

**Rating Action: Moody's downgrades Erste Group Bank's mortgage covered bonds to Aa1, reviews mortgage and public-sector covered bonds for downgrade**

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London, 08 September 2014 -- Moody's Investors Service has downgraded to Aa1 from Aaa the ratings on the mortgage covered bonds issued by Erste Group Bank AG (deposits Baa2 negative, bank financial strength rating D+/adjusted baseline credit assessment ba1), which the Austrian Mortgage Bank Act (Hypothekbankengesetz) governs. In addition, Moody's has placed on review for downgrade the ratings on Erste Bank Group's mortgage covered bonds and public-sector covered bonds because the current rating levels can only be maintained if the issuer decides to provide contractually committed over-collateralisation (OC) above the statutory minimum level. Today's rating action follows the downgrade of the issuer ratings to Baa2 from Baa1 on 5 September 2014.

**RATINGS RATIONALE**

The downgrade of Erste Group Bank's mortgage covered bond ratings, as well as the review for downgrade of the mortgage covered bond ratings and the public-sector covered bond ratings, follow the downgrade of Erste Group Bank's long-term debt rating to Baa2 from Baa1 on 5 September 2014.

As a result of this downgrade, the timely payment indicator (TPI) framework now caps the ratings on the mortgage covered bonds at Aa1. In addition, the issuer will need to provide committed OC of 13% in order to maintain the Aa1 ratings on the mortgage covered bonds and a committed OC of 21% in order to maintain the Aaa ratings on the public-sector covered bonds. For the mortgage covered bonds, the total level of OC consistent with the current rating is 19% (all OC levels provided are in present-value terms). The highest ratings achievable without contractual OC commitment are Aa2 for the public-sector covered bonds and Aa3 for the mortgage covered bonds.

Moody's has assigned a TPI of "Probable" to the mortgage covered bond programme and a TPI of "High" to the public-sector covered bond programme.

**KEY RATING ASSUMPTIONS/FACTORS**

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

**EXPECTED LOSS:** Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The CB anchor for both programmes is the senior unsecured rating plus one notch given that the debt ratio is between 5% and 10%, and the uplift of the issuer's senior unsecured rating over the adjusted BCA is two notches.

Moody's currently models cover pool losses for Erste Group Bank's mortgage covered bonds at 25.3% following a CB anchor event. Moody's splits cover pool losses between market risk of 18.6% and collateral risk of 6.7%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which is currently 10.1% for this programme.

Moody's currently models cover pool losses for Erste Group Bank's public-sector covered bonds at 15.8% following a CB anchor event. Moody's splits cover pool losses between market risk of 13.1% and collateral risk of 2.7%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which is currently 4.9% for this programme.

The OC in the mortgage cover pool is 31.8%, of which Erste Group Bank AG provides 0% on a "committed" basis.

The minimum OC level consistent with the Aa1 rating target is 19%, of which the issuer should provide 13% in a "committed" form.

The OC in the public-sector cover pool is 24.6%, of which Erste Group Bank AG provides 0% on a "committed" basis. The minimum OC level consistent with the Aaa rating target is 21%, of which the issuer should provide 21% in a "committed" form. All OC level numbers are indicated in present-value terms.

All numbers in this section are based on the most recent Performance Overview/Moody's most recent modelling, which used data as of 31 March 2014.

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's, please refer to "Moody's Global Covered Bonds Monitoring Overview", published quarterly.

**TPI FRAMEWORK:** Moody's assigns a TPI, which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

#### FACTORS THAT WOULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before downgrading the covered bonds because of TPI framework constraints.

Based on the current TPI of "Probable", the TPI Leeway for the mortgage programme is 0 notches, implying that Moody's might downgrade the mortgage covered bonds because of a TPI cap, if it lowers the CB anchor by one notch, all other variables being equal.

Based on the current TPI of "High", the TPI Leeway for the public sector programme is 0 notches, implying that Moody's might downgrade the public-sector covered bonds because of a TPI cap, if it lowers the CB anchor by one notch, all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain limited circumstances, such as (1) a sovereign downgrade negatively affecting both the issuer's senior unsecured rating and the TPI, (2) a multiple-notch downgrade of the issuer, or (3) a material reduction of the value of the cover pool.

#### RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds", published in March 2014. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

#### REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

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