Information letter for Moody's and investors

Efficient cover pool management at Hypo Vorarlberg – overcollateralisation of the two cover pools to be reduced

<u>Initial situation:</u>

Vorarlberger Landes- und Hypothekenbank Aktiengesellschaft (Hypo Vorarlberg) issues covered bonds in accordance with the Pfandbriefgesetz (Pfandbrief Law): The nominal value of all issued covered bonds must be collateralised by cover assets of at least the same value and at least the same interest income at all times. In addition, a surplus cover of 2 per cent of the nominal value of the covered bonds in circulation must be maintained. Potential collateral must be located in the EEA or Switzerland. Moreover, the articles of association of Hypo Vorarlberg oblige not to exceed a debt limit of 60 per cent for mortgage cover assets. These requirements of the Pfandbrief Law in conjunction with our articles of association ensure a high-quality collateral for the covered bonds. The high security level of our mortgage and public covered bonds is also reflected in the Aaa ratings that Moody's has issued for both covered bond programmes.

However, the rating agency's Aaa ratings are accompanied by the requirement for very high overcollateralisation. Because of our good stand-alone rating, it is sufficient for Moody's if we maintain this overcollateralisation on a "non-contractual" basis.

<u>Planned measure:</u>

As refinancing via covered bonds is becoming increasingly important, we have been dealing with the issue of "cover pool management" intensively in recent years. One of the measures was the introduction of a new cover pool management software. In November 2015, Wincredit was productively introduced as a new software. This high-quality cover pool management system allows us to access daily updated, detailed data of our assets and thus to manage our two cover pools even more efficient. The daily monitoring of all gaps (such as interest and currency gaps) allows a response to any mismatches in the long term and thus a further increase in the quality of the two covered bond programmes. There are additional steps planned for cover pool management, which are also intended to ensure the best possible management of the available cover pools.

This raises the question of whether maintaining the very high overcollateralisation required for an Aaa rating makes economic sense for an issuer. A significant reason for this high requirement is the currency mismatch of EUR and CHF in the cover pool, which Moody's perceives critically. However, the CHF business is part of our core business merely because of our geographical location. Although the extension of CHF loans to private individuals has been sharply restricted, there are many cross-border commuters and business clients in Vorarlberg who naturally require CHF loans, because of their CHF income.

Covered bonds form an essential part of our medium term refinancing planning for the upcoming periods In this regard, several collateralised benchmark issues from Hypo Vorarlberg can be expected for the next few years. The overcollateralisation requirement (38 per cent for mortgage covered bonds and 39 per cent for public covered bonds) seems exaggerated and uneconomical from a business perspective. In the future, we therefore intend to stop maintaining the overcollateralisation required for an Aaa rating both in the mortgage and public segment, to reduce overcollateralisation to an economically reasonable level and to aim for a credit rating for both covered bond programmes of Aa1.

This will be significantly conducive to a forward-looking refinancing strategy, which on the other hand constitutes an advantage for our investors, as lower overcollateralisation will provide notably higher issuing flexibility. In the interests of early transparency, we want to communicate these plans already and we are convinced that Aa1 covered bonds from Hypo Vorarlberg will also be of an excellent quality. This change is not expected to have any negative influence on the risk weight (standard approach) or the LCR and central bank eligibility of our covered bonds.

Bregenz, 18 March 2016