

**Rating Action: Moody's confirms Aa1 ratings assigned to Erste's mortgage covered bonds and downgrades Erste's public sector covered bonds**

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London, 24 October 2014 -- Moody's Investors Service has today confirmed the Aa1 ratings assigned to the mortgage covered bonds issued by Erste Group Bank AG (Erste; deposits Baa2 negative, standalone bank financial strength rating D+, adjusted baseline credit assessment ba1). At the same time Moody's has downgraded to Aa1 from Aaa the ratings of Erste's public sector covered bonds.

This rating action concludes the review of the bonds, which Moody's initiated on 8 September 2014.

**RATINGS RATIONALE**

Moody's rating actions follow Erste's decision to enter into agreements to maintain 13.0% over-collateralisation (OC) for its mortgage covered bonds and 3.0% OC for its public-sector covered bonds in a form that Moody's considers "committed". Erste has signed this agreement on 22 October 2014. The OC commitment comes in the form of a contract for the benefit of a third party, the bondholders. Erste's commitment to maintain OC in committed form will apply to the existing covered bonds and all newly issued covered bonds under both covered bond programmes.

Under Moody's rating approach, only limited value is given to collateral that is not considered "committed". Moody's considers OC to be "committed" if the issuer's discretion to remove this is sufficiently restricted.

**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 this programme is SUR plus one notch given the debt ratio is between 5 and 10% and the uplift of the issuer's deposit rating over the adjusted BCA is 2 notches.

The cover pool losses for each programme are an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risks and collateral risks. Market risks measure losses stemming from refinancing risks and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risks measure losses resulting directly from cover pool assets' credit quality. Moody's derives the collateral risk from the collateral score.

**--- MORTGAGE COVERED BONDS**

The cover pool losses are 22.9%, with market risk of 16.3% and collateral risk of 6.6%. The collateral score is 9.8%. The present value OC in this cover pool is 25.5%, of which Erste provides 13.0% on a "committed" basis. The minimum OC level that is consistent with the Aa1 rating target is 17.0% in present value terms, of which Erste should provide 13.0% in a "committed" form. These numbers show that Moody's is relying to some degree on "uncommitted" OC in its expected loss analysis for the Aa1 rating of the mortgage covered bonds.

**--- PUBLIC-SECTOR COVERED BONDS**

The cover pool losses are 16.4%, with market risk of 13.8% and collateral risk of 2.6%. The collateral score is 5.3%. The present value OC in this cover pool is 35.3%, of which Erste provides 3.0% on a "committed" basis. The minimum OC level that is consistent with the Aa1 rating target is 11.5% in present value terms, of which Erste should provide 3.0% in a "committed" form. These numbers show that Moody's is relying to some degree on "uncommitted" OC in its expected loss analysis for the Aa1 rating of the mortgage covered bonds.

All numbers in this section derive from Moody's most recent modelling, based on data as per 30 June 2014. For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across all covered bond programmes rated by Moody's please refer to "Moody's EMEA Covered Bonds Monitoring Overview", published quarterly.

**TPI FRAMEWORK:** Moody's assigns a "timely payment indicator" (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.

The Timely Payment Indicator (TPI) remains "Probable" for Erste's mortgage covered bonds and "High" for the public-sector covered bonds.

Factors that would lead to an upgrade or downgrade of the ratings:

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 the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "Probable" for Erste's mortgage covered bonds, there is no TPI Leeway for the mortgage programme. This implies that Moody's might downgrade the covered bonds because of a TPI cap, if it lowers the CB anchor by 1 notch, all other variables being equal.

Based on the current TPI of "High" for Erste's public sector covered bonds, the TPI Leeway for this programme is 1 notch. This implies that Moody's might downgrade the covered bonds because of a TPI cap, if it lowers the CB anchor by 2 notches 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 CB anchor and the TPI; (2) a multiple-notch lowering of the CB anchor; 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.moody.com](http://www.moody.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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Alexander Zeidler  
Vice President - Senior Analyst  
Structured Finance Group  
Moody's Investors Service Ltd.  
One Canada Square  
Canary Wharf  
London E14 5FA  
United Kingdom  
JOURNALISTS: 44 20 7772 5456  
SUBSCRIBERS: 44 20 7772 5454

Juan Pablo Soriano  
MD - Structured Finance  
Structured Finance Group  
JOURNALISTS: 44 20 7772 5456  
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:  
Moody's Investors Service Ltd.  
One Canada Square  
Canary Wharf  
London E14 5FA  
United Kingdom  
JOURNALISTS: 44 20 7772 5456  
SUBSCRIBERS: 44 20 7772 5454

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