MOODY'S
INVESTORS SERVICE

Announcement: Moody's reviews Erste Group Bank's A1/C- ratings for downgrade (Austria)

Global Credit Research - 04 Nov 2011

Frankfurt am Main, November 04, 2011 -- Moody's Investors Service has today placed on review for downgrade Erste Group Bank AG's (Erste) standalone bank financial strength rating (BFSR) of C- (mapping to Baa1 on the long-term scale) and the A1 long-term debt and deposit ratings. Consequently, several subordinated and junior subordinated debt ratings were placed on review for downgrade. The P-1 short-term rating was affirmed. A full list of affected ratings is listed at the end of this press release.

The review for downgrade on the BFSR follows the bank's report of a major loss that partly stems from previously undisclosed credit default swap (CDS) exposures. Accordingly, the review will focus on Erste's risk management, internal controls and financial transparency as well as the risk-adjusted profit generating capacity of its business model. The review for downgrade of the A1 long-term ratings follows the review on the BFSR.

As part of the re-assessment of the C- BFSR, a lower mapping of the standalone credit strength to Baa2 from Baa1 is likely, while a move of the BFSR below the C- range cannot be ruled out entirely. Consequently, the rating agency notes that a one-notch downgrade of the long-term debt and deposit ratings is the most likely outcome of the rating review.

RATINGS RATIONALE

The decision to review Erste's C- BFSR for downgrade was prompted by Moody's concerns about the bank's risk appetite as well as its related risk-management policies, internal controls and financial transparency following an announcement on 10 October 2011 of extraordinary charges leading to a net loss of EUR1.5 billion in Q3 2011. Particularly relevant is the disclosure of a EUR5.2 billion net CDS portfolio (protection sold), which appears to be unrelated to Erste's core business operations and had previously been recognised at cost, rather than at fair value. Erste also announced the harmonisation of IT tools requiring the restatement of certain income-recognition accounting, raising questions about the uniform application of appropriate risk-management tools as well as financial transparency on a group-wide basis.

Both changes may mean that earlier qualitative assumptions that Moody's had assumed are no longer consistent with the C- BFSR and the Baa1 standalone credit assessment.

At the same time, Moody's acknowledges the bank's announcement -- during its Q3 2011 earnings call -- that it has reduced its net CDS exposure to EUR300 million as of 27 October 2011 through various measures such as novation, close-outs and -- to a much lesser extent -- hedges. It is Moody's understanding that these actions have effectively reduced the contingent liability relating to these derivatives contracts and related earnings volatility. However, the restatement of the CDS exposures had a negative impact of approximately EUR460 million after tax. This, combined with the other extraordinary charges (predominantly goodwill write-offs for its Hungarian and Romanian businesses), required the bank to postpone the planned repayment of EUR1.2 billion in government-provided participation capital. This could limit the bank's strategic and financial flexibility for a longer period than Moody's previously expected. In the absence of previously anticipated meaningful profit generation for the full-year 2011, Erste's 7.4% core Tier 1 capital ratio (excluding government participation capital) as per 30 September 2011 is weak compared with other banks' capital ratios rated at the C- BFSR level. In Moody's view, the comparative weakness increases the pressure on Erste to make a rapid return to its earlier earnings-generation capacity to bolster its regulatory capital levels.

Erste's A1 long-term ratings currently benefit from the very high support assumptions as a systemically relevant bank in Austria which results in three notches of uplift from the bank's Baa1 standalone credit strength. Accordingly, the long-term rating is expected to move in tandem with Erste's standalone risk assessment.

WHAT COULD CHANGE THE RATING UP/DOWN

There is currently no upward rating pressure as expressed by the review for downgrade.

In addition to the factors described above, the bank's BFSR could come under downward rating pressure due to (1) a stalled economic recovery in Eastern Europe resulting in additional substantial credit charges, beyond levels anticipated by Moody's, (2) an extended period of weak earnings and hence lower internal capital generation, and (3) weakened capitalisation levels as a result of strong asset growth in Eastern Europe.

The bank's long-term ratings could come under downward pressure in case of a weakening in its intrinsic financial strength, as well as adverse changes in the systemic support assumptions currently factored into Erste's ratings. However, Moody's does not consider this likely at present.

RATINGS AFFECTED

Erste Group Bank AG:

The following ratings are on review for downgrade:

- C- bank financial strength rating mapping to Baa1 on the long-term rating scale

- A1 long-term bank deposit and senior unsecured debt ratings

- A2 subordinated debt ratings

- Ba1 (hyb) junior subordinated rating (cumulative)

- Ba2 (hyb) junior subordinated rating (non-cumulative)

- Ba1 (hyb) non-cumulative preferred securities

The following ratings were affirmed:

- Prime-1 short-term ratings

PRINCIPAL METHODOLOGIES

The principal methodologies used in this rating 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.

Erste Group Bank AG is headquartered in Vienna, Austria. At 30 September 2011 it had total assets of EUR216 billion and reported a net loss of EUR973 million for the first nine month of 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.

The rating has been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

Information sources used to prepare the rating are the following : parties involved in the ratings, public information, and confidential and proprietary Moody's Investors Service information.

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

Moody's adopts all necessary measures so that the information it uses in assigning a rating is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

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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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