MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades Heta Asset Resolution AG's deficiency-guaranteed senior unsecured bonds to Caa3; outlook changed to positive

07 May 2018

Frankfurt am Main, May 07, 2018 -- Moody's Investors Service has today upgraded the deficiency-guaranteed senior unsecured debt ratings of Heta Asset Resolution AG (Heta) to Caa3 from Ca and changed the outlook on these instruments to positive from stable. At the same time, Moody's affirmed the deficiency-guaranteed subordinated debt ratings of Heta at C.

The upgrade of Heta's backed senior unsecured bonds was triggered by better than expected results of Heta's asset wind-down and proceeds distribution, as reported in the bank's 2017 annual report.

Heta's Aa1 rated backed subordinate bond (ISIN XS0863484035) that benefits from an unconditional and irrevocable guarantee of the Government of Austria (Aa1 stable) was unaffected by today's rating actions.

For a list of all affected ratings, please refer to the end of this press release.

RATINGS RATIONALE

UPGRADE OF HETA'S BACKED SENIOR BONDS REFLECTS IMPROVING ASSET RECOVERY OUTLOOK

The upgrade of Heta's backed senior unsecured bonds reflects Moody's assessment that the expected loss for the remaining outstanding instruments has reduced following Heta's progress in its wind-down process during 2017.

Moody's now expects senior unsecured bondholders to face losses within a range of 20% to 35% of the original claim, as expressed by the Caa3 rating, as opposed to a 35% to 65% loss range represented by the prior Ca rating.

The rating agency's expected loss calculation takes into account both the expected ultimate principal recovery and the loss of contractual coupons that have been reset to zero for all of Heta's unsecured debt instruments by Austria's Financial Market Authority (FMA) since 1 March 2015.

Moody's expects the ultimate principal recovery rate for Heta's senior unsecured bonds to be based on various sources, including 1) an interim cash payment received in 2017, equivalent to 44% of the original claims; 2) a guarantee settlement payment by the State of Carinthia (Aa3 positive), equivalent to 11% of the original claims; 3) the distribution of unrestricted cash on Heta's 2017 local GAAP balance sheet available to satisfy senior unsecured claims of €3.2 billion or 24% of original claims; and 4) the proceeds of the wind-down of other remaining non-cash assets, with a net book value of €1.5 billion or 11% of original claims.

The main upside and downside risks from Heta's resolution to senior unsecured creditor claims resides in the recovery and profit and loss impact from Heta's non-cash assets. On a consolidated basis, Heta's remaining €1.5 billion of non-cash claims have been provisioned for with €2.2 billion of specific and portfolio loan loss reserves, resulting in a coverage ratio close to 60%.

THE POSITIVE OUTLOOK REFLECTS POTENTIAL FOR ACCELERATED AND HIGHER REPAYMENT PROCEEDS

The positive outlook on Heta's backed senior bonds reflects the potential for earlier and higher principal payments that could further reduce the expected loss severity for these instruments.

The relatively small remaining balance of non-cash assets, and Heta's plan to have its total assets reduced by 95% as of year-end 2018 in comparison to year-end 2014, raise the chances that bondholders will receive further early principal redemption payments. At the same time, an early final settlement of Heta's outstanding debts remains contingent upon the conclusion of, among others, the ongoing lawsuits with its former owner, Bayerische Landesbank (deposits Aa3 stable, senior unsecured A1 negative, Baseline Credit Assessment baa3).

Early interim distributions would reduce the expected loss contribution from foregone coupon payments for Heta's bondholders. Furthermore, asset recovery rates in excess of the loan loss provisions currently built against the remaining non-cash claims might raise the principal recovery rate for Heta's senior bonds. Together, these two potential drivers of lower economic losses underpin the positive outlook on Heta's backed senior unsecured bonds.

AFFIRMATION OF DEFICIENCY-GUARANTEED SUBORDINATED DEBT REFLECTS UNCHANGED RECOVERY EXPECTATION

Heta's wind-down results in a strictly sequential principal distribution of proceeds to senior unsecured creditors ahead of subordinated debt investors. Because Moody's expects the ultimate principal recovery of senior debt investors to remain below the original claim, subordinated debt investors will not benefit from any such asset recoveries, as implied by the FMA's 100% principal haircut imposed on Heta's subordinated debt.

Moody's believes Heta's subordinated debt investors will therefore only benefit from the 10.98% guarantee-settlement payment by the State of Carinthia, which translates into an expected loss rate in excess of 65%, commensurate with the current C ratings on these instruments.

WHAT COULD CHANGE THE RATING - UP

An upgrade of Heta's deficiency-guaranteed senior unsecured bonds could be triggered by 1) higher than currently anticipated proceeds from the asset wind-down; and 2) early interim cash distributions that limit the foregone interest amount for bondholders.

An upgrade of Heta's deficiency-guaranteed subordinated bonds could be triggered by asset recoveries far in excess of current expectations.

WHAT COULD CHANGE THE RATING - DOWN

A downgrade of Heta's deficiency-guaranteed senior unsecured bonds could be triggered by an unexpected reduction of assets and cash available for the distribution to senior unsecured bondholders.

The C ratings of Heta's deficiency-guaranteed subordinated bonds are already at the lowest possible level.

LIST OF AFFECTED RATINGS

Upgrade:

.... Carinthian-state-guaranteed Senior Unsecured (Local & Foreign Currency), Upgraded to Caa3 from Ca, Outlook changed to Positive from Stable

Affirmation:

.... Carinthian-state-guaranteed Subordinate Debt Ratings (Local Currency), affirmed at C

Outlook Action:

....Outlook, changed to Positive from Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in April 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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