

RATING ACTION COMMENTARY

Fitch Revises Erste Group's Outlook to Stable; Affirms at 'A'

Wed 27 Oct, 2021 - 12:22 ET

Fitch Ratings - Frankfurt am Main - 27 Oct 2021: Fitch Ratings has revised Erste Group Bank AG's (Erste) Outlook to Stable from Negative and affirmed the bank's ratings, including the Long-Term Issuer Default Rating (IDR) at 'A' and Viability Rating (VR) at 'a'. A full list of rating actions is detailed below.

The revision of the Outlook reflects Fitch's updated economic assumptions for the bank's main operating countries, reflecting sufficient rating headroom to absorb residual pandemic-related risks. Fitch expects strong forecast economic recovery in Erste's core region will support the group's asset quality and operating profitability, which we expect to remain close to their four-year average in 2021-2022.

KEY RATING DRIVERS

IDRS, VR, DERIVATIVE COUNTERPARTY RATING AND SENIOR UNSECURED DEBT RATINGS

The IDRs, VR and senior preferred ratings of Erste reflect a leading franchise in retail and SME banking in Austria, Czech Republic, Slovakia and Romania and strong execution of its consistent strategy. At the same time, the group's material operations in less developed and more volatile countries in central and eastern Europe (CEE) translate into a slightly weaker operating environment compared with that of peers that solely focus on Austria. As a result, Erste needs to report better financial metrics than purely Austrian-focused peers to achieve a given rating level.

Asset quality is supported by the dominance of the group's fairly low-risk Austrian lending and stable Czech operations. Exposure to other countries in CEE gives rise to potential

volatility in loan impairment charges (LICs), but we believe risk controls and credit standards in CEE are tighter than local peers' in the respective countries.

The impact of the pandemic on Erste's asset quality has so far been mostly visible through a sharp increase of Stage 2 loans and coverage since end-2020, but Erste's Stage 3 loans ratio remained broadly stable at 2.5% at end-1H21. We believe that the risk of asset quality weakening has subsided, and we expect only a moderate deterioration in the bank's corporate and SME loan book (43% of gross loans at end-1H21) in 2022, following the end of government-support measures.

After a sharp decline in net income due to prudent frontloading of pandemic-related provisions in 2020, Erste posted exceptionally high profits in 1H21 as a result of low LICs combined with strong business growth. We project its operating profits/risk-weighted assets (RWAs) to return to pre-pandemic levels in 2021, as the release of pandemic-related collective provisions should substantially mitigate the inflow of LICs in 2H21.

In the long term, we believe that Erste's revenue will continue to benefit from sound operating margins and growth potential available in the group's markets, with only modest variability over the cycle. Targeted growth in revenues from the asset management-and-security business will also add to revenue diversification, mitigating net interest margin pressure from increasing competition in CEE and low interest rates in the eurozone. Despite inflationary pressures, Erste has some room to improve its cost efficiency, particularly in Austria, and we believe that management's cost/income ratio target of 55% for 2024 is achievable.

Erste's fully loaded common equity Tier 1 (CET1) ratio of 14.2% at end-1H21 and 13.5% target are broadly commensurate with the group's risk profile. Capitalisation also benefits from strong retained earnings, low unreserved Stage 3 loans, moderate concentrations and good capital-markets access through its listing. Erste's leverage ratio of 6.3% is higher than large European peers', driven by the CEE operations' higher RWA density.

The Short-Term IDR of 'F1' is the baseline option mapping to a Long-Term IDR of 'A', and reflects the group's robust funding & liquidity, which we score at 'a'. Customer deposits, mostly from retail clients, are the main source of funding and are in excess of customer loans. Erste accesses debt-capital markets through a wide range of products. Wholesale-funding maturities are reasonably well-spread, and an ample liquidity buffer adequately mitigates refinancing risk.

Erste's resolution strategy is multiple-point-of-entry (MPE), with one resolution group for each of its six core EU markets. We believe that this limits intra-group contagion risk, which is already largely mitigated by the group's policy that CEE subsidiaries must be largely self-funded. However, the MPE strategy does not change our assumptions for intra-group

support, as we still expect Erste to support its foreign subsidiaries via pre-emptive measures, such as capital injections, guarantees or liquidity lines, in case of need.

Issuance activities in CEE to comply with the minimum requirements for own funds and eligible liabilities (MREL) of the various resolution groups have progressed substantially, with senior non-preferred debt (SNP) placements in Czech Republic, Romania and Slovakia and first international senior preferred (SP) placements in Croatia. The less developed capital markets in some of these countries have not been a constraint so far, as demand is sustained by supra-nationals and European investors (a large portion of the issuance was in euros) in search of yields. Total MREL-driven issuance needs in CEE over the next three years will be around EUR5 billion.

Erste's SNP debt is rated one notch below the Long-Term IDR (and SP debt is rated in line with the Long-Term IDR) to reflect the risk of the SNP debt's below-average recoveries in a resolution. This is because we expect Erste to use SP debt to meet its resolution buffer requirements, and we do not expect SNP and more junior debt to sustainably exceed 10% of the Austrian resolution group's RWAs.

Erste Finance (Delaware) LLC's commercial paper programme's 'F1' rating 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 (SR) 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 Bank Recovery and Resolution Directive and the Single Resolution Mechanism, which provide a resolution framework that is likely to require senior creditors participating in losses, if necessary, instead, or ahead, of a bank receiving sovereign support.

SUBORDINATED DEBT

The subordinated Tier 2 debt is rated two notches below the VR to reflect subordinated debt's higher loss severity in a resolution scenario. The notching reflects our expectation that the bank will not maintain buffers of Tier 2 and additional Tier 1 (AT1) debt exceeding 10% of the Austrian resolution group's RWAs.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Rating upside for Erste is limited in the medium term. An upgrade of its VR, DCR, Long-Term IDR and debt ratings would require an improvement of its operating environment in CEE, stronger asset-quality metrics and earnings generation above pre-pandemic levels, together with higher capital ratios.

The DCR and the long-term SP and SNP debt ratings could also be upgraded by one notch above the Long-Term IDR if we expect Erste's SNP and more junior debt buffers to sustainably exceed 10% of the Austrian resolution group's RWAs.

Erste's Short-Term IDR and short-term SP debt rating, as well as Erste Finance (Delaware) short-term unsecured debt rating, would be upgraded if Erste's funding and liquidity score is upgraded to 'aa-' or above.

An upgrade of the SR and upward revision of the 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 prevailing regulatory environment, in our view.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

We could downgrade the ratings if asset quality and operating profitability deteriorate substantially and on a sustained basis, most likely due to severe damage to the SME-and-corporate loan portfolios. In particular, an impaired loan ratio above 5% or operating profitability/RWAs materially below 2% on a sustained basis would lead to a downgrade. We would also downgrade the ratings if the CET1 ratio falls below its 13.5% target on a sustained basis.

Erste's Short-Term IDR and short-term SP debt rating, as well as Erste Finance (Delaware)'s short-term unsecured debt rating, would be downgraded if both Erste's Long-Term IDR and funding and liquidity score are downgraded.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Erste Group Bank AG	LT IDR	A Rating Outlook Stable	Affirmed	A Rating Outlook Negative
	ST IDR	F1	Affirmed	F1
	Viability	a	Affirmed	a
	Support	5	Affirmed	5
	Support Floor	NF	Affirmed	NF
	DCR	A(dcr)	Affirmed	A(dcr)
	● Senior preferred	LT	A	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Patrick Rioual

Senior Director

Primary Rating Analyst

+49 69 768076 123

patrick.rioual@fitchratings.com

Fitch Ratings – a branch of Fitch Ratings Ireland Limited

Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Marco Diamantini

Associate Director

Secondary Rating Analyst

+49 69 768076 114

marco.diamantini@fitchratings.com

Christian Kuendig

Senior Director

Committee Chairperson
+44 20 3530 1399
christian.kuendig@fitchratings.com

MEDIA CONTACTS

Louisa Williams
London
+44 20 3530 2452
louisa.williams@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

ENDORSEMENT STATUS

Erste Finance (Delaware) LLC
Erste Group Bank AG

EU Issued, UK Endorsed
EU Issued, UK Endorsed

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, THE FOLLOWING [HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT](https://www.fitchratings.com/rating-definitions-document) DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND

PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE OR ANCILLARY SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF PERMISSIBLE SERVICE(S) FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) OR ANCILLARY SERVICE(S) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

[READ LESS](#)

COPYRIGHT

Copyright © 2021 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's [Regulatory Affairs](#) page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

[Banks](#) [North America](#) [Europe](#) [Austria](#) [United States](#)
