

Rating Action: Moody's affirms Vorarlberger Landes- und Hypothekenbank AG's ratings, outlook changed to stable from negative

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Frankfurt am Main, April 25, 2016 -- Moody's Investors Service has today affirmed the long-term debt and deposit ratings of Vorarlberger Landes- und Hypothekenbank AG (VLH) at Baa1 as well as its backed long-term debt and deposit ratings at A3, and changed the outlook to stable from negative; the rating agency has also affirmed VLH's subordinated debt program rating at (P)Ba1 and its backed subordinated debt at Baa3. Moody's has affirmed the bank's short-term deposit ratings at Prime-2, its backed short-term deposit ratings at Prime-2, VLH's standalone baseline credit assessment (BCA) and adjusted BCA at baa3, and its Counterparty Risk (CR) Assessment (CR Assessment) at A3(cr)/Prime-2(cr).

The rating actions reflect Moody's assessment of a stabilisation in the bank's credit profile based on reduced downside risks to VLH from its joint and several liability for Pfandbriefbank (Oesterreich) AG (Pfandbriefbank, Backed Senior Unsecured debt Ba1 stable).

Please refer to the end of this press release for a list of all affected ratings.

RATINGS RATIONALE

--- AFFIRMATION OF VLH'S LONG-TERM RATINGS

The affirmation of VLH's long-term debt and deposit ratings reflects a stabilizing trend in the bank's credit profile as evidenced through the financial performance in 2015 and reduced tail risks related to support measures for Pfandbriefbank under the statutory multi-recourse joint & several liability scheme of its member banks and related Austrian federal states.

On 10 April, the Austrian Financial Market Authority (FMA) imposed several resolution measures on Heta Asset Resolution AG (Heta, Carinthia-backed senior unsecured debt Ca developing), including a bail-in of liabilities. The FMA's emergency administrative decision ("Mandatsbescheid") reduces the face value of Heta's senior unsecured liabilities to 46.02%, while the entity's subordinated liabilities have been written down to zero. In addition, the regulator canceled interest payments and extended the maturity of all affected liabilities until 31 December 2023, effectively rolling over the payment moratorium that the regulatory body ordered in March 2015.

VLH's exposure to Heta is mostly indirectly through its joint and several liability for Pfandbriefbank. The bank has provisioned for its commitments to Heta to a level that is largely in line with the haircut as announced by the FMA on 10 April. The State of Vorarlberg (unrated) considers recovering its part of the financial burden through a special dividend of VLH, so that VLH continues to face the risk of assuming losses for the currently not provisioned support (half of total support) provided to Pfandbriefbank. Against the background of the bank's operating profitability and its loan loss provisions and reserves on half of its indirect Heta exposure, Moody's considers VLH's additional downside risks from Heta exposure to be manageable for the bank and therefore view the expected additional adverse effects on VLH's profits and capitalization to be adequately reflected in its baa3 BCA.

--- RATIONALE FOR STABLE RATING OUTLOOKS ON BACKED SENIOR DEBTS AND DEPOSITS

In addition to reduced downside risks resulting from the bank's liquidity provision to Pfandbriefbank and the joint and several liability for the obligations of that entity, Moody's expects VLH to report an improvement in its financial profile as of year-end 2015, a trend partly offset by the bank's possible liability for Pfandbriefbank-related losses, the recent announcement of an unexpected departure of its CEO and the uncertainty in relation to VLH's strategic direction associated with it.

VLH pre-announced an improvement in its regulatory Common Equity Tier 1 ratio to 11.2% as of December 2015, up from 10.4% as of September 2015. At the same time, company-reported non-performing loans increased to 3.5% (from 2.6% in December 2014, when the bank had not yet paid out liquidity support to Pfandbriefbank). The bank's net income of EUR121.1 million dwarfs prior-year after-tax profits of EUR54

million, but the improvement is partly attributable to lower reserve and provisioning needs for Pfandbriefbank claims and positive non-recurring items. In addition, VLH continued to make progress in the execution of its refinancing plan, which in particular targets an improved maturity profile of currently still concentrated deficiency-guaranteed liabilities in 2017. In the fourth quarter of 2015 and the first quarter of 2016, VLH accessed the market through a broad range of instruments, including covered bonds, Italian lease ABS and subordinate debt placed with retail clients.

On 7 April, VLH's CEO Michael Grammer announced his departure, resulting in increased strategic uncertainty for the bank. Moody's considers the maintenance of a constructive relationship with the bank's owners, Vorarlberg, Landesbank Baden-Wuerttemberg (LBBW, deposits Aa3 stable/senior unsecured A1 stable, BCA baa3) and L-Bank (deposits Aaa stable/senior unsecured Aaa stable), to be vital for the incoming CEO to ensure strategic continuity. Together with the limited willingness demonstrated by Vorarlberg to bear losses related to Pfandbriefbank or to abstain from recovering these from VLH, these developments somewhat offset otherwise positive trends in VLH's financials and lead Moody's to assign a stable outlook.

--- AFFIRMATION OF 'S BACKED LONG-TERM RATINGS

Moody's considers the deficiency guarantee of the State of Vorarlberg (unrated) for the benefit of VLH's backed deposits, backed senior unsecured debt and backed subordinate debt to provide a "moderate" likelihood of support for these instruments, resulting in one notch of uplift compared to VLH's unguaranteed instruments of equal seniority.

In a decision published in July 2015, the Austrian Constitutional Court set high hurdles for invalidating a deficiency guarantee granted by an Austrian region for the benefit of bank creditors and the FMA's communication around the Heta haircut makes it clear that the bail-in does not legally relieve the State of Carinthia (Carinthia, B3 negative) from its obligations as a guarantor. At the same time, a timely payment under such deficiency guarantees remains uncertain, as illustrated by Carinthia's rejection of creditor claims for full repayment of Heta's unsecured guaranteed liabilities and the thus far unsuccessful joint attempt of Carinthia and the Republic of Austria (Aaa negative) to reach a distressed exchange agreement with Heta's unsecured creditors.

Against this background, Moody's continues to consider the timely enforcement of deficiency guarantees for the benefit of Austrian bank creditors to be dependent upon the willingness and ability of the guarantor to abide by its commitments. For VLH, the likelihood of guarantor support is moderate, based on the adequate share of guarantee commitments for the bank's debt when compared to the economic strength of Vorarlberg and based on Vorarlberg's reluctance to participate in the joint support effort for Pfandbriefbank.

WHAT COULD MOVE THE RATINGS UP/DOWN

An upgrade of VLH's long-term debt and deposit ratings could result from (1) an upgrade of its standalone BCA and/or (2) higher rating uplift as result of Moody's Advanced LGF analysis. VLH's standalone BCA could be upgraded based on a combination of improved capital levels and the successful implementation of a long-term sustainable funding structure. A future upgrade of VLH's long-term debt and deposit ratings would most likely be driven by an upgrade of the bank's standalone BCA.

A downgrade of VLH's long-term debt and deposit ratings could be triggered following (1) a lowering in the bank's standalone BCA; and/or (2) an increase in the expected loss severity following a material shift in the bank's funding mix as part of its ongoing refinancing of deficiency-guaranteed debt maturities with foremost covered bond issuance could result in a future decline in uplift for senior debts as a result of Moody's LGF analysis. Moody's Advanced LGF analysis would likely result fewer notches of rating uplift in particular if the overwhelming part of VLH's maturing senior unsecured instruments are replaced with secured debt instruments. A downgrade of VLH's standalone BCA could be triggered if (1) Moody's were to conclude that additional, incremental liabilities of VLH under the support scheme for Pfandbriefbank have a further material negative impact on the bank's financial strength; (2) the departure of VLH's CEO is a harbinger for disagreement between the bank and its owners about the strategic direction.

LIST OF AFFECTED RATINGS

Vorarlberger Landes- und Hypothekbank AG (VLH):

The following ratings were affirmed:

- BCA and adjusted BCA of baa3

- Counterparty Risk Assessment of A3(cr)/Prime-2(cr)
- short-term deposit and issuer ratings of Prime-2
- state-guaranteed short-term deposit rating of Prime-2
- senior unsecured MTN program rating of (P)Baa1
- state-guaranteed senior unsecured MTN program rating of (P)A3
- subordinate MTN program of (P)Ba1
- state-guaranteed subordinate debt ratings of Baa3
- state-guaranteed subordinate MTN program rating of (P)Baa3

The following ratings were affirmed and the outlook was changed to stable from negative:

- long-term debt, deposit and issuer ratings of Baa1, outlook changed to stable from negative
- state-guaranteed long-term debt and deposit ratings of A3, outlook changed to stable from negative

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

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