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Erste Group Bank AG

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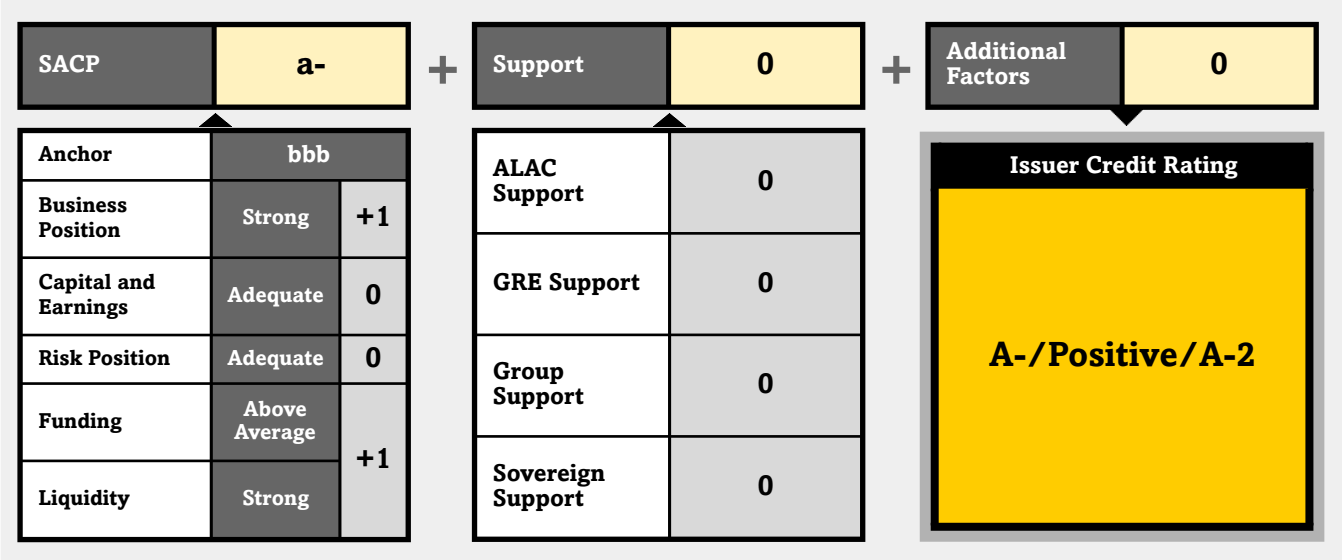
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Erste Group Bank AG



Major Rating Factors

| | |
|---|--|
| Strengths: | Weaknesses: |
| <ul style="list-style-type: none"> 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. | <ul style="list-style-type: none"> Sensitivity to economic and political developments in the CEE region. Moderate reliance on wholesale funding. |

Outlook: Positive

S&P Global Ratings' positive outlook on Erste Group Bank AG (Erste) reflects our view that, over the next two years, a clearer indication of the pace and size of Erste's build-up of additional loss-absorbing capacity (ALAC) could eventually lead us to include one notch of uplift in the rating. We expect that the operating environment in Erste's biggest core markets will remain stable, facilitating the generation of sound earnings from its traditional customer-led retail and corporate customer business.

We would most likely raise the rating if greater insight into the ramp-up leads us to add to the rating one notch of support for ALAC. However, this would hinge on our view of the group's creditworthiness as being clearly in line with that of 'A' rated peers.

While less likely, an upgrade could follow an improvement in Erste's operating environment or a moderate shift in operations toward lower-risk countries that leads us to revise the anchor to 'bbb+' from 'bbb'. At this stage, however, we are unlikely to revise the SACP to 'a' because we would take into account our view of Erste's other rating factors, such as its business position, relative to peers with 'bbb+' anchors.

We could revise the outlook to stable if we come to conclusion that it's less likely that Erste's ALAC will rise substantially, for example if we observe aggressive growth in higher-risk countries that suggests a limited scope for improvement in Erste's creditworthiness.

Rationale

We base our analysis on the consolidated Erste Bank Group 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.

The starting point for our ratings on Erste is its 'bbb' anchor, which reflects our view of weighted economic risks in the countries where the bank operates and our industry risk assessment for Austria.

We assess Erste's stand-alone credit profile (SACP) at 'a-'. We consider Erste's business position to be strong, reflecting the leading market position in Austria and several core countries in CEE, capital and earnings as adequate mirroring our expectation of RAC ratio in the range of 9.0%-9.5% in the next 12-24 months, risk position as adequate owing to sound asset quality metrics in Erste's diversified loan portfolio, funding as above average, and its liquidity as strong due to the strong deposit franchise and elevated liquidity buffers both at group and single-subsidiary level.

We believe that the prospect of extraordinary government support for the Austrian banking sector is uncertain and do not incorporate any uplift above the bank's SACP for government support. Furthermore, our assessment of Erste's ALAC does not currently lead us to add any uplift to the rating. Consequently, the issuer credit rating on Erste is at the same level as the SACP.

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

Our bank criteria 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 '4'. 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 '4' and industry risk score of '4' 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.

With regard to industry risk, the Austrian banking industry benefits from a high share of core customer deposits, which limits dependence on external borrowing. However, we consider that the significant overcapacity in the banking sector's domestic operations results in very low bank earnings and may pose a threat to the stability of the Austrian banking system.

Table 1

| Erste Group Bank AG Key Figures | | | | | |
|---------------------------------|------------------------|-----------|-----------|-----------|-----------|
| | --Year-ended Dec. 31-- | | | | |
| (Mil. €) | 2017* | 2016 | 2015 | 2014 | 2013 |
| Adjusted assets | 221,420.0 | 206,836.8 | 198,278.8 | 194,846.4 | 197,435.3 |
| Customer loans (gross) | 137,518.0 | 135,267.5 | 131,905.7 | 128,325.0 | 127,697.7 |
| Adjusted common equity | 13,675.0 | 13,424.0 | 12,143.3 | 11,163.4 | 11,973.6 |
| Operating revenues | 1,560.2 | 6,505.4 | 6,500.9 | 5,900.6 | 7,111.9 |
| Noninterest expenses | 976.5 | 3,862.1 | 3,705.7 | 3,787.3 | 4,188.6 |
| Core earnings | 413.1 | 1,976.8 | 1,643.6 | (555.3) | 820.5 |

*Data as of March 31.

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

We regard Erste's business position as strong. This reflects the bank's strong and sustainable franchises in retail, small and midsize enterprises (SMEs), and corporate banking in the Austrian and CEE markets.

Erste, with total assets of €222.8 billion as of March 31, 2017, is one of the top-three banks in Austria, with 19.7% share of retail loans and 18.9% of deposits in 2017. 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. We expect its local market shares to remain stable overall, except in Hungary. 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 a plus 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. Although Erste's Austrian operations show thin margins, they provide stable returns and we expect this to continue (1.8% net interest margin [NIM] of savings banks in Austria, in contrast to overall NIM of 2.33% and 2.5%-4.8% in CEE markets in Q1 2017).

Compared with many large Western European banks, Erste has a stronger focus on retail clients (52% of total revenues in Q1 2017), and typically derives most of its revenues from that segment, along with small businesses and corporate lending (22% of total revenues), which we view as stable sources. The savings banks segment, consisting of the member savings banks in the cross-guarantee system, generates another 22% in total revenues. 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-- | | | | |
| (%) | 2017* | 2016 | 2015 | 2014 | 2013 |
| Loan market share in country of domicile | 19.7 | 19.6 | 19.4 | 19.2 | 19.0 |
| Deposit market share in country of domicile | 18.9 | 18.8 | 18.5 | 18.4 | 19.0 |
| Total revenues from business line (currency in millions) | 1,560.2 | 6,644.1 | 6,500.9 | 5,900.6 | 7,180.8 |
| Commercial banking/total revenues from business line | 22.4 | 22.6 | 22.7 | 24.7 | 6.6 |
| Retail banking/total revenues from business line | 52.0 | 49.5 | 51.2 | 56.2 | 76.5 |
| Commercial & retail banking/total revenues from business line | 74.4 | 72.1 | 73.9 | 81.0 | 83.1 |
| Trading and sales income/total revenues from business line | 8.7 | 7.8 | 6.4 | 7.0 | 6.4 |
| Other revenues/total revenues from business line | 16.9 | 20.1 | 19.7 | 12.0 | 10.5 |
| Investment banking/total revenues from business line | 8.7 | 7.8 | 6.4 | 7.0 | 6.4 |
| Return on equity | 8.7 | 11.0 | 9.3 | (13.6) | 0.5 |

*Data as of March 31.

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

We view Erste's capital and earnings as adequate. We base this mainly on our projection that its RAC ratio will increase to 9.0%-9.5% in the next 12-24 months, compared with 8.4% as of year-end 2016, driven by sound earnings retention. The capital build-up is also being supported by hybrid issues such as additional tier 1 instruments issued in April 2017 and May 2016, 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. The change in our assessment of Erste's operating environment in the Czech Republic has a positive impact of about 20 basis points (bps) in the RAC ratio pro forma as of December 2016. We anticipate Erste's total lending volume and our measure of risk-weighted assets to grow moderately at about 2% in 2017-2018. At the same

time, as expected the NIM declined slightly in 2016 and repricing the customer portfolio will, in our view, have an effect from 2017 onward. The net fee and commission income will remain under pressure in 2017-2018, driven mainly by lower securities and payment fees, but also by lower interchange fees in the card business.

Owing to the improvement in asset quality, we forecast the bottom line will benefit from stable risk costs of 40 bps-50 bps in 2017-2018 compared with previous lows of 15 bps in 2016 and 19 bps in Q1 2017. Regulatory costs and bank levies remain material for Erste, reaching about €360 million in 2016, but we expect overall operating costs to remain relatively flat in 2017-2018. As a mitigating factor, Erste booked a one-off gain of about €139 million from the sale of its share in Visa Europe in the second quarter of 2016. We estimate pre-tax profits of €1.8 billion-€2.0 billion in 2017-2018 (2016: €1.95 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, is expected to improve to about 0.90% 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 51%, 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 2017-2018, which contributes to the overall adequate quality of capital.

Table 3

| Erste Group Bank AG Capital And Earnings | | | | | |
|---|-------------------------------|-------------|-------------|-------------|-------------|
| | --Year-ended Dec. 31-- | | | | |
| (%) | 2017* | 2016 | 2015 | 2014 | 2013 |
| Tier 1 capital ratio | 13.0 | 13.3 | 12.0 | 10.6 | 11.8 |
| S&P Global Ratings RAC ratio before diversification | N.M. | 8.4 | 7.3 | 6.0 | 6.5 |
| S&P Global Ratings RAC ratio after diversification | N.M. | 9.5 | 7.8 | 6.6 | 7.4 |
| Adjusted common equity/total adjusted capital | 96.5 | 96.4 | 99.1 | 98.9 | 99.0 |
| Net interest income/operating revenues | 67.4 | 67.2 | 68.4 | 76.2 | 67.9 |
| Fee income/operating revenues | 29.3 | 27.4 | 28.6 | 31.7 | 25.5 |
| Market-sensitive income/operating revenues | 5.1 | 4.3 | 4.8 | (5.4) | 2.2 |
| Noninterest expenses/operating revenues | 62.6 | 59.4 | 57.0 | 64.2 | 58.9 |
| Provision operating income/average assets | 1.1 | 1.3 | 1.4 | 1.1 | 1.4 |
| Core earnings/average managed assets | 0.8 | 1.0 | 0.8 | (0.3) | 0.4 |

*Data as of March 31. N.M.--Not meaningful. RAC--Risk-adjusted capital.

Table 4

| Erste Group Bank AG Risk-Adjusted Capital Framework Data | | | | | |
|--|-----------|-----------------------|--------------------------|-----------------------------------|---|
| (Mil. €) | 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 | 55,034 | 2,403 | 4 | 8,542 | 16 |
| Institutions | 11,178 | 3,346 | 30 | 2,616 | 23 |
| Corporate | 75,190 | 48,214 | 64 | 65,953 | 88 |
| Retail | 74,940 | 20,082 | 27 | 40,289 | 54 |
| Of which mortgage | 39,717 | 7,841 | 20 | 13,057 | 33 |
| Securitization§ | 1,444 | 135 | 9 | 653 | 45 |
| Other assets | 8,861 | 5,259 | 59 | 12,162 | 137 |
| Total credit risk | 226,646 | 79,439 | 35 | 130,214 | 57 |
| Market risk | | | | | |
| Equity in the banking book† | 1,700 | 2,453 | 159 | 12,889 | 758 |
| Trading book market risk | -- | 3,612 | -- | 5,419 | -- |
| Total market risk | -- | 6,065 | -- | 18,308 | -- |
| Insurance risk | | | | | |
| Total insurance risk | -- | -- | -- | 0 | -- |
| Operational risk | | | | | |
| Total operational risk | -- | 15,138 | -- | 16,871 | -- |
| | | Basel III RWA | | S&P Global Ratings RWA | % of S&P Global Ratings RWA |
| Diversification adjustments | | | | | |
| RWA before diversification | | 101,815 | | 165,393 | 100 |
| Total Diversification/Concentration Adjustments | | -- | | (18,186) | (11) |
| RWA after diversification | | 101,815 | | 147,206 | 89 |
| | | Tier 1 capital | Tier 1 ratio (%) | Total adjusted capital | S&P Global Ratings RAC ratio (%) |
| Capital ratio | | | | | |
| Capital ratio before adjustments | | 13,753 | 13.4 | 13,921 | 8.4 |
| Capital ratio after adjustments‡ | | 13,753 | 13.4 | 13,921 | 9.5 |

*Exposure at default. §Securitisation Exposure includes the securitisation 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, 2016, S&P Global Ratings.

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

We assess Erste's risk position as adequate in line with its weighted economic risk score of '4'. 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 €137.5 billion as of March 31, 2017 are widely diversified between

countries as well as between retail (42% of loan portfolio) and corporate clients (58% 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 some 16% of the total portfolio in Q1 2017 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 6.8% of the loan portfolio as of March 31, 2017. Swiss franc loans (3.7% 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. Nonperforming loans (NPLs) declined to a reported 4.9% as of March 31, 2017 compared with 9.6% at the peak in 2013, and we expect this positive trend to continue, supported by the further write-offs and sales of NPL portfolios (total of €1.6 billion in 2016). In our view, this has led to sustainable stabilization 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 67.6% NPL coverage to be adequate and in line with peers. The positive development has translated into historically low credit losses at 15 bps in 2016 and 19 bps in Q1 2017, outperforming the peer group but we expect them to stabilize at about 40-50 bps in the next two years.

We believe that Erste's risk management is comprehensive and efficient, which is crucial in light of 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-- | | | | |
| (%) | 2017* | 2016 | 2015 | 2014 | 2013 |
| Growth in customer loans | 6.7 | 2.5 | 2.8 | 0.5 | (3.2) |
| Total diversification adjustment/S&P Global Ratings RWA before diversification | N.M. | (11.0) | (5.9) | (9.0) | (12.0) |
| Total managed assets/adjusted common equity (x) | 16.3 | 15.5 | 16.4 | 17.6 | 16.7 |
| New loan loss provisions/average customer loans | 0.2 | 0.1 | 0.6 | 1.7 | 1.4 |
| Net charge-offs/average customer loans | (0.2) | (0.1) | (0.1) | 0.0 | N.M. |
| Gross nonperforming assets/customer loans + other real estate owned | 5.1 | 5.3 | 7.4 | 8.9 | 9.6 |
| Loan loss reserves/gross nonperforming assets | 64.2 | 65.0 | 61.2 | 65.9 | 63.5 |

*Data as of March 31. RWA--Risk-weighted assets. N.M.--Not meaningful.

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 year-end 2016), with very low single-name concentrations. We expect the ratio of loans to deposits to remain at the current level (94.8% at the end of Dec. 31, 2016), which compares very well with peers'. Furthermore, S&P Global Ratings' stable funding ratio for Erste fluctuates around 120%, reinforcing our above-average assessment (estimated at 125% as of Dec. 31, 2016).

At the end of 2016, wholesale funding (which we define as interbank, unsecured, and secured issues) accounted for about one-quarter of Erste's total funding. Therefore, Erste's reliance on investor-sensitive wholesale funding is moderate with new market funding of less than €2 billion in 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 3.9x at Dec. 31, 2016. Our liquidity ratios at group level and main subsidiaries are stronger than those of the overwhelming majority of domestic and large European peers with 1.0x-2.0x ratios. These metrics reflect the structural strengths of Erste's deposit-heavy funding profile, in addition to management's policy of maintaining ample buffers of unencumbered high-quality securities eligible for refinancing by the European Central Bank. As of year-end 2016, the liquidity buffer (defined as unencumbered collateral plus cash) stood at €51.2 billion or 26.7% 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-- | | | | |
| (%) | 2017* | 2016 | 2015 | 2014 | 2013 |
| Core deposits/funding base | 72.9 | 76.4 | 74.1 | 72.2 | 70.7 |
| Customer loans (net)/customer deposits | 93.5 | 94.8 | 98.7 | 99.0 | 97.9 |
| Long-term funding ratio | 89.2 | 92.4 | 91.7 | 90.8 | 89.9 |
| Stable funding ratio | 125.7 | 125.2 | 120.4 | 121.5 | 121.0 |

Table 6

| Erste Group Bank AG Funding And Liquidity (cont.) | | | | | |
|--|-------|------|------|------|------|
| --Year-ended Dec. 31-- | | | | | |
| (%) | 2017* | 2016 | 2015 | 2014 | 2013 |
| Short-term wholesale funding/funding base | 11.7 | 8.3 | 8.9 | 9.8 | 10.8 |
| Broad liquid assets/short-term wholesale funding (x) | 3.0 | 3.9 | 3.3 | 3.0 | 2.8 |
| Net broad liquid assets/short-term customer deposits | 42.4 | 41.8 | 41.7 | 44.9 | 49.3 |
| Short-term wholesale funding/total wholesale funding | 42.6 | 34.7 | 34.3 | 35.3 | 36.8 |

*Data as of March 31.

High systemic importance in a country where we assess government support for banks as uncertain

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 no longer 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 nevertheless 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 about 4.5% at year-end 2016 and we project the buffer to increase to about 5.0% by 2018. 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. However, this leaves the bank below our 5.5% threshold of risk-weighted assets for a one-notch uplift. 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.

Ratings on hybrid instruments

We rate the nondeferrable subordinated debt instruments of Erste 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 'BB+', 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.

Additional rating factors: Subsidiaries

We continue to consider Czech-based Ceska Sporitelna to be a core subsidiary of Erste, since Ceska plays an integral role in Erste's strategy in CEE countries. In our view, Erste continues to be fully committed to Ceska Sporitelna, and to the Czech Republic, which remains one of the most attractive markets in which Erste operates.

However, the core group status does not translate into additional notches of support for Ceska Sporitelna, given the 'a-' assessment of Erste's group credit profile (GCP), which is one notch below Ceska Sporitelna's issuer credit rating of 'A'.

We believe that Ceska Sporitelna is generally eligible to be rated above Erste's GCP, because we consider it to be a prudentially regulated subsidiary that we currently expect to be subject to a separate resolution process from its parent Erste. Consequently, we think it will be able to continue operating without defaulting on its senior unsecured obligations in the event of a resolution of the parent and that it cannot be used to recapitalize another part of the group.

Related Criteria And Research

Related Criteria

- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity - April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - January 29, 2015
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework - June 22, 2012
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions - December 06, 2010
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks - March 23, 2004
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- Methodology for Linking Long-Term and Short-Term ratings, April 7, 2017
- General Criteria: Guarantee Criteria - October 21, 2016

Related Research

- Banking Industry Country Risk Assessment Update: June 2017, June 2, 2017
- Banking Industry Country Risk Assessment: Austria, May 29, 2017
- Erste Group Bank AG Outlook Revised To Stable On Improving Capitalization; 'BBB+/A-2' Ratings Affirmed, May 17, 2016
- Erste Group Bank AG Upgraded To 'A-/A-2' On Stronger Financial Profile; Outlook Positive, March 14, 2017

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 June 19, 2017)

Erste Group Bank AG

| | |
|----------------------------|-----------------|
| Counterparty Credit Rating | A-/Positive/A-2 |
| Commercial Paper | |
| <i>Local Currency</i> | A-2 |
| Junior Subordinated | BB+ |
| Senior Unsecured | A- |
| Short-Term Debt | A-2 |
| Subordinated | BBB |

Counterparty Credit Ratings History

| | |
|-------------|-------------------|
| 14-Mar-2017 | A-/Positive/A-2 |
| 17-May-2016 | BBB+/Stable/A-2 |
| 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 (Republic of) | AA+/Stable/A-1+ |
|-----------------------|-----------------|

Related Entities**Erste Group Bank AG, Hong Kong Branch**

| | |
|-----------------------|-----|
| Commercial Paper | |
| <i>Local Currency</i> | A-2 |

*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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Financial Institutions Ratings Europe; FIG_Europe@spglobal.com

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