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Research Update:

Erste Group Bank 'A/A-1' Ratings Placed On CreditWatch Negative On Risks Of Diminishing State Support

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Overview

- The Austrian government has recently proposed legislation to bail in holders of Hypo Group Alpe Adria's subordinated debt, despite a grandfathered guarantee provided by the State of Carinthia.
- This extraordinary development could lead to our reassessment of the likelihood of state support for the banking sector.
- Therefore, we are placing our 'A/A-1' ratings on Austria's Erste Group Bank AG (Erste) on CreditWatch negative.
- The CreditWatch mainly reflects that we could lower the ratings on Erste if we believed that there is diminishing potential for potential extraordinary government support for systemically important banks in Austria.

Rating Action

On June 10, 2014, Standard & Poor's Ratings Services placed its 'A/A-1' long-term and short-term counterparty credit ratings on Austria-based Erste Group Bank AG (Erste) and its core subsidiary Czech Republic-based Ceska Sporitelna A.S. (Ceska) on CreditWatch with negative implications.

Rationale

The CreditWatch placement follows the Austrian government's decision to introduce special legislation to bail in Hypo Group Alpe Adria's (HGAA's) subordinated debt holders, despite a grandfathered guarantee provided by the State of Carinthia. We understand that this legislation will form a part of the upcoming law concerning the transformation of HGAA from a bank to a wind-down unit.

In our view, if losses are ultimately imposed on HGAA's grandfathered bond holders despite a grandfathered guarantee from the State of Carinthia, or if the developments surrounding HGAA trigger a general change in the Austrian government's attitude toward supporting banks, the result may be a weakening of state support for systemically important banks and government-related entities in the country (see "Decision Pending Over Hypo Alpe Adria's Future Has No Immediate Rating Impact On Austrian Banks Or GREs," published on March 7, 2014, on RatingsDirect). Increased uncertainty about the potential state support could prompt us to review our assessment of Austria's supportiveness

for the banking system or the systemic importance of individual banks. This could lead us to reduce or remove the notches of government support currently incorporated in the ratings and consequently lower by up to two notches the ratings on banks that we consider highly systemically important, including Erste.

We view Ceska as a "core" subsidiary of Erste under our criteria, and therefore equalize our counterparty credit ratings on Ceska with the ratings on Erste.

CreditWatch

The CreditWatch mainly reflects our opinion that the introduction of the legislation and the political considerations around the restructuring of HGAA may decrease the likelihood of extraordinary state support for Erste.

We would likely downgrade the bank if the law is enacted as currently under discussion. We expect to resolve the CreditWatch over the next three months or once there is clarity on the timing and details of the upcoming law.

A downgrade could also be triggered by our reassessment of the economic or industry risks for banks operating in Austria, leading to a weaker starting point for our ratings on Austrian banks.

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

We could expect to resolve the CreditWatch if the government decided not to impose losses on grandfathered bond holders of HGAA. In this case, our assessment of the likelihood of state support for the bank will remain unchanged, and we would affirm the ratings and assign a negative outlook to reflect medium-term risks of diminishing extraordinary government support under the new EU Bank Recovery and Resolution Directive as well as our view of banking industry risks in Austria and Erste's sensitivity to risk costs from its operations in Central and Eastern Europe.

Ratings Score Snapshot

Issuer Credit Rating	A/Watch Neg/A-1
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

- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec 6., 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Seven Austrian Banks Placed On CreditWatch Negative On Planned Bail-In Of State-Guaranteed Debt Of Hypo Group Alpe Adria, June 10, 2014
- Ratings On Seven Austrian Banks Affirmed, With Various Outlooks, On Stabilizing Economic Risks, June 3, 2014
- Banking Industry Country Risk Assessment: Austria, June 3, 2014
- Banking Industry Country Risk Assessment Update: May 2014, May 13, 2014
- 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 (Republic of), April 25, 2014
- Austria Ratings Affirmed At 'AA+/A-1+' On Continuing Fiscal Consolidation And Resilient Economy; Outlook Stable, March 28, 2014
- Decision Pending Over Hypo Alpe Adria's Future Has No Immediate Rating Impact On Austrian Banks Or GREs, March 7, 2014

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Erste Group Bank AG		
Ceska Sporitelna A.S.		
Counterparty Credit Rating	A/Watch Neg/A-1	A/Negative/A-1
Erste Group Bank AG		
Senior Unsecured	A/Watch Neg	A
Subordinated	BBB/Watch Neg	BBB
Commercial Paper	A-1/Watch Neg	A-1

Erste Finance (Delaware) LLC

Commercial Paper*

A-1/Watch Neg

A-1

*Guaranteed by Erste Group Bank AG.

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