

FitchRatings

Tagging Info

Fitch Affirms Leading Polish Banks Ratings Endorsement Policy

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Fitch Ratings-Warsaw/London-26 November 2014: Fitch Ratings has affirmed the ratings of Bank Pekao SA, Bank Handlowy w Warszawie (Handlowy), ING Bank Slaski (Bank Slaski) and Bank Zachodni WBK (BZ WBK).

Fitch has also affirmed Pekao's mortgage bank subsidiary, Pekao Bank Hipoteczny (PBH) and Powszechna Kasa Oszczednosci Bank Polski (PKO BP). A full list of rating actions is provided at the end of this commentary.

KEY RATING DRIVERS - IDRS, SUPPORT AND NATIONAL RATINGS

The Support Ratings of Handlowy, Bank Slaski, BZWBK and Pekao, and the Issuer Default Ratings (IDRs) of each of these banks, with the exception of Pekao, reflect Fitch's view on potential support from the banks' shareholders. In Fitch's opinion, there is an extremely high probability of support for Handlowy and Bank Slaski, and a high probability of support for BZ WBK and Pekao. The banks' majority owners are, respectively, Citigroup Inc (A/Stable/a), ING Bank NV (A+/Negative/a), Banco Santander S.A. (Santander, A-/Stable/a-) and UniCredit S.p.A. (UniCredit; BBB+/Negative).

Fitch believes that Handlowy, Bank Slaski, BZ WBK and Pekao are strategically important subsidiaries for their respective parents, even if their presence in the broader CEE region, with the exception of UniCredit, is limited. Fitch expects that continued parent support will provide a floor for the four banks' Long-term IDRs at one notch below those of their parents. The Outlooks on Handlowy, Bank Slaski and BZ WBK reflect those on their parent institutions.

Pekao's IDRs are based on its intrinsic strength, as reflected in its Viability Rating (VR) of 'a-' (see below).

PBH's ratings are equalised with those of its parent and share the same Stable Outlook, reflecting Fitch's view that it is a core subsidiary for Pekao.

PKO BP's Support Rating of '2' reflects Fitch's view of the high probability of support from the Polish sovereign. This is based on (a) the bank's high domestic systemic importance; (b) significant state ownership (31.4% at end-3Q14); (c) the sovereign's commitment to retain control of the bank (d) and potential reputational damage should the bank default.

RATING SENSITIVITIES - IDRS, SUPPORT AND NATIONAL RATINGS

The IDRs of Handlowy, Bank Slaski and BZ WBK are sensitive to a strengthening or weakening of potential support from their majority owners.

In Fitch's view there is a clear intention ultimately to reduce implicit state support for financial institutions in the EU, as demonstrated by a series of legislative, regulatory and policy initiatives. As a result of those changes, Fitch plans to downgrade and revise ratings driven by sovereign support by mid-2015. Consequently, the Long-term IDR of ING Bank will likely be downgraded by one notch, to the level of its 'a' VR, and Bank Slaski's Long-term IDR will as a result likely also be downgraded, to 'A-'. The Long-term IDRs of UniCredit and Citigroup Inc are at the level of their VRs.

Following alignment of ING Bank's Long-term IDR with its VR, the Long-term IDRs of Handlowy, Bank Slaski and BZ WBK could be downgraded in case of (i) a downgrade of the VRs, and hence Long-term IDRs, of their parent institutions; or (ii) a weakening of the parent banks' propensity to support their subsidiaries. Neither of these is currently expected by Fitch. However, any potential downgrades of Handlowy, Bank Slaski or BZ WBK's Long-term IDRs would likely be limited to one notch because the Long-term IDRs of the three banks would still

be underpinned by their own, fairly high, VRs.

The Stable Outlook on Pekao's Long-term IDR reflects the outlook for the bank's standalone risk profile, as well as the Stable Outlook on Poland's sovereign ratings. A weakening of Pekao's standalone profile or a downgrade of the sovereign ratings could result in a downgrade of Pekao.

An upgrade of Pekao would be contingent on both a sovereign upgrade and a further strengthening of the bank's standalone profile. PBH's IDRs are likely to move in tandem with those of Pekao.

PKO BP's Support Rating will likely be downgraded to '5' due to expected review of sovereign support in the EU in 1H15.

KEY RATING DRIVERS - VRs: BANK SLASKI, BZ WBK, HANDLOWY, PEKAO

The VRs of all four banks reflect their strong standalone credit risk profiles, underpinned by their healthy internal capital generation, solid performance, sound asset quality, strong liquidity and stable funding bases. The 'a-' VR of Pekao reflects the combination of its high capital ratios, consistently robust performance, strong franchise and conservative management. The 'bbb' VR of BZ WBK reflects its more moderate but still sound capital ratios than peers and short track record of financial metrics following the integration and consolidation of other banks.

All banks have reported stable and decent profitability throughout the financial crisis. BZ WBK and Pekao reported net interest margin (NIM) of 3.9% and 3.1% in 9M14, respectively, in what Fitch considers to be reasonable performance given the competitive market environment and low interest rates. BZ WBK's NIM and pre-impairment profitability was higher than Pekao's but following greater impairment charges reported similar bottom-line profitability to Pekao.

Handlowy delivered strong performance on adequate NIM, a significant share of stable non-interest income and net release of provisions. Bank Slaski's profitability is catching up with peers, due to more rapid loan growth than the sector as it moves to increase customer loans as a share of assets.

Liquidity is a rating strength for all banks, benefitting both from stable funding position, low loan-to-deposit ratios and large equity positions. For Pekao and BZ WBK gross loan-to-deposit ratios are close to 100% but liquidity positions are strong, particularly for Pekao, which benefits from an ample equity base. Loans-to-deposit ratios are much lower for Handlowy and Bank Slaski and the share of liquid assets in the balance sheet is high, especially for Handlowy, partly reflecting a need to provide additional buffer against volatile large deposits sourced from corporate customers.

Underlying trends in asset quality were broadly positive for the Polish banking sector as a whole and for all four banks. Impaired loan ratios were much below sector average of 7.1% at end-3Q14 for Bank Slaski (4.1%) and Bank Handlowy (5.3%). The underlying trend for BZ WBK was also positive and the marginal increase in impaired loans to 7.96% from 7.88% at end-2013 was expected and resulted from the consolidation of Santander Consumer Bank. Pekao's asset quality improved slightly faster than for the market, with impaired loans at 6.9% at end-3Q14, down from 7.46% in 2013. Coverage of impaired loans by specific provisions is similar and at reasonable level of between 62% and 65% for Pekao, Bank Slaski and BZ WBK, which is better than the market average of 56.5%. Handlowy reports a much higher coverage of around 75%, driven by a large share of legacy impaired exposures.

Capitalisation is a rating strength at all four banks and reflects their conservative risk management, sufficient coverage of impaired loans by reserves, moderate concentrations in the loan book and healthy internal capital generation. In particular, the strong capitalisation underpins the VRs of Pekao and Handlowy in light of their very high loss absorption capacity.

At end-3Q14 Fitch core capital (FCC) ratios equalled about 19% for Handlowy, Pekao and Bank Slaski and around 13% for BZ WBK. However, Bank Slaski's ratio benefits significantly from the advanced internal ratings-based method for calculating capital requirements for the non-retail portfolio. Handlowy, BZ WBK and Pekao apply the standardised method.

RATING SENSITIVITIES - VRs: BANK SLASKI, BZ WBK, HANDLOWY, PEKAO

Fitch believes that the rating strengths of Handlowy, Pekao, Bank Slaski and BZ WBK sufficiently mitigate risks related to a moderate deterioration in the operating environment. However, their VRs could come under pressure if there is a marked and prolonged weakening in the Polish economy, which Fitch does not expect at

present.

A downgrade of Poland's sovereign rating would most likely result in the downgrade of Pekao's VR. Under Fitch's base case scenario, Pekao's VR will not be impacted by a further downgrade of UniCredit's Long-term IDR, given the agency's view of only moderate contagion risk from negative developments at UniCredit. This reflects Pekao's low dependence on group and wholesale funding, its robust domestic franchise and a strong domestic regulator. In Fitch's view, the regulator is unlikely to permit excessive transfers of capital and liquidity from Polish banks to their foreign parents. Pekao's ratings would only likely come under negative pressure from a multi-notch downgrade of UniCredit, which Fitch does not expect at present.

Upgrades of the banks' VRs are unlikely in the short term because of (a) rather rapid credit expansion (Bank Slaski); (b) a rather limited franchise (Handlowy); (c) the short track record after significant organisational changes (BZ WBK); (d) and the current high level of the VR (equalised with the Polish sovereign) and pressures on UniCredit's credit profile (Pekao). However, BZ WBK's VR could be upgraded by one notch, to 'bbb+' if it continues to perform strongly after the integration of other group banks, if key financial metrics remain sound and if there is no significant deterioration in the Polish economy.

The full list of rating actions is as follows:

Handlowy

Long-term IDR: affirmed at 'A-'; Outlook Stable

Short-term IDR: affirmed at 'F2'

Viability Rating: affirmed at 'bbb+'

Support Rating: affirmed at '1'

Bank Slaski

Long-term IDR: affirmed at 'A'; Outlook Negative

Short-term IDR: affirmed at 'F1'

Viability Rating: affirmed at 'bbb+'

Support Rating: affirmed at '1'

Pekao

Long-term IDR: affirmed at 'A-', Outlook Stable

Short-term IDR: affirmed at 'F2'

Viability Rating: affirmed at 'a-'

Support Rating: affirmed at '2'

PBH

Long-term IDR: affirmed at 'A-', Outlook Stable

Short-term IDR: affirmed at 'F2'

Support Rating: affirmed at '1'

National Long-term rating: affirmed at 'AA(pol)', Outlook Stable

National Short-term rating: affirmed at 'F1+(pol)'

BZWBK

Long-term IDR: affirmed at 'BBB+', Outlook Stable

Short-term 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)'

PKO BP

Support Rating: affirmed at '2'

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Additional information is available on www.fitchratings.com.

PKO BP did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 31 January 2014, and the 'National Scale Rating Criteria', dated 30 October 2013 are available at www.fitchratings.com.

Applicable Criteria and Related Research:

National Scale Ratings Criteria
Global Financial Institutions Rating Criteria

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