S&P Global Ratings

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Erste Group Bank AG

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Erste Group Bank AG

SACP	a

Anchor	bbb+	
Business Position	Strong	+1
Capital and Earnings	Adequate	0
Risk Position	Adequate	0
Funding	Above Average	+1
Liquidity	Strong	

+

Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating
A/Positive/A-1

Resolution Counterparty Rating
A+/--/A-1

Major Rating Factors

Strengths:	Weaknesses:
• Strong franchise in Austria and Central and Eastern European (CEE) countries. • Stable operating revenues from traditional customer-led retail and commercial banking operations. • Strong liquidity and funding profile dominated by granular retail deposits.	• Sensitivity to economic and political developments in the CEE region. • Moderate reliance on wholesale funding could reduce needs to build up higher additional loss-absorbing capital (ALAC) buffers.

Outlook: Positive

The positive outlook on Austria-based Erste Group Bank AG (Erste) reflects S&P Global Ratings' view that, over the next two years, the group will continue to strengthen its risk-adjusted capitalization, partly supported by the issuance of further hybrid capital instruments. We expect that the operating environment in Erste's biggest core markets will remain stable, facilitating the generation of sound earnings in its traditional customer-led retail and corporate customer business.

Upside scenario

We could raise our issuer credit ratings (ICR) by one notch if Erste were to continue strengthening its risk-adjusted capital (RAC) ratio or if there was greater insight into the pace and size of its build-up of bail-in-able capital buffers. Such improvement could lead to a better capital assessment, if the RAC ratio were to increase and remain higher than 10% or to an uplift based on ALAC if the buffer strengthened sufficiently. An upgrade of the ICR would, however, hinge on our view of the group's creditworthiness as being clearly and sustainably consistent with that of similarly rated peers at that higher rating level, in particular regarding profitability, diversification, and asset quality. However, an uplift based solely on higher ALAC buffers could improve the banks' ICR but not their stand-alone creditworthiness, and we would therefore not apply a corresponding potential ratings uplift to the banks' regulatory capital instruments.

Downside scenario

We could revise the outlook to stable if, for example, we observe aggressive growth in higher-risk countries that suggests limited scope for improvement of Erste's creditworthiness, or if we see a lower likelihood of a substantial rise in the RAC or ALAC metrics.

Rationale

We base the ratings on our analysis of the consolidated Erste Group Bank AG together with its subsidiaries and participations including Erste Bank Oesterreich, Salzburger Sparkasse, Tiroler Sparkasse, s-Bausparkasse, other savings banks of the Haftungsverbund in Austria, and core subsidiaries in CEE countries.

Our 'a' group credit profile (GCP) on Erste is based on its 'bbb+' anchor, the starting point for our ratings on Erste. The anchor reflects our view of weighted economic risks in the countries where Erste operates and our industry risk assessment for Austria, as well as our understanding that growth of Erste's retail and corporate lending will mainly be in lower-risk countries such as Austria, Czech Republic, and Slovakia.

The ratings also take into account Erste's strong business position, reflecting our expectation that it will maintain a leading market position with sustainable franchises in retail, small and midsize enterprises (SMEs), and corporate banking in Austria and several core countries in CEE markets. We factor in Erste's adequate capital and earnings positions, based on our expectation of a RAC ratio in the range of 9.5%-10.0% in the next 12-24 months. This is driven by sound earnings generation and retention into capital from stable economic environments in Erste's main countries of operation, and we consider that Erste's retail and SME focus supports its quality of earnings, making revenues predictable and relatively resilient to economic swings. We expect Erste to maintain its adequate risk position, on the back of sound asset quality metrics in its diversified loan portfolio, supported by growth in mainly lower-risk countries, materially improved asset quality from reductions in nonperforming loans (NPLs), and relatively low single-name and sector concentrations in the loan book. We consider Erste's funding to be above average and its liquidity strong, which reflects our view of the stability of Erste's large retail funding base, especially in its largest markets in Austria, the Czech Republic, and Slovakia, and its moderate reliance on wholesale funding. We believe that the strong consolidated funding and liquidity ratios we observe at Erste group level are now also evident at the main operating subsidiaries. Our assessment of Erste's liquidity as strong primarily reflects the bank's prudent liquidity management and high liquidity reserves.

Our assessment of Erste's ALAC does not currently lead us to add any uplift to the ratings. We include all of the consolidated group's junior instruments in our ALAC assessment because, over our projection period, we believe they have capacity to absorb losses without triggering a default on Erste's senior obligations.

We view the Erste group as having high systemic importance in Austria, but we assess Austria's tendency to support private sector commercial banks as uncertain. As a result, for a systemic bank like Erste we do not include any uplift for extraordinary government support in the long-term rating.

We set the RCRs on Erste Group bank AG at 'A+', one notch above the 'A' long-term issuer credit rating, reflecting the typical approach under our framework when the issuer credit rating ranges from 'BBB-' to 'A+'. It also reflects our jurisdiction assessment on Austria.

Anchor: 'bbb+', reflecting blended economic risks in Austria and CEE countries and industry risk in Austria

We use our Banking Industry Country Risk Assessment to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our economic risk score for Austria is '2' on a scale of '1' to '10' ('1' is the lowest risk and '10' the highest). However, the weighted average of economic risks of countries in which Erste operates, based on the geographic distribution of its exposures at default, is close to '3'. We believe that Erste will retain its higher risk profile compared with purely domestic banks, because of its strong presence in CEE. We anticipate no material shift in the geographic split of the bank's exposures in the next two years. However, changes in our assessment of the economic risk in Erste's operating countries might affect weighted economic risk.

Reflecting the average weighted economic risk score of '3' and industry risk score of '3' for the Austrian banking system, we derive a 'bbb+' anchor for Erste.

Our economic risk assessment is based on Austria's highly competitive and diverse economy, with strong economic fundamentals, high integration in Western European economies, and strong ties to Eastern and Southeastern Europe. Economic growth is aiding the banking sector's performance. We believe that the Austrian economy will remain in an expansionary phase, but don't expect an accumulation of imbalances due to further increases in real estate prices. Credit risk in the economy is likely to remain low, reflecting a healthy private sector, low lending growth, and prudent lending standards, which we expect will persist.

With regard to industry risk, Austrian banks face similar challenges as their global peers regarding business model optimization, ensuring sufficient and sustainable profitability, leveraging the benefits of the digital era, and introducing measures to avoid disruption and franchise damage from cyber-attacks and customer data mismanagement. We believe that most Austrian banks still have much work to do to improve profitability, as we continue to see moderate overcapacity in their domestic operations and low prices in core banking products, resulting in lower domestic margins than those of many peers in other countries. In our view, enhanced focus on efficiency and profitability and recent de-risking contribute to stability of the system over the cycle.

Table 1

Erste Group Bank AG Key Figures					
		--Year-ended Dec. 31--			
(Mil. €)	**2018***	**2017**	**2016**	**2015**	**2014**
Adjusted assets	233,344.7	219,135.9	206,836.8	198,278.8	194,846.4
Customer loans (gross)	150,627.4	143,509.3	135,267.5	131,905.7	128,325.0
Adjusted common equity	15,418.1	14,378.9	13,270.0	12,143.3	11,163.4
Operating revenues	4,963.6	6,511.9	6,505.4	6,500.9	5,900.6
Noninterest expenses	2,966.9	3,990.4	3,862.1	3,705.7	3,787.3
Core earnings	1,726.0	1,951.1	1,976.8	1,643.6	(555.3)

*Data as of Sept. 30.

Business position: Strong and stable retail and corporate franchise in Austria and CEE

We expect Erste to maintain a strong business position, reflecting our expectation that it will maintain a leading market position with sustainable franchises in retail, SMEs, and corporate banking in Austria and several core countries in CEE markets. Thanks to its widespread operations, Erste benefits from good geographic diversification of revenues, although we acknowledge certain correlations among CEE countries and between CEE and Austria and the banks' higher reliance on net interest income sources than similarly rated peers.

Erste, with total assets of €235 billion as of Sept. 30, 2018, is one of the top-three banks in Austria, with about 20% share in domestic retail loans and in retail deposits as of at end-September 2018. Equally important for our assessment is Erste's strong position across several CEE countries, including Czech Republic, Slovakia, and Romania, where it is the local market leader. Erste's management team is stable and has in our view followed a generally consistent strategy. We expect the group strategy to remain focused on its domestic market and organic growth in a few CEE markets where Erste holds a strong footprint. Positively, we note that Erste is not present in higher-risk countries.

Erste's savings bank brand is strong in terms of image and customer loyalty, notably in Austria, but also in the Czech Republic and Slovakia. Domestic retail operations are concentrated in 47 savings banks that differ widely in terms of size. Owing to the cross-guarantee contract (Haftungsverbund), Erste also consolidates those savings banks in which it does not hold a majority stake.

Thanks to its widespread operations, Erste benefits from good geographic diversification of revenues, although we acknowledge certain correlations among CEE countries and between CEE and Austria. We also take into consideration Erste's exposure to some economically riskier countries in CEE when deriving its anchor. Both margins and credit losses are typically higher in CEE than in Austria, which means that these countries tend to positively influence the group's profitability through the cycle. Although Erste's Austrian operations show lower margins, they provide stable returns and we expect this to continue.

Compared with many large Western European banks, Erste has a stronger focus on retail clients (about 50% of revenues), and typically derives most of its revenues from that segment. The bank also generates revenues from small businesses and the corporate lending segment, as well as the savings banks segment, comprising the member savings banks in the cross-guarantee system (each segment roughly 20% of revenues), which we view as steady sources. We believe this will provide the business model with revenue stability and compensate for Erste's lower business diversity than larger Western European banking groups.

Table 2

Erste Group Bank AG Business Position					
		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Loan market share in country of domicile	20.2	20.0	19.6	19.4	19.2
Deposit market share in country of domicile	19.7	19.2	18.8	18.5	18.4
Total revenues from business line (mil. €)	4,963.6	6,511.9	6,644.1	6,500.9	5,900.6
Commercial banking/total revenues from business line	22.7	22.6	22.6	22.7	24.7
Retail banking/total revenues from business line	52.0	50.7	49.5	51.2	56.2
Commercial & retail banking/total revenues from business line	74.8	73.3	72.1	73.9	81.0
Trading and sales income/total revenues from business line	7.6	8.5	7.8	6.4	7.0
Other revenues/total revenues from business line	17.6	18.2	20.1	19.7	12.0
Investment banking/total revenues from business line	7.6	8.5	7.8	6.4	7.0
Return on average common equity	12.7	10.6	11.0	9.3	(13.6)

*Data as of Sept. 30.

Capital and earnings: Adequate capitalization supported by sound earnings and hybrid issuance

We view Erste's capital and earnings as adequate based on our expectation of a RAC ratio of 9.5%-10.0% in the next 12-24 months, compared with 9.3% at end-2017, driven by sound earnings retention. The capital build-up is also being supported by hybrid issues such as additional tier 1 instruments issued in past two years and planned issuances in upcoming years, which qualify as loss-absorbing capital under our definition.

We expect the stable economic environment in Erste's main countries of operation to translate into sound revenue generation. We anticipate Erste's total lending volume and our measure of risk-weighted assets to grow moderately at about 4% in 2018-2019. At the same time, as expected, the net interest margin declined slightly in 2017 and repricing the customer portfolio will, in our view, have an effect from 2018 onward. We expect that the net fee and commission income will continue to improve moderately in 2018-2019.

Owing to the improvement in asset quality, we forecast the bottom line will benefit from stable risk costs of around 10 basis points (bps) on average customer loans in 2018-2019 compared with previous lows of 9 bps in 2017 and reversals of 9 bps until Sept. 30, 2018. We see a downward trend in regulatory costs and bank levies post reduction in banking tax rates in Austria, reaching about €106 million in 2017 from €389 million in 2016. We expect overall operating costs to remain relatively flat in 2018-2019. We estimate pre-tax profits of €2.0 billion-€2.2 billion in 2018-2019 (2017: €2.08 billion).

We consider that Erste's retail and SME focus supports its quality of earnings, making revenues predictable (at around

€6.5 billion) and relatively resilient to economic swings. The volatile portion of revenues is small on average, and nonrecurring elements have traditionally been low for Erste. The three-year average earnings buffer, reflecting the bank's ability to cover normalized losses, will stand around 0.80% in the forecast period (an earnings buffer of about 1.0% indicates adequate earnings capacity).

Almost one-third of total adjusted capital (TAC)--our main measure of loss-absorbing capital--consists of minority capital. However, in our opinion this does not weaken the quality of the capital base because of the way the cross-guarantee system in the Austrian savings bank sector is set up. The steering company, in which Erste indirectly holds 63.9%, implements the provisions of the agreement governing the cross-guarantee system. As Erste owns the controlling interest in the steering company, it has to fully consolidate all members of the cross-guarantee system according to International Financial Reporting Standards rules. At the same time, Erste indirectly controls the uniform risk management and strategy across the sector. Hybrids included in TAC are expected to remain below 10% in 2018-2019, which contributes to the overall adequate quality of capital.

Table 3

Erste Group Bank AG Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	13.3	13.8	13.3	12.0	10.6
S&P Global Ratings' RAC ratio before diversification	N/A	9.3	8.4	7.3	6.0
S&P Global Ratings' RAC ratio after diversification	N/A	9.8	9.5	7.8	6.6
Adjusted common equity/total adjusted capital	93.9	93.5	96.4	99.1	98.9
Net interest income/operating revenues	67.9	66.8	67.2	68.4	76.2
Fee income/operating revenues	28.8	28.4	27.4	28.6	31.7
Market-sensitive income/operating revenues	2.5	5.6	4.3	4.8	(5.4)
Noninterest expenses/operating revenues	59.8	61.3	59.4	57.0	64.2
Preprovision operating income/average assets	1.2	1.2	1.3	1.4	1.1
Core earnings/average managed assets	1.0	0.9	1.0	0.8	(0.3)

*Data as of Sept. 30. RAC--Risk-adjusted capital. N/A--Not applicable.

Table 4

Erste Group Bank AG Risk-Adjusted Capital Framework Data

	Exposure*	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global RWA**	**Average S&P Global RW (%)**
Credit risk					
Government and central banks	61,532,516,376	2,453,704,800	4	9,130,726,015	15
Of which regional governments and local authorities	5,304,623,592	640,697,488	12	826,762,588	16
Institutions and CCPs	10,306,413,993	3,128,854,536	30	1,545,426,268	15
Corporate	80,734,347,090	52,530,571,800	65	67,263,360,647	83
Retail	80,584,882,061	21,374,486,088	27	42,101,711,522	52
Of which mortgage	42,480,352,731	7,449,624,338	18	13,585,986,382	32
Securitization§	1,024,667,263	100,783,981	10	741,532,343	72

Table 4

Erste Group Bank AG Risk-Adjusted Capital Framework Data (cont.)					
Other assets†	9,314,604,932	4,462,311,300	48	13,041,346,521	140
Total credit risk	248,802,055,307	84,050,712,504	34	133,824,103,316	54
Credit valuation adjustment					
Total credit valuation adjustment	--	622,245,813	--	0	--
Market risk					
Equity in the banking book	1,262,577,391	2,142,308,700	170	9,172,147,514	726
Trading book market risk	--	2,913,787,500	--	4,745,243,750	--
Total market risk	--	5,056,096,200	--	13,917,391,264	--
Operational risk					
Total operational risk	--	17,912,500,000	--	16,756,008,795	--
		Basel III RWA		**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification	--	110,066,554,517	--	164,497,503,374	100
Total Diversification/Concentration Adjustments	--	--	--	(7,981,353,833)	(5)
RWA after diversification	--	110,066,554,517	--	156,516,149,541	95
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments	--	15,368,000,000.0	14.0	15,371,914,600.0	9.3
Capital ratio after adjustments‡	--	15,368,000,000.0	14.0	15,371,914,600.0	9.8

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2017, S&P Global.

Risk position: Sound asset quality metrics and risks adequately captured by RAC framework

We expect Erste to maintain its adequate risk position, thanks to sound asset quality metrics in its diversified loan portfolio, supported by growth mainly in lower-risk countries, materially improved asset quality from reductions in NPLs, and relatively low single-name and sector concentrations in the loan book. Furthermore, we believe our capital framework adequately captures Erste's risks of operating in more vulnerable countries than Austria by applying higher risk weights in calculating our RAC ratio.

Risk exposures in Erste's gross loan portfolio of €151 billion as of Sept. 30, 2018 are widely diversified between countries as well as between retail and savings banks clients (about 55% of loan portfolio) and corporate, Group market clients and ALM (45% of loan portfolio). Positively, we note that Erste continues to concentrate on lower-risk retail lending, mortgage loans, and SME and corporate lending, while placing minor emphasis on market-sensitive business. Single-name and sector concentrations in the loan book are, in our view, low. Real estate comprised about 10% of the total portfolio at end- September, but we understand that it is mainly income-producing real estate. Furthermore, we regard risks not fully covered by our capital framework, such as credit spread or interest rate risk in the banking book, as limited.

There is potential credit risk for the bank from lending in foreign currencies; this constituted 6% of the loan portfolio as of June 30, 2018. Swiss franc loans (2.5% of total portfolio) are primarily booked in Austria, while euro-denominated loans are concentrated in Croatia, Serbia, and Romania. Currency risk for customers, which could translate into credit risk for the bank, is a legacy issue, particularly in Austria and at certain subsidiaries.

Erste's asset quality has materially improved over the past two years. NPLs declined to a reported 3.5% at end-September 2018 from a peak of 9.6% in 2013. We expect this positive trend to continue, supported by the further write-offs and sales of its NPL portfolios. In our view, this has led to sustainable stability of Erste's asset quality metrics over the past two years and compares favorably with the main domestic peers Raiffeisen Bank International (and the wider Raiffeisen Banking Group) and UniCredit Bank Austria. We consider the 71% NPL coverage at end-September to be adequate and in line with peers. The positive development has translated into historically low credit losses at 9 bps in 2017 and recent reversals of 9 bps in third-quarter 2018, outperforming the peer group; but we expect them to stabilize at about 10-15 bps in the next two years.

We believe that Erste's risk management is comprehensive and efficient, which is crucial given the bank's wide geographic reach. There are no particularly complex businesses or products, and the bank's governance does not present unusual risk. All the CEE operations are run as stand-alone banks, applying the bank's strategy locally and using group-wide risk tools, risk management standards, and frameworks.

The same rules also apply to Erste's savings bank network in Austria. Although Erste owns the majority of only four of the 47 local savings banks, it exercises control over the members of the cross-guarantee system through its majority ownership of the system's management company. The management company has the power to implement and monitor risk policies, as well as intervene if a savings bank were to breach the network's policies.

Table 5

Erste Group Bank AG Risk Position					
		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	6.6	6.1	2.5	2.8	0.5
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	(4.9)	(3.8)	(5.9)	(9.0)
Total managed assets/adjusted common equity (x)	15.2	15.3	15.7	16.4	17.6
New loan loss provisions/average customer loans	(0.1)	0.1	0.1	0.6	1.7
Net charge-offs/average customer loans	(0.1)	(0.1)	(0.1)	(0.1)	0.0
Gross nonperforming assets/customer loans + other real estate owned	3.8	4.4	5.3	7.4	8.9
Loan loss reserves/gross nonperforming assets	62.4	63.4	65.0	61.2	65.9

*Data as of Sept. 30. RWA--Risk-weighted assets. N/A--Not applicable.

Funding and liquidity: Stable and granular customer deposits and ample liquidity at the group level and main operating subsidiaries

We consider Erste's funding to be above average and its liquidity strong. This reflects our view of the stability of Erste's retail funding base, especially in its largest markets in Austria, the Czech Republic, and Slovakia, and its moderate reliance on wholesale funding. We believe that the strong consolidated funding and liquidity ratios we observe at Erste group level are now also evident at the main operating subsidiaries.

Erste's large retail branch network in Austria and CEE and its relationships with domestic corporate clients provide it with a stable and granular deposit base (76% of the funding base at Sept. 30, 2018), with very low single-name concentrations. We expect the ratio of loans to deposits to remain at the current level (93%), which compares very well with peers'. Furthermore, S&P Global Ratings' stable funding ratio for Erste fluctuates around 125%, reinforcing our above-average assessment.

Wholesale funding (which we define as interbank, unsecured, and secured issues) accounts for about one-quarter of Erste's total funding (24% as of Sept. 30, 2018). Therefore, Erste's reliance on investor-sensitive wholesale funding is moderate and new €3 billion market funding needs for 2018 were fulfilled by June 30, 2018, after €2.1 billion in full year 2017. We also view as manageable the €2 billion-€3 billion yearly repayments of debt securities given Erste's strong funding profile.

Our assessment of Erste's liquidity as strong primarily reflects the bank's prudent liquidity management and high liquidity reserves. S&P Global Ratings' liquidity ratio, which shows coverage of short-term wholesale funding by broad liquid assets, was high at 3.7x at Sept. 30, 2018. Our liquidity ratios at group level and main subsidiaries are stronger than those of the overwhelming majority of domestic and large European peers with 1x-2x ratios. These metrics reflect the structural strengths of Erste's deposit-heavy funding profile, which is also supported by a strong 42% of net broad liquid assets-to-short-term customer deposits at Sept. 30, 2018. In addition, we take comfort from management's policy of maintaining ample buffers of unencumbered high-quality securities eligible for refinancing by the European Central Bank. As of year-end 2017, the liquidity buffer (defined as unencumbered collateral plus cash) stood at €66.1 billion or 31.2% of total liabilities.

We believe that there has been an overall improvement in the funding profiles in Erste's network banks, demonstrated by a marked reduction of intragroup funding from the parent bank over the past five years that exceeded our expectations. We now see each network bank as being able to deal with potential liquidity stresses on its own, which we consider a critical factor given the restrictions on intra-group liquidity transfers. In our view, Erste and its main operating subsidiaries would likely benefit from customers' flight to quality in a financial crisis and liquidity coverage would buffer against a lack of access to wholesale funding for more than 12 months, as well as moderate reductions in customer deposits.

Table 6

Erste Group Bank AG Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	76.2	77.7	76.4	74.1	72.2
Customer loans (net)/customer deposits	92.8	93.1	94.8	98.7	99.0
Long-term funding ratio	91.8	92.6	92.4	91.7	90.8
Stable funding ratio	125.3	127.9	125.2	120.4	121.5
Short-term wholesale funding/funding base	8.8	8.1	8.3	8.9	9.8
Broad liquid assets/short-term wholesale funding (x)	3.7	4.1	3.9	3.3	3.0
Net broad liquid assets/short-term customer deposits	42.0	44.6	41.8	41.7	44.9
Short-term wholesale funding/total wholesale funding	36.4	35.4	34.7	34.3	35.3

*Data as of Sept. 30.

External support: Currently no uplift for government support or ALAC

We view Erste group as having high systemic importance in Austria, but we assess Austria's tendency to support private sector commercial banks as uncertain. As a result, for a systemic bank like Erste, we do not include any uplift for extraordinary government support in the long-term rating.

Our view of uncertain extraordinary government support for the Austria banking sector follows the country's full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers, in January 2015. We view the Austrian resolution regime as effective because, among other factors, we believe it contains a well-defined bail-in process under which authorities would permit nonviable systemically important banks to continue critical functions as going concerns following a bail-in of eligible liabilities.

Our assessment of Erste's ALAC does not currently lead us to add any uplift to the ratings. We include all of the consolidated Erste group's junior instruments in our ALAC assessment because, over our projection period, we believe they have capacity to absorb losses without triggering a default on Erste's senior obligations. On this basis, we calculate that the ALAC proportion of risk-weighted assets was just surpassing the adjusted threshold of 5.5% at year-end 2017 and we project in the next two years this buffer will remain between 5.0% and 5.5%, our adjusted threshold of risk-weighted assets for a one-notch uplift. This will principally be on the back of a small rise in total adjusted capital beyond that taken into account in our capital assessment and a rollover of existing capital instruments. We use an adjusted threshold for the Erste group, as opposed to the usual 5.0%, because we anticipate that Erste will have to deploy substantial ALAC--primarily consisting of excess core capital--in its CEE subsidiaries and we see fungibility of such resources as constrained by capital restrictions set by host regulators.

Additional rating factors: Subsidiaries

We continue to expect that Ceska remains a core subsidiary of Erste Group Bank, since Ceska plays an integral role in the Erste group's strategy in the CEE. However, the core status does not translate into additional notches of support given our assessment of Ceska's stand-alone credit profile (SACP) is at the same level as Erste Group Bank's GCP.

At the same time, we consider Ceska to be a prudentially regulated subsidiary, which, under our base-case scenario, we expect would be subject to a separate resolution from its parent. This resolution scenario, when supported by a substantial bail-in buffer, would allow it to continue operating without defaulting on its senior unsecured obligations in the event of a resolution of the parent. That said, we note that Erste is the 100% shareholder of Ceska after the squeeze out in 2018 and currently the only investor in Ceska's AT1 instruments, which we expect to fulfil Ceska's potential future MREL requirements (minimum requirement for own funds and eligible liabilities). We therefore consider that Ceska could benefit from the strengthening creditworthiness of its parent bank, driven by Erste's improving risk-adjusted capitalization or the build-up of ALAC. If we were to revise upward our assessment of Erste's GCP, we would likely incorporate uplift for group support into the rating on Ceska.

Ratings on hybrid instruments

We rate Erste's nondeferrable subordinated debt instruments at 'BBB+', two notches below the bank's SACP, reflecting the debt's contractual subordination as Tier 2 instruments and our view that BRRD creates the equivalent of a contractual write-down clause.

We rate Erste's additional Tier 1 instruments at 'BBB-', four notches lower than the SACP, reflecting our deduction of:

- One notch for contractual subordination;
- Two notches for the notes' status as Tier 1 regulatory capital; and
- One notch because the instruments allow for the full or partial temporary write-down of the principal amount.

Resolution counterparty ratings (RCRs)

We set the RCRs on Erste Group bank AG at 'A+', one notch above the 'A' long-term issuer credit rating, reflecting the typical approach under our framework when the issuer credit rating ranges from 'BBB-' to 'A+'. It also reflects our jurisdiction assessment on Austria.

An RCR is a forward-looking opinion of the relative default risk of certain senior liabilities that may be protected from default through an effective bail-in resolution process for the issuing financial institutions. RCRs apply to issuers in jurisdictions where we assess the resolution regime to be effective and we consider the issuer likely to be subject to a resolution that entails a bail-in if it reaches nonviability.

Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
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- General Criteria: Group Rating Methodology, Nov. 19, 2013
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- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
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- Industry Report Card: The Austrian Banking System Is Likely To Remain Resilient In A Downturn, Nov. 23, 2018
- 2018 EU Bank Stress Test: Harsher Macro Assumptions And IFRS 9 Will Raise The Bar For Some Banks, Oct. 31, 2018
- European Bank M&A: More Talk Than Action, Aug. 6, 2018
- Banking Industry Country Risk Assessment: Austria, May 30, 2018
- The Resolution Story For Europe's Banks: The Clock Is Ticking, April 25, 2018
- Resolution Counterparty Ratings Jurisdiction Assessment For Austria Completed, June 29, 2018
- Chasing Shadows Or Rainbows? Sustainable Profitability Still Eludes Some Major European Banks, March 15, 2018

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	**3**	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	**bbb+**	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of December 12, 2018)

Erste Group Bank AG	
Issuer Credit Rating	A/Positive/A-1
Resolution Counterparty Rating	A+/--/A-1
Commercial Paper	
Local Currency	A-1
Junior Subordinated	BBB-
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB+
Issuer Credit Ratings History	
30-Oct-2017	A/Positive/A-1
14-Mar-2017	A-/Positive/A-2
17-May-2016	BBB+/Stable/A-2

Ratings Detail (As Of December 12, 2018) (cont.)	
09-Jun-2015	BBB+/Negative/A-2
03-Feb-2015	A-/Watch Neg/A-2
13-Aug-2014	A-/Negative/A-2
10-Jun-2014	A/Watch Neg/A-1
Sovereign Rating	
Austria	AA+/Stable/A-1+
Related Entities	
Erste Group Bank AG (Hong Kong Branch)	
Commercial Paper	
Local Currency	A-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.