MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades Erste Group Bank's senior ratings to Baa1, assigns stable outlook

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Baseline credit assessment also upgraded to baa3, reflecting sustained improvement in the bank's financial fundamentals

Frankfurt am Main, June 20, 2016 -- Moody's Investors Service (Moody's) today upgraded Erste Group Bank AG's (Erste) long-term senior debt and deposit ratings to Baa1 from Baa2, and assigned a stable outlook. At the same time, the rating agency upgraded Erste's baseline credit assessment (BCA) and adjusted BCA to baa3 from ba1, and its long-term Counterparty Risk Assessment (CR Assessment) to A3(cr) from Baa1(cr). Further, Moody's upgraded the bank's subordinated debt ratings to Ba1 from Ba2, and certain junior subordinated debt ratings issued by the bank or its issuing entities to Ba3(hyb) from B1(hyb), and to Ba2(hyb) from Ba3(hyb). The bank's short-term ratings were affirmed at P-2 as well as the bank's short-term Counterparty Risk Assessment at P-2(cr).

The rating upgrade is supported by the continued strengthening of Erste's financial fundamentals whilst the stable outlook reflects Moody's expectation that Erste will be able to sustain its more solid credit metrics.

Moreover, Moody's assigned an unsolicited provisional (P)Ba3 rating to Erste's low trigger undated deeply subordinated Additional Tier 1 (AT1) note program. The rating was not initiated at the request of the rated entity. Moody's issues provisional ratings in advance of the final issuance. These ratings represent the rating agency's preliminary credit opinion. A definitive rating may differ from a provisional rating if the terms and conditions of the final issuance are materially different from those of the draft prospectus reviewed.

Concurrently, the rating agency assigned an unsolicited Ba3(hyb) rating to the EUR500 million low-trigger AT1 notes issued on 2 June 2016 under Erste's AT1 note program to which Moody's assigned a (P)Ba3 rating, three notches below the bank's baa3 adjusted BCA. These ratings were not initiated at the request of the rated entity.

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

RATINGS RATIONALE

UPGRADE OF ERSTE'S BASELINE CREDIT ASSESSMENT

The upgrade of the bank's BCA follows the sustained strengthening of Erste's key credit metrics and reflects: (1) The bank's successful and continued de-risking of its balance sheet through continued problem loan sales, leading to meaningfully lower risk costs that Moody's believes to be sustainable; (2) the continuous build-up of the bank's capital adequacy ratios; and (3) Erste having returned to its long-term earnings potential, absent external one-off factors.

The bank succeeded in reducing its problem loan ratio to 6.7% as of 31 March 2016 from 9.7% as of 30 June 2013 and improved its coverage ratio to 66.5% from 61.7% as of the same dates. As of end-March 2016, problem loans were at EUR8.9 billion, down from EUR12.6 billion at their peak in June 2013, helped by pro-active portfolio sales, particularly in Romania and Hungary. Moody's expects the problem loan ratio to drop further if the bank is able to continue with its portfolio sales and maintains tight control of any potential new problem loan formation.

The de-risking of the bank was further supported by a strengthening of the bank's fully-loaded common equity Tier 1 (CET1) ratio to 12.3% (including retained earnings) as of 31 March 2016 (June 2015: 11.3%) as well as by a recovery of its earnings generation power and thus capital generation capacity, displaying a net profit of EUR968 million in 2015 and EUR275 million during the first quarter of 2016. Moody's considers the improved capitalisation to be sufficient to cover the intrinsic risks of the bank's operating model, which is geared towards Central and Eastern Europe (CEE).

At the achieved capital and profitability levels, the rating agency considers the bank to be well prepared to comply with upcoming regulatory requirements, specifically with regard to the expected implementation of a systemic risk buffer by the Austrian regulator over the next 12 months. Moody's also believes that Erste will be able to continuously digest the ongoing burden from external charges, such as various bank levies and contributions to the deposit guarantee schemes.

UPGRADE OF THE BANK'S LONG-TERM SENIOR RATINGS

The upgrade of Erste's long-term senior ratings by one notch to Baa1 follows the one-notch upgrade of the bank's BCA. The long-term ratings therefore reflect: (1) The bank's baa3 BCA and adjusted BCA; (2) the results of Moody's Advanced Loss Given Failure (LGF) analysis, which continues to provide two notches of uplift to the bank's long-term ratings from its adjusted BCA; and (3) Moody's assumption of a low probability of government support from the Austrian government (Aaa, negative) to be forthcoming to Erste in case of need, despite its classification as a systemically-relevant financial institution. This assumption leads to no additional rating uplift from government support and continues to hold following the events surrounding the resolution of Heta Asset Resolution AG (Carinthian state-guaranteed senior unsecured debt Ca, rating under review for upgrade), which illustrates the Austrian government's high willingness to apply burden sharing to senior creditors.

RATIONALE FOR THE STABLE OUTLOOK ON SENIOR DEBT AND DEPOSIT RATINGS

The stable outlook on Erste's long-term senior deposit and debt ratings reflects Moody's expectation that Erste will be able to maintain its recently restored earnings generation capacity in the medium term, in line with or slightly below its announced target of a return on tangible equity of 10-11% in 2016. This should result in a further stabilisation of the banks' financial fundamentals over the next 12-18 months, despite continued pressures from the persistent low interest-rate environment on the bank's earnings as well as a potential weakening of the operating environment in its core operating markets, including Austria.

UPGRADE OF THE BANK'S HYBRID CAPITAL INSTRUMENTS

The rating agency upgraded the supplementary capital and hybrid debt instrument ratings issued by Erste or its dedicated issuing entities by one notch. The new rating levels continue to depend on the terms and conditions of these securities and their respective coupon skip mechanisms:

(1) For Erste's cumulative junior subordinated debt maturing in 2019 (ISIN: XS0303559115, Moody's Debt ID: 820418491), Moody's upgraded the rating by one notch to Ba2(hyb) from Ba3(hyb), two notches below the bank's baa3 adjusted BCA from which the rating is notched. The ratings reflect the junior subordinated claim in liquidation and cumulative deferral features tied to the breach of a net loss trigger.

(2) For two junior subordinated debt securities, Moody's has upgraded the rating by one notch to Ba2(hyb) from Ba3(hyb) (ISIN: AT000B000450, Moody's Debt ID: 809640880; ISIN: AT000B000518, Moody's Debt ID: 809783821), two notches below the adjusted BCA from which the rating is notched. The ratings reflect the rating agency's assessment of these instruments' cumulative coupon deferral mechanisms tied to the breach of a net loss trigger.

(3) For one junior subordinated debt security (ISIN: XS0143383148, Moody's Debt ID: 10323181), Moody's upgraded the rating by one notch to Ba3(hyb) from B1(hyb), three notches below the bank's baa3 adjusted BCA from which the rating is notched. The ratings reflect the rating agency's assessment of the instrument's junior subordinated claim in liquidation and non-cumulative deferral features tied to the breach of a net loss trigger.

(4) The ratings of Erste's three non-cumulative preferred securities (ISIN XS0268694808, Moody's Debt ID: 809807559; and ISIN XS0215338152, Moody's Debt ID: 808192280; and ISIN XS0188305741, Moody's Debt ID: 807484307) have been upgraded to Ba3(hyb), from B1(hyb), three notches below the bank's baa3 adjusted BCA from which these rating are notched. The ratings reflect the junior subordinated claim in liquidation and non-cumulative deferral features tied to the breach of a balance-sheet loss trigger.

ASSIGMENT OF Ba3 RATINGS TO ERSTE'S AT1 PROGRAM AND ISSUED AT1 INSTRUMENTS

Following the June 2016 issuance of EUR500 million of low trigger undated deeply subordinated Additional Tier 1 (AT1) instruments out of Erste's EUR2 billion AT1 note program, Moody's assigned an unsolicited (P)Ba3 rating to the program and an unsolicited Ba3(hyb) rating to the EUR500 million AT1 notes issued under this program, three notches below the bank's baa3 adjusted BCA from which the ratings are notched. These ratings were not initiated at the request of the rated entity.

The ratings reflect the rating agency's assessment of the instrument's deeply subordinated claim in liquidation as well as its non-cumulative coupon deferral features. In addition, the securities' principal is subject to a partial or full write-down on a contractual basis if: (1) Erste's CET1 ratio falls below 5.125%; or (2) the issuer receives public support; and/or (3) the Austrian Financial Market Authority (FMA) determines that the conditions for a full write-down of the instrument are fulfilled and orders such a write-down to prevent insolvency as a protectionary measure.

WHAT COULD CHANGE THE RATINGS UP / DOWN

Erste's ratings could be upgraded because of: (1) An upgrade of its BCA; and/or (2) an increase in subordinated debt volumes.

Upward pressure on Erste's baa3 stand-alone BCA would be prompted by (1) a further significant and sustained reduction in the volume of NPLs; (2) a sustained and further improvement in capitalisation building a meaningful buffer over and above the requirements set by the Austrian and/or European regulators; and (3) a further improvement in the bank's operating performance and capital-generation capacity from levels achieved in 2015. In addition, an upgrade would require the bank to maintain its meanwhile solid risk management and corporate governance track record.

Upward rating pressure on the bank's debt and deposit ratings would also develop if the bank increases the amount of subordinated debt that could be bailed in ahead of senior unsecured debt, providing one additional notch of rating uplift from our LGF analysis.

Downward pressure could be exerted on Erste's long-term ratings as a result of: (1) A lowering of its baa3 BCA; or (2) a significant decrease in its bail-inable debt cushion, leading to fewer notches of rating uplift as a result of our LGF analysis.

Downward pressure on Erste's baa3 BCA could be exerted following: (1) A renewed and sustained formation of problem loans and related loan loss charges, in particular if stemming from the bank's operations in CEE; (2) a sustained weakening in the bank's earnings- and thus capital-generation capacity; and (3) a weakening of the bank's recently improved capitalisation levels.

LIST OF AFFECTED RATINGS

The following ratings and rating assessments of Erste Group Bank AG were upgraded:

- Long-term senior debt and deposit ratings to Baa1 stable, from Baa2 positive;

- Senior Unsecured MTN program to (P)Baa1, from (P)Baa2

- Subordinated and senior subordinated debt ratings to Ba1, from Ba2;

- Subordinated MTN program to (P)Ba1, from (P)Ba2;

- Baseline Credit Assessment (BCA) to baa3, from ba1;

- Adjusted Baseline Credit Assessment to baa3, from ba1;

- Long-term Counterparty Risk Assessment to A3(cr), from Baa1(cr);

- Cumulative junior subordinate debt ratings (ISIN: XS0303559115, ISIN: AT000B000450, ISIN: AT000B000518) to Ba2(hyb), from Ba3(hyb);

- Non-cumulative junior subordinate debt ratings (ISIN: XS0143383148) to Ba3(hyb), from B1(hyb).

The following ratings and risk assessments of Erste Group Bank AG were affirmed at their current levels:

- Short-term deposit ratings at P-2;

- Commercial Paper ratings at P-2;

- Other Short-term ratings at (P)P-2

- Short-term Counterparty Risk Assessment at P-2(cr).

The following ratings were assigned to Erste Group Bank AG and were not initiated at the request of the rated entity:

- Provisional non-cumulative preferred securities program rating (low-trigger AT1) at (P)Ba3;

- Non-cumulative preferred securities rating (€500 million low-trigger AT1 drawdown) at Ba3(hyb).

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

- Long-term deposit rating to Baa1 stable, from Baa2 positive;

- Long-term Counterparty Risk Assessment to A3(cr), from Baa1(cr).

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

- Short-term Counterparty Risk Assessment at P-2(cr).

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

- Backed Commercial Paper at P-2.

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

- Non-cumulative preferred securities (ISIN XS0268694808, Moody's Debt ID: 809807559) to Ba3(hyb), from B1(hyb).

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

- Backed non-cumulative preferred securities (ISIN XS0188305741, Moody's Debt ID: 807484307) to Ba3(hyb), from B1(hyb).

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

- Backed non-cumulative preferred securities (ISIN XS0215338152, Moody's Debt ID: 808192280) to Ba3(hyb), from B1(hyb).

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

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