

**Moody's downgrades Hypo Alpe-Adria-Bank International's public-sector covered bonds**

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Moody's Investors Service has today downgraded to Baa3 from A1 the ratings on the guaranteed public-sector covered bonds, and to Baa3 from A3 the ratings on the unguaranteed public-sector covered bonds, both issued by **Hypo Alpe-Adria**-Bank International AG (HAA, not rated). The ratings on the guaranteed covered bonds were previously on review for downgrade, while the ratings on the unguaranteed covered bonds were on review with direction uncertain. The downgrade of the ratings on the guaranteed covered bonds follows the downgrade of the ratings on HAA's guaranteed senior unsecured debt to Caa1 from Ba1.

For more details on HAA, please refer to our press release "Moody's downgrades **Hypo Alpe Adria's** guaranteed subordinated debt ratings to C and Ca", published on 20 June 2014.

**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.

Guaranteed senior unsecured debt still benefits from Carinthia's deficiency guarantee. However, the draft law has implications for HAA's remaining debt benefitting from this deficiency guarantee and shows the government's communicated willingness to apply unconventional measures.

The new Baa3 ratings for the guaranteed and unguaranteed covered bonds reflects the risk that the government will implement similar legislation detrimental to the value of the deficiency guarantee on senior debt and the lack of a guarantee for the deregulated wind-down entity. Moody's believes that HAA's covered bonds will be placed with the wind-down entity.

**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 Caa1 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 Baa3 rating target for the guaranteed covered bonds is 50.5%, of which the issuer should provide 19.0% in a "committed" form. The minimum OC level consistent with the Baa3 rating target for the unguaranteed covered bonds is 53.0%, of which the issuer should provide 36.0% 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](http://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.

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