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/Stable/A-1

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

Major Rating Factors

Strengths:	Weaknesses:
• Strong franchise in Austria and Central and Eastern European (CEE) countries. • Solid operating revenue from traditional customer-led retail and commercial banking operations. • Strong liquidity and funding profile dominated by granular and sticky retail deposits.	• Challenging operating conditions because of the COVID-19 pandemic. • Uncertainties in the build-up of higher additional loss-absorbing capital (ALAC) buffers amid stressed capital markets.

Outlook: Stable

The stable outlook on Austria-based Erste Group Bank AG (Erste) reflects S&P Global Ratings' view that Erste will manage the risks it faces in the coming 12-24 months. This includes our opinion that economic risk for the Austrian banking system could increase over the medium term because of the pandemic-related slowdown, and weakening operating conditions in Erste's core strategic CEE markets.

Downside scenario

We could lower our ratings on Erste if operating conditions deteriorate significantly, leading to a more material setback to profitability and asset quality, particularly if the bank became loss-making. This would challenge our view that Erste should demonstrate superior resilience in difficult markets.

Upside scenario

We could raise our ratings over the next 24 months if Erste were to strengthen materially and sustainably its risk-adjusted capital (RAC) ratio to beyond 10%, or if we had visibility that Erste would build-up material bail-inable capital buffers over the medium term. The pre-condition for the upgrade would be improved global economic conditions, including stable economic and industry risk trends for the Austrian banking industry and the main markets where the bank operates.

Rationale

Our ratings reflect Erste's well-managed business model in its leading market position with sustainable franchises in retail, small and midsize enterprises (SMEs), and corporate banking in Austria and six core strategic countries in CEE markets. We believe the downturn from the pandemic has led to weaker economic and operating conditions for Erste's main markets. Nevertheless, we think the group is well-positioned to weather the COVID-19-induced downturn. Aside from the temporary economic implications of the pandemic, we acknowledge management's continuing efforts to digitalize the bank, which will help safeguard the customer base against changing consumer preferences. The management team is stable and has, in our view, followed a generally consistent strategy.

We expect that Erste will continue to strengthen its balance sheets from solid earnings and retention into capital. Moreover, the bank's sound risk management and well-diversified business mix from its retail and SME focus supports its quality of earnings, also making revenue predictable and relatively resilient to material economic worsening in Erste's main countries of operation. Accordingly, we project that our main capital indicator, the RAC ratio, on Erste will be close to 9.75% in the next 12-24 months. This includes our understanding that growth of the bank's retail and corporate lending will mainly be in lower-risk countries such as Austria, the Czech Republic, and Slovakia. In addition, Erste shows strong asset quality, with nonperforming assets (NPAs) decreasing and reaching a decade-low of 2.6% by our measures. We expect NPAs to increase, peaking close to 3.5% in 2021.

Erste strongly benefits from its through-the-cycle tested franchise and stability in large retail funding base, especially in its largest markets of Austria, the Czech Republic, and Slovakia; and its moderate and declining reliance on wholesale funding. Strong consolidated funding and liquidity ratios at the group level are similarly evident at the bank's main operating subsidiaries, and we expect that the group will continue to stand out in terms of prudent liquidity management and high liquidity reserves in the next years.

We do not add any notches of uplift from the SACP into the long-term rating on Erste for ALAC support, as in our view there is no sufficient visibility that the bank will build up a material bail-inable buffer over the medium term. We understand that the bank is opting for a multiple point of entry (MPE) approach in resolution, implying that the Austrian resolution entity and the group's subsidiaries would enter a separate resolution path from its parent.

Anchor:'bbb+', reflecting Erste's 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' being the lowest risk). However, the weighted average of economic risks of countries in which Erste operates, based on the geographic distribution of its exposures at default, is '3'. We believe the group 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 exposure in the next two years, and expect growth of Erste's retail and corporate lending will mainly be in lower-risk countries such as Austria, the Czech Republic, and Slovakia. However, changes in our assessment of the economic risk in Erste's operating countries might affect weighted economic risk.

We view Austria's economic risk trend as negative, reflecting the significant downside risk to our base-line scenario due to the pandemic's economic effects. If the repercussions prove more prolonged or deeper than we expect, household and corporate sector financial health could deteriorate, particularly given that Austria's economy focuses on service industries.

We view the trend on Austria's banking industry risk as stable. In our view, despite a material one-off deterioration of the sector's performance, overall sector stability is unlikely to deteriorate, given banks' comfortable capital and provisions. Furthermore, massive government support programs and the robust social benefits system are likely to limit the hit to the banking system. We base our view on the expectation that the medium-term profitability decrease will not lead to greater risk appetite, and banks' lending policies will remain prudent. We also believe that risks to the banking system from tech disruption will be contained, mainly because consumers' preferences are still conservative.

Table 1

Erste Group Bank AG--Key Figures

		--Year ended Dec. 31--			
(Mil. €)	**2020***	**2019**	**2018**	**2017**	**2016**
Adjusted assets	270,652	244,325	235,285	219,136	206,837
Customer loans (gross)	166,983	161,965	151,444	143,509	135,267
Adjusted common equity	17,943	17,037	15,871	14,705	13,297
Operating revenues	5,286	7,280	6,730	6,512	6,505
Noninterest expenses	3,236	4,262	3,997	3,990	3,862
Core earnings	890	2,494	2,444	1,951	1,977

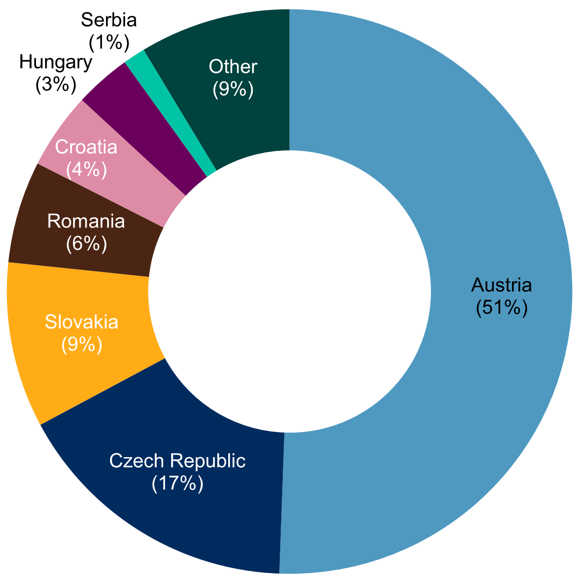
*Data as of Sept. 30.

Business position: Leading retail and corporate franchise in Austria and some CEE countries

With assets of €272 billion at Sept. 30, 2020, Erste is one of the leading banks in Austria. The bank has a 20% market share in domestic retail loans and retail deposits. Thanks to its widespread operations, Erste will continue to benefit from good geographic diversification of revenue, in our view, although we acknowledge some correlation among CEE countries and between CEE and Austria. Also, the group has a somewhat higher reliance on net interest income sources than most similarly rated peers. We anticipate Erste will maintain its leading market position with sustainable franchises in retail, SMEs, and corporate banking in Austria and several core countries in CEE markets (see charts 1 and 2).

Chart 1

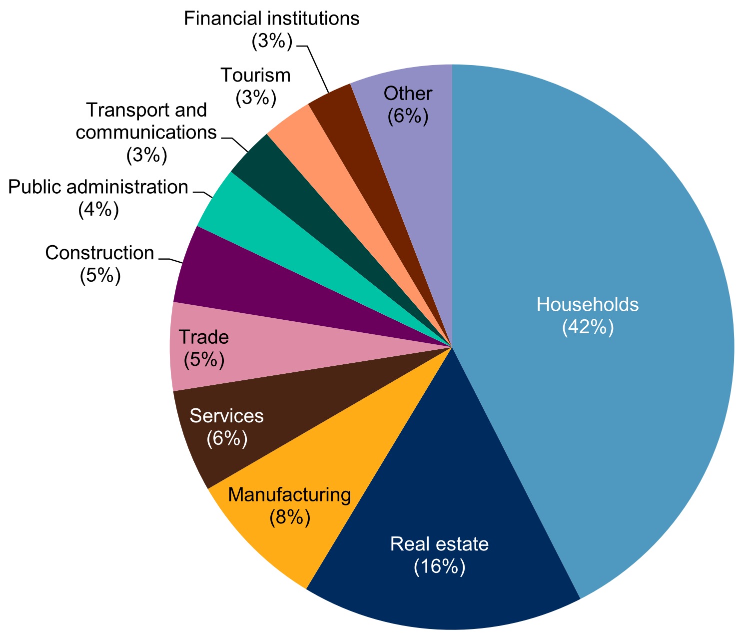
Erste Benefits From Geographical Diversification..
Erste's exposures as of Q3-2020 by geography



Source: S&P Global Ratings. Note: Exposures defined as net customer loans.

Chart 2

...And From A Diversified Client Portfolio
Erste's exposures as of Q3-2020 by customer groups



Source: S&P Global Ratings. Note: Exposures defined as gross customer loans.

Erste's savings bank brand is strong in terms of image and customer loyalty, notably in Austria, but also in the Czech Republic, Slovakia, and Croatia. Domestic retail operations are concentrated in 47 savings banks that differ widely in size. Owing to the cross-guarantee contract (Haftungsverbund), Erste also consolidates those savings banks in which it does not hold a majority stake. We also take into consideration the group's exposure to some economically riskier countries in CEE. Both margins and credit losses are typically higher in CEE than Austria, which overall translates into higher risk-adjusted returns through the cycle.

We view positively the stability and consistency of Erste's management and a strategy that aims to strengthen operating revenue, improve cost efficiency, and progress with the bank's digital transformation. The pandemic is likely to postpone some strategic initiatives but the long-term direction is unchanged, in our view. We expect the group strategy to continue focusing on its domestic market and growth in a few CEE markets where Erste holds a strong footprint. We also believe the group could expand in its core markets with potential small-scale acquisitions to strengthen business areas such as its bancassurance product offering.

Erste's digital platform (known as George), also rolled out to its subsidiaries in the Czech Republic, Croatia, Slovakia, and Romania, complements traditional retail sales channels. The pandemic has accelerated the groupwide use of digital banking, with more than 6 million (close to 40%) of clients using the George application as of Sept. 30, 2020. We understand that a further digitalization of products and services, particularly with the rollout of George to other core markets, is an important pillar of the digital strategy. We also note Erste's increasing efforts to digitize its corporate banking offerings.

Table 2

Erste Group Bank AG--Business Position					
		--Year ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Retail loan market share in country of domicile	20.7	20.8	20.4	20.2	19.7
Retail deposit market share in country of domicile	20.5	20.6	20	19.5	18.9
Total revenues from business line (mil. €)	5,286.0	7,280.3	6,730.0	6,511.9	6,644.1
Commercial banking/total revenues from business line	21.7	22.0	22.6	22.6	22.6
Retail banking/total revenues from business line	46.0	48.5	51.5	50.7	49.5
Commercial and retail banking/total revenues from business line	67.7	70.5	74.2	73.3	72.1
Trading and sales income/total revenues from business line	7.0	7.4	7.9	8.5	7.8
Other revenues/total revenues from business line	25.3	22.1	17.9	18.2	20.1
Investment banking/total revenues from business line	7.0	7.4	7.9	8.5	7.8
Return on average common equity	5.9	10.7	13.7	10.6	11.0

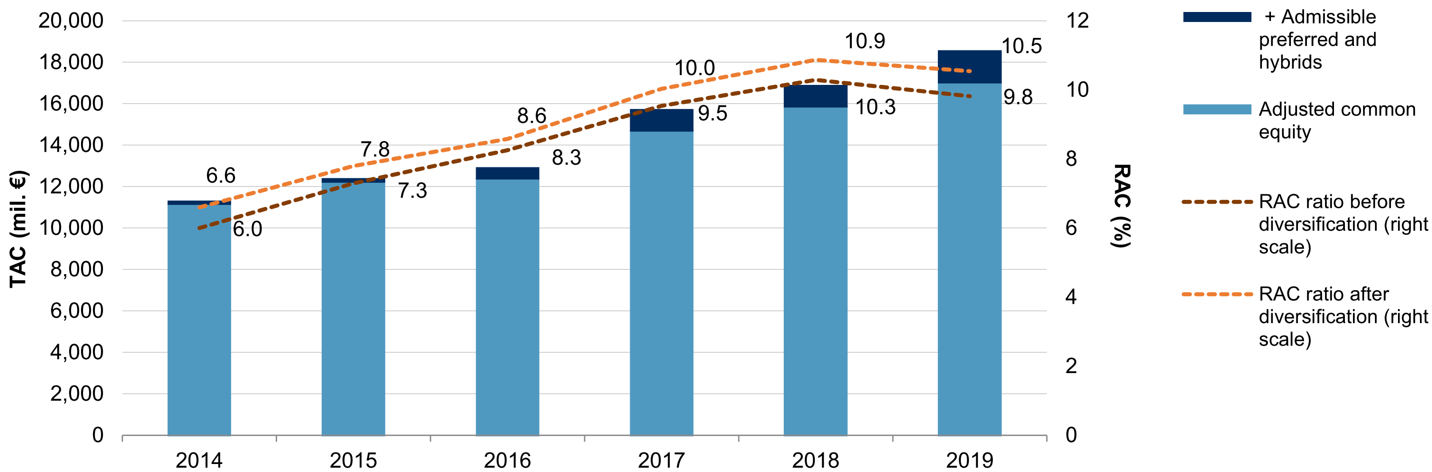
*Data as of Sept. 30.

Capital and earnings: Capitalization will remain adequate despite COVID-19 shock

We assess Erste's capital and earnings as a neutral ratings factor, which mainly reflects our projection that our main capital indicator, the RAC ratio, will be close to 9.75% in the next 12-24 months, having reached 9.8% at year-end 2019. In previous years the ratio had been on a steady upward path (see chart 3); however, the trajectory is likely to slow amid the pandemic.

Chart 3

Erste's Risk-Adjusted Capital Ratio Will Likely Be Stable Amid Pandemic-Related Stress
Erste's risk-adjusted capital developments 2014-2019



TAC--Total adjusted capital. RAC--Risk-adjusted capital. Source: S&P Global Ratings.

Our forecast for the next two years includes the following assumptions:

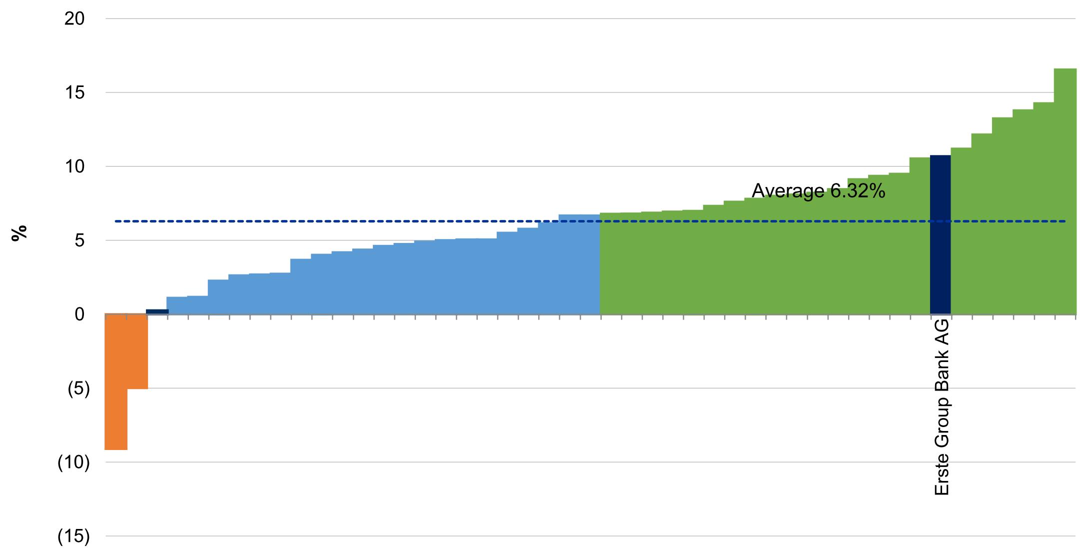
- Operating revenue declining by about 12% in 2020, mainly due to weaker interest and fee and commission income, followed by a rebound of almost 5% in 2021;
- COVID-19-related decline in operating expense by about 3% in 2020, and increasing by 2% in 2021, which is slower than before due to ongoing cost efficiency measures;
- Substantial increase of credit losses of about 65 basis points (bps) in 2020 and 50 bps in 2021, reflecting COVID-19-induced loan loss provisions;
- Growth of S&P Global Ratings' risk-weighted assets (RWAs) of 5%-6% in 2020 and 2021, broadly in line with the loan book growth; and
- Dividends of €1.00-€1.50 per share in 2021 following the regulatory recommendation to postpone dividends in 2020.

In January 2020, before the COVID-19 outbreak became a pandemic, Erste issued €500 million in additional Tier 1 (AT1), which we fully classify as part of S&P Global Ratings total adjusted capital (TAC)--our main measure of loss-absorbing capital--and supports our view of Erste's capitalization. The bank is in a good position to issue further AT1 instruments as demonstrated with its placement of a €750 million AT1 issuance in November 2020. We expect hybrids included in TAC to remain close to 10%, contributing to the overall adequate quality of capital.

We think Erste will demonstrate superior earning resilience, in large part due to its well-managed business model, sound risk management, and well-diversified business mix from its retail and SME focus. We expect the group's return on equity (RoE) to remain in the higher range compared with its top-50 peer banks in Europe at year-end 2020, as the bank managed in 2019 (see chart 4). Erste has demonstrated visibly resilient earnings generation over the past five years, showing double-digit RoEs.

Chart 4

Erste's Profitability Is Better Than Many Other Peer Banks In Europe
European Top-50 banks: Return on equity as of year-end 2019



Note: Data as of June 16, 2020. Data for Cooperative Banking Sector Germany, Nordea Bank AB, Raiffeisen Banking Group Austria, and S-Finanzgruppe Hessen-Thueringen are not available.
Source: S&P Global Ratings.

The sound earnings also offer a solid buffer to the expected spike in credit losses, more so than for many leading European peers. Beyond the negative medium-term effects from the pandemic, we believe that the bank's earnings capacity will remain adequate, owing to stable operating revenue and further cost containment measures. This is reflected in our expected three-year average earnings buffer of 50-70 bps in the next two years, which is in line with that of its rated peers. The earnings buffer is a metric that measures the capacity of earnings to absorb "normalized losses" through the credit cycle.

Table 3

Erste Group Bank AG--Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	15.9	15.0	14.3	13.8	13.3
S&P Global Ratings' RAC ratio before diversification	N/A	9.8	10.3	9.5	8.3
S&P Global Ratings' RAC ratio after diversification	N/A	10.5	10.9	10.0	8.6

Table 3

Erste Group Bank AG--Capital And Earnings (cont.)

		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Adjusted common equity/total adjusted capital	90.0	92.0	94.1	93.7	96.4
Net interest income/operating revenues	67.9	65.2	68.1	66.8	67.2
Fee income/operating revenues	27.4	27.5	28.4	28.4	27.4
Market-sensitive income/operating revenues	2.0	4.8	3.0	5.6	4.3
Cost to income ratio	61.2	58.5	59.4	61.3	59.4
Preprovision operating income/average assets	1.1	1.3	1.2	1.2	1.3
Core earnings/average managed assets	0.5	1.0	1.1	0.9	1.0

*Data as of Sept. 30. N/A--Not applicable.

Table 4

Erste Group Bank AG--Risk-Adjusted Capital Framework Data

(€000s)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government and central banks	43,399,639,247	3,940,621,781	9	7,160,238,115	16
Of which regional governments and local authorities	5,378,692,700	376,229,367	7	932,503,667	17
Institutions and CCPs	19,814,776,652	3,455,084,348	17	2,793,472,962	14
Corporate	105,976,233,322	59,212,214,766	56	85,984,007,637	81
Retail	93,901,418,101	20,670,174,432	22	52,047,554,636	55
Of which mortgage	47,574,223,261	6,596,493,288	14	14,903,618,871	31
Securitization§	1,866,337,070	930,715,713	50	933,108,454	50
Other assets†	10,754,722,299	3,613,861,123	34	14,974,243,336	139
Total credit risk	275,713,126,693	91,822,672,163	33	163,892,625,140	59
Credit valuation adjustment					
Total credit valuation adjustment	--	568,883,913	--	0	--
Market risk					
Equity in the banking book	1,254,179,324	2,913,202,063	232	5,960,786,892	475
Trading book market risk	--	2,794,534,162	--	4,735,417,139	--
Total market risk	--	5,707,736,225	--	10,696,204,032	--
Operational risk					
Total operational risk	--	14,937,500,000	--	14,129,936,278	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	118,336,792,301	--	188,718,765,449	100
Total diversification/concentration adjustments	--	--	--	(12,896,203,945)	(7)
RWA after diversification	--	118,336,792,301	--	175,822,561,505	93

Table 4

Erste Group Bank AG--Risk-Adjusted Capital Framework Data (cont.)

	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)
Capital ratio				
Capital ratio before adjustments	17,749,000,000	15.0	18,527,303,000	9.8
Capital ratio after adjustments‡	17,749,000,000	15.0	18,527,303,000	10.5

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡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 2019', S&P Global Ratings.

Risk position: Asset quality will likely deteriorate amid COVID-19-induced defaults

Erste's risk profile compares well to its domestic peer banks with a strong focus on retail banking or with international peers in markets with a similar industry risk (such as Belgium, Germany, Finland, and Sweden). We continue to anticipate that the group's risk position will remain a neutral rating factor over the next two years.

In our view, Erste is appropriately capitalized for the risks it faces. This is because of the group's improved asset quality metrics in recent years, its diversified loan portfolio, supported by growth mainly in lower-risk countries, and relatively low single-name and sector concentration in the loan book. The group lowered potential credit risk for the bank from lending in foreign currencies to what we consider manageable; this constituted 4.9% of the loan portfolio as of Sept. 30, 2020. 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.

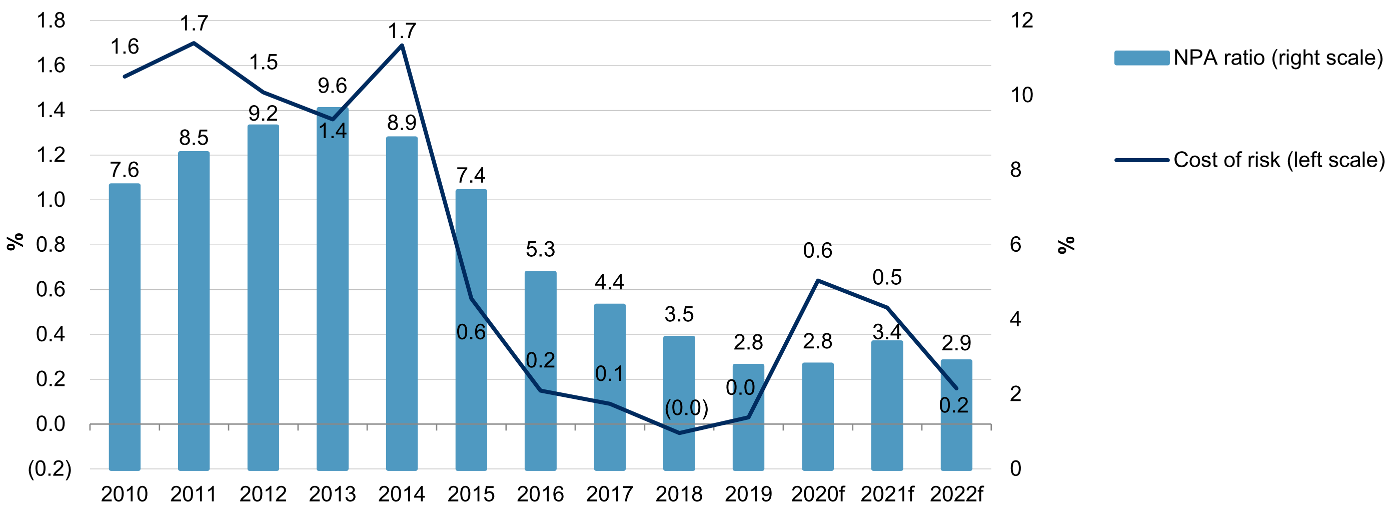
Risk exposures in the gross loan portfolio of €167 billion as of Sept. 30 are widely diversified between countries and client segments. Positively, Erste continues to concentrate on lower-risk retail lending, mortgage loans, and SME and corporate lending, while placing only a moderate emphasis on market-sensitive business. Single-name and sector concentration in the loan book are low, in our view. Real estate (residential and commercial real estate) constituted about 22% of the total portfolio on Sept. 30, but we understand that it is mainly income-producing real estate (more than 80%) with a solid average loan-to-value ratios of about 60%. Positively, highly cyclical exposures, like lending to office and shopping center projects, were so far not heavily affected by the sudden stop of activities and economic shutdowns in the operating markets as a result of the pandemic.

In line with the broader European bank peer group, we expect Erste's asset quality metrics and cost of risk to deteriorate over our two-year forecast period (see chart 5) because of the pandemic, but anticipate that fiscal mitigation measures like debt moratoria and guarantee programs will help offset some of the damage in its core markets. Our measure of gross nonperforming assets reached 2.6% of the group's gross customer loans as of Sept. 30, an adequate level to enter the recession, in our view. We think the sustainable stability of Erste's asset quality metrics over the past three years compares favorably with those of main domestic peers. We think the record-high 96% NPL coverage ratio as of Sept. 30, 2020, will decline because of Erste's prudent management overlay that was booked as part of loan loss provisions in second-quarter 2020.

Chart 5

Erste's Asset Quality And Cost Of Risk Performance Will Likely Deteriorate In 2020 And 2021

NPA ratio and cost of risk from 2010-2022f



Source: S&P Global Ratings. Cost of risk defined as new loan loss provisions as % of average customer loans. NPA ratio defined as gross nonperforming assets as % of customer loans + other real estate owned.

f--Forecast.

We believe that Erste's risk management is comprehensive and efficient, which is crucial given the bank's wide geographic reach. Nonfinancial risks, like money laundering, sanctions, and cyber risks, are adequately covered by headcounts and tools used in the risk and compliance department. There are no particularly complex businesses or products, and the bank's governance does not present unusual risk.

Table 5

Erste Group Bank AG--Risk Position

		--Year ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	4.1	6.9	5.5	6.1	2.5
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	(6.8)	(5.3)	(4.9)	(3.8)
Total managed assets/adjusted common equity (x)	15.2	14.4	14.9	15.0	15.7
New loan loss provisions/average customer loans	0.7	0.0	(0.0)	0.1	0.1
Net charge-offs/average customer loans	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Gross nonperforming assets/customer loans + other real estate owned	2.5	2.8	3.5	4.4	5.3
Loan loss reserves/gross nonperforming assets	87.6	69.5	64.7	63.4	65.0

*Data as of Sept. 30.

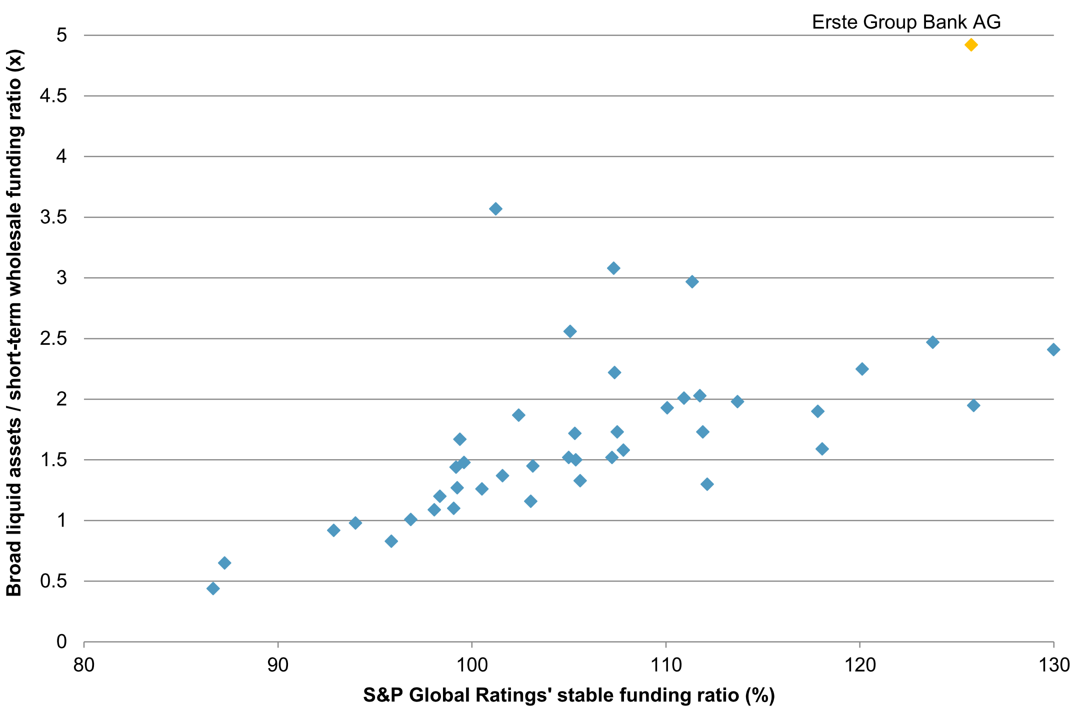
Funding and liquidity: Stable and granular customer deposits and ample liquidity at the group level and main operating subsidiaries

We continue to view Erste's funding profile as stronger than many of its peers in Europe (see chart 6) and view its liquidity as a strength to the rating. This reflects the stability of the group's large retail funding base, especially in its core markets in Austria, the Czech Republic, and Slovakia, and its moderate reliance on wholesale funding. We expect that the group's main risk indicators of strong consolidated funding and liquidity ratios at the group level also remain evident at the main operating subsidiaries. This is also an absolute view on how well placed Erste is regionally to withstand extended market or idiosyncratic stress, as demonstrated during the pandemic.

Chart 6

Erste Has A Stronger Funding And Liquidity Profile Than Its Peers

European top 50 banks, key funding and liquidity metrics at end-2019



Source: S&P Global Ratings.

We expect the group's large retail branch network in Austria and CEE, along with its strong franchise with domestic corporate clients, will continue providing it with a stable and granular core deposit base (75% of the funding base at Sept. 30), and with very low single-name concentrations. We expect the indicator of ratio of net loans to deposits to remain near current levels (90.0%), which compares well with peers'. Furthermore, S&P Global Ratings' stable funding ratio for Erste fluctuates around 130% (comfortably above the 95%-115% range that we see for most European peers), reinforcing our above-average assessment.

Wholesale funding (which we define as interbank, unsecured, and secured issues) accounts for about one-quarter of the group's total funding (25% as of Sept. 30). We also view as manageable the €2 billion-€4 billion yearly repayments of debt securities given the group's strong funding profile. Erste took advantage of the attractive pricing conditions offered by the European Central Bank's targeted long-term refinancing operations (TLTRO III), which reached €14.1 billion as of Sept. 30. Given its contribution to net interest income, we deem Erste's TLTRO III uptake as a profit-driven decision and not a funding-relevant need. We have classified this type of funding as noncore and wholesale by our definitions and note that most of these lines mature in 2024.

Our assessment of Erste's liquidity as strong also reflects the bank's ongoing 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 4x at Sept. 30. Our liquidity ratios at the 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 45% of net broad liquid assets-to-short-term customer deposits (which measures liquid asset coverage of deposits even after a run-off of short-term wholesale funding) at Sept. 30, 2020.

We believe the funding profiles in Erste's network banks has improved overall, demonstrated by a marked reduction of intragroup funding from the parent bank over the past five years that exceeded our expectations. The self-funded nature of Erste's subsidiaries in CEE is a credit positive, in our view. We believe Erste's liquidity stress testing and results from its survival period analysis means the bank would withstand an extended period of market or idiosyncratic stress. Existing liquidity coverage act as a solid buffer against a lack of access to wholesale funding for more than 12 months, in our view.

Table 6

Erste Group Bank AG--Funding And Liquidity					
		--Year ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	75.1	78.9	76.5	77.7	76.4
Customer loans (net)/customer deposits	89.8	92.5	91.8	93.1	94.8
Long-term funding ratio	91.6	94.4	91.5	92.6	92.4
Stable funding ratio	131.6	125.8	126.1	127.9	125.2
Short-term wholesale funding/funding base	9.1	6.1	9.2	8.1	8.3
Broad liquid assets/short-term wholesale funding (x)	3.9	4.9	3.5	4.1	3.9
Net broad liquid assets/short-term customer deposits	45.2	38.7	37.3	44.6	41.8
Short-term wholesale funding/total wholesale funding	35.6	28.2	38.5	35.4	34.7

*Data as of Sept. 30. N/A--Not applicable.

External support: No uplift for government support or ALAC

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

At the same time, 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 lead us to add any uplift to the ratings. We understand that the group, in the unlikely scenario of nonviability, would enter a resolution with a multiple point of entry (MPE) strategy, implying that each of the six resolution groups would enter a separate resolution path from its parent with own MREL requirements and own bail-inable instruments. At April 30, 2020, Erste Bank AG, the resolution entity of the Austrian resolution group, received its minimum requirement for own funds and eligible liabilities (MREL) target by the Single Resolution Board, which is set at 14.9% of total liabilities and own funds or 27.49% of regulatory RWAs based on year-end 2017 data. Erste estimates for its Austrian resolution entity that it already complies with the MREL targets with its existing eligible instruments.

While we understand that Erste Group Bank is is opting for a MPE approach, we believe that over the medium term at least, the group will effectively operate as a single point of entry, reflecting the transition time needed for subsidiaries to accumulate sufficient bail-inable buffers. At Dec. 31, 2019, the group's ALAC buffer as a share of S&P Global Ratings' RWAs was close to 4.5%. 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.

On this basis, we calculate the ALAC proportion of risk-weighted assets in the next two years to decline somewhat toward a level of 3.5%. This is below our 5.5% our adjusted threshold of risk-weighted assets for a one-notch uplift. We use an adjusted threshold for the 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 a flexible deployment of these resources as constrained by capital restrictions set by host regulators.

Environmental, social, and governance (ESG)

We think Erste's ESG standards are in line with those of other banks in Europe and do not affect its credit quality differently. We understand that ESG efforts of subsidiaries in CEE are aligned with Erste's.

In our view, risk roles and responsibilities are adequately defined across the group while risk monitoring and control practices, including know-your-customer processes, and sanction controls in its operating markets are well advanced. We think this has prevented major incidents and significant litigation. As a result, Erste's corporate governance is well advanced, in our view. Nevertheless, as a large and international bank, we consider the bank exposed to tail governance risks with its business activities in higher risk countries in CEE.

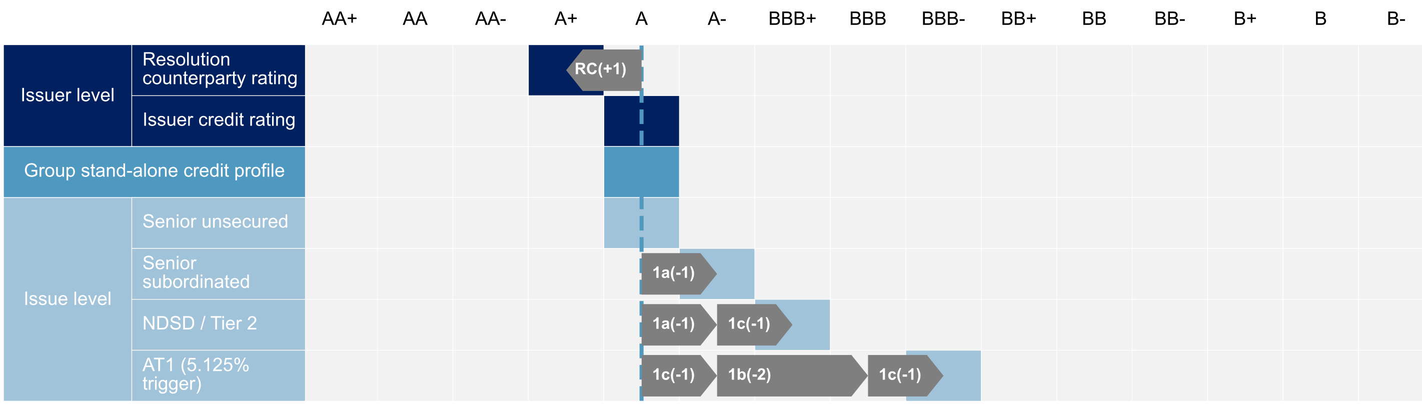
Social and environmental factors are also in line with peers in Europe and not a rating differentiator. Lending to the coal industry is immaterial, at less than 1% of total loans. We expect Erste will implement more measures to transition into a greener bank. The management team deems cooperation with environmental nongovernment organizations also an important pillar to foster the sustainability efforts of the group. To that end, it has established a Group Sustainability Office and a department for Social Banking Development in its organization.

Ratings on hybrid instruments

We rate the group's nondeferrable subordinated debt instruments 'BBB+', two notches below the bank's SACP (see chart 7), 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 'BBB-', four notches lower than the SACP, reflecting the following deductions:

- 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.

Erste Group Bank AG: Notching



Key to notching

----- Group stand-alone credit profile

------ Issuer credit rating

RC Resolution counterparty liabilities (senior secured debt)

1a Contractual subordination

1b Discretionary or mandatory nonpayment clause and whether the regulator classifies it as regulatory capital

1c Mandatory contingent capital clause or equivalent

Note: The number-letter labels in the table above are in reference to the notching steps we apply to hybrid capital instruments, as detailed in table 3 of our "Hybrid Capital: Methodology And Assumptions" criteria, published on July 1, 2019.
AT1--Additional Tier 1. NDSD--Non-deferrable subordinated debt.

Resolution counterparty ratings (RCRs)

We set the RCRs on Erste 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 for 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

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, 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: 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
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Banks 2021 Outlook: Banks Will Face The Next Test Once Support Wanes, Nov. 17, 2020
- How COVID-19 Is Affecting Bank Ratings, October 2020 Update, Oct. 22, 2020
- Erste Group Bank's Mid-Year Results Highlight COVID-19 Uncertainty, July 31, 2020
- Banking Industry Country Risk Assessment: Austria, June 17, 2020
- 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
- Deepening COVID-19 Risks Cause Economic Risk Trends To Shift In Several CEE Countries, April 29, 2020

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 14, 2020)*	
Erste Group Bank AG	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Commercial Paper	
Local Currency	A-1
Junior Subordinated	BBB-
Senior Subordinated	A-
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB+
Issuer Credit Ratings History	
29-Apr-2020	A/Stable/A-1
30-Oct-2017	A/Positive/A-1
14-Mar-2017	A-/Positive/A-2
17-May-2016	BBB+/Stable/A-2
Sovereign Rating	
Austria	AA+/Stable/A-1+
Related Entities	
Erste Group Bank AG (Hong Kong Branch)	
Commercial Paper	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.

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