

Research Update:

Erste Group Outlook Revised To Positive On Effective Resolution Strategy And Loss-Absorption Buffers; 'A/A-1' Affirmed

September 29, 2021

Overview

- We think Erste Group Bank AG (Erste) and its subsidiaries are making progress in strengthening their additional loss-absorbing capacity (ALAC) buffers, which provide protection to senior creditors in a resolution scenario.
- The group is effectively operating under a multiple point of entry strategy, implying that each of the six resolution groups would enter a separate resolution path from its parent, in the unlikely scenario of nonviability.
- We therefore revised our outlook on Erste to positive from stable and affirmed our 'A/A-1' issuer credit ratings.
- The positive outlook reflects our expectation that Erste could build sufficient bail-in-able buffers to merit rating uplift for ALAC during 2022.

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Rating Action

On Sept. 29, 2021, S&P Global Ratings revised its outlook on Erste Group Bank AG (Erste) to positive from stable. We also affirmed the 'A/A-1' long- and short-term issuer credit ratings and the 'A+' resolution counterparty ratings on Erste.

In addition, we affirmed our issue ratings on Erste's hybrid instruments, including our 'A-' rating on the senior subordinated debt.

Rationale

In our revised base case, the group is effectively operating under a multiple point of entry (MPE) resolution framework. The outlook revision is based on our view that Erste and its subsidiaries have shown good progress on the resolution strategy and build-up of bail-in-able buffers in recent

years. We expected Central and Eastern Europe (CEE) subsidiaries to require a transition period to accumulate sufficient additional loss-absorbing capacity (ALAC) buffers. All, but one, of Erste's subsidiaries have successfully issued bail-in-able debt amid binding minimum requirements for own funds and eligible liabilities (MREL) under the Bank Recovery and Resolution Directive II. We therefore see the group as effectively operating under a well-defined MPE resolution framework, including plans and their execution, in case of need. Under this framework, the group would fragment into multiple resolution subgroups if parts of it become nonviable. We understand that this is in full agreement with the Single Resolution Board (SRB) and local regulators in CEE. At June 1, 2021, the resolution entity of the Austrian resolution group (Erste Bank AG, savings banks, and other local subsidiaries), received an updated MREL target from the SRB, which is binding in two steps after January 2022 (interim target) and January 2024 (fully loaded). On a fully loaded basis and as a final requirement, the resolution group's MREL needs to exceed 28.63% of total risk exposure and 9.92% of the leverage ratio. However, within these headline ratios, Erste is allowed to include significant unsubordinated MREL. It already complies with the interim MREL target.

Sufficient ALAC buffers could merit rating uplift in the next 12 months. We assess the loss-absorbing capacity and the potential ALAC uplift for each of the resolution groups. We include all of the Austrian subgroup's junior instruments in our ALAC measure because, over our projection period, we believe they have capacity to absorb losses without triggering a default on senior obligations. At the same time, we deduct from its ALAC buffer any intragroup capital investments in the CEE subsidiaries because these holdings could have minimal residual value if those subgroups fail, in our view. Based on mid-year 2020 data, the ALAC ratio was 4.6%. We project that the Austrian subgroup's ALAC over S&P Global Ratings' risk-weighted assets (RWAs) could possibly move above 5.0% by year-end 2023. Our projections reflect an RWA increase of 6.0%-7.0% and plans to issue ALAC instruments until 2023. However, the evolution of the ALAC ratio also depends on the volume of subordinated MREL that Erste issues. If we expect that the Austrian subgroup would build ALAC sustainably above the 5.0% threshold, this could warrant an upgrade within the next 12 months. Because we have switched to an analytical MPE approach, we now focus on Erste's Austrian subgroup, and have consequently lowered the relevant ALAC threshold from the previous 5.5% to the standard 5.0% that applies for most European banking groups.

For subsidiaries, the MPE framework means lower intragroup interdependences and possibly easier separability in an acute stress scenario. Under the MPE resolution approach, Erste's non-Austrian subgroups are responsible for building their own bail-in-able buffers. Therefore, we consider potential group support in our ratings on these entities in relation to Erste's group stand-alone credit profile (SACP)--in effect our assessment of its intrinsic creditworthiness. Our group status assessment for Erste's subsidiaries considers the potential for parental support on a going concern basis and whether there could be meaningful divestment risk. Until now, we assessed the group status of Ceska sporitelna a.s (Ceska), Erste's key Czech subsidiary, in the highest category--core--meaning we saw it as likely to receive support from the group under any foreseeable circumstance. In light of the switch to an MPE approach, we now assess Ceska as a highly strategically important subsidiary. Undoubtedly, Ceska remains Erste's largest and most important subsidiary in CEE. It plays an integral role in the group's strategy in the Czech Republic and is highly profitable with solid operational performance. However, we now see somewhat weaker financial and operational interconnectedness among Erste's resolution subgroups. This is because the MPE resolution approach envisages that the group could be split apart and resolved individually if any subsidiaries reach the point of nonviability. Although we still see Erste as a likely

highly supportive parent, we see this greater separability as also allowing more flexibility, like any MPE parent, to divest subgroups in a recovery phase if it faced significant stress.

Outlook

The positive outlook on Erste reflects our view that, over the next 12 months, we should have a clearer indication of the size of its ALAC build-up, which could imply materially greater protection for senior unsecured (preferred) creditors if the bank fails. We also expect economies to recover in Erste's core markets, facilitating sound earnings from its traditional customer-led retail and corporate customer business.

Upside scenario

We would most likely raise our issuer credit rating (ICR) on Erste one notch if we expect that it will build and sustain its ALAC buffers above 5%. This will hinge on the bank's net issuance plans for subordinated bail-in-able debt, and its targeted loan growth--particularly in CEE--until 2023. We would not upgrade the bank's hybrid instruments in this scenario, since they are rated with reference to the group SACP.

Although less likely, we could also revise up the group SACP (and so the ICR and all issue ratings) if, for example, Erste strengthens its risk-adjusted capital ratio materially while the risk profile and performance are unchanged. This would be supported by stabilized trends in Erste's operating environment but would also depend on whether we see its intrinsic creditworthiness as being in line with that of 'a+' peers.

Downside scenario

We could revise the outlook to stable if we see a higher likelihood that Erste's bail-in-able buffers remain below the relevant ALAC threshold. We could also revise the outlook if we see material or prolonged setbacks for profitability and asset quality, particularly if the bank becomes loss-making. This would challenge our current view that Erste demonstrates superior resilience in its operating regions, with a market-leading position.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A/Positive/A-1	A/Stable/A-1
SACP	a	a
Anchor	bbb+	bbb+
Business position	Strong (+1)	Strong (+1)
Capital and earnings	Adequate (0)	Adequate (0)
Risk position	Adequate (0)	Adequate (0)
Funding and	Above average	Above average
Liquidity	Strong (+1)	Strong (+1)
Support	(0)	(0)

	To	From
ALAC support	(0)	(0)
GRE support	(0)	(0)
Group support	(0)	(0)
GRE support	(0)	(0)
Additional factors	(0)	(0)

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Ceska Outlook Revised To Positive On Effective Resolution Strategy And Loss-Absorption Buffers; Affirmed At 'A/A-1', Sept. 29, 2021
- Banking Industry Country Risk Assessment: Austria, July 13, 2021
- CESEE Banks Face COVID Headwinds From A Solid Starting Point, March 17, 2021
- Austria-Based Erste Group Bank Ratings Affirmed On Solid Buffers, Outlook To Stable On Deepening COVID-19 Risks, April 29, 2020
- Outlook Revisions On Several Austrian Banks On Deepening COVID-19 Downside Risks, April 29, 2020

Ratings List

Ratings Affirmed

Erste Group Bank AG

Resolution Counterparty Rating	A+/-/-A-1
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Erste Group Bank AG

Senior Unsecured	A
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Senior Subordinated	A-
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Subordinated	BBB+
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Junior Subordinated	BBB-
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Commercial Paper	A-1
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Erste Finance (Delaware) LLC

Commercial Paper	A-1
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Erste Group Bank AG (Hong Kong Branch)

Commercial Paper	A-1
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Ratings Affirmed; Outlook Action

	To	From
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Erste Group Bank AG

Issuer Credit Rating	A/Positive/A-1	A/Stable/A-1
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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