

FITCH AFFIRMS 4 LEADING POLISH BANKS; OUTLOOK STABLE

Fitch Ratings-Warsaw/London/Moscow-09 November 2016: Fitch Ratings has affirmed the Long-Term Issuer Default Ratings (IDRs) of Bank Pekao SA (A-), Bank Handlowy w Warszawie (Handlowy, A-), ING Bank Slaski (Bank Slaski, A) and Bank Zachodni WBK (BZ WBK, BBB+). Fitch has also affirmed the ratings of Pekao's mortgage bank subsidiary, Pekao Bank Hipoteczny (PBH, A-). All Long-Term IDRs are on Stable Outlook.

The Viability Rating (VR) of Handlowy has been upgraded to 'a-' from 'bbb+' while the VRs of other banks have been affirmed; Pekao at 'a-', and BZ WBK and Bank Slaski at 'bbb+'. A full list of rating actions is provided at the end of this commentary.

KEY RATING DRIVERS

IDRS, SUPPORT RATINGS, NATIONAL RATINGS AND SENIOR DEBT

The IDRs of Pekao are driven by the bank's intrinsic strength, as reflected in its VR. The IDRs of BZ WBK and, following its VR upgrade, Handlowy, are driven by their individual credit profiles, but also underpinned by potential shareholder support. The IDRs of Bank Slaski are driven by potential shareholder support.

The Support Ratings of the four banks reflect Fitch's view on potential support from the respective banks' shareholders. In Fitch's opinion, the probability of support is extremely high for Handlowy and Bank Slaski, and high for BZ WBK and Pekao. The banks' largest shareholders are, respectively, Citigroup Inc (A/Stable/a), ING Bank NV (A+/Stable/a+), Banco Santander S.A. (Santander, A-/Stable/a-) and UniCredit S.p.A. (UniCredit; BBB+/Negative/bbb+).

In mid-October, UniCredit confirmed that it was in talks with PZU SA and the Polish Development Fund (Polski Fundusz Rozwoju), regarding a possible sale transaction involving Pekao. The placement of Pekao's Support Rating on Rating Watch Negative reflects this potential sale and the expectation that Fitch's assessment of the new controlling shareholders' ability and propensity to provide extraordinary support, should a sale go through, will be lower than at present.

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

VIABILITY RATINGS

The affirmations of the VRs of Pekao, BZ WBK and Bank Slaski are underpinned by their sound fundamental credit quality and by the absence of any major changes in their financial metrics over the last 12 months. The upgrade of Handlowy's VR reflects a reassessment of the benefits of the bank's conservative business model, low risk appetite, and strong capital and liquidity buffers for the bank's standalone credit profile.

The VRs of the four banks continue to reflect a strong capacity for ongoing viability. Their common rating strengths are a generally conservative risk appetite, strong capitalisation, sound asset quality and stable funding based on customer deposits. The higher (by one notch) VRs of Pekao and Handlowy reflect their higher capital ratios, extended track record of consistent performance (Pekao) and particularly low-risk business model (Handlowy).

The banks' results have been under pressure since 2013 from falling interest rates (with the repricing of assets lagging behind liabilities), subdued credit demand and inflated regulatory costs.

BZ WBK and Bank Slaski were able to mitigate these with loan book expansion and funding cost optimisation.

Fitch expects 2H16 results to show that revenue pressures have abated as margins gradually recover and lending growth remains positive, trends we believe will continue in 2017. However, the bank levy will continue to weigh on profitability. In 1H16, the bank levy absorbed between 9% (Handlowy) and 16% (Bank Slaski) of operating profit, but was largely offset by non-recurring income on transactions with Visa Europe.

HANDLOWY

Handlowy's overall franchise is narrower than peers, and the bank has a more moderate scale (about 3% market share by total assets at end-1H16). However, Handlowy has leading positions in its strategic segments, such as credit cards for private individuals and banking products and services for multinational companies.

Handlowy's risk appetite is the most conservative among rated Polish banks and reflects stability through-the-cycle, a focus on generally low-risk lending segments, tight underwriting standards and a robust control environment underpinned by stringent parental supervision.

At end-1H16, impaired loans fell to about 3.4% of gross loans (sector: 6.4%) and were around 85% covered by loan loss reserves (coverage stronger than at peers). Handlowy's non-loan exposures are of high quality, comprising debt securities (almost solely Polish sovereign risk) and cash and cash equivalents, and accounted for about half of the bank's balance sheet.

One of Handlowy's strategic goals is to maintain a highly liquid balance sheet and a large surplus of customer deposits over loans. At end-1H16, the gross loans/deposits ratio stood at about 60% and unencumbered liquid assets were sufficient to fully repay all wholesale liabilities and about 55% of customer deposits. Deposits are dominated by the non-retail segment (about a 70% share) but their stability is underpinned by long-term customer relationships.

Handlowy's capitalisation is a rating strength, with a Fitch Core Capital (FCC) ratio of about 18% at end-1H16. In assessing the bank's capitalisation, Fitch views favourably its conservative risk management, immaterial stock of unreserved impaired loans and healthy internal capital generation.

PEKAO

Capitalisation is a rating strength for Pekao and a key driver of its 'a-' VR. This strength is based on the bank's high capital ratios, conservative risk management, low unreserved impaired loans (around 10% of FCC at end-1H16), moderate concentrations in the loan book, low exposure to foreign currency mortgages, modest growth and healthy internal capital generation. At end-1H16, the FCC ratio stood at 19.3%; the highest among rated Polish peers.

Pekao's asset quality improved marginally faster than the sector over the last 18 months and the impaired loan ratio stood at 6.5% at end-1H16, despite Pekao being less active than some of its peers in writing off impaired loans. Coverage of impaired loans by provisions is reasonable at 72%.

The loan-to-deposit ratio is close to 100%, and liquidity is strong, benefitting from a stable funding position, based on balanced and diversified customer deposits, a low share of wholesale funding and an ample equity base.

The VR of Pekao is one notch above the IDR of its parent. The rating differential, with the potential to increase to two notches in case of a downgrade of UniCredit to 'BBB', reflects the low dependence of Pekao on group and wholesale funding, its robust domestic franchise and a strong

domestic regulator, which in Fitch's view will likely continue to prevent any sizable upstreaming of capital to shareholders.

BZ WBK

The bank's solid capitalisation is reflected in a high FCC of almost 17% at end-3Q16, a material surplus over regulatory minimum capital ratios and healthy internal capital generation. Unreserved impaired and performing forbore loans represented a moderate almost 20% of FCC.

BZ WBK's appetite for loan growth is high, but the bank's strong risk control environment should limit excessive expansion or a material build-up of high-risk exposures. A full consolidation of Santander Consumer Bank (SCB, 60% stake acquired in 2014) has inflated the consolidated stock of impaired loans, but is positive for the bank's profitability.

BZ WBK's asset quality is moderately weaker than peers due to the bank's material exposure to legacy residential mortgages denominated in foreign currency (about 15% of consolidated gross loans, currently performing well) and commercial property loans (about 8%). At end-3Q16, the consolidated impaired loans ratio was 6.8% (or about 8.5% including forbore loans classified as performing) and the bank plans to reduce the figure to below 6% in 2017. Reserve coverage was reasonable at about 75% (coverage at SCB was considerably higher).

BZ WBK's funding profile is solid because the bank is self-funded by diversified deposits and its liquidity is strong. At end-3Q16, the consolidated gross loans/deposits ratio was almost 100% (BZ WBK itself at about 90%). Refinancing risk at SCB is low due to its own reasonable liquidity buffer, fairly easy access to the local wholesale market and customer deposits, the diversified maturity of its liabilities and the relatively short tenor of its loan book.

BANK SLASKI

Fitch believes that Bank Slaski's asset quality will remain strong in 2017, despite the bank's significant appetite for credit expansion (including in cash loans, though from a low base). This view is based on the bank's track record of conservative underwriting and strong risk controls. At end-3Q16, the bank's impaired loans ratio (2.8%) was notably below the domestic sector average (around 6.4%) and most peers. The ratio was partly diluted by rapid loan growth and moderate bad debt sales, but the inflow of new impaired loans also remained under control and comfortably below the bank's solid loss absorption capacity.

At end-3Q16, Bank Slaski maintained moderate buffers over local regulatory capital requirements, which reflected its growing risk-weighted assets (RWAs) and regular dividend payments. However, capitalisation is underpinned by prudent risk management, low unreserved impaired loans (around 7% of FCC at end-3Q16), resilient profitability and potential support available from the higher-rated parent. The FCC ratio stood at 16.9 % at end-3Q16.

Bank Slaski's strong funding profile is underpinned by a large customer deposit base (90% of total funding at end-3Q16), which was concentrated in granular and stable retail savings. The bank's comfortable liquidity position is supported by a sizeable pool of highly liquid assets (covering around a third of total customer deposits) and a modest loans/deposits ratio (86% at end-3Q16).

RATING SENSITIVITIES

IDRS, SUPPORT RATINGS, NATIONAL RATINGS AND SENIOR DEBT

The IDRs of Bank Slaski are sensitive to changes to potential support from its majority owner. As a result, the Outlook on the bank's Long-Term IDR reflects that on the parent.

An upgrade of Handlowy's and BZ WBK's Long-Term IDRs would be contingent on either an upgrade of their VRs, or their respective parents. A downgrade would also require a downgrade of both their VRs and their parents' IDRs.

The IDRs of Pekao are driven by its VR and share the same rating sensitivities. Pekao's Support Rating could be downgraded in case of a further material reduction of Unicredit's 40.1% stake in the bank. PBH's IDRs are likely to move in tandem with those of Pekao.

VIABILITY RATINGS

The VRs of the four banks would likely be resilient to a moderate deterioration in the operating environment. However, a marked and prolonged weakening in the Polish economy (not Fitch's base scenario) materially affecting the banks' asset quality, capitalisation and profitability, could lead to the VRs being downgraded.

The VRs of four banks will not be affected by the potential cost of the spread refund law. They either have negligible (Handlowy) or small (Pekao, Bank Slaski) exposures to foreign currency mortgages, or have enough loss absorption capacity in their income (BZ WBK) to absorb potential cost.

Upside for Handlowy's and Pekao's VRs is limited, given their already high VR levels (in line with Poland's sovereign IDRs) and limited franchise (Handlowy). A downgrade of Poland's sovereign rating would likely result in the downgrade of Pekao's and Handlowy's VRs. Pekao could also be downgraded in case of a weakening of its capital position or a significant increase in risk appetite.

Upgrades of the VRs of BZ WBK and Bank Slaski are unlikely unless the operating environment and the banks' standalone credit profiles improve, and their growth appetites moderate.

The rating actions are as follows:

Handlowy

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

Short-Term IDR: affirmed at 'F1'

Viability Rating: upgraded to 'a-' from 'bbb+'

Support Rating: affirmed at '1'

National Long-Term Rating: assigned at 'AA+(pol)'; Outlook Stable

National Short-Term Rating: assigned at 'F1+(pol)'

BZ WBK

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)'

Bank Slaski

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

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: '2' on Rating Watch Negative

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)'

Contact:

Primary Analysts

Artur Szeski (Pekao, PBH)

Senior Director

+48 22 338 6292

Fitch Polska SA

Krolewska 16,

Warsaw 00-103

Michal Bryks, ACCA (BZ WBK, Bank Slaski, Handlowy)

Director

+48 22 338 6293

Fitch Polska SA

Krolewska 16,

Warsaw 00-103

Secondary Analysts

Agata Gryglewicz (Bank Slaski, Handlowy)

Associate Director

+48 22 330 6970

Jakub Kopiec, CFA (BZ WBK, Pekao, PBH)

Analyst

+48 22 330 6702

Committee Chairperson

James Watson

Managing Director

+7 495 956 6657

Media Relations: Elaine Bailey, London, Tel: +44 203 530 1153, Email:

elaine.bailey@fitchratings.com; Malgorzata Socharska, Warsaw, Tel: +48 22 338 62 81, Email:

malgorzata.socharska@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria

Global Bank Rating Criteria (pub. 15 Jul 2016)

<https://www.fitchratings.com/site/re/884135>

National Scale Ratings Criteria (pub. 30 Oct 2013)

<https://www.fitchratings.com/site/re/720082>

ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2016 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001