MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Hypo Alpe Adria's guaranteed debt ratings to non-investment grade, ratings remain on review for downgrade

Global Credit Research - 23 May 2014

New rating levels reflect Austrian government's intentions to impose losses on guaranteed subordinated debt by introducing new legislation

Frankfurt am Main, May 23, 2014 -- Moody's Investors Service has today downgraded the guaranteed subordinated debt ratings of Hypo Alpe-Adria-Bank International AG (HAA) to B3 from Baa3. This rating action was prompted by statements from the Austrian government on 14 March 2014 that stakeholders will be required to participate in the costs of winding-down the bank. In particular, the Austrian government now intends to extend burden sharing beyond previous shareholders to include subordinated debt holders, notwithstanding the deficiency guarantee from Carinthia (A2, stable) that extends to HAA's guaranteed subordinated debt. The government stated that it may pursue legislation to bypass the statutory deficiency guarantee, to which Moody's attributes a reasonable prospect for success.

Moody's also downgraded the guaranteed senior unsecured ratings to non-investment grade, at Ba1 from Baa2, to reflect the heightened risk to all bondholders arising from the government's apparent willingness to impose losses on creditors notwithstanding the existence of a statutory guarantee.

The ratings remain on review for further downgrade.

RATINGS RATIONALE

Moody's downgraded the ratings on 14 February 2014 to reflect its concerns that bondholders would no longer be fully protected in the wind-down of the bank, even if the agency considered this an unlikely outcome given the statutory deficiency guarantee on their holdings. The government at the time had stated that it intended to explore all available options to save taxpayers' money when resolving HAA, including insolvency, but it had given no clear indication of what this might mean for senior and subordinated creditors. The ratings were therefore left on review for downgrade.

Since that date, further capital needs have become apparent and the government has clarified its objectives and announced plans to resolve HAA in a manner which would avoid an insolvency of the bank, but would nevertheless see subordinated debtholders contributing to the costs of the wind-down of HAA. Moody's believes that legislative change would likely be needed to impose losses on subordinated debt in a going concern scenario, particularly given the existence of a statutory guarantee. However, the government has indicated a willingness to enact new legislation allowing such an outcome.

Moody's rating action reflects the significant increase in risk to subordinated bondholders given the government's publicly stated intentions. The assignment of a B3 rating to subordinated debt, rather than a lower rating, reflects both some uncertainty around political will and practical difficulties in effecting the legislative steps necessary to impose losses on subordinated creditors. The ratings remain on review for further downgrade to allow the rating agency to assess the likely success of the government in meeting its stated objectives, which would be very adverse for HAA's subordinated bondholders.

The lower but still increased risk to senior unsecured creditors is reflected in the Ba1 rating. Moody's considers this debt class to be at a lower direct risk of loss given the government's current focus on subordinated debt. However, if it were to impose losses on subordinated debt, this would set an important precedent that would significantly diminish the value of the guarantee also for senior unsecured debt. Once again, the ratings remain on review for further downgrade to allow Moody's to evaluate the government's progress.

The bank's intrinsic creditworthiness remains under material pressure, and continues to suffer from further asset-quality deterioration in its significant legacy portfolio. As of end 2013, the bank reported non-performing loans of EUR9.3 billion. In order to ensure observance of regulatory capital requirements, HAA received EUR1.75 billion capital support from the Austrian government in 2013, and a further EUR750 million in April 2014. With the plan to sell the bank's operations in Southern Eastern Europe as quickly as possible (total assets of EUR8.6 billion as of year-end 2013), the remainder of the bank is supposed to be transferred to a deregulated, private-sector company by September 2014 and then liquidated over time.

--- FOCUS OF THE REVIEW

During the review, Moody's will seek clarity on whether the Austrian authorities will have the political will and ability to take the legislative steps needed to allow losses to be imposed on holders of guaranteed subordinated debt. Depending on new legislation becoming available, this will inform Moody's judgment on whether and to what extent bondholders can continue to rely on the deficiency guarantee from Carinthia.

The downward direction of the review reflects the fact that, even if the government encounters challenges as it seeks to implement burden sharing with guaranteed creditors, its willingness to aggressively pursue such options in combination with the potential lack of timely payment under a deficiency guarantee implies ongoing risks to bondholders that are now more fully reflected in the ratings.

--- WHAT COULD MOVE THE RATINGS UP / DOWN

HAA's guaranteed subordinated debt would be downgraded if Moody's were to conclude that the government had progressed in its ability to impose losses on subordinated debt holders. This would also result in further downward pressure on guaranteed senior debt given the diminished value of the guarantee. Downward pressure on the guaranteed debt would also result if Carinthia's credit quality were to deteriorate or if Moody's were to conclude that Austria's willingness and/or ability to support HAA had declined still further.

The review for downgrade also reflects the lack of upward pressure on HAA's guaranteed debt. Upward pressure could develop if additional remedial measures became available to the bank; such as, the transfer of HAA into a bad bank scheme benefitting from a direct guarantee from the Austrian government.

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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