

Rating Action: Moody's upgrades Erste Group Bank AG's senior ratings to A3, changes outlook to positive

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Baseline Credit Assessment upgraded to baa2, reflecting faster-than-anticipated improvement in the bank's financial fundamentals

Frankfurt am Main, July 26, 2017 -- Moody's Investors Service (Moody's) today upgraded Erste Group Bank AG's (Erste) long-term senior unsecured debt and deposit ratings to A3 from Baa1, and changed the outlook to positive from stable. At the same time, the rating agency upgraded Erste's Baseline Credit Assessment (BCA) and Adjusted BCA to baa2 from baa3, and its long- and short-term Counterparty Risk Assessment (CR Assessment) to A2(cr)/P-1(cr) from A3(cr)/P-2(cr). Further, Moody's upgraded the bank's subordinated debt ratings to Baa3 from Ba1, and its junior subordinated debt rating to Ba1(hyb) from Ba2(hyb). The bank's short-term ratings were affirmed at P-2.

Concurrently, the rating agency upgraded Erste's additional Tier 1 (AT1) note program to (P)Ba2 from (P)Ba3 as well as the bank's low-trigger AT1 notes issued under this program (ISIN XS1425367494 and ISIN XS1597324950) to Ba2(hyb) from Ba3(hyb), three notches below the bank's baa2 Adjusted BCA.

The rating upgrades were supported by the continued strengthening of Erste's financial fundamentals while the positive outlook reflects Moody's expectation that Erste will be able to further improve its asset risk as well as capital metrics. At the same time, the rating agency believes that raising the proportion of loss-absorbing subordinated debt instruments may help reduce the severity of loss for the bank's senior unsecured debt and deposits over time, thereby offering the potential for one additional notch of rating uplift as a result of the rating agency's Advanced Loss Given Failure (LGF) analysis.

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 followed the continued strengthening of Erste's key credit metrics and reflects: (1) the bank's further and sustained de-risking of its balance sheet, leading to meaningfully lower risk costs supporting its earnings-generation capacity; and (2) the fostering of the bank's capital adequacy ratios resulting from its fully restored earnings-generation power. The upgrade also reflects Erste's favorable funding profile largely consisting of highly granular retail deposits and the resulting very low market funding needs over the next few years.

The upgrade of the bank's BCA was further supported by the improvement of the bank's Macro Profile to 'Strong' from 'Strong-', reflecting gradual shifts in Erste's geographical diversification benefiting from proportionally higher exposures towards the stronger and more stable countries in its Central and Eastern European (CEE) franchise as well as its home market Austria.

Over the past twelve months, the bank reduced its problem loan ratio to 4.9% as of 31 March 2017 from 6.7% as of end-March 2016 and maintained sufficient coverage ratios. This improvement in the bank's credit risk profile was supported by pro-active portfolio sales and an underlying improvement in asset quality in Erste's CEE markets, particularly in Romania and Hungary. Moody's expects the group's problem loan ratio to decline at a more gradual rate going forward, and only if the bank maintains tight control of its geographical concentrations as well as lending criteria amid favorable business conditions, thereby avoiding undue new problem loan formation.

The bank further strengthened its fully loaded common equity Tier 1 (CET1) ratio to 12.8% (including retained earnings) as of 31 March 2017 (March 2016: 12.3%). Moody's believes the bank's higher earnings generation power and thus capital generation capacity will allow for a sustained build-up of Erste's fully loaded CET1 capital ratio to above 13% over the next 12-18 months, despite pressure on the bank's earnings from high competition, margin pressure in a persistently low interest-rate environment and regulatory costs.

In Moody's view, the sustained higher capital and profitability levels will help comfortably cover intrinsic risks and concentrations of the bank's operating model, which is geared towards more volatile CEE markets, as well as upcoming regulatory requirements, specifically with regard to the 2019 capital requirements under the European Banking Authority's Supervisory Review and Evaluation Process (SREP), including a fully loaded 2.0% buffer as a local systemically important bank (D-SIB; so-called O-SII buffer) in Austria.

UPGRADE OF THE BANK'S LONG-TERM SENIOR RATINGS

The upgrade of Erste's long-term senior ratings by one notch to A3 follows the one-notch upgrade of the bank's BCA. The long-term ratings therefore reflect: (1) the bank's baa2 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 Moody's expectation that Erste will be able to maintain its high earnings generation capacity over the next 12-18 months. This, coupled with further gradual improvements in the bank's asset risk metrics, will likely result in a further build-up of the bank's capital base over time, supporting the bank's financial profile. This assessment takes account of continued pressures from the persistent low interest-rate environment on the bank's earnings as well as a potential unexpected weakening of the operating environment in its core operating markets, including Austria.

Moreover, a sustained increase in the volume and level of subordinated debt relative to the bank's tangible asset base may lead to a higher rating uplift for the bank's senior unsecured debt and deposit ratings as a result of Moody's Advanced LGF analysis which currently provided two notches of rating uplift.

UPGRADE OF THE BANK'S HYBRID CAPITAL INSTRUMENTS

The rating agency upgraded the supplementary capital and hybrid debt instrument ratings issued by Erste 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 upgraded the rating by one notch to Ba1(hyb) from Ba2(hyb), two notches below the bank's baa2 Adjusted BCA. The ratings reflect the junior subordinated claim in liquidation and cumulative deferral features tied to the breach of a net loss trigger.

(2) The ratings of Erste's low trigger undated deeply subordinated Additional Tier 1 (AT1) instruments (ISIN XS1425367494 and ISIN XS1597324950) were upgraded to Ba2(hyb), from Ba3(hyb), three notches below the bank's baa2 Adjusted BCA. The ratings reflect the rating agency's assessment of the instruments' 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; 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 precautionary measure.

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 baa2 stand-alone BCA would be prompted by a combination of two or more 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 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 meaningful buffer over and above the bank's SREP ratio requirements; or (3) a continuation of the bank's solid operating performance and capital-generation capacity around levels

achieved in 2016.

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 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 baa2 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 baa2 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 or if resulting from a loosening of credit standards amid bright operating conditions; (2) a sustained weakening in the bank's earnings- and, thus, capital-generation capacity; or (3) an unexpected weakening of the bank's meanwhile solid capitalisation levels.

LIST OF AFFECTED RATINGS

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

- Long-term senior unsecured debt and deposit ratings to A3 positive, from Baa1 stable;
- Senior Unsecured MTN program to (P)A3, from (P)Baa1
- Subordinated and senior subordinated debt ratings to Baa3, from Ba1;
- Subordinated MTN program to (P)Baa3, from (P)Ba1;
- Baseline Credit Assessment (BCA) to baa2, from baa3;
- Adjusted Baseline Credit Assessment to baa2, from baa3;
- Long-term Counterparty Risk Assessment to A2(cr), from A3(cr);
- Short-term Counterparty Risk Assessment to P-1(cr), from P-2(cr).
- Cumulative junior subordinate debt rating (ISIN: XS0303559115) to Ba1(hyb), from Ba2(hyb);
- Non-cumulative preferred securities program rating (low-trigger AT1) to (P)Ba2, from (P)Ba3;
- Non-cumulative preferred securities ratings (ISIN XS1425367494 and ISIN XS1597324950) to Ba2(hyb), from Ba3(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

Outlook Action:

- Outlook changed to Positive from Stable

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

- Long-term deposit rating to A3 positive, from Baa1 stable;
- Long-term Counterparty Risk Assessment to A2(cr), from A3(cr);
- Short-term Counterparty Risk Assessment to P-1(cr), from P-2(cr).

Outlook Action:

- Outlook changed to Positive from Stable

The following rating of Erste Finance (Delaware) LLC was affirmed:

- Backed Commercial Paper at P-2

No Outlook assigned

PRINCIPAL METHODOLOGY

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

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