B3

These subordinated debt instruments were downgraded to C, which is the lowest rating category and implies zero recoveries, to reflect the planned write-down of this debt class in full and the voiding of the State of Carinthia's statutory deficiency guarantee.

--DOWNGRADE OF OTHER SUBORDINATED AND SENIOR DEBT STILL BENEFITTING FROM STATUTORY DEFICIENCY GUARANTEES

The removal through statute of the guarantee from the State of Carinthia for some of the bank's subordinated debt marks a substantial departure from measures previously taken by other EU governments. Although subordinated debt maturing after 30 June 2019 and senior debt continue to benefit from Carinthia's statutory deficiency guarantee, Moody's no longer places any weight on the guarantee in assessing the credit risk associated with these instruments. This is because if any future bail-in measures are required, there is a strong likelihood that the guarantee would, similarly, be declared null and void in order to allow these securities to be written down.

The downgrade of the remaining subordinated debt to Ca, one notch above the written-down debt instruments, reflects Moody's view that the additional capital generated by the write-down allows for some possibility that this tranche of debt will avoid default or that holders of these instruments will make some recoveries in the event of default.

The downgrade of the senior debt to Caa1, four notches above the written-down debt instruments, reflects two factors. First, there is in Moody's view some residual possibility of public sector support for the senior debt, given for example earlier statements by the government ruling out an insolvency for HAA, which continues to be factored in the ratings using Moody's standard Joint-Default-Analysis (JDA) approach. Second, the additional capital generated by the write-down allows for some possibility that this tranche of debt will avoid default or that holders of these instruments will make some recoveries in the event of default.

Given the government's communicated willingness to apply unconventional measures for cost sharing to protect taxpayers, the negative outlook reflects Moody's expectation that such a scenario becomes more likely as the debt profile of HAA matures given its weak asset quality as reflected in NPLs of EUR9.3 billion (32.5% of its loan book) as of year-end 2013.

--AFFIRMATION OF THE Aaa RATING OF GOVERNMENT-GUARANTEED SUBORDINATED DEBT

The affirmation reflects the direct, irrevocable and unconditional guarantee provided by the Federal Republic of Austria (Aaa, stable) which ranks pari passu to all other senior obligations of the Austrian government.

In affirming the ratings, Moody's has taken several factors into account (1) the strong protection offered by this guarantee compared with the looser terms of the deficiency guarantee previously extended by Carinthia; (2) the fact that this guarantee was extended very recently (in December 2012) as part of a range of measures to preserve both HAA and, more broadly, financial stability; and (3) Moody's assumption that the willingness of the Austrian government to honor its direct guarantee obligations remains unaffected by its recent actions given for example its need to preserve its ability to use similar tools in future. The stable outlook reflects the outlook on the government's ratings.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Upward ratings pressure is unlikely to develop on HAA's senior and subordinated debt ratings that are backed by the deficiency guarantees of the State of Carinthia as indicated by the negative outlook. The ratings would be downgraded if there were indications that the Austrian government would contemplate the removal of the statutory deficiency guarantees for these debt instruments.

The deterioration in the creditworthiness of the Republic of Austria or indications that the abrogation of the guarantee was contemplated would exert downward pressure on HAA's Aaa-rated government-guaranteed subordinated debt instruments.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Global Banks published in May 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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