

Rating Action: Moody's upgrades Erste Group Bank AG's senior ratings to A2, maintains positive outlook

30 Apr 2018

Baseline Credit Assessment upgraded to baa1

Frankfurt am Main, April 30, 2018 -- Moody's Investors Service (Moody's) today upgraded Erste Group Bank AG's (Erste) senior unsecured debt and deposit ratings to A2 from A3, and maintained the positive outlook. At the same time, the rating agency upgraded Erste's Baseline Credit Assessment (BCA) and Adjusted BCA to baa1 from baa2, and its long-term Counterparty Risk Assessment (CR Assessment) to A1(cr) from A2(cr), while it affirmed the P-1(cr) short-term CR Assessment.

Further, Moody's upgraded Erste's short-term ratings to P-1 from P-2, its subordinated debt ratings to Baa2 from Baa3, and its junior subordinated debt rating to Baa3(hyb) from Ba1(hyb). Erste's low-trigger additional Tier 1 (AT1) notes issued under its program were also upgraded to Ba1(hyb) from Ba2(hyb).

The rating upgrades take account of the sustainability of Erste's improved financial fundamentals, in particular its asset risk and profitability metrics. The upgrade also reflects Moody's expectation that Erste will maintain its solid capitalisation and further improve its favorable funding profile largely consisting of highly granular retail deposits with consequently very low market funding needs over the next few years.

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 reflects the rating agency's view that Erste will be able to maintain its improved key credit metrics, in particular: (1) sustain the achieved de-risking of its balance sheet, supporting lower risk costs through the cycle, and thereby enhancing Erste's earnings-generation capacity; (2) maintain its solid capital adequacy ratios despite regulatory pressures and anticipated business growth, and owing to the bank's continued high earnings retention resulting from its now higher earnings-generation power; and (3) contain its currently low reliance on market funding sources owing to the bank's strong deposit growth and balanced maturity profile that will help keep refinancing needs very low over the next few years.

During 2017, the bank reduced its problem loan ratio to 4.0% as of 31 December 2017 from 4.9% as of year-end 2016 and maintained its already solid level of loan loss reserves, as displayed by strong problem loan coverage ratios in many of Erste's core markets. While this improvement in the bank's credit risk profile was to a lesser extent supported by pro-active portfolio sales, the benign operating environment supported a further gradual reduction in problem loans in Erste's domestic and Central and Eastern Europe (CEE) markets. Moody's expects the group's problem loan ratio to fluctuate around its current level over the next 12-18 months, supported by the bank maintaining tight control of its geographical concentrations as well as lending criteria. The rating agency believes that this will help avoid any more meaningful unexpected or undue new problem loan formation even under less favorable business conditions.

The bank further sustained its solid regulatory capitalisation as displayed by its fully loaded common equity Tier 1 (CET1) ratio to 12.9% as of 31 December 2017 (2016: 12.8%). Supported by the bank's sustained high earnings generation power, Moody's believes that Erste's will be able to sustain and further gradually grow its fully loaded CET1 capital ratio, despite continued regulatory tightening as well as intense competition leading to margin pressure in a persistently low interest-rate environment. In Moody's view, sustaining higher capital and profitability levels will remain key to mitigate intrinsic risks and concentrations of the bank's operating model, which is geared towards more volatile markets in CEE.

UPGRADE OF THE BANK'S LONG-TERM SENIOR RATINGS

The upgrade of Erste's long-term senior ratings by one notch to A2 follows the one-notch upgrade of the bank's BCA. The long-term ratings therefore reflect: (1) the bank's baa1 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 senior ratings from its Adjusted BCA; and (3) Moody's assumption of a low probability of government support from the Austrian government (Aa1, stable) to be forthcoming to Erste in case of need, despite its classification as a systemically-relevant financial institution. This assumption continues to lead to no additional rating uplift from government support.

RATIONALE FOR THE POSITIVE OUTLOOK ON ERSTE'S SENIOR UNSECURED DEBT AND DEPOSIT RATINGS

The positive outlook on Erste's long-term senior unsecured debt and deposit ratings reflects the potential for higher rating uplift under Moody's Advanced LGF analysis to three notches from currently two notches, subject to further issuance of sufficient volumes of subordinated debt instruments which would sustainably reduce the loss given failure for senior creditors of Erste. In addition, and if the bank issued sufficient volumes of subordinated debt, including low-trigger AT1 instruments under its €2 billion AT1 note program, this could also support the LGF notching (currently one notch deduction from the bank's Adjusted BCA) assigned to the bank's subordinated debt ratings.

WHAT COULD CHANGE THE RATINGS UP / DOWN

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

Upward pressure on Erste's baa1 stand-alone BCA would be prompted by a combination of all of the following factors: (1) A further significant and sustained reduction in the volume of problem loans, specifically if this led to a problem loan ratio of meaningfully below 4% through the cycle, and provided the bank maintains its solid risk management track record and strict lending criteria; (2) a sustained and further improvement in Erste's capitalisation metrics building a sizeable buffer above the bank's fully loaded SREP ratio requirements; and (3) Erste improving its operating performance such that it achieves higher profitability well above the levels achieved in 2016 and 2017.

Upward rating pressure on the bank's debt and deposit ratings could also develop if the bank meaningfully, and on a sustained basis, increased the amount of subordinated debt that could be bailed in ahead of senior unsecured debt, providing one additional notch of rating uplift from Moody's Advanced LGF analysis.

Downward pressure could be exerted on Erste's long-term ratings as a result of: (1) a downgrade of its baa1 BCA; or (2) a significant decrease in its bail-inable debt cushion, leading to fewer notches of rating uplift as a result of Moody's LGF analysis.

Downward pressure on Erste's baa1 BCA could be exerted following: (1) A meaningful and sustained formation of problem loans and related loan loss charges, in particular if stemming from the bank's operations in CEE or if resulting from a loosening of credit standards amid worsening operating conditions; (2) a meaningful and unexpected weakening of the bank's solid capital adequacy metrics; (3) a sudden and significant weakening in the bank's earnings-generation power; or (4) a forced increase in the group's reliance on confidence-sensitive wholesale funding sources beyond Moody's current expectations, in particular if triggered by regulatory requirements such as the minimum requirement for own funds and eligible liabilities (MREL) affecting Erste's domestic and CEE funding needs.

LIST OF AFFECTED RATINGS

Issuer: Erste Group Bank AG

..Upgrades:

...Adjusted Baseline Credit Assessment, upgraded to baa1 from baa2

...Baseline Credit Assessment, upgraded to baa1 from baa2

...Long-term Bank Deposits, upgraded to A2 Positive from A3 Positive

...Short-term Bank Deposits, upgraded to P-1 from P-2

...Senior Unsecured Regular Bond/Debenture, upgraded to A2 Positive from A3 Positive

...Senior Unsecured Medium-Term Note Program, upgraded to (P)A2 from (P)A3

...Senior Subordinated Regular Bond/Debenture, upgraded to Baa2 from Baa3
...Subordinate Regular Bond/Debenture, upgraded to Baa2 from Baa3
...Subordinate Medium-Term Note Program, upgraded to (P)Baa2 from (P)Baa3
...Junior Subordinated Regular Bond/Debenture, upgraded to Baa3(hyb) from Ba1(hyb)
...Preferred Stock Non-cumulative, upgraded to Ba1(hyb) from Ba2(hyb)
...Preferred Stock Non-cumulative Medium-Term Note Program, upgraded to (P)Ba1 from (P)Ba2
...Commercial Paper, upgraded to P-1 from P-2
...Other Short Term, upgraded to (P)P-1 from (P)P-2
...Long-term Counterparty Risk Assessment, upgraded to A1(cr) from A2(cr)

..Affirmations:

...Short-term Counterparty Risk Assessment, affirmed P-1(cr)

..Outlook Action:

...Outlook remains Positive

Issuer: Erste Bank, New York

..Upgrades:

...Long-term Counterparty Risk Assessment, upgraded to A1(cr) from A2(cr)

...Long-term Bank Deposit, upgraded to A2 Positive from A3 Positive

..Affirmation:

...Short-term Counterparty Risk Assessment, affirmed P-1(cr)

..Outlook Action:

...Outlook remains Positive

Issuer: Erste Finance (Delaware) LLC

..Upgrade:

...Backed Commercial Paper, upgraded to P-1 from P-2

..No Outlook assigned

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in April 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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Michael Rohr
VP - Senior Credit Officer
Financial Institutions Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Carola Schuler
MD - Banking
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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