

FTfm Hypo Alpe-Adria-Bank International AG

Possible default of Austrian bad-bank bond rattles Europe

Government-guaranteed debt across the continent could be repriced



Heta Asset Resolution was set up to deal with the collapse of Hypo Alpe Adria © Bloomberg

Steve Johnson MARCH 22 2015

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A move by Austria to potentially default on a state-backed bond could lead to the repricing of government-guaranteed debt across Europe, a large investor has warned.

Vienna has ordered a 15-month moratorium on principal and interest payments on around €10bn of bonds issued by Heta Asset Resolution, the so-called bad bank set up to deal with the collapse of stricken lender Hypo Alpe Adria, after an audit of its balance sheet revealed a hole of up to €7.6bn

Austria's financial regulator has suggested senior bondholders should suffer a writedown of up to 50 per cent, despite the bonds being guaranteed by the regional government of Carinthia. This backstop was instrumental in encouraging many investors, such as German banks, to buy the bonds in the first place.

Alexander Schindler, the board member responsible for institutional clients at Frankfurt-based Union Investment, the German fund group, said the decision could lead to a repricing of government-backed debt across Europe.

40%

Percentage of Heta Asset Resolution's bonds held by German banks

"The Austrian government no longer wants to guarantee bonds that have been issued by local governments. I am concerned about the general outlook. Others might follow," said Mr Schindler. He added that Union Investment did not hold any Hypo Alpe Adria paper because the guarantee

meant it had traded at a negligible spread to Austrian sovereign debt.

"That a haircut is intended, although there is a public guarantee, could have an impact on other European securities of this kind. [If other countries followed suit] we would have to reprice the debt," said Mr Schindler, whose house has €250bn of assets under management.

10%

Estimated reduction in 2015 German bank profits in case of 50% haircut

Fitch Ratings said the Heta moratorium illustrated the "decreasing propensity for sovereign support" under the EU's new Bank Recovery and Resolution Directive, which allows central banks to "bail in" lenders and depositors in the event of a bank failure.

As a result, Fitch said it expected to lower the ratings of banks, not just in Austria but across much of the EU by the middle of this year.

Fitch estimated that 40 per cent of Heta's bonds are held by German banks, and that a 50 per cent haircut on this debt would reduce the German banking sector's 2015 net profit by up to 10 per cent.

Pimco, the US bond house owned by Germany's Allianz, is reported to have held €251m of Heta bonds at the end of 2014.

Robin Creswell, managing principal of Payden & Rygel Global, the London-based asset manager, said investors should not have been caught out by the withdrawal of the Carinthia guarantee.

“If people owned this debt, they may have been relying on the guarantee. That might have been reasonable but there were factors people could have taken into consideration.

“Under the new era [of bank resolutions], state guarantees are being withdrawn. Even if the announcement came as a surprise, the actuality should not have been a surprise.”

A number of the German banks left holding Heta debt have said they are considering their legal options.

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