INVESTORS SERVICE

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

Global Credit Research - 27 May 2014

Frankfurt am Main, May 27, 2014 -- Moody's Investors Service has today downgraded the guaranteed public-sector covered bonds of Hypo Alpe-Adria-Bank International AG (the issuer/HAA; not rated) to A1 on review for downgrade from Aa2 on review for downgrade. The downgrade of the guaranteed covered bonds follows the downgrade of the guaranteed senior unsecured debt ratings of HAA to Ba1 on review for downgrade from Baa2 on review for downgrade.

The unguaranteed public-sector covered bonds remain rated A3 on review direction uncertain.

For more details on HAA please refer to our press release "Moody's downgrades Hypo Alpe Adria's guaranteed debt ratings to non-investment grade, ratings remain on review for downgrade", published on 23 May 2014.

RATINGS RATIONALE

--- GUARANTEED PUBLIC-SECTOR COVERED BONDS

On 14 March 2014 the Austrian government announced plans to extend the burden sharing for the cost of the wind-down of HAA to include subordinated debtholders, notwithstanding the deficiency guarantee from State of Carinthia (A2, stable) that extends to HAA's guaranteed subordinate debt. Moody's believes that legislative changes would likely be needed to achieve this objective. If losses were to be imposed on guaranteed subordinated debt, this would set a precedent that would significantly diminish the value of the guarantee for senior debt. The starting point for Moody's covered bond analysis is the Ba1 guaranteed senior unsecured debt rating of HAA, which benefits from the statutory deficiency guarantee from the Austrian state of Carinthia.

--- UNGUARANTEED PUBLIC-SECTOR COVERED BONDS

On 24 February 2014, Moody's had downgraded the unguaranteed public-sector covered bonds of HAA to A3 on review direction uncertain. The downgrade reflected the lack of transparency towards the future positioning of these debt instruments. The situation has not changed since then, and Moody's continues to believe that the covered bonds will form part of the wind-down entity. However, the A3 rating also reflects the implied risk to bondholders if alternative solutions are explored.

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a 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 probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The CB anchor for the guaranteed covered bonds is the Ba1 guaranteed senior unsecured debt rating. The CB anchor for the unguaranteed covered bonds is unpublished.

The cover pool losses for this programme are 43.6%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 33.6% and collateral risk of 10.1%. 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 20.1%.

The over-collateralisation in the cover pool is 338.2 %, of which HAA provides 38.5% on a "committed" basis. The minimum OC level consistent with the A1 rating target for the guaranteed covered bonds is 51.5%, of which the issuer should provide 29.5% in a "committed" form. The minimum OC level consistent with the A3 rating target for the unguaranteed covered bonds is 53.0%, of which the issuer should provide 35.5% in a "committed" form. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's please refer to "Moody's Global Covered Bonds Monitoring Overview", published quarterly. All numbers in this section are based on the most recent Performance Overview based on data, as per 31 December 2013.

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

For HAA's public-sector covered bonds, Moody's has assigned a TPI of "High".

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

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

The TPI Leeway for HAA's public-sector covered bonds is limited, and thus any reduction of the CB anchor may lead to a downgrade of the covered bonds.

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 this rating was "Moody's Approach to Rating Covered Bonds" published in March 2014. 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.

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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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