Moody's Investors Service

Announcement: Moody's places ratings of seven Hungarian banks on review for downgrade

Global Credit Research - 04 Oct 2011

Milan, October 04, 2011 -- Moody's Investors Service has today placed on review for downgrade the standalone bank financial strength ratings (BFSR) of six Hungarian banks and the debt and deposit ratings of seven Hungarian banks. The banks are: OTP Bank NyRt, OTP Mortgage Bank, K&H Bank, Budapest Bank, FHB Mortgage Bank, Erste Bank Hungary and MKB Bank.

The review for downgrade was prompted by the recently approved law, which gives foreign-currency mortgage borrowers the option to repay the full outstanding amount at exchange rates below market rates. The review will assess the impact of the law on a bank by bank basis, taking into account: (i) the level of exposure to foreign-currency mortgages; (ii) the take-up rate by borrowers; (iii) the level of profitability; and (iv) the capital buffers available. Moody's anticipates that there are considerable differences between the rated banks with respect to these metrics.

In addition, the review will focus on Moody's assumptions of the likelihood of systemic and parental support for Hungarian banks given the overall weakening support environment.

The full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

Moody's says that the review for downgrade was prompted by a government law, approved on 19 September, which gives foreign-currency mortgage borrowers the option to repay the full outstanding amount at exchange rates below market rates. As foreign-denominated loans account for 70% of mortgage lending, Moody's believes that the approved law will likely trigger losses for the banks and impact their capital positions. Based on a 30% total take-up rate, Moody's estimates that the conversion at the current market rates would imply a possible loss up to 300 basis points of the regulatory capital adequacy ratio of the system, which was equal to 13.8% in June 2011. However, Moody's anticipates that the potential impact varies significantly among the rated banks.

The newly approved framework allows borrowers to voluntarily repay in a lump sum (by end of February 2012) their foreign-currency mortgages. The exchange rates proposed -- HUF180 to one Swiss franc and HUF250 to one euro -- are 36% and 19% below current market rates of around HUF246 and HUF298, respectively, thereby imposing haircuts and triggering losses for the lenders.

Moody's notes that the number of borrowers who might take advantage of the option is highly uncertain, because many eligible borrowers may be unable or unwilling to convert their loans for the following reasons: (i) repayments depend on the stretched borrowers' ability to either mobilise enough cash savings, or to find banks willing to provide refinancing in forints; and (ii) the average interest rate on forint-based loans is significantly higher than for foreign-currency loans.

Moody's also acknowledges that the government's scheme adds stress to a banking system already under significant pressure, reflected by deteriorating asset quality and weak profitability. This additional scheme will exert negative pressure on the banks' standalone credit profiles and may constrain the banking sector's capacity to contribute to economic growth.

In addition, following the ongoing macroeconomic challenges and the effect of the euro-area debt crisis, the National Bank of Hungary has reduced its 2011 GDP growth expectations for Hungary to 1.6%, from 2.6% in June, and has lowered the growth estimates for 2012 to 1.5%, from 2.7% in June. Unemployment is expected to remain above 10%. This indicates continuous asset quality challenges for banks.

SYSTEMIC AND PARENTAL SUPPORT COMES UNDER INCREASING SCRUTINY

Moody's notes that the average (asset-weighted) deposit rating for Hungarian banks is Baa3, as many banks benefit by an average of two notches of uplift from their current standalone BFSR due to parental support assumptions, and two banks benefit by one notch of uplift from their standalone BFSR due to systemic support assumptions.

The newly approved government law represents a sizeable move away from the principles of contract law. This, together with a set of government policy decisions since 2010 that include a punitive banking tax and regulations that still restrict repossessions of collateral on delinquent mortgages, have been adding pressure to lenders and are creating increasing uncertainty on the likelihood of systemic support for Hungarian banks.

Around 80% of the Hungarian banking system is owned by foreign banks. For some of the parent banks, their Hungarian operations form part of a larger network in Central and Eastern Europe from which they derive a portion of their profits. Moody's does not expect the foreign parents of the rated banks to immediately alter their commitment to Hungary. However, the rating agency acknowledges that these banks' strategic priorities and cost-benefit rationales are being increasingly affected by government policy decisions that are making the business environment in Hungary more difficult and less attractive to international investors.

Moody's has taken the following rating actions:

OTP Bank

- Local-currency deposit ratings Baa3/Prime-3 were placed on review for downgrade

- Foreign-currency deposit ratings Baa3/Prime-3 were placed on review for downgrade

- Foreign-currency senior unsecured debt rating Baa3 was placed on review for downgrade

- Foreign-currency subordinated debt rating (Lower Tier 2) Ba1 was placed on review for downgrade

- Foreign-currency junior subordinated debt rating (Upper Tier 2) Ba2 (hyb) was placed on review for downgrade

- D+ BFSR (mapping to Baa3 on the long-term scale) was placed on review for downgrade

OTP Mortgage Bank

- Local-currency deposit ratings Baa3/Prime-3 were placed on review for downgrade

- Foreign-currency deposit ratings Baa3/Prime-3 were placed on review for downgrade

- D+ BFSR (mapping to Baa3 on the long-term scale) was placed on review for downgrade

K&H Bank

- Local-currency deposit ratings Baa3/Prime-3 were placed on review for downgrade

- Foreign-currency deposit ratings Baa3/Prime-3 were placed on review for downgrade

- D BFSR (mapping to Ba2 on the long-term scale) was placed on review for downgrade

Budapest Bank

- Local-currency deposit ratings Baa3/Prime-3 were placed on review for downgrade

- Foreign-currency deposit ratings Baa3/Prime-3 were placed on review for downgrade

- D- BFSR (mapping to Ba3 on the long-term scale) was placed on review for downgrade

FHB Mortgage Bank

- Local-currency long-term deposit rating of Ba1 was placed on review for downgrade

- Foreign-currency long-term deposit rating of Ba1 was placed on review for downgrade

- D BFSR (mapping to Ba2 on the long-term scale) was placed on review for downgrade

Erste Bank Hungary

- Local-currency long-term deposit rating of Ba1 was placed on review for downgrade

- Foreign-currency long-term deposit rating of Ba1 was placed on review for downgrade

- D- BFSR (mapping to Ba3 on the long-term scale) was placed on review for downgrade

MKB Bank

- Local-currency long-term deposit rating of Ba2 was placed on review for downgrade

- Foreign-currency long-term deposit rating of Ba2 was placed on review for downgrade

- Foreign-currency senior unsecured debt rating Ba2 was placed on review for downgrade

- Foreign-currency subordinated debt rating (Lower Tier 2) B1 was placed on review for downgrade

- E+ BFSR maintains a stable outlook, but its corresponding standalone rating of B1 was placed on review for downgrade

CORRECTION OF HYBRID INSTRUMENT LABELLING

Moody's has attached the "hyb" indicator to the rated hybrid instrument issued by OTP Bank and relabelled this security as "junior subordinated". Due to an internal administrative error, this instrument was inadvertently mislabelled as "subordinated" when it was initially rated on November 20, 2006 and the hybrid indicator (hyb) was not later added to the rating in accordance with our Rating Symbols and Definitions published in May 2011.

The instrument affected by today's correction is as follows:

EUR500 million perpetual junior subordinated debt (Upper Tier 2) (ISIN: XS0274147296)

PRINCIPAL METHODOLOGIES

The methodologies used in rating OTP Mortgage Bank, K&H Bank, Budapest Bank, FHB Mortgage Bank, and Erste Bank Hungary were Bank Financial Strength Ratings: Global Methodology published in February 2007, and Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology published in March 2007. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

The methodologies used in rating OTP Bank and MKB Bank were Bank Financial Strength Ratings: Global Methodology published in February 2007, Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology published in March 2007, and Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt published in November 2009. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

Headquartered in Budapest, Hungary, OTP Bank reported consolidated total assets of HUF9,712 billion (EUR36.3 billion) as of 30 June 2011.

Headquartered in Budapest, Hungary, OTP Mortgage Bank reported consolidated total assets of HUF1,681 billion (EUR6.02 billion) as of 31 December 2010.

Headquartered in Budapest, Hungary, K&H Bank reported consolidated total assets of HUF2,922 billion (EUR10.9 billion) as of 30 June 2011.

Headquartered in Budapest, Hungary, Budapest Bank reported consolidated total assets of HUF887 billion (EUR3.31 billion) as of 30 June 2011.

Headquartered in Budapest, Hungary, FHB Mortgage Bank reported consolidated total assets of HUF839.8 billion (EUR3.14 billion) as of 30 June 2011.

Headquartered in Budapest, Hungary, Erste Bank Hungary reported consolidated total assets of HUF3,300 billion (EUR12.3 billion) as of 30 June 2011.

Headquartered in Budapest, Hungary, MKB Bank reported consolidated total assets of HUF2,939 billion (EUR11.01 billion) as of 30 June 2011.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides relevant regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides relevant regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides relevant regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Moody's considers the quality of information available on the rated entity, obligation or credit satisfactory for the purposes of issuing a rating.

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Please see Moody's Rating Symbols and Definitions on the Rating Process page on www.moodys.com for further information on the meaning of each rating category and the definition of default and recovery.

Please see ratings tab on the issuer/entity page on www.moodys.com for the last rating action and the rating history. The date on which some ratings were first released goes back to a time before Moody's ratings were fully digitized and accurate data may not be available. Consequently, Moody's provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website www.moodys.com for further information.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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