

RATING ACTION COMMENTARY

Fitch Places 5 Polish Banks' VRs and 3 IDRs on RWN

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Fitch Ratings - Warsaw - 05 Aug 2022: Fitch has placed the Viability Ratings (VRs) of Bank Pekao S.A. (Pekao, bbb+), mBank S.A. (mBank, bbb-), Santander Bank Polska S.A. (Santander BP, bbb+), BNP Paribas Bank Polska S.A. (BNP BP, bbb-) and ING Bank Slaski S.A. (ING BSK, bbb+) on Rating Watch Negative (RWN). The IDRs and Long-Term National Ratings of Pekao (BBB+), Pekao Bank Hipoteczny (Pekao BH, BBB+) and mBank (BBB-) have also been placed on RWN. Bank Handlowy w Warszawie S.A.'s (Handlowy, a-) VR has been maintained on RWN. A full list of rating actions is below.

The IDRs of Santander BP, Bank Handlowy, BNP BP and ING BSK remain underpinned by support and are unaffected by this rating action, as we do not expect parent banks' commitment to their subsidiaries to weaken as a result of recent events.

KEY RATING DRIVERS

The RWN on the five VRs is driven by the downgrade of the operating environment score for Poland to 'bbb' from 'bbb+'. The VRs of the affected banks are either above or one notch below the revised operating environment score, which constrains (but does not always cap) a bank's VR. The downgrade of the operating environment score may therefore result in downgrades of VRs that are above the operating environment score. For banks with 'bbb-' VRs, the lowering of the operating environment score combined with other factors could lead to downgrades.

The RWN on Handlowy's VR now reflects the lowering of the operating environment score in addition to the expected exit from the consumer business. The latter was announced by parent Citigroup Inc. in April 2021, and the RWN reflected limited

transparency over the scope and the timeframe of the transaction and uncertainty over the potential impact on the bank's standalone profile.

The IDRs of Pekao and mBank have been placed on RWN because they are driven by their respective VRs, while the Pekao BH's IDRs are equalised with those of its parent, Pekao.

Fitch has downgraded the operating environment score because in its view, the recently introduced payment holidays on local-currency mortgages are further evidence of the willingness of the Polish authorities to intervene in the banking sector and impose large additional costs on banks. This most recent measure comes in addition to the sizeable bank tax and as banks need to make substantial provisions for legal risks relating to swiss-franc mortgage loans. The authorities have been also putting pressure on banks to raise deposit rates .

In our view, the level of intervention by the state, combined with the expected slowdown of the economy, significantly affects banks' ability to operate consistently profitable business models, and has driven the lowering of the operating environment score. This increased intervention risk partially offsets the benefits for the banking system of operating in a relatively large, EU-based, diversified economy.

The measure on credit holidays came into force on 28 July and allows all zloty mortgage borrowers financing their housing needs (about 95% of the stock of zloty mortgages), regardless of their ability to service their loans, to suspend the payment of four installments (both principal and interest) in 2H22 and four in 2023. Banks are obliged to provide suspension at the borrower's request. The suspended installments would be rescheduled at the end of the life of the mortgage, and no interest on these would be accrued.

We estimate the maximum cost of this legislation for the Polish banking sector at about PLN21 billion, and believe the actual cost could be in the region of PLN16 billion-PLN17 billion, assuming actual participation at about 80% of eligible borrowers. This compares with modest sector net income of PLN8.9 billion in 2021, and a large part of the loss will be booked by banks upfront in 3Q22.

In our view, the positive impact of higher interest rates on margins should more than offset the loss on the mortgage holidays, and allow the sector to increase its net income in 2022 relative to 2021. However, the loss means that banks' performance will remain heavily constrained, even during the most favourable part of the interest rate cycle, with sector return on average equity likely to be below 5%.

Fitch will resolve the RWN following a full review of the affected banks, including an assessment of the impact of the revised operating environment score and the direct impact of the credit holiday on key financial metrics.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

VRs

- The VRs of Pekao, ING BSK and Santander BP could be affirmed at one notch above the operating environment score if we conclude that their business and risk profiles are sufficiently independent from the risk profile of the Polish operating environment. However, this is unlikely, given that these banks operate exclusively in Poland and have exposure to a broad range of both corporate and retail customers.

- Handlowy's VR could remain at its current level if we conclude that the bank's exceptionally low-risk and diversified business model, coupled with solid capitalisation and strong liquidity, are sufficient to rate it two notches above the operating environment score for Poland. We consider this highly unlikely.

- The VRs of mBank and BNP BP could be affirmed if we conclude that the effect of the downgrade of the operating environment score on their business and risk profiles is modest and the cost of credit holiday and other measures can be absorbed without material deterioration of their key financial metrics.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

VRs

- We will downgrade the VRs of the five banks, most likely by one notch, if we conclude that the downgrade of the operating environment score negatively affects our overall assessment of their credit profiles, either by itself or in combination with other factors.

Following a potential downgrade, Handlowy's VR would likely be maintained on RWN, reflecting uncertainty over the potential impact on the bank's standalone profile of the planned exit from retail operations.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The National Ratings of Pekao, Pekao BH and mBank reflect their creditworthiness relative to Polish peers'. The Long-Term National Ratings have been placed on RWN as

they are linked to their respective IDRs.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

IDRs

The IDRs of Pekao and mBank are sensitive to changes in their respective VRs. Pekao BH's IDR is sensitive to changes in Pekao's IDR or in the parent's propensity to provide support if needed. We do not expect the latter to change.

NATIONAL RATINGS

The National Ratings of Pekao, Pekao BH and mBank are sensitive to changes in their Long-Term IDR and the banks' creditworthiness relative to Polish peers.

ESG CONSIDERATIONS

Handlowy, Pekao, mBank, Santander BP, ING BSK and BNP BP's ESG Relevance Scores for Management Strategy have been revised to '4' from '3'. This reflects our view of elevated government intervention risk in the Polish banking sector, which impacts the banks' operating environment and their ability to define and execute on their strategies and has a negative implication for their ratings in combination with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entities, either due to their nature or the way in which they are being managed by the entities. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit

<https://www.fitchratings.com/site/re/10111579>

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Pekao BH's ratings are driven by a high probability of support from its parent Pekao.

RATING ACTIONS

ENTITY / DEBT ⇅	RATING ⇅	PRIOR ⇅
mBank S.A.	LT IDR BBB- Rating Watch Negative Rating Watch On	BBB- Rating Outlook Negative
	ST IDR F3 Rating Watch Negative Rating Watch On	F3
	Natl LT A+(pol) Rating Watch Negative Rating Watch On	A+ (pol) Rating Outlook Negative
	Natl ST F1(pol) Affirmed	F1(pol)
	Viability bbb- Rating Watch Negative Rating Watch On	bbb-
Senior non-preferred	LT BBB- Rating Watch Negative Rating Watch On	BBB-

Senior preferred	LT	BBB Rating Watch Negative	BBB
		Rating Watch On	
ING Bank Slaski S.A.	Viability	bbb+ Rating Watch Negative	bbb+
		Rating Watch On	
Santander Bank Polska S.A.	Viability	bbb+ Rating Watch Negative	bbb+
		Rating Watch On	
Bank Pekao S.A.	LT IDR	BBB+ Rating Watch Negative	BBB+ Rating Outlook Stable
		Rating Watch On	

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APPLICABLE CRITERIA

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

[Bank Rating Criteria \(pub. 12 Nov 2021\) \(including rating assumption sensitivity\)](#)

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Bank Pekao S.A.	EU Issued, UK Endorsed
BNP Paribas Bank Polska SA	EU Issued, UK Endorsed
ING Bank Slaski S.A.	EU Issued, UK Endorsed
mBank S.A.	EU Issued, UK Endorsed
Santander Bank Polska S.A.	EU Issued, UK Endorsed

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Structured Finance: Covered Bonds Structured Finance Banks Europe Poland
