

## FITCH TAKES VARIOUS RATING ACTIONS ON POLISH BANKS

Fitch Ratings-Warsaw/London-29 February 2016: Fitch Ratings has downgraded the Long-term Issuer Default Ratings (IDRs) of Getin Noble Bank SA to 'BB-' from 'BB' and Bank Ochrony Srodowiska (BOS) to 'B+' from 'BB'. The agency has also affirmed the Long-term IDRs of mBank at 'BBB-', mBank Hipoteczny (mBH) at 'BBB-', Bank Millennium at 'BBB-', Alior Bank SA at 'BB', Bank Zachodni WBK (BZ WBK) at 'BBB+' and Eurobank at 'A-'. A full list of rating actions is at the end of this commentary.

The downgrades of Getin and BOS are driven mainly by their significantly weakened loss absorption capacity, in part as a result of the new bank tax, and weak asset quality. The affirmations of Alior, Millennium, mBank and BZ WBK reflect their more robust profitability and greater capital flexibility, and limited changes in their financial metrics since the last review. The affirmations of mBank, BZ WBK and Eurobank also reflect Fitch's opinion that there is a high probability that they would be supported, if required, by their respective majority shareholders: Commerzbank AG (BBB-/Positive/bbb-), Banco Santander S.A. (Santander, A-/Stable/a-) and Societe Generale (SG; A/Stable/a). Fitch has not factored banks' potential losses from foreign currency mortgage restructuring into these rating actions due to a still high degree of uncertainty on the solution that will be imposed.

Fitch has also upgraded Eurobank's Viability Rating (VR) to 'bb' from 'bb-', which mainly reflects the bank's extended track record of solid performance following the refocusing of its strategy in 2010.

### KEY RATING DRIVERS

#### IDRS, SUPPORT RATINGS, NATIONAL RATINGS AND SENIOR DEBT OF ALL BANKS

Fitch believes that BZ WBK, mBank and Eurobank are strategically important subsidiaries for their parents, and therefore their Long-term IDRs and senior debt ratings are notched once from the parent IDRs. The potential cost of support should be easily manageable for the banks' owners in light of the subsidiaries' small relative size. The IDRs and Senior debt ratings of mBank and BZ WBK and National Rating of BZ WBK are also underpinned by the banks' VRs, which are currently at the same level as their support-driven Long-term IDR.

mBH's IDRs are equalised with those of its direct parent, mBank, as we view the subsidiary as core to mBank. Debt issues by mFinance France and BOS Finance AB are fully guaranteed by mBank and BOS, respectively. Potential support from Commerzbank for mBank's subsidiaries could be extended directly or flow through mBank.

Millennium's IDRs are driven by its standalone strength, as reflected in its VR. Its Support Rating (SR) reflects potential support available from its parent, Banco Comercial Portugues S.A. (BCP; BB-/Stable/bb-), due to the subsidiary's strategic importance.

The IDRs and National Ratings of Alior, BOS (also senior debt ratings) and Getin, like Millennium, are driven by their standalone strength, as reflected in their VRs.

#### SUPPORT RATINGS AND SUPPORT RATING FLOORS OF ALIOR, BOS AND GETIN

The Support Rating Floors (SRF; 'No Floor') and the SRs of '5' for Getin and Alior express Fitch's opinion that potential sovereign support of the banks cannot be relied upon. This is underpinned by the EU's Bank Recovery and Resolution Directive (BRRD), which provides a framework for

resolving banks that are likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

BOS's SRF ('B') and SR ('4') reflect Fitch's view of an only limited probability of extraordinary support for BOS from the Polish sovereign, mostly due to the combination of BRRD and EU state aid considerations. At the same time, Fitch believes that the state would endeavour to act pre-emptively to avoid BOS breaching regulatory capital adequacy requirements due to the state's indirect ownership of the bank and BOS's role in financing Poland's environmental protection projects.

The bank's direct majority shareholder (the state-owned National Fund for Environment Protection and Water Management, the Fund) plans to provide capital for BOS by end-1H16. Fitch believes it would be difficult for a capital increase directly from the Fund to be made without triggering state aid and bail-in considerations, if private shareholders demonstrate that they are unwilling to support the bank.

## VRS OF ALL BANKS

### BOS

BOS's VR of 'b+' is driven largely by its mounting industry- and single-borrower loan book concentrations and weak profitability outlook, which weigh on the bank's capitalisation. This is notwithstanding BOS's plan to raise capital in 1H16, with the likely participation of its majority shareholder (the Fund), which should enable the bank to meet increased regulatory capital requirements. The VR also reflects BOS's weak overall market franchise, poor strategy execution, moderate exposure to Swiss franc retail mortgages (9% of total gross loans at end-2015), low reserve coverage of impaired loans and significant reliance on fairly price-sensitive term customer deposits and wholesale debt funding (PLN1bn of Eurobonds mature in May 2016).

The bank's high single-name loan book concentrations have been fuelled by financing of wind farm development projects, which were equal to around twice the bank's Fitch core capital at end-November 2015. Credit risks related to this form of financing are amplified by long tenors and regulatory risks as wind farms rely on state subsidies. The bank's operating profitability has suffered from low market interest rates, increased funding costs and the volatile profitability of its brokerage house subsidiary. Fitch understands that BOS is likely to be exempt from the bank tax (about PLN50m) as result of entering a rehabilitation programme due to its 2015 annual loss.

The National Long-term Rating of BOS's subordinated debt is notched down twice from the bank's National Rating to reflect weak recovery prospects in case of default.

### MBANK

mBank's VR of 'bbb-' reflects its modest risk appetite, stable asset quality, fairly strong retail and corporate franchise and solid capitalisation. The VR also reflects material (albeit slowly declining) exposure to foreign-currency (FC) mortgages and substantial FC refinancing needs (still largely sourced from the parent). At end-2015, residential mortgages granted in Poland and denominated in FC accounted for 28% of total gross loans and the majority had LTVs above 100%. mBank's strategic focus on improving its self-financing capacity assumes a gradual repayment of Commerzbank loans and subordinated debt, which represented 13% of total funding at end-2015.

mBank applies relatively conservative underwriting standards as evidenced by its low proportion of unsecured lending, well diversified corporate exposure by single name and industry and moderate growth appetite. mBank's retail borrowers are largely based in urbanised areas, which limits credit risks related to unsecured retail lending. The bank's pre-impairment operating profit and capitalisation are sufficient to cushion even a material deterioration in asset quality. However, mBank's capitalisation is highly vulnerable to a sharp and prolonged depreciation of the Polish

zloty against CHF. At end-2015, the ratio of impaired loans improved to 5.7% (market average: 6.4%) and unreserved impaired loans accounted for a small 14% of Fitch core capital (FCC).

## ALIOR

Alior's VR of 'bb' largely reflects its rapid credit expansion, relatively high appetite for credit risk, weak capitalisation and fast inflow of new impaired loans. At end-3Q15, the impaired loans ratio was 8.6%, or 10.1% including PLN510m impaired loans written off in 9M15. Alior's credit risk profile is also driven by the bank's strategic focus on unsecured retail lending, some concentration in riskier industries (such as wind farms and the construction sector) and only moderate coverage of impaired loans by loan loss reserves.

Alior's internal capital generation lags behind balance sheet growth and in 2016 the bank will need to either rein in its appetite for expansion or raise fresh capital. The ratings also take into consideration Alior's conservative funding strategy based predominantly on retail deposits, adequate liquidity position and a net interest margin higher than the market average, which should somewhat cushion the impact of the bank levy.

## GETIN

Getin's VR of 'bb-' suffers from weakening profitability (due to the low interest rate environment and the bank levy) and weak asset quality. At end-3Q15, the impaired loans ratio of 15% was one of the highest in the banking sector and the unreserved impaired loans almost equalled FCC. Getin's loss absorption capacity through the income statement may be insufficient to withstand even moderate stress in its loan book, essentially in light of a large stock of legacy high-LTV mortgages disbursed with relaxed credit standards. Getin could pay about PLN200m bank tax in 2016 (assuming no countermeasures from the bank), which was higher than its 9M15 annualised consolidated operating profit.

FC mortgages comprise a material, albeit slowly declining, proportion of the loan book (about 30% of gross loans at end-3Q15). The bank's high reliance on currency swaps to refinance CHF loans exposes Getin to potential prohibitive pricing for new swaps or their limited supply in case of market stress. At the same time, Getin's ratings are also driven by the bank's mainly deposit funding, improved liquidity position and its mid-sized franchise.

## BZ WBK

BZ WBK's VR of 'bbb+' reflects the bank's strong capitalisation and loss absorption capacity as well as a track record of solid internal capital generation. The FCC ratio stood at 16.8% at end-2015, and the quality of BZ WBK's capital is sound, underpinned by a low uncovered impaired loans/FCC ratio of 12% at end-2015. Return on equity (net of one-off gains and costs) fell moderately in 2015, but remained solid at 13.7%; however, this will come under pressure in 2016, due to persistently low interest rates and the bank tax.

The impaired loans ratio fell to 7.3% at end-2015 (end-2014: 8.4%) and coverage of impaired loans by provisions improved moderately to 71% (2014: 67%). Single name and sector concentrations in the loan book are low. BZ WBK's exposure to legacy FC mortgages is moderate, at 16% of the consolidated loan book in 2015, and performance of this part of the portfolio has been sound to date.

Liquidity is adequate, benefitting from the bank's stable funding position, based on diversified, predominantly retail, customer deposits (90% of total funding excluding derivatives in 2015). The loan-to-deposit ratio was just below 100%.

## MILLENNIUM

Millennium's VR ('bbb-') is driven by its fairly strong market franchise, moderate risk appetite, good asset quality, solid capital buffers and profitability, and stable deposit-based funding. The VR also reflects the bank's substantial exposure to Swiss franc retail mortgages (37% of total gross loans at end-2015), most of which have fairly high loan-to-value ratios. The asset quality

in this portfolio is vulnerable to an increase in CHF LIBOR and a potential sharp and prolonged weakening of the Polish zloty. Millennium is also reliant largely on CHF/PLN swaps to refinance the Swiss franc loans; therefore, its liquidity position is sensitive to potential margin calls (if the zloty weakens).

The FCC ratio was a solid 17.2% at end-2015, and unreserved impaired loans were a small 12% of FCC. Internal capital generation has been solid, but will come under pressure from the bank tax.

## EUROBANK

Eurobank's VR ('bb') reflects its small size, market franchise limited to retail customers, significant concentration (though declining) in higher-risk unsecured consumer loans (46% of total gross loans at end-2015) and a moderate Swiss franc mortgage portfolio (13% of total gross loans). These factors are counterbalanced by the bank's adequate capital buffers, solid operating profitability, relatively high (but stable) risk appetite and comfortable funding and liquidity positions due to substantial long-term parental funding (in both local and foreign currency).

Eurobank's impaired loans ratio of 8.7% at end-2015 reflects the significant share of unsecured consumer loans in the loan book. However, impaired loans are reasonably covered by reserves and loan book quality has gradually improved due to the amortisation of the legacy portfolio, improved underwriting standards and increased local currency mortgage lending. The bank tax will not significantly weaken profitability due to Eurobank's robust net interest margin (end-2015: 5.1%).

## RATING SENSITIVITIES

The support-driven ratings of BZ WBK, mBank, mBH and Eurobank are sensitive to the IDRs of their respective parent banks. However, BZ WBK and mBank's IDRs are also underpinned by their VRs, and so would only be downgraded in case of both a lowering of their VRs and a weakening of parental support.

The IDRs and National Ratings of Millennium, Alior, Getin and BOS (also senior debt ratings) are sensitive to changes in their VRs.

Downward pressure on all banks' VRs could, to varying degrees, arise from (i) significant losses resulting from a restructuring of FC mortgages; (ii) a further sharp and prolonged depreciation of the domestic currency combined with a deterioration of the operating environment; (iii) a material deterioration in asset quality; and (iv) considerably weaker internal capital generation.

Fitch's base case assumption is that any potential administrative solution to FC mortgages will not result in significant one-off losses for the banking sector. However, if risks related to administrative actions materialise, then the VRs of Getin and Millennium, and to a lesser extent mBank and BOS, could come under most pressure. This reflects their large FC-mortgage portfolios relative to the total loan book and their FCC. Exposure is significantly less at BZWBK and Eurobank and very limited at Alior.

Fitch does not expect to upgrade the banks' VRs in the foreseeable future given the weakening profitability of the Polish banking sector due to the bank tax and the low interest rate environment, and risks relating to FC mortgages. However, stand-alone credit profiles could benefit from (i) stronger capitalisation (Getin, Alior, BOS); (ii) a track record of still solid profitability in an environment of low interest rates and the bank tax; and (iii) a material reduction in FC mortgages (Getin, Millennium, mBank, BOS) if this could be achieved without significant conversion losses.

The rating actions are as follows:

Alior

Long-term foreign currency IDR: affirmed at 'BB', Stable Outlook

Short-term foreign currency IDR: affirmed at 'B'  
National Long-term Rating: affirmed at 'BBB+(pol)', Stable Outlook  
National Short-term Rating: affirmed at 'F2(pol)'  
Viability Rating: affirmed at 'bb'  
Support Rating: affirmed at '5'  
Support Rating Floor: affirmed at 'No Floor'

## BOS

Long-term foreign currency IDR: downgraded to 'B+' from 'BB', Outlook Stable  
Short-term foreign currency IDR: affirmed at 'B'  
National Long-term Rating: downgraded to 'BB+(pol)' from 'BBB(pol)', Outlook Stable  
National Short-term Rating: downgraded to 'B(pol)' from 'F3(pol)'  
Viability Rating: downgraded to 'b+' from 'bb'  
Support Rating: affirmed at '4'  
Support Rating Floor: affirmed at 'B'  
PLN2bn long-term senior unsecured bond programme: downgraded to 'BB+(pol)' from 'BBB(pol)';  
Recovery Rating 'RR4'  
PLN2bn short-term senior unsecured bond programme: downgraded to 'B(pol)' from 'F3(pol)'  
PLN83m subordinated debt: downgraded to 'BB-(pol)' from 'BBB-(pol)'  
EUR250m long-term senior unsecured eurobonds issued by BOS Finance AB: downgraded to 'B+'  
from 'BB'; Recovery Rating 'RR4'

## Eurobank

Long-term foreign currency IDR: affirmed at 'A-'; Outlook Stable  
Short-term foreign currency IDR: affirmed at 'F1'  
National Long-term Rating: affirmed at 'AA(pol)'; Outlook Stable  
National Short-term Rating: affirmed at 'F1+'  
Support Rating: affirmed at '1'  
Viability Rating: upgraded to 'bb' from 'bb-'

## Millennium

Long-term foreign currency IDR: affirmed at 'BBB-'; Outlook Stable  
Short-term foreign currency IDR: affirmed at 'F3'  
National Long-term Rating: affirmed at 'A-(pol)'; Outlook Stable  
Viability Rating: affirmed at 'bbb-'  
Support Rating: affirmed at '4'

## Getin

Long-term foreign currency IDR: downgraded to 'BB-' from 'BB'; Outlook Stable  
Short-term foreign currency IDR: affirmed at 'B'  
National Long-term Rating: downgraded to 'BBB-(pol)' from 'BBB(pol)'; Outlook Stable  
Viability Rating: downgraded to 'bb-' from 'bb'  
Support Rating: affirmed at '5'  
Support Rating Floor: affirmed at 'No Floor'

## mBank

Long-term foreign currency IDR: affirmed at 'BBB-'; Outlook Positive  
Short-term foreign currency IDR: affirmed at 'F3'  
Viability Rating: affirmed at 'bbb-'  
Support Rating: affirmed at '2'  
Long-term senior unsecured debt rating: affirmed at 'BBB-'  
Short-term senior unsecured debt rating: affirmed at 'F3'  
Long-term senior unsecured rating for eurobonds issued by mFinance France: affirmed at 'BBB-'

mBank Hipoteczny  
Long-term foreign currency IDR: affirmed at 'BBB-'; Outlook Positive  
Short-term foreign currency IDR: affirmed at 'F3'  
Support Rating: affirmed at '2'

#### BZ WBK

Long-term foreign currency IDR: affirmed at 'BBB+', Outlook Stable  
Short-term foreign currency IDR: affirmed at 'F2'  
Viability Rating: affirmed at 'bbb+'  
Support Rating: affirmed at '2'  
National Long-term Rating: affirmed at 'AA-(pol)', Outlook Stable  
Senior unsecured debt: affirmed at 'AA-(pol)'

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#### Applicable Criteria

Global Bank Rating Criteria (pub. 20 Mar 2015)

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