

Rating Action: Moody's downgrades Austrian banks following change in systemic support assumptions

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Action follows introduction of draft legislation to wind-down Hypo Alpe Adria

Frankfurt am Main, June 20, 2014 -- Moody's Investors Service has today taken a number of actions on the long and short-term debt and deposit ratings of Austrian banking groups to reflect its reassessment of the likelihood of systemic support being extended to the sector in case of need. This follows the 11 June 2014 proposal by the Austrian government to enact legislation designed to allow the government to bail-in nationalised Hypo Alpe-Adria-Bank International AG's (HAA) subordinated debt holders and void the State of Carinthia's (A2 stable) deficiency guarantees on that portion of the bank's debt.

The unprecedented nature of the government's decision to place taxpayers' interests above the rights of creditors who had previously benefited from a public sector guarantee indicates, in Moody's opinion, that Austrian authorities are now generally more willing to countenance bank resolutions in which losses may also be imposed on senior creditors. As a result, today's rating actions reflect Moody's decision to lower its assessment of the probability of systemic support being made available for all Austrian banks, as well as very limited value Moody's now places on deficiency guarantees for senior unsecured debt only, to ensure full and timely payment of interest and principal of related debt obligations.

The following rating actions have been taken:

- One-notch downgrade of the senior long-term debt and deposit ratings of 11 banks. The negative outlook on those ratings is maintained. The related short-term debt and deposit ratings of those banks were either affirmed or downgraded by one notch.
- Downgrade of the senior long and short-term debt and deposit ratings of Kommunalkredit Austria AG to Ba1/Not-Prime from Baa3/Prime-3 previously. The long-term ratings were placed on review for further downgrade.
- Affirmation of the senior long-term and short-term debt and deposit ratings of BAWAG P.S.K. (BAWAG), Unicredit Bank Austria AG (UBA) and its subsidiary card complete Service Bank AG (card complete). While the rating outlook on UBA and card complete remains negative, the rating outlook for BAWAG is now negative from stable previously.
- Multiple-notch downgrades of the senior debt ratings of three banks whose debt is backed by statutory deficiency guarantees issued by various Austrian regional and local governments.
- Multiple-notch downgrades of the subordinated debt ratings of three banks whose debt is backed by statutory deficiency guarantees issued by various Austrian regional and local governments.
- Affirmation of the guaranteed Aaa long-term ratings of Oesterreichische Kontrollbank AG (OKB) and former Oesterreichische Postsparkasse AG (now fully integrated into BAWAG).
- Downgrade to Aa3 from Aaa of the long-term senior debt ratings of Pfandbriefstelle der Oesterreichischen Landes-Hypothekenbanken (Pfandbriefstelle) backed by a statutory joint and several guarantee from its member banks. The ratings remain on review for further downgrade.

Please click on this link http://www.moodys.com/viewresearchdoc.aspx?docid=PBC_172116 for the List of Affected Credit Ratings. This list is an integral part of this press release and identifies each affected issuer. These banks' other ratings are unaffected by today's action.

RATINGS RATIONALE

As part of a recent rating action impacting EU banks, Moody's revised to negative the outlook on most Austrian banks' long-term debt and deposit ratings to reflect its view that the balance of risk for banks' senior unsecured creditors had shifted to the downside following the adoption of the Bank Recovery and Resolution Directive

(BRRD).

In Moody's view the Austrian Council of Ministers' approval of a draft law establishing a bad bank solution for HAA sends a strong signal that the Austrian authorities' willingness to support senior creditors in future is both less reliable and less predictable. The draft law will, if approved by Parliament (1) write down subordinated debt to recapitalise the bank; and (2) declare void long-standing statutory deficiency guarantees of the Austrian federal state of Carinthia for some subordinated debt instruments. The unprecedented nature of the government's decision to declare a statutory guarantee issued by a public body null and void leads Moody's to believe that Austrian authorities are now generally more willing to consider bank-resolution scenarios in which losses may also be imposed on senior creditors.

Consequently, Moody's has lowered its assessment of the probability of systemic support being extended to the banks affected by this rating action.

-- DOWNGRADE OF SENIOR LONG-TERM DEBT AND DEPOSIT RATINGS ON 11 BANKS

Moody's has changed its assumption on systemic support to "high" from "very high" and removed one notch of systemic support from the long-term senior unsecured debt and deposit ratings of: Erste Group Bank AG (Erste), all eight Moody's rated entities of the Raiffeisen sector including Raiffeisen Bank International AG (RBI), as well as Hypo Tirol Bank AG (Hypo Tirol), and Vorarlberger Landes- und Hypothekbank AG (VLH).

The continued negative outlook on the banks' long-term debt and deposit ratings reflects the possibility that the recent adoption of the BRRD and the Single Resolution Mechanism (SRM) regulation in the EU will have further negative consequences for Austrian banks' creditors. The related short-term debt and deposit ratings of those banks were either affirmed or downgraded by one notch.

-- DOWNGRADE OF KOMMUNALKREDIT AUSTRIA TO Ba1 UNDER REVIEW FOR FURTHER DOWNGRADE

The downgrade and placement on review for further downgrade of Kommunalkredit Austria (KA) reflects the lowering of the rating agency's systemic support assumptions. During the review period, the rating agency will examine the appropriateness of the lowered, but still very high support assumptions incorporated into the bank's senior unsecured ratings for this nationalised bank. KA is currently in wind-down under a plan approved by the European Commission after the previously intended re-privatisation was abandoned.

-- AFFIRMATION OF BAWAG, UNICREDIT BANK AUSTRIA AND CARD COMPLETE, WITH NEGATIVE OUTLOOKS

Moody's affirmed the long-term debt and deposit ratings of BAWAG, and of UBA. The two notches of systemic support uplift incorporated into these banks' ratings already reflected only a 'high', rather than a 'very high' probability of support, and therefore the ratings are unaffected by today's actions. Furthermore, Moody's affirmed the long-term deposit ratings of card complete that benefit from parental support uplift from UBA, and the three banks' short-term ratings. The outlook on BAWAG's long-term ratings was changed to negative from stable for the same reason as for the other banks affected by today's actions. The outlook for UBA and card complete remains negative reflecting the ongoing pressure on systemic support assumptions following the recent adoption of the BRRD and the SRM regulation in the EU.

--- AFFIRMATION OF GUARANTEED DEBT RATINGS

Moody's affirmed the Aaa ratings on the guaranteed senior debt of former Oesterreichische Postsparkasse (now fully integrated into BAWAG) and the guaranteed Aaa long-term ratings and short-term ratings ratings of Oesterreichische Kontrollbank AG (OKB). The outlook on the Aaa ratings is stable. Oesterreichische Postsparkasse's guaranteed Aaa ratings are based on an unlimited and irrevocable statutory guarantee from the Republic of Austria (Aaa stable). OKB's guaranteed Aaa/Prime-1 ratings are based on the unconditional and irrevocable guarantee from Austria for all domestic and foreign liabilities issued under the Export Financing Guarantees Act.

In affirming these ratings, Moody's has taken several factors into account (1) the strong protection offered by these guarantees compared to the looser terms of the deficiency guarantee as extended by other public bodies; and (2) the assumption that the willingness of the Austrian government to honour its direct guarantee obligations remains unaffected by its recent actions.

OKB occasionally issues (mainly short-term revolving) debt not covered by the Guarantees Act. The affirmation of

the non-guaranteed short-term senior unsecured rating of Prime-1 reflects OKB's comfortable liquidity situation, based on its good market access via its guaranteed debt programs and the minor role of senior-unsecured funding for the bank and its liquidity. The outlook on all of the long-term ratings is stable, in line with the ratings outlook for Austria.

--- DOWNGRADE OF RATINGS WITH DEFICIENCY GUARANTEE

Moody's has concluded that the Austrian government's proposal to declare null and void the deficiency guarantees covering the large part of HAA's subordinated debt implies that little if any weight should be placed on these guarantees in future. This has thus prompted the multi-notch downgrade of the ratings of the guaranteed senior and subordinated debt instruments of Hypo Tirol, VLH and UBA (including its assumed entity Creditanstalt) -- i.e., the ratings that benefit from statutory deficiency guarantees from individual Austrian federal states or the City of Vienna (Aaa stable).

As a result, Moody's has therefore aligned the ratings of guaranteed subordinated debt instruments with non-guaranteed subordinated debt at one notch below the respective banks' adjusted baseline credit assessment (BCA) levels, which incorporates parental support where applicable.

In addition, the ratings of the backed long-term senior debt instruments supported by a deficiency guarantee were downgraded to a level at one notch above the respective banks' senior unsecured debt ratings, thereby reflecting a small probability that federal states would be willing and permitted to honour deficiency guarantees on this asset class.

This rating action concludes the review for downgrade that was opened on 18 February 2014.

--- DOWNGRADE OF PFANDBRIEFSTELLE'S LONG-TERM RATINGS

The downgrade was triggered by (1) the impact that today's action had on Pfandbriefstelle's asset profile which is primarily composed of deficiency guaranteed senior obligations of Austrian Landeshypothekenbanks; and (2) the declining creditworthiness of Landeshypothekenbanks as reflected in today's downgrade of some of those member banks' respective long-term ratings.

Specifically, Moody's has downgraded the long-term backed senior debt ratings of Pfandbriefstelle to Aa3 from Aaa and left the ratings on further review for downgrade. The review for downgrade will re-assess the credit profiles of Pfandbriefstelle's member banks.

The rated debt obligations of Pfandbriefstelle are grandfathered under statutory joint and several guarantees by its member banks -- Landeshypothekenbanken (regional commercial and mortgage banks) -- and those banks' guarantors, i.e. the respective Austrian federal states (Bundeslaender), according to Austrian federal law.

WHAT COULD MOVE THE RATINGS UP / DOWN

Any deterioration of the creditworthiness of the Austrian sovereign would exert downward pressure on ratings that benefit from credit substitution.

In addition, with the recent adoption of the BRRD and the SRM regulation in the EU, the balance of risk for banks' senior unsecured creditors has shifted to the downside. The probability has risen that the rating agency might revise its support assumptions further downwards to reflect the new framework.

PRINCIPAL METHODOLOGIES

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

The ratings assigned to government guaranteed long-term debt and deposit ratings reflect the full risk transfer to the guarantor, i.e., by applying a "credit substitution approach" that is based on an irrevocable and unconditional guarantee provided by the Republic of Austria.

In addition, Moody's does not follow the usual approach of establishing a BFSR to reflect Oesterreichische Kontrollbank's and Pfandbriefstelle's standalone creditworthiness, nor does the rating agency apply a bank financial strength scorecard, given the limited value in these institutions carrying a BFSR.

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The ratings of rated entity Oesterreichische Postsparkasse AG were initiated by Moody's and were not requested by this rated entity.

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