Published on *Zero Hedge* (http://www.zerohedge.com)

A Black Swan Lands In Southern Austria: The Ripple Effects Of "Mini-Greece Going Off In The Heartland Of Europe"

By *Tyler Durden*
Created *03/08/2015 - 23:48*

 [1]

Submitted by Tyler Durden [1] on 03/08/2015 23:48 -0400

8.5% [2] Bad Bank [3] Barclays [4] Black Swan [5] Creditors [6] Detroit [7] France [8] Germany [9] Insurance Companies [10] Investment Grade [11] Ireland [12] Lehman [13] NASDAQ [14] Rating Agency [15] ratings [16] recovery [17]

By far the most notable news of the past week, which has *still* gone largely unnoticed by the greater investing community whose focus instead was on whether algos would ramp the Nasdaq to 5000, and keep the S&P above 2100, even before Mario Draghi finally began buying bonds that nobody wants to sell, was the "Spectacular Development" In Austria [18], whereby the "bad bank" of failed Hypo Alpe Adria - the Heta Asset Resolution AG - itself went from *good to bad*, with its creditors forced into an involuntary "bail-in" following the "discovery" of a $8.5 billion capital hole in its balance sheet primarily related to ongoing deterioration in central and eastern European economies.

This shocking announcement promptly sent the price of Heta bonds crashing [19]as creditors, no longer enjoying the explicit guarantee of the state, scrambled to get out of "northern Europe's" first Lehman moment.

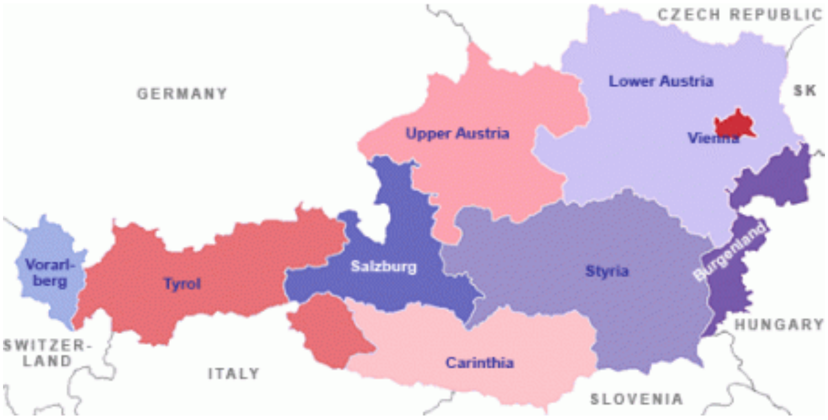
[20]

But while the acute pain came and went for Heta bondholders who have seen a nearly 50% loss in just a few short months, the bigger and far more diffuse pain is only just starting, or as Bloomberg put it, [21]"Austria's decision to wind down Heta Asset Resolution AG sent ripples through the financial system, causing credit rating downgrades in Austria and bank losses in Germany."

The first casualty: the beautifully picturesque southern Austrian province of Carinthia.

[22]


[23]



[24]

Why and how was one of the 9 Austrian provinces just sacrificed? Telegraph explains:

> ***[The Heta] bonds are notionally guaranteed by the Austrian state of Carinthia, which now theoretically becomes liable for the bail-in.*** *It's an echo of the mess Ireland got itself into at the height of the banking crisis, when it foolishly attempted to stem the panic by underwriting all Irish banking liabilities; the move very nearly ended up bankrupting the entire country.* ***Hypo will bankrupt Carinthia.***
>
> *Essentially, what the Austrian government is doing is cutting loose an entire region, rather in the way the federal authorities in the US allowed Detroit to go bust a number of years ago.*
>
> ***It's a mini-Greece going off in the heartlands of Europe.***

Specifically, to quantify the Carinthian exposure vis-a-vis its guarantee which will now be put in play: **Carinthia provides deficiency guarantee on Heta's senior debt: the total is equivalent to €10.2 billion, or nearly five times the state's 2014 operating revenue**. Carinthia's budgeted revenue in 2015 is just €2.36 billion, and as such the southern province of 556,000 would be unable to honor the guarantees if they came due now or in a year's time, *Governor Peter Kaiser told Austrian radio ORF on Tuesday.*

In other words, we now have a waterfall bailout chain whereby the state guaranteeing the debt of the insolvent entity that guaranteed yet another insolvent entity, will itself need to be bailed out by the sovereign, Austria! Or perhaps not: Finance Minister Hans Joerg Schelling has said repeatedly that the Austrian government isn't liable to cover Carinthia's guarantees.

This is also why late on Friday, Moody's downgrades the State of Carinthia's rating to Baa3 from A2 (outlook to negative from stable). This is what the rating agency said:

> *The rating action follows the decision of the Austrian Financial Market Authority (FMA) on 1 March 2015 to initiate resolution measures on Heta Asset Resolution AG (wind-down entity of former Hypo-Alpe-Adria), in accordance with the Federal Banking Restructuring and Resolution Act (BaSAG). BaSAG is the national implementation law of the European Bank Recovery and Resolution Directive (BRRD), effective since 1 January 2015. The FMA also imposed a temporary payment moratorium on Heta's liabilities until 31 May 2016. This follows the disclosure of Heta's recent asset review by external auditors, which indicated an additional shortfall of assets of up to EUR7.6 billion, compared to the EUR4 billion expected before.*

> ***Carinthia provides a statutory deficiency guarantee on a very high portion of Heta's senior debt; the total guarantees are equivalent to nearly EUR10.2 billion, or nearly five times the state's 2014 operating revenue****. In addition, Carinthia provides a statutory deficiency guarantee to Pfandbriefbank (Oesterreich) AG (A2, RUR) of which about EUR1.2 billion is related to Heta as of year-end 2014.*
>
> ***The downgrade reflects an increased susceptibility to event risks, including litigation from Heta's bondholders and further actions by the FMA, and greater than anticipated shortfalls of Heta's assets.*** *All these factors could lead to a crystallization of a significant portion of Carinthia's guaranteed debt. This amount could exceed Carinthia's liquidity resources, likely lead to increased financial leverage and could require some form of extraordinary central government support.*
>
> *We understand that there is a likelihood that the deficiency guarantee could not be enforced upon a full or partial cancellation of bailed-in debt under BaSAG, because of the guarantee's accessory nature.* ***However, we see an increased uncertainty regarding further resolution actions. Additionally, uncertainty could result from the legal risk associated with different contractual provisions of Heta-bonds.***

Whether or not the Telegraph is right remains to be seen, and the otherwise beautiful province of Carinthia is now insolvent remains to be seen, but the bigger problem is that the Heta fallout does not stop there.

As Bloomberg reports [21], "among Heta's liabilities affected by the moratorium and a future bail-in **are 1.24 billion euros Heta owes to Pfandbriefbank Oesterreich AG, which issues bonds on behalf of Austrian provincial banks**."

> *Moody's said it may cut Pfandbriefbank's A2 rating as well as the ratings of two of its biggest member banks, Hypo Tirol Bank AG and Vorarlberger Landes- und Hypothekenbank AG, owned by the western Austrian provinces of Tyrol and Vorarlberg, respectively. A2 is the sixth-lowest investment grade rating at Moody's.*

Below are all the Pfandbriefbank members, all of which will now suffer and require further capital injections in some capacity:

FIGURE 2

Members of Pfandbriefbank (Österreich) AG

Ticker	Name	Total assets (YE 13 in € mn)	Total equity (YE 13 in € mn)
EBHYPO	Hypo-Bank Burgenland AG	4,287	547
ANADI	Austrian Anadi Bank AG	3,177*	156*
HETAR	Heta Asset Resolution AG	-	-
HYNOE	HYPO NOE Gruppe Bank AG	14,210	554
OBLB	Oberoesterreichische Landesbank AG	8,614	341
SALZBK	Salzburger Landes-Hypothekenbank AG	4,869	189
LANSTM	Landes-Hypothekenbank Steiermark AG	4,764	200
LANTIR	Hypo Tirol Bank AG	8,902	546
VORHYP	Vorarlberger Landes- und Hypothekenbank AG	14,145	847

Note: As of mid 2014. Source: Pfandbriefbank, annual reports

[25]

Some additional color from Barclays:

> *The main purpose of the exclusion of secured liabilities from the application of the bail-in tool is to prevent contagion. Indeed, there are a number of contagion channels when treating the guaranteed liabilities of HETAR not as secured liabilities.*
>
> ***First, the securities benefiting from the deficiency guarantee of Carinthia are also regarded as eligible collateral for a wide range of public sector covered bonds across the EU, including Austria, Germany, Luxembourg and France.*** *As of 30 September 2014, Austrian banks had a total of €2.7bn of exposure to Carinthia, which partially consisted of exposure to HETAR. Furthermore, Pfandbriefbank (Österreich) AG (PFBKOS), the universal legal successor of Pfandbriefstelle der österreichischen Landes-Hypothekenbanken, has €1.2bn of Carinthia guaranteed claims against HETAR. These claims were explicitly made subject to the moratorium. According to article 2 of the Austrian Pfandbriefstelle law, the member banks of PFBKOS are jointly and severally liable for the debt of PFBKOS.* ***Thus, irrespective of the future of PFBKOS, there is an incentive for the member banks to jointly step in for missing payments from HETAR, as otherwise debt holders of PFBKOS bonds could claim payment from any of the member banks individually****. Notably, the FMA decided to exclude public sector Pfandbriefe issued by HETAR from the moratorium, indicating a degree of concern about contagion risk. We believe that the inclusion of guaranteed HETAR securities in the application of the bail-in measures adds to contagion risk, as demonstrated by the PFBKOS example.*
>
> ***Second, a number of Austrian banks, including HYPO NOE Gruppe Bank AG and Vorarlberger Landes- und Hypothekenbank AG reported in their annual accounts for 2013 that they had direct exposure to HAA****. At this point in time* ***<u>no write-downs were made as reference was made to the "value of the guarantee given by the state of Carinthia",</u>*** *as well as the fact that there has been no "statutory procedure allowing a territorial authority to declare insolvency". When announcing the moratorium, FMA explicitly expressed doubts about the value of the respective guarantees. Furthermore, this week Austrian Finance Minister Schilling, in an interview with Austrian state radio, ORF, was quoted as saying that "****many have been saying that one should have known that a province like Carinthia can't guarantee for debts of that size".*** *Thus, it appears very likely that Austrian banks will have to provision for claims they hold against HETAR and which were now made subject to the moratorium.*
>
> *Third, according to article 115(2) of the EU's Capital Requirements Regulation (CRR),* ***claims benefiting from the deficiency guarantee of an Austrian sub-sovereign can be treated as an exposure to the central government.*** *The respective list of the European Banking Authority contains all nine Austrian regional governments, as well as more than 2,300 local authorities.* ***Based on this rule, EU banks are allowed to apply a 0% risk-weighting to these exposures.*** *In combination with article 10 of the EU's delegated act on the Liquidity Coverage Ratio, they are also allowed to treat these assets as "extremely high quality liquid assets" under the level 1 bucket of their liquidity buffer portfolios. Finally, solvency 2 rules foresee that debt issued by Austrian regions could be treated by EU based insurance companies and pension funds similarly to debt issued by the Austrian central government with a 0% capital charge.*

Irony #1: the very same bonds that are about to lead to a waterfall in impairments are the ones that were, according to EU regulations, "riskless." One can only imagine how much latent risk Europe's bank have as a result of the supremely idiotic decision to keep a major subsection of European debt as 0% RWA. That may work as long as the ECB backstops everything, but the second Mario Draghi ends QE, does everything implode under its own weight?

And then there is the question, how much more maximum pain could there be in Austria. Barclays responds again"

> *As of year-end 2013, there were about €60bn of claims guaranteed by Austrian regions. We estimate about €50-55bn of such claims were still outstanding as of year-end 2014. In particular, we note that as of year-end 2012, the guarantee commitments of six out of nine Austrian regions exceeded the total annual income.*

The full breakdown of who guarantees what in Austria:

FIGURE 4

Overview of Austrian sub-sovereign guaranteed bank liabilities and risk metrics of sub-sovereigns

Bank	Owner(s)	Guarantor	Total assets (30 Jun. 2014; € mn)	Guaranteed bank liabilities[1]	Other state guarantees[1]	All state guarantees[1]	State income[1]	Guarantees / Income	Deficit[1]	Debt[1]	Deficit / GDP (%)	Debt / GDP (%)
Heta Asset Resolution	Republic of Austria	Carinthia	16,788	10,824	2,486	13,311	2,489	535%	-49	3,160	-0.02%	1.0%
HYPO-BANK Burgenland AG	Grazer Wechselseitige Versicherung AG	Burgenland	4,109	2,155	522	2,677	1,165	230%	42	1,045	-0.01%	0.3%
HYPO NOE Gruppe Bank AG	Lower Austria	Lower Austria	15,026	5,316	6,677	11,993	8,708	138%	-282	8,181	-0.09%	2.5%
Ober-oesterreichische Landesbank AG	Upper Austria (51%), Raiffeisenlandesbank Oberösterreich AG (38.57 %), Oberösterreichische Versicherungs AG (6.98 %), Generali Holding Vienna AG (3.04 %), Employees (0.84%)	Upper Austria	9,073	2,663	6,700	9,363	5,565	168%	-216	1,790	-0.07%	0.6%
Salzburger Landes Hypothekenbank AG	Raiffeisenlandesbank Oberösterreich (majority owner through direct and indirect participations)	Salzburg	4,724	55	1,775	1,830	4,548	40%	-76	2,228	-0.02%	0.7%
Landes-Hypothekenbank Steiermark AG	Raiffeisenlandesbank Steiermark (75%), State of Steiermark (25%)	Steiermark	4,560	2,463	1,743	4,206	5,403	78%	-178	3,517	-0.06%	1.1%
Hypo Tirol Bank AG	Tyrol	Tyrol	8,514	4,683	75	4,758	3,336	143%	132	388	0.04%	0.1%
Vorarlberger Landes- und Hypothekenbank AG	Vorarlberg (76%), Landesbank Baden-Wuerttemberg (24%)	Vorarlberg	14,044	4,720	142	4,862	1,541	315%	-20	413	-0.01%	0.1%
Bank Austria AG	UniCredit s.p.a	City of Vienna	183,124	6,758	303	7,061	12,471	57%	-250	5,890	-0.08%	1.8%
			Total:	**39,637**	**20,423**	**60,060**	**45,227**	**133%**		**26,612**		

Note: [1]€ mn as of YE 2013. Source: Annual accounts of Austrian states for 2013. Bank mid-year and annual reports, Statistics Austria, Barclays Research

[26]

And then, once the impairment wave of the latest European insolvency shocker is done with Austria - **a wave which nobody expected at all, and it thus a legitimate Black Swan** - it will flow over into Germany. From Bloomberg:

> *German banks yesterday also emerged as major Heta bondholders. Dexia's Dexia Kommunalbank Deutschland AG said it owns 395 million euros of Heta bonds and will take an unspecified charge in the first quarter. Deutsche Pfandbriefbank AG also owns 395 million euros of Heta bonds and said it will write them down by 120 million euros, cutting its expected pretax profit by two-thirds.*
>
> *NRW Bank confirmed it owned Heta bonds, declining to specify the size of its exposure. WDR TV station reported the bank owns 276 million euros of them.*

Irony #2, and the biggest one of all: while German banks had spent the past 3 years preparing for the inevitable Grexit and offloading all their exposure to the now insolvent Greek state, it was a waterfall chain of events which started in Germany's own "back yard", courtesy of auditors who decided it was unnecessary to mark losses to market until it was far too late, and the immediate outcome is that one ninth of until recently Aaa/AAA-rated Austria is now also insolvent. And that is just the beginning.

One can only imagine how many such other "0% risk-weighted" Pandora boxes lie in wait across what are otherwise considered Europe's safest banks, provinces and nations.

8.5% Bad Bank Barclays Black Swan Creditors Detroit France Germany Insurance Companies Investment Grade Ireland Lehman NASDAQ Rating Agency ratings recovery

Source URL: http://www.zerohedge.com/news/2015-03-08/black-swan-lands-southern-austria-ripple-effects-mini-greece-going-heartland-europe

Links:
[1] http://www.zerohedge.com/users/tyler-durden
[2] http://www.zerohedge.com/taxonomy_vtn/term/10418
[3] http://www.zerohedge.com/taxonomy_vtn/term/10979
[4] http://www.zerohedge.com/taxonomy_vtn/term/7847
[5] http://www.zerohedge.com/taxonomy_vtn/term/9956
[6] http://www.zerohedge.com/taxonomy_vtn/term/9885
[7] http://www.zerohedge.com/taxonomy_vtn/term/8126
[8] http://www.zerohedge.com/taxonomy_vtn/term/12348
[9] http://www.zerohedge.com/taxonomy_vtn/term/8300
[10] http://www.zerohedge.com/taxonomy_vtn/term/9294
[11] http://www.zerohedge.com/taxonomy_vtn/term/10088
[12] http://www.zerohedge.com/taxonomy_vtn/term/9119
[13] http://www.zerohedge.com/taxonomy_vtn/term/10959
[14] http://www.zerohedge.com/taxonomy_vtn/term/10969
[15] http://www.zerohedge.com/taxonomy_vtn/term/9260
[16] http://www.zerohedge.com/taxonomy_vtn/term/12371
[17] http://www.zerohedge.com/taxonomy_vtn/term/11361
[18] http://www.zerohedge.com/news/2015-03-01/spectacular-developments-austria-bail-arrives-after-%E2%82%AC76-billion-bad-bank-capital-hol
[19] http://www.zerohedge.com/news/2015-03-02/lehman-moment-austrian-bad-bank-means-worse-coming
[20] http://www.zerohedge.com/sites/default/files/images/user3303/imageroot/2015/03/20150302_heta.jpg
[21] http://www.bloomberg.com/news/articles/2015-03-07/heta-damage-spreads-in-austrian-downgrades-german-losses
[22] http://www.zerohedge.com/sites/default/files/images/user5/imageroot/2015/03/oesterreich_karte_en_0.gif
[23] http://www.zerohedge.com/sites/default/files/images/user5/imageroot/2015/03/Carinthia.jpg
[24] http://www.zerohedge.com/sites/default/files/images/user5/imageroot/2015/03/oesterreich_karte_en.gif
[25] http://www.zerohedge.com/sites/default/files/images/user5/imageroot/2015/03/pfandbriefbank.jpg
[26] http://www.zerohedge.com/sites/default/files/images/user5/imageroot/2015/03/austrian%20guarantees.jpg