MOODY'S INVESTORS SERVICE

Credit Opinion: Bank Zachodni WBK S.A.

Global Credit Research - 25 Mar 2015

Warsaw, Poland

Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Bank Deposits	*Baa1/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa2

* Rating(s) within this class was/were placed on review on March 17, 2015

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Key Indicators

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

	[2]**9-14**	[3]**12-13**	[3]**12-12**	[3]**12-11**	[3]**12-10**	**Avg.**
Total Assets (PLN billion)	**129.9**	**105.6**	**60.0**	**59.9**	**53.2**	[4]**25.0**
Total Assets (EUR million)	**31,096.0**	**25,388.8**	**14,709.5**	**13,431.2**	**13,410.8**	[4]**23.4**
Total Assets (USD million)	**39,282.0**	**34,984.3**	**19,392.9**	**17,435.7**	**17,991.1**	[4]**21.6**
Tangible Common Equity (PLN billion)	**12.6**	**10.6**	**7.9**	**6.7**	**6.0**	[4]**20.3**
Tangible Common Equity (EUR million)	**3,020.4**	**2,558.9**	**1,932.4**	**1,493.8**	**1,518.2**	[4]**18.8**
Tangible Common Equity (USD million)	**3,815.6**	**3,526.1**	**2,547.6**	**1,939.2**	**2,036.7**	[4]**17.0**
Problem Loans / Gross Loans (%)	**--**	**7.9**	**5.4**	**5.5**	**6.9**	[5]**6.4**
Tangible Common Equity / Risk Weighted Assets (%)	**12.2**	**12.2**	**15.1**	**13.8**	**14.3**	[6]**12.2**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**--**	**39.9**	**23.9**	**27.0**	**32.0**	[5]**30.7**
Net Interest Margin (%)	**3.5**	**3.5**	**3.8**	**3.7**	**3.4**	[5]**3.6**
PPI / Average RWA (%)	**3.2**	**4.0**	**4.6**	**4.2**	**4.1**	[6]**3.2**
Net Income / Tangible Assets (%)	**1.6**	**1.6**	**2.4**	**2.1**	**2.0**	[5]**1.9**
Cost / Income Ratio (%)	**47.4**	**50.5**	**43.9**	**50.3**	**49.9**	[5]**48.4**
Market Funds / Tangible Banking Assets (%)	**11.2**	**8.2**	**4.0**	**6.8**	**5.9**	[5]**7.2**
Liquid Banking Assets / Tangible Banking Assets (%)	**29.5**	**29.9**	**29.3**	**32.6**	**34.6**	[5]**31.2**
Gross Loans / Total Deposits (%)	**96.1**	**89.1**	**86.8**	**83.9**	**81.2**	[5]**87.4**

Source: Moody's

[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

Opinion

SUMMARY RATING RATIONALE

On March 17, we placed Bank Zachodni WBK's (BZ WBK) deposit ratings of Baa1/Prime-2 on review for possible upgrade. The bank's baseline credit assessment (BCA) of baa3 was unaffected.

The review was prompted by the implementation of the advanced Loss Given Failure, which is a component of our new bank rating methodology. LGF takes into account the risks faced by the different debt and deposit classes across the liability structure should the bank enter resolution. BZ WBK is subject to an operational resolution regime.

The review will focus on the loss expectancy for deposits based on 1) seniority of claim, 2) the level of debt, which provides protection to it, and 3) the volume of a given liability category, which helps determine loss severity, since any given loss is absorbed by more creditors within that instrument class.

BZ WBK's baa3 BCA is supported by (i) its expanding franchise in the Polish market, (ii) a good liquidity profile, and (iii) adequate capitalisation, supported by high internal capital creation. The BCA is constrained by the bank's (i) asset quality, slightly weaker than the system average, and (ii) some dependence on medium-term wholesale FX funding due to the acquired FX mortgage portfolio.

BZ WBK'S RATINGS ARE SUPPORTED BY POLAND'S STRONG- MACRO PROFILE

Poland's Macro Profile balances the country's very high economic and high institutional strengths against its moderate susceptibility to event risk. While the operating conditions for banks in Poland are relatively benign, the banking system continues to carry a sizeable, albeit declining, burden of foreign-currency mortgages, which carries higher credit and funding risks, constraining the banks' good financial fundamentals.

Rating Drivers

- A rapidly growing franchise in the Polish market, through the acquisition of Kredyt Bank and Santander Consumer Bank

- Loan quality is slightly weaker than the system average

- Capitalisation is adequate, supported by high internal capital creation

- Self funding profile underpinned by a large retail deposit base, but some dependence on medium-term wholesale FX funding due to the acquired FX mortgage portfolio

Rating Outlook

BZ WBK's deposit ratings are on review for possible upgrade. We expect that after the conclusion of the review they are likely to be 1 notch higher.

What Could Change the Rating - Up

As stated in the rating rationale section, BZ WBK's deposit ratings are on review for possible upgrade in response to the implementation of the advanced LGF, which is a component of our new banking methodology.

What Could Change the Rating - Down

BZ WBK's ratings could come under pressure if asset quality shows significant deterioration, which is likely to have a negative effect on profitability and capital creation levels. Inability to maintain its currently favorable loan-to-deposit ratio would also be an important element of rating pressure.

DETAILED RATING CONSIDERATIONS

-- A RAPIDLY GROWING FRANCHISE IN THE POLISH MARKET THROUGH THE ACQUISITION OF KREDYT BANK AND SANTANDER CONSUMER BANK

Following the acquisition of Kredyt Bank in January 2013 and SCB in July 2014, BZ WBK's total assets more than doubled between end-2012 to year-end 2014, to PLN 134.5 billion from PLN 60 billion. As a result, BZ WBK became the third-largest bank in Poland with market shares of customer deposits and loans of, respectively, 9.5% and 8.9% as of December 2014 . The bank has a well-established franchise in corporates, focusing on large and medium-sized clients, where we expect competition to remain relatively high. The acquisition of Kredyt Bank has also significantly boosted the bank's mortgage franchise which was lagging behind its peers (mortgage loans more than tripled at YE 2013). The consolidation of SCB, which is about 14% of the assets of BZ WBK, also helped to expand the bank's presence in retail lending.

The bank's retail franchise is supported by its branch network in Poland, which comprised 961 branches (combined with SCB) as of December 2014.

-- ASSET QUALITY IS SLIGHTLY WEAKER THAN THE SYSTEM AVERAGE

Similarly to some of its peers in the region, BZ WBK's risk profile has been influenced by its exposure to the commercial real estate segment which, however, declined significantly for the past few years. This segment (internally classified as property) accounted for 13.5% of gross loans at year-end 2013.

The ratio of non-performing loans of BZ WBK increased to about 8.4% in Q4 2014, from 7.5% in H1, driven by the consolidation of SCB, and is slightly higher than the average for the Polish banking sector of 7.4% (as of November 2014). At the same period, the coverage ratio stood at 58.4%, a decline from 64.6% in Q3 driven by sale of non-performing loans. As a result, we adjust down the asset risk score to ba3.

-- CAPITALISATION IS ADEQUATE, SUPPORTED BY HIGH INTERNAL CAPITAL CREATION

BZ WBK's reported a total capital ratio of 12.9% and Tier 1 ratio of 12.5% as at December 2014 .

The bank has maintained a relatively high internal capital generation with reported annualised ROE at 14.4% and estimate ROA of around 1.5% during 2014. However, we note that ROE declined from 16.6% in 2013, due to the costs for the integration of the newly acquired operations. In addition, we note that high ROE ratios have not translated into equivalent capital increases, as the bank has maintained a relatively high dividend payout ratio of around 50% during recent years.

-- SELF FUNDING PROFILE UNDERPINNED BY LARGE RETAIL DEPOSIT BASE, BUT SOME DEPENDENCE ON MEDIUM-TERM WHOLESALE FX FUNDING DUE TO THE ACQUIRED FX MORTGAGE PORTFOLIO

Liquidity and funding constitute important rating drivers for BZ WBK given its good reliance on customer funds, with gross loan-to-deposit ratio at 95.7%% as of December 2014. The bank also has comfortable liquidity buffer (liquid assets as a percentage of total assets stood at 30% at Q3 2014). These ratios compare favourably to the bank's Polish peer group.

In the past BZ WBK had limited exposure to FX loans and was able to fund the bulk of them with its FX deposits. However, as part of the acquisition of Kredyt Bank and SCB, BZ WBK took over a large CHF mortgage portfolio, as a result of which the bank's CHF on-balance sheet funding gap increased significantly (CHF loans increased to around PLN 13.9 billion in 2014, from PLN 2 billion in 2012).

As part of the acquisition agreement, KBC (the former parent of Kredyt Bank) committed to cover part of the FX mismatches with cash collateralised funding, subordinated debt and medium term swap facility. Nevertheless, around 62% of the currency gap remains managed through the derivatives market, in the form of medium-term FX derivatives. While this indicates that the bank is currently well hedged in FX, it is also required to maintain free liquidity reserves for collateral needs in case of unfavourable developments in the foreign currency markets. As a result, we adjust down the funding structure score to baa2.

Notching Considerations

AFFILIATE SUPPORT

We assess a moderate probability of parental support for BZ WBK from its parent Banco Santander (Baa1 under review for upgrade; baa1).

This leads to one notch of uplift in BZ WBK's adjusted BCA of baa2.

LOSS GIVEN FAILURE

BZ WBK operates in Poland, which is an EU-member country. As such, under the Bank Resolution and Recovery Directive (BRRD) it is subject to an Operation Resolution Regime, similar to other EU countries. Poland is expected to adopt a national version of the directive in the course of 2015. 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, 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) two notches above the Adjusted BCA, reflecting a very low loss-given failure.

GOVERNMENT SUPPORT

We believe there is 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, we do not incorporate any systemic support from Polish authorities to BZ WBK's deposit ratings.

ABOUT MOODY'S BANK 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 Factors

Bank Zachodni WBK S.A.

Macro Factors	
Weighted Macro Profile	**Strong -**

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	-	-	↓	ba3	Expected trend	
Capital						
TCE / RWA	12.2%	baa2	←→	baa2	Stress capital resilience	
Profitability						
Net Income / Tangible Assets	1.6%	a3	←→	a3	Expected trend	
Combined Solvency Score		-		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking	8.2%	a3	↓	baa2	Extent of market funding	Market funding quality

Assets					reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	29.9%	baa2	←→	baa2	Quality of liquid assets	
Combined Liquidity Score		baa1		baa2		

Financial Profile	**baa3**

Qualitative Adjustments	**Adjustment**
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**

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency rating**	**Foreign Currency rating**
Deposits	--	--	--	--	Baa1 RUR Possible Upgrade	Baa1 RUR Possible Upgrade

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