



Fitch Upgrades Erste to 'A', Outlook Stable

Fitch Ratings-London-05 February 2019: Fitch Ratings has upgraded Erste Group Bank AG's Viability Rating (VR) to 'a' from 'a-' and its Long-Term Issuer Default Rating (IDR), Derivative Counterparty Rating (DCR) and long-term senior debt ratings to 'A' from 'A-'. The Outlook on the Long-Term IDR is Stable.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

IDRS, VR, DCR AND SENIOR DEBT

The upgrades reflect Erste's improved financial strength and resilience, benefiting from sound execution and strong management quality, and a conservative risk appetite. Thanks to this as well as improved economic conditions in Erste's central and eastern Europe (CEE) markets, profitability has improved substantially in recent years, supporting sound capital generation. Erste's ratings also reflect the bank's established franchise in its largest core markets of Austria, the Czech Republic, Slovakia and Romania, and its diversified business model, focused on retail and corporate banking.

Cost-cutting measures combined with disciplined pricing underpin Erste's pre-impairment profitability, which is expected to be resilient and only moderately variable over the cycles. The bank expects to report a EUR1.8 billion net income for 2018, on the back of an improved operating result and net credit provision releases. We believe that the inherent political risk in some of Erste's markets, potentially translating into burden, such as the introduction of a quarterly bank levy on financial assets in Romania, is mitigated by the currently favourable interest rate environment in CEE, but also in the medium term by Erste's overall focus on economically stronger CEE countries. Balanced and resilient profit contribution from CEE subsidiaries, where operating profits are higher than in Austria, should sustain the bank's capital ratios through the cycle, despite gradually increasing dividend pay-outs and moderate growth ambitions.

Erste targets a common equity Tier 1 (CET1) ratio of 13.5% by 2020, which is comfortably above regulatory requirements and broadly commensurate with the bank's risk profile. Its leverage ratio compares well with European peers given relatively high risk-weighted asset density from the bank's CEE exposure. The capital ratios benefit from Erste's institutional protection scheme (IPS), which under EU regulations, exempts the group from deducting EUR4 billion minority interests in savings bank members from its regulatory CET1 capital.

Erste's risk controls over the IPS's members are being further strengthened by the group-wide centralisation of risk data and reporting. The bank's risk appetite and underwriting standards are generally low risk, having tightened over the past years. Together with the bank's robust and centralised risk controls this should help Erste maintain its positive asset quality trajectory.

Erste's impaired loans ratio has improved steadily over the past five years, helped by improving economic conditions as well as portfolio sales and write-offs. Management showed a solid execution track record in successfully deleveraging the bank's exposure to some weaker CEE markets following post-crisis challenges in the region.

Erste's Short-Term IDR of 'F1' corresponds to its Long-Term IDR of 'A' and reflects the bank's stable liquidity and funding, which benefit from a large and stable deposit base. Wholesale funding needs have declined as

Erste's CEE subsidiaries are now largely self-funded. We expect that Erste will issue senior non-preferred debt (SNP), together with additional Tier 1 instruments, during 2019 for Minimum Requirement for Own Funds and Eligible Liabilities purposes, once the bank receives clarity on its resolution strategy.

Erste's senior preferred notes' rating is equalised with its Long-Term IDR because the bank's available buffer of qualifying junior and SNP debt is not large enough to warrant a one-notch uplift of the senior preferred debt rating. The SNP debt class was introduced in Austrian law in July 2018 by transposing the revision of the EU's Bank Recovery and Resolution Directive (BRRD) agreed in December 2017. Under the revised Austrian resolution regime, Erste's senior unsecured debt issued prior to July 2018 ranks pari passu with any future senior preferred debt issuance and senior to any future SNP issuance.

The DCR is equalised with Erste's Long-Term IDR because derivative counterparties in Austria have no definitive preferential status over other senior obligations in a resolution scenario.

The 'F1' rating assigned to Erste Finance (Delaware) LLC's commercial paper programme is equalised with Erste's Short-Term IDR, based on our view that Erste will honour its obligations under its guarantee of the programme.

SUPPORT RATING AND SUPPORT RATING FLOOR

Erste's Support Rating and Support Rating Floor (SRF) reflect Fitch's view that senior creditors can no longer rely on full extraordinary state support. This is driven by the EU's BRRD, which has been in force with its bail-in tool since 1 January 2015.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Erste's Tier 2 debt is rated one notch below the VR to reflect the instruments' below-average recovery prospects.

RATING SENSITIVITIES

IDRS, VR, DCR AND SENIOR DEBT

Erste's ratings would come under pressure if earnings and asset quality deteriorate, which could happen as a result of changes in market or economic conditions, if capital deteriorates from insufficient earnings retention or losses, or if Erste's risk appetite increases materially.

The Stable Outlook reflects Fitch's view that upside potential is currently limited. A further upgrade would require stronger asset quality metrics and earnings generation, together with higher capital ratios.

Erste's Short-Term IDR could be downgraded to 'F2' if the Long-Term IDR is downgraded and the bank's liquidity position deteriorates. Erste Finance (Delaware) LLC's commercial paper rating is primarily sensitive to changes in Erste's Short-Term IDR.

The DCR is primarily sensitive to changes in Erste's Long-Term IDR. It could be upgraded to one notch above the IDR if changes in legislation create legal preference for derivatives over certain other senior obligations. The DCR and the senior preferred debt rating could be upgraded if in Fitch's view, the volume of junior and SNP instruments provides a substantial enough buffer to protect derivative counterparties and senior preferred from default in a resolution scenario.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of Erste's Support Rating and upward revision of its SRF would be contingent on a positive change in the sovereign's propensity to support the bank. This is highly unlikely in light of the regulatory environment, in our view.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The rating of the Tier 2 notes is primarily sensitive to changes in the bank's VR.

The rating actions are as follows:

Erste Group Bank AG

Long-Term IDR: upgraded to 'A' from 'A-'; Outlook Stable

Short-Term IDR: affirmed at 'F1'

Viability Rating: upgraded to 'a' from 'a-'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'No Floor'

Derivative Counterparty Rating: upgraded to 'Adcr' from 'A-dcr'

Long-Term senior preferred notes and debt issuance programme: upgraded to 'A' from 'A-'

Short-Term senior debt issuance programmes: affirmed at 'F1'

Tier 2 debt: upgraded to 'A-' from 'BBB+'

Erste Finance (Delaware) LLC CP programme guaranteed by Erste: affirmed at 'F1'

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Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)

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Dodd-Frank Rating Information Disclosure Form

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