



Rating Action: Moody's changes outlook on Heta's Ca Carinthian-state-guaranteed debt ratings to developing; affirms ratings

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Frankfurt am Main, August 06, 2015 -- Moody's Investors Service has today changed the outlook on the Ca Carinthian-state-guaranteed senior unsecured debt ratings of Heta Asset Resolution AG's (Heta) to developing from negative. Concurrently, Moody's has affirmed these ratings, as well as the entity's C Carinthian-state-guaranteed subordinated debt ratings.

The rating action follows the declaration by the Austrian Constitutional Court on 28 July 2015 that unconstitutional legislation (the Hypo Reorganisation Act (HaaSanG)) was introduced in August 2014, allowing the government to (1) bail-in Heta's subordinated debt holders, and (2) declare void the State of Carinthia's (Carinthia, B3 negative) deficiency guarantees on that portion of Heta's subordinated debt.

A list of affected ratings is available at the end of this press release.

RATINGS RATIONALE

-- RATIONALE FOR DEVELOPING OUTLOOK

The developing outlook reflects uncertainties surrounding the extent to which Carinthia will honour its deficiency guarantee, given (1) the Court's ruling that guaranteed bondholders cannot be selectively discriminated against other senior Carinthian creditors; (2) the continued unwillingness of the Austrian government to provide financial support which could be used by Carinthia to honour the guarantees; and (3) continued uncertainty regarding the potential for higher expected bondholder losses during the resolution process of Heta.

Furthermore, Moody's believes that the Court's decision declaring the cancellation of deficiency guarantees as unconstitutional, generally results in a positive value for the beneficiaries of such deficiency guarantees. However, the rating agency believes that the rationale underpinning the Court's conclusion leaves the Austrian government room to explore other options that avoid Carinthia's insolvency and share losses among Heta's creditors. In Moody's view, the Court's ruling will not reduce government efforts to find alternative measures.

-- AFFIRMATION OF CARINTHIAN-STATE-GUARANTEED SENIOR AND SUBORDINATED DEBT

The affirmation of Heta's Carinthian-state-guaranteed senior and subordinated ratings at Ca and C, respectively, reflects Moody's unchanged assessment that expected losses will be in the 35%-65% and the greater-than-65% range, respectively, following the Court's repeal of the HaaSanG.

The HaaSanG, which was implemented in August 2014 by the Austrian government, paved the way for the nationalised Austrian lender, Heta, to be transferred to an unregulated wind-down entity (GSA) and led to the termination of its banking license pursuant to the Austrian Banking Act (Heta continues to hold a special banking license pursuant to the Federal Act to create a wind-down entity). The law allowed the recapitalisation of Heta through the full write-down of all subordinated debt maturing on or before 30 June 2019, notwithstanding the existence of Carinthia's deficiency guarantee, which was declared null and void.

The Court has now repealed this legislation in its entirety and declared the unequal treatment of junior creditors by a

set cut-off date of 30 June 2019 unconstitutional and a violation of property rights. The Court's decision will lead to a charge of around EUR800 million for Heta, to be booked in its half-year statements and thus increasing its negative equity, which the entity reported at EUR7.0 billion at year-end 2014 (local GAAP accounting).

In Moody's view, the court ruling will not change the potential haircut that Heta's senior unsecured creditors may face as result of its wind-down. These creditors may ask Carinthia as the guarantor of the deficiency guarantee to compensate them for the difference. The ruling sends a strong signal that the value of the deficiency guarantee cannot be fully eliminated by law in hindsight by isolated measure.

In its ruling, the Court did not address the payment moratorium introduced on 1 March 2015 by Austria's Financial Market Authority (FMA) on Heta's unsecured obligations. This moratorium remains in place until May 2016.

Heta's case is atypical because it is not a bank as defined by the EU's Capital Requirements Regulation (CRR). However, the application of the EU's Bank Recovery and Resolution Directive (BRRD) resolution directive to this entity has only been possible as a result of a discretionary additional article included during the transposition of BRRD into Austrian law. The Federal Act to create a wind-down entity (GSA) was not repealed by the constitutional court. At end-2014 (local GAAP accounting), Heta's liability structure was dominated by EUR8.6 billion debt securities issued. Almost all of this legacy debt carries a deficiency guarantee from Carinthia.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Upward ratings pressure on Heta's Carinthian-state-guaranteed senior unsecured debt ratings could result from Moody's assessment of a higher probability that the guarantor is willing and able to honour the deficiency guarantee and/or if the expected loss assumptions would be significantly lowered as result of higher recovery rates during the wind-down of Heta.

Moody's would consider downgrading the ratings if the expected loss assumptions on these instruments were higher than currently expected.

LIST OF AFFECTED RATINGS

The following ratings of Heta were affirmed:

- Carinthian-state-guaranteed senior unsecured debt ratings at Ca, with developing outlook
- Carinthian-state-guaranteed subordinated debt ratings at C

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in March 2015. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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