

**Rating Action: Moody's downgrades certain supplementary capital and hybrid capital instruments of Erste Group Bank**

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Global Credit Research - 18 Dec 2014

**Long-term senior ratings affirmed at Baa2 negative; outlook on standalone D+ BFSR changed to negative from stable**

Frankfurt am Main, December 18, 2014 -- Moody's Investors Service has today taken a series of rating actions that resulted in the downgrade and/or affirmation of the supplementary capital and hybrid capital instruments of Erste Group Bank AG (Erste). The rating agency also affirmed Erste's long-term debt and deposit ratings at Baa2 with a negative outlook, and affirmed the short-term debt and deposit ratings at Prime-2. At the same time, Moody's affirmed Erste's standalone bank financial strength rating (BFSR) at D+, with the corresponding baseline credit assessment (BCA) at ba1, and changed the outlook on the BFSR to negative from stable. The subordinated and senior subordinated debt ratings were affirmed at Ba2 with a negative outlook (previously stable).

The rating actions on the supplementary capital and hybrid capital instruments follow Erste's announcement on 9 December 2014 to pay no coupons on these instruments in 2015. The non-payment of coupons is a result of management's expectation of a lack of sufficient profits (prior to movements in reserves) in the case of the supplementary capital instruments (Upper Tier 2 [UT2]), and the lack of sufficient distributable funds, in the case of the hybrid capital instruments. Each calculation is for the financial year 2014 on a single entity basis of Erste Group Bank AG in accordance with Austrian GAAP and the Austrian Banking Act. The rating action also reflects the correction of an input error in relation to 2 instruments as described more fully below.

The affirmation of Erste's BFSR with a negative outlook (formerly stable) reflects (1) Moody's assessment of uncertainties over potential negative implications on some of the bank's operations in Central Eastern Europe (CEE) from the deterioration of operating conditions in Russia; and (2) Moody's assessment regarding the bank's ability to provide a buffer for negative developments in its pressured profitability in order to avoid losses for subordinated creditors.

Please see the end of this press release for a full list of the affected ratings.

**RATINGS RATIONALE**

**NEGATIVE OUTLOOK ON ERSTE'S BFSR REFLECTS INCREASED RISKS FOR ITS MAIN OPERATIONS IN CEE AND VULNERABILITY IMPLIED BY HYBRID COUPON SKIP**

Moody's decision to affirm the bank's BFSR and change the outlook to negative reflects concerns over the potential adverse effect of the significant deterioration of the operating environment in Russia on the credit metrics of some of the bank's main operations in CEE. At the same time, the rating agency takes into account that Erste's direct exposure to Russia is limited. The outlook change also reflects Moody's assessment of risks regarding the bank's ability to provide a buffer for negative developments in its pressured profitability in order to avoid losses for subordinated creditors. Moody's regards the skip or delay in coupon payments on subordinated debt as a significant credit event which not only impairs these securities, but also indicates some vulnerability of the bank's fundamental credit strength.

**AFFIRMATION OF LONG-TERM SENIOR DEBT AND DEPOSIT RATINGS; MAINTAINING THE NEGATIVE OUTLOOK**

The affirmation of Erste's Baa2 long-term debt and deposit ratings follows the affirmation of the bank's BFSR and reflects our unchanged assumptions around support being made available from the government of Austria (Aaa, stable) in the event of need, which provides two notches of rating uplift. The negative outlook on those ratings reflects the negative outlook on the bank's BFSR and the rating agency's view that the balance of risk for banks' senior unsecured creditors had shifted to the downside following the adoption of the Bank Recovery and Resolution Directive (BRRD) in Europe which will be transposed into national legislation in Austria as of 1 January 2015.

**NEW RATING LEVELS FOR SUPPLEMENTARY CAPITAL AND HYBRID CAPITAL REFLECT COUPON SKIP**

The rating actions on Erste's supplementary capital and hybrid capital instruments reflect the bank's announcement to pay no coupons on these instruments in 2015. The ratings are positioned at the lower of normal notching or on an expected loss basis once the coupons stop paying. The new rating levels depend on the terms and conditions of these securities and their respective coupon levels. Four securities continue to be rated according to Moody's notching approach. Six securities have been downgraded, reflecting Moody's decision to rate these securities on an expected loss basis. The outlook on these six ratings is stable, as Moody's does not expect any further impairments at the current rating levels for these instruments.

Ratings that continue to be rated according to Moody's notching approach:

(1) For Erste's cumulative junior subordinated debt maturing in 2019 (ISIN:XS0303559115, Moody's Debt ID: 820418491), Moody's affirmed the ratings at their current level of B1(hyb) (three notches below the ba1 adjusted BCA) as bondholders benefit from Erste's obligation to pay the 2015 coupons once the bank has sufficient annual profits to resume payments. The ratings reflect the junior subordinated claim in liquidation and cumulative deferral features tied to the breach of a net loss trigger. The rating agency changed the outlook to negative in line with the outlook on Erste's BFSR.

(2) For three junior subordinated debt securities, Moody's has lowered the rating by one notch to B2(hyb) (ISIN:AT000B000450, Moody's Debt ID: 809640880; ISIN:AT000B000518, Moody's Debt ID: 809783821; ISIN:AT000B001078, Moody's Debt ID: 820411086) from B1(hyb). The new rating levels at four notches below the adjusted BCA down from previously three notches reflect the agency's assessment that the bond documentation allows for management discretion to defer or skip coupons. While the agency expects Erste to resume payments in 2016, the additional notch reflects the higher uncertainty for investors due to the discretionary nature of the coupon deferral or skip mechanism, which has become more relevant in the context of the recent announcement. The outlook on these ratings is stable.

Ratings that are based on Moody's expected loss approach:

(3) The ratings of Erste's non-cumulative preferred securities now reflect the expected recovery rate given the announced loss of coupon payments in 2015 -- leading to downgrades to Caa1(hyb) (ISIN XS0268694808, Moody's Debt ID: 809807559; XS0215338152, Moody's Debt ID: 808192280) from B1(hyb), and to B2(hyb) (ISIN XS0188305741, Moody's Debt ID: 807484307) from B1(hyb).

(4) For two junior subordinated debt securities (ISIN:AT000B000062, Moody's Debt ID: 809202341; and ISIN:XS0143383148, Moody's Debt ID: 10323181), Moody's also corrected an input error to correctly assess the deferral features as non-cumulative. The previous rating levels -- at B1(hyb) -- had wrongly reflected the agency's understanding that the securities contained cumulative deferral features. On an expected loss basis, these securities are now rated Caa1(hyb) (AT000B000062) and B2(hyb) (XS0143383148).

(5) Moody's has downgraded Erste's junior subordinated debt maturing in 2015 (ISIN:AT000B000708, Moody's Debt ID: 815144235) to Caa1(hyb) given that the agency does not expect bondholders to recoup the lost coupons at maturity.

#### WHAT COULD CHANGE THE RATING - DOWN

Downward pressure could be exerted on Erste's D+ standalone BFSR following (1) further additional credit charges, in particular related to the bank's operations in CEE; (2) further weakening in earnings that result in lower internal capital generation; and (3) weakened capitalisation levels.

Downward pressure could be exerted on Erste's long-term ratings as a result of (1) a lowering of its standalone ba1 BCA; or (2) a re-assessment of Moody's systemic support assumptions.

#### WHAT COULD CHANGE THE RATING - UP

There is currently no upward rating pressure as reflected by the negative outlook.

Upward pressure on Erste's D+ standalone BFSR would be prompted by (1) a significant and sustained reduction in the volume of NPLs; (2) a material increase of its capitalisation; and (3) sustained improvement in the bank's operating performance and its capital generation capacity.

If Erste were to resume payments on its supplementary capital and hybrid capital instruments on a sustained basis, upward pressure would develop on these ratings to the extent that ratings would return to normal notching.

## LIST OF AFFECTED RATINGS

The following ratings of Erste Group Bank AG were affirmed with no change in outlook:

- Long-term senior debt and deposit ratings at Baa2 negative;
- Short-term debt and deposit rating at Prime-2.

The following ratings of Erste Group Bank AG were affirmed with a change in outlook:

- D+ BFSR negative from previously stable, equivalent to a BCA of ba1,
- Subordinated and senior subordinated debt ratings at Ba2 negative, formerly stable;
- Certain junior subordinate debt ratings to B1(hyb) negative, formerly stable (ISIN:XS0303559115).

The following ratings of Erste Group Bank AG were downgraded:

- Certain junior subordinate debt ratings to B2(hyb) stable, from B1(hyb) stable (ISIN: XS0143383148; ISIN:AT000B000450, ISIN:AT000B000518, ISIN:AT000B001078).
- Certain junior subordinate debt ratings to Caa1(hyb) stable, from B1(hyb) stable (AT000B000062, ISIN:AT000B000708)

The following ratings of Erste Capital Finance (Jersey) Tier I PC were downgraded:

- Non-cumulative preferred securities to Caa1(hyb) stable, from B1(hyb) stable.

The following ratings of Erste Finance Jersey (4) Limited were downgraded

- Non-cumulative preferred securities to B2(hyb) stable, from B1(hyb) stable.

The following ratings of Erste Finance Jersey (6) Limited were downgraded:

- Backed non-cumulative preferred securities to Caa1(hyb) stable, from B1(hyb) stable.

The following ratings of Erste Finance (Delaware) LLC were affirmed:

- Backed Commercial Paper at Prime-2.

The following ratings of Erste Bank, New York, were affirmed:

- Bank deposit ratings at Baa2 negative.

## PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Global Banks published in July 2014. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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