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CREDIT OPINION
9 September 2016

Update

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RATINGS

Bank Zachodni WBK S.A.

Domicile	Warsaw, Poland
Long Term Deposit	A3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Bank Zachodni WBK S.A.

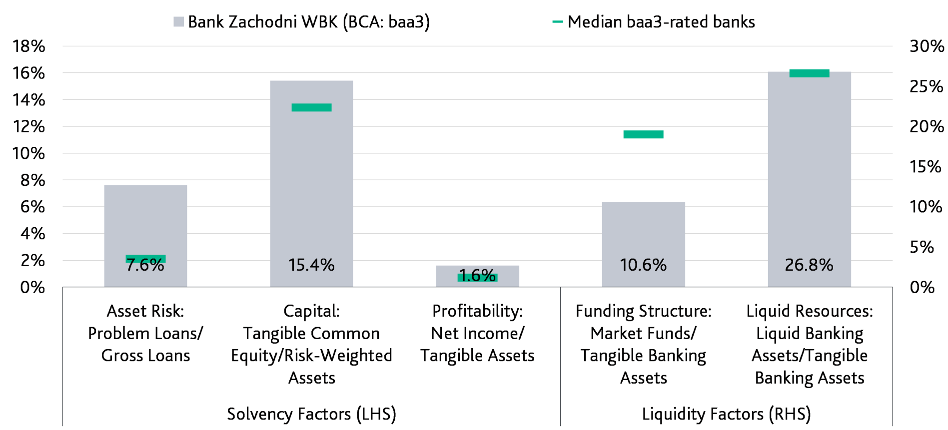
Semi-annual update

Summary Rating Rationale

Bank Zachodni WBK's (BZ WBK) A3/Prime-2 deposit ratings incorporate: (1) the bank's standalone baseline credit assessment (BCA) of baa3, (2) our assumption of moderate parental support from Banco Santander (Deposits A3 stable; BCA baa1) which results in one notch uplift from the bank's BCA, (3) the results of our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by the different liability classes in resolution, and which leads to two notches of rating uplift for BZ WBK's deposit ratings, and (4) our assumption of low likelihood of support from the Polish Government (A2, negative) in case of need, which does not result in additional uplift. The bank's Counterparty Risk Assessment (CR Assessment) is A2(cr)/P-1(cr).

BZ WBK's BCA of baa3 is supported by Poland's Macro Profile of Strong-, and reflects the bank's (i) expanding franchise in the Polish market, (ii) improved asset quality and strong profitability, and (iii) good liquidity profile. At the same time, the bank's capitalisation, although at a good level, may come under pressure from faster lending growth and potential government initiatives on CHF mortgages.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Credit Strengths

» Third largest banking franchise in the Polish market

» Asset quality is improving, and is in line with peers

» Capitalisation is adequate, but pressure may arise from faster lending growth and potential government initiatives on CHF mortgages

» Profitability is strong, but is facing challenges

» Good liquidity buffer

Credit Challenges

» Moderate exposure to Swiss-Franc mortgages

» Deposit funded profile, but some dependence on medium-term wholesale FX funding due to the FX mortgage portfolio

Rating Outlook

The outlook for BZ WBK's ratings is stable.

Factors that Could Lead to an Upgrade

Upward pressure of BZ WBK's ratings would be largely conditional on continuous improvement in asset quality, while maintaining or improving its regulatory capital, profitability, funding and liquidity.

Any additional volumes of subordinated instruments implying higher protection for senior creditors and a lower loss given-failure in resolution, which could lead to an additional uplift for the deposit ratings up to one notch.

Factors that Could Lead to a Downgrade

BZ WBK's ratings could come under pressure in case of: (1) significant deterioration in asset quality, profitability and/or capital levels, (2) substantial increase in market funding reliance, and shift of the funding profile away from deposits, or (3) BZ WBK's volume of subordinated instruments decreases relative to its total banking assets resulting in the reduction in the two-notch rating uplift of BM's deposits ratings per our Advanced LGF analysis.

Key Indicators

Exhibit 2
Bank Zachodni WBK S.A. (Consolidated Financials) [1]

	6-16[2]	12-15[2]	12-14[2]	12-13[3]	12-12[3]	Avg.
Total Assets (PLN billion)	142.2	138.7	134.0	105.5	60.0	24.1[4]
Total Assets (EUR million)	32322.9	32336.2	31171.0	25381.8	14709.5	21.8[4]
Total Assets (USD million)	35909.2	35126.7	37718.5	34974.7	19392.9	16.7[4]
Tangible Common Equity (PLN billion)	16.5	17.5	13.1	10.6	7.9	20.3[4]
Tangible Common Equity (EUR million)	3748.3	4069.9	3036.6	2560.4	1932.4	18.0[4]
Tangible Common Equity (USD million)	4164.2	4421.1	3674.5	3528.1	2547.6	13.1[4]
Problem Loans / Gross Loans (%)	6.8	7.3	8.4	7.9	5.4	7.2[5]
Tangible Common Equity / Risk Weighted Assets (%)	-	15.4	12.3	12.2	15.1	13.9[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	33.1	32.2	41.9	39.9	23.9	34.2[5]
Net Interest Margin (%)	3.3	3.2	3.4	3.5	3.9	3.4[5]
PPI / Average RWA (%)	-	3.1	3.3	4.0	4.6	3.2[6]
Net Income / Tangible Assets (%)	1.6	1.5	1.6	1.6	2.4	1.8[5]
Cost / Income Ratio (%)	51.8	51.0	47.3	50.5	43.9	48.9[5]
Market Funds / Tangible Banking Assets (%)	9.6	10.6	12.0	8.2	4.0	8.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	24.0	26.8	30.2	29.9	29.3	28.0[5]
Gross loans / Due to customers (%)	100.0	98.2	95.8	91.2	88.0	94.6[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation
Source: Moody's Financial Metrics

Detailed Rating Considerations

Third largest franchise in the Polish market

BZ WBK became the third-largest bank in Poland, following a number of acquisitions in recent years, with a 10% market share in both customer deposits and loans as of June 2016. The acquisition of Kredyt Bank has also significantly boosted the bank's mortgage franchise which was lagging behind its peers, while the consolidation of SCB (about 14% of the assets of BZ WBK) helped to expand the bank's presence in consumer lending. In addition, the bank has a good presence across Poland, supported by a wide branch network, comprised 666 own branches, with additional 164 branches through SCB's network as of June 2016.

As of June 2016, BZ WBK has a well-balanced loan book, with retail loans accounting for 51% of total loans, with mortgage loans making up two thirds of this.

During the first half of 2016 the loan book of BZ WBK increased by 10.8% year-on-year, outpacing the overall Polish market which increased by 5.4%, supported by the good macroeconomic environment and consumer sentiment. The bank reported a consistent increase in the loan book across all segments with consumer loans growing by 11%, mortgage loans by 9%, SME loans by 15% and large corporate loans by 11% .

Asset quality is improving, and is in line with peers

The ratio of non-performing loans of BZ WBK continued to decline in 2016, reaching 6.8% in June, from 7.3% in 2015, and 8.4% in 2014. The level is in line with the average for the Polish banking sector and also similar to its closest peers PKO BP (Deposits A2 neg, BCA baa2) and Bank Pekao (Deposits A2 neg(m), BCA baa1). The improvement is a result of the growing loan book combined with a stable stock of impaired loans.

At the same time, we calculate that the non-performing loan coverage ratio also continued to improve reaching to 72.7%, from 70.6% in 2015 and 67.4% as of year-end 2014.

BZ WBK has also inherited a legacy of CHF mortgages from Kredyt Bank and SCB, which made up 13% of its loan book as of June 2016 (the size of the CHF mortgage loans portfolio increased to PLN 13.8 billion in H1 2016, from PLN 2 billion in 2012 as a result of the two acquisitions). Although this portfolio has performed well to date, with NPL ratio of 1.5% for BZ WBK (compared to 3.6% for the sector), the depreciation of the Polish zloty against the Swiss franc of over 50% since 2008 has resulted in substantial increase in the loan-to-value (LtV) of these loans, with BZ WBK reporting an average LtV for its CHF mortgages of 120% as of H1 2016, creating a higher risk for the level of potential recovery in case of borrower default.

Capitalisation is adequate, but pressure may arise from faster lending growth and potential government initiatives on CHF mortgages

BZ WBK reported a consolidated Common Equity Tier 1 (CET1) ratio of 14.0 % and Total Capital ratio (TCR) of 14.4% as at June 2016, a slight decline from 14.1% and 14.6% as of year-end 2015 following distribution of 40% of the bank's unconsolidated profit for 2015 as dividend to its shareholders.

At the end of 2015, the Polish Financial Supervision Authority (KNF) announced the introduction of two additional capital buffers - a system-wide capital conservation buffer of 1.25% and a foreign-currency mortgage risk buffer of 0.72% (part of the Pillar 2 requirements, and applied on individual basis) - lifting the capital requirements for BZ WBK to a total of 10.79% for CET1 and 14.0% for TCR, which the bank is already covering with its year-end 2015 regulatory capital. However, we expect that the strong loan growth could lead to some decline in the capital ratios. In order to reflect this we adjust the capital score down by two notches to baa1.

A source of risk for the capital buffers stems from potential government measures in regard to foreign currency mortgages, as such an action could have a significant negative impact on Polish banks' capital levels. However, at this stage such discussions in the government have been postponed at least until 2017.

Profitability is strong, but is facing challenges

BZ WBK has maintained good internal capital generation during the first half of 2016. The bank reported an increase in net interest income by 9.3% year-on-year to PLN 2.3 billion, while its net fee and commission income declined by 1.8% to PLN 944 million. Since February 2016 Polish banks are required to pay annually a bank tax equal to 0.44 per cent of their adjusted assets. As a result BZ WBK recognised a PLN 173 million cost during the first half of 2016. This full 2016 tax cost will partially be offset by the PLN 316m million of income which BZ WBK recorded for the sale of Visa Europe Limited. As a result, the bank reported a net income of PLN 1.4 billion, resulting in a ROE of 13.5% and a ROA of 2.0%, whereas the adjusted ratios, if we exclude the one-off income from the Visa transaction would be 11.6% and 1.6%, respectively.

In addition to the bank tax, the President's office has proposed a draft law under which banks will be forced to reimburse foreign currency mortgage borrowers for the spreads charged over a “fair margin”. According to the President's office original estimate the one-off cost of this initiative for the sector is around PLN 4 billion, which we estimate to be around a sizable one quarter of the annualised pre-tax profit of the sector for 2016.

We expect that the above mentioned system-wide developments will continue to put pressure on the profitability of the sector, including BZ BWK. To reflect this expectation we adjust the profitability score down by two notches to baa2.

Deposit funded profile, but some dependence on medium-term wholesale FX funding due to the FX mortgage portfolio

BZ WBK is predominantly deposit funded, with deposits from retail customers accounting for 58% of the total deposits as of June 2016. The bank's loan to deposit ratio was 100% as of the same time, a slight increase from 98.2% in 2015, driven by the loan growth outpacing the increase in deposits.

The bank also has comfortable liquidity buffer with liquid assets as a percentage of tangible assets at 24% at H1 2016 which has reduced from 27% in 2015 as a result of the sustained loan growth.

BZ WBK has a funding gap due to the CHF mortgage portfolio. As of Q4 2015, the bank covered most of the currency mismatches (78% of the total) related to this portfolio through medium-term swaps with varied maturities. In our view, this exposes the bank to the volatile nature of the derivatives market at times of increased market volatility. To reflect the risks from this form of off-balance-sheet financing, we adjust down the funding structure score by two notches to baa2.

Notching Considerations

Affiliate Support

We assess a moderate probability of parental support for BZ WBK from its parent Banco Santander, given the 69.4% ownership stake in the bank and Banco Santander's commitment to its Polish business. This assessment results in on notch of uplift from the baa3 BCA of BZ BWK to an adjusted BCA of baa2.

Loss Given Failure

BZ WBK operates in Poland, which is an EU-member country. As such, under the Bank Recovery and Resolution Directive (BRRD) it is subject to an Operation Resolution Regime, similar to other EU countries. As a result, in accordance with our methodology, we apply our advanced LGF analysis, considering the risks faced by the different debt and deposit classes across the liability structure should the bank enter resolution. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, a 26% proportion of junior deposits (EU average) and assign a 25% probability to deposits being preferred to senior unsecured debt. These are in line with our standard assumptions.

This results in a Preliminary Rating Assessment (PRA) of a3, two notches above the Adjusted BCA, reflecting a very low loss-given failure.

Government Support

We incorporate a low likelihood of government support for BZ WBK's deposits in the event of its failure. This reflects the operational resolution regime which is likely to restrict the ability of the government to provide such support, even if it were willing to do so, requiring losses to be imposed on even senior creditors and large depositors under many circumstances.

As a result, BZ WBK's deposit rating do not benefit from any systemic support from Polish authorities.

Counterparty Risk Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment of BZ WBK is positioned at A2(cr), three notches above the Adjusted BCA of baa2, based on the cushion against default provided to the senior obligations. In addition, the low probability of government support does not result in any uplift

About Moody's Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Methodology and Scorecard Factors

Exhibit 3

Bank Zachodni WBK S.A.

Macro Factors							
Weighted Macro Profile	**Strong -**	**100%**					

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	7.6%	ba2	←→	ba2	Expected trend	
Capital						
TCE / RWA	15.4%	a2	↓	baa1	Capital retention	Expected trend
Profitability						
Net Income / Tangible Assets	1.6%	a3	↓	baa2	Expected trend	
Combined Solvency Score		baa2		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	10.6%	a3	←→	baa2	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	26.8%	baa2	←→	baa2	Expected trend	
Combined Liquidity Score		baa1		baa2		
Financial Profile				baa3		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				A2		
Scorecard Calculated BCA range				baa2-ba1		
Assigned BCA				baa3		
Affiliate Support notching				1		
Adjusted BCA				baa2		

Balance Sheet	**in-scope (PLN)**	**% in-scope**	**at-failure (PLN)**	**% at-failure**
Other liabilities	26,382	18.8%	37,170	26.5%
Deposits	105,758	75.5%	94,971	67.8%
Preferred deposits	78,261	55.8%	74,348	53.1%
Junior Deposits	27,497	19.6%	20,623	14.7%
Senior unsecured bank debt	3,344	2.4%	3,344	2.4%
Dated subordinated bank debt	441	0.3%	441	0.3%
Junior subordinated bank debt				
Preference shares (bank)				
Senior unsecured holding company debt				
Dated subordinated holding company debt				
Junior subordinated holding company debt				
Preference shares (holding company)				
Equity	4,204	3.0%	4,204	3.0%
Total Tangible Banking Assets	140,129	100%	140,129	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Assessment	20.4%	20.4%	20.4%	20.4%	3	3	3	3	0	a2 (cr)
Deposits	20.4%	3.3%	20.4%	5.7%	2	2	2	2	0	a3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Counterparty Risk Assessment	3	0	a2 (cr)	0	A2 (cr)	--
Deposits	2	0	a3	0	A3	A3

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
BANK ZACHODNI WBK S.A.	
Outlook	Stable
Bank Deposits	A3/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A2(cr)/P-1(cr)

Source: Moody's Investors Service

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