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Research Update:

Ratings On Austria-Based Bank Erste Affirmed At 'A/A-1' Following Government Support Review; Outlook Remains Negative

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Overview

- We consider that potential extraordinary government support for European banks will likely decrease as resolution frameworks are put into place.
- We are affirming our 'A/A-1' counterparty credit ratings on Erste Group Bank AG (Erste) and its core subsidiary Ceska Sporitelna A.S. We are also affirming our unsolicited public information (pi) rating on Erste's core subsidiary Slovenska Sporitelna A.S.
- The negative outlook reflects the possible removal of government support by year-end 2015. It also reflects our view that current economic conditions could hinder Erste's buildup of capital, and could increase industry risk as Austrian banks strive to generate earnings.

Rating Action

As previously announced on April 29, 2014, Standard & Poor's Ratings Services has affirmed its 'A/A-1' counterparty credit ratings on Austria-based Erste Group Bank AG (Erste) and its core subsidiary Czech Republic-based Ceska Sporitelna A.S. (Ceska). The outlook on Erste and Ceska is negative.

At the same time, we affirmed our 'Api' unsolicited public information (pi) rating on Erste's core subsidiary Slovakia-based Slovenska Sporitelna A.S. (SLSP). We do not ascribe '+' or '-' modifiers or assign outlooks to public information ratings.

Rationale

The affirmation follows the completion of our review of potential extraordinary government support for European banks (see "Standard & Poor's To Review Government Support In European Bank Ratings," published on March 4, 2014, on RatingsDirect). We observe that European authorities are taking steps to increase the resolvability of banks and require creditors rather than taxpayers to bear the burden of the costs of failure (see "Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review," published on April 29, 2014). In the near term, we expect that governments will remain supportive of systemically important banks' senior unsecured creditors while resolution frameworks take shape. From January 2016, however, the EU Bank Recovery and Resolution Directive (BRRD) is set to introduce the mandatory bail-in of a minimum amount of eligible liabilities,

potentially including certain senior unsecured obligations, before governments could provide solvency support. Accordingly, we believe that the potential extraordinary government support available to Erste's senior unsecured bondholders will likely diminish within our two-year rating horizon.

Currently, we consider that Erste has "high" systemic importance to Austria, which we view as "supportive" of private-sector commercial banks. As a result, and in line with our criteria, the 'A' long-term counterparty credit rating on Erste stands two notches above the 'bbb+' stand-alone credit profile (SACP). We could reduce or remove these notches shortly before the January 2016 introduction of the BRRD's bail-in powers for senior unsecured liabilities. These rules would indicate to us that EU governments would be much less able to support senior unsecured bank creditors, even though it may take several more years to eliminate concerns about financial stability and the resolvability of systemically important banks.

Specifically, if we perceive that support for senior unsecured creditors is less predictable under the new legislative framework, we would likely remove the government support notches from our ratings on Erste. This would most likely arise from a reclassification of Austria's support for private-sector commercial banks to "uncertain" under our criteria. Any decision to reclassify governments would be subject to our review of the final resolution legislation and technical standards, and other relevant information.

If, on the other hand, our view was that extraordinary government support may still be forthcoming to Erste's senior unsecured creditors, we could retain one or both notches of support in the ratings. This would be the case if authorities publicly confirmed their supportive stance toward senior unsecured creditors, or if we believed that precautionary capital injections would still be likely under the new legislation to minimize the wider economic impact of the resolution of a systemically important bank. In this case, we may consider that Austria remained "supportive" and that Erste had "high" or "moderate" systemic importance. We could revise our view of Erste's systemic importance to "moderate" from "high" if we considered that its resolution under the new framework would have a material, but manageable, adverse impact on the country's financial system and economy.

In addition to our view of the SACP and potential extraordinary government support, future rating actions on Erste may also result from other relevant factors. These may include measures to mitigate bail-in risks to senior unsecured creditors, such as building a large buffer of subordinated instruments (see "Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks," published on April 29, 2014).

We view SLSP and Ceska as "core" subsidiaries of Erste under our criteria, and therefore equalize our counterparty credit ratings on Ceska and unsolicited public information rating on SLSP with the ratings on Erste.

The potential reduction of extraordinary government support in the counterparty credit and senior unsecured issue ratings on Erste has no impact

on the subordinated issue ratings. We have long believed that subordinated creditors would not receive extraordinary government support in a stress scenario, and for that reason we already notch these instruments down from the SACP.

Outlook

The negative outlook indicates that we may lower the ratings on Erste by year-end 2015 if we believe there is a greater likelihood that senior unsecured liabilities may incur losses if the bank fails. Specifically, we may lower the long-term counterparty credit rating by up to two notches if we consider that extraordinary government support is less predictable under the new EU legislative framework.

The negative outlook also reflects our assessment that Erste remains vulnerable to the current economic environment, which puts pressure on Erste's financial performance and impedes the bank's ability to build up capital. We could consider lowering the ratings if we see significant increase in Erste's nonperforming loans or cost of risk.

In addition, we consider that industry risk in the Austrian banking system may increase as banks strive to generate earnings in the difficult operating environment amid continuously low domestic lending margins.

We could revise the outlook back to stable if we consider that potential extraordinary government support for Erste's senior unsecured creditors is unchanged in practice, despite the introduction of bail-in powers and international efforts to increase banks' resolvability; or if we believe that other rating factors, such as a stronger SACP or a large buffer of subordinated instruments, fully offset increased bail-in risks.

We could also revise the outlook to stable if we saw tangible signs that Erste's asset quality metrics are stabilizing, and economic pressure is lifting in the eurozone and Erste's markets in Central and Eastern Europe, mainly Romania and Hungary. We would also need to see evidence that Austrian banks are not relaxing their lending standards in the domestic market.

The negative outlook on Ceska mirrors that on its parent and reflects our view of its core status within the Erste group, as defined by our criteria.

The unsolicited public information rating on SLSP does not carry an outlook, as we do not assign outlooks to public information ratings.

Ratings Score Snapshot

Issuer Credit Rating	A/Negative/A-1
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SACP	bbb+
Anchor	bbb+
Business Position	Strong (+1)
Capital and Earnings	Moderate (-1)
Risk Position	Adequate (0)
Funding and Liquidity	Above Average and Adequate (0)
Support	+2
GRE Support	0
Group Support	0
Sovereign Support	+2
Additional Factors	0

Related Criteria And Research

Related Criteria

- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Standard & Poor's Takes Various Rating Actions On European Banks Following Government Support Review, April 29, 2014
- Credit FAQ: The Rating Impact Of Resolution Regimes For European Banks, April 29, 2014
- Austria Ratings Affirmed At 'AA+/A-1+' On Continuing Fiscal Consolidation And Resilient Economy; Outlook Stable, March 28, 2014
- Standard & Poor's To Review Government Support In European Bank Ratings, March 4, 2014
- Banking Industry Country Risk Assessment: Austria, Sept. 12, 2013
- Erste Group Bank AG, June 24, 2013
- Slovenska Sporitelna A.S., Dec. 16, 2013
- Ceska Sporitelna A.S., Dec. 18, 2013

Ratings List

Ratings Affirmed

Erste Group Bank AG

Ceska Sporitelna A.S.

Counterparty Credit Rating

A/Negative/A-1

Slovenska Sporitelna A.S.

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Counterparty Credit Rating	Api
Erste Finance (Delaware) LLC	
Commercial Paper (1)	A-1
Erste Group Bank AG	
Senior Unsecured (2)	AA+
Senior Unsecured	A
Subordinated	BBB
Commercial Paper	A-1

(1) Guaranteed by Erste Group Bank AG.

(2) Guaranteed by the Republic of Austria.

pi--Public information.

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