Rating Action: Moody's downgrades Kommunalkredit's covered bonds to Aa1 from Aaa

Global Credit Research - 30 Jul 2010

Frankfurt, July 30, 2010 -- Moody's Investors Service has today taken the following rating action on the covered bonds or fundierte Bankschuldverschreibungen issued by Kommunalkredit Austria AG ("Kommunalkredit" or "the issuer") under its public sector covered bond programme:

- Public-sector covered bonds: Downgrade to Aa1 on review for possible downgrade; previously on 6 November 2008 Aaa ratings were placed on review for possible downgrade.

The downgrade of the covered bonds ("fundierte Bankschuldverschreibungen") was triggered by the downgrade of Kommunalkredit's senior unsecured rating to Baa1 from Aa3 (see Moody's press releases dated 13 October 2009 and 11 November 2009). The bonds remain under review while Moody's considers additional enhancements that Kommunalkredit is proposing to add to this programme.

Following the downgrade of Kommunalkredit to Baa1, Moody's expected loss modelling only relies on over-collateralisation that is in committed form in the case of Kommunalkredit. The rating agency is currently assessing a proposal from Kommunalkredit which may result in further committed over-collateralisation for the covered bond programme. If no committed over-collateralisation is added to the covered bond programme, the expected loss would not be consistent with an Aa1 rating.

Kommunalkredit's public-sector covered bonds rated by Moody's are governed by the Austrian covered bond legislation ("Gesetz betreffend fundierter Bankschuldverschreibungen"), which requires, among other factors, mandatory over-collateralisation of 2% on a present-value basis. However, this level of over-collateralisation is not sufficient to support an Aa1 rating under Moody's expected loss analysis given Kommunalkredit's rating of Baa1.

Moody's notes that the Timely Payment Indicator (TPI) is not a constraint for the current Aa1 rating. Moody's has assigned a TPI of "High" to Kommunalkredit's public-sector covered bonds, which is in line with other public-sector covered bonds issued under an Austrian covered bond act.

RATING METHODOLOGY

Moody's rating for any covered bond is determined after applying a two-step process:

(1) Moody's Expected Loss (EL) Method: Moody's determines a rating based on the EL on the bond. This is modelled as a function of the issuer's probability of default and the stressed losses on the cover pool assets following issuer default.

(2) TPI Framework: Moody's assigns a TPI which indicates the likelihood that timely payment will be made to covered bondholders following issuer default. The effect of the TPI is to limit the covered bond rating to a certain number of notches above the issuer's rating.

Moody's monitors this transaction using the rating methodology for EMEA Covered Bond transactions as described in the Rating Methodology reports "Moody's Rating Approach to European Covered Bond", published in March 2010 and "Assessing Swaps as Hedges in the Covered Bond Market", published in September 2008. All are available on www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating these transactions can also be found in the Rating Methodologies sub-directory on Moody's website. In addition, Moody's publishes a weekly summary of structured finance credit, ratings and methodologies in "Structured Finance Quick Check" at www.moodys.com/SFQuickCheck

The rating assigned by Moody's addresses the expected loss posed to investors. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.

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