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Research Update:

Poland-Based Bank Pekao Affirmed At 'BBB+ / A-2' Following Sovereign Rating Action; Outlook Negative

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Overview

- On Jan. 15, 2016, we lowered our long-term foreign currency sovereign credit rating on Poland to 'BBB+' from 'A-' and our long- and short-term local currency sovereign credit ratings to 'A-/A-2' from 'A/A-1'. We affirmed the short-term foreign currency sovereign credit rating at 'A-2'. The outlook is negative.
- Although we consider Bank Polska Kasa Opieki (Pekao) to have high systemic importance in the Polish banking sector, we do not include notches of support in its rating given the level of the local currency sovereign rating.
- Consequently, we are affirming our 'BBB+/A-2' counterparty credit ratings on Pekao.
- The negative outlook on Pekao reflects the one-in-three possibility of a downgrade driven by the introduction of the resolution framework in Poland or a further negative rating action on the sovereign.

Rating Action

On Jan. 19, 2016, Standard & Poor's Ratings Services affirmed its 'BBB+/A-2' long- and short-term counterparty credit ratings on Poland-based Bank Polska Kasa Opieki S.A. (Pekao). The outlook remains negative.

Rationale

The affirmation reflects our assessment that Pekao's creditworthiness is unchanged following the downgrade of Poland (see "Poland Foreign Currency Rating Lowered To 'BBB+' On Weakening Institutions; Outlook Negative," published Jan. 15, 2015, on RatingsDirect).

We consider that Pekao has high systemic importance in the Polish banking sector, particularly reflecting the bank's position as the second-largest bank in Poland, with a market share of about 12% in customer deposits. Moreover, we still assess the Polish government as supportive toward its banking sector.

However, our view of a moderately high likelihood that the bank would receive extraordinary government support if needed does not translate into ratings uplift, in line with our criteria for rating financial institutions. This is because the level of the local currency sovereign credit rating on Poland is

only one notch above our assessment of the bank's the stand-alone credit profile (SACP), which we assess at 'bbb+'.

The ratings on Pekao would likely be constrained by the sovereign rating on Poland, its country of domicile. If we were to lower the sovereign foreign-currency ratings on Poland further to 'BBB' we would likely follow with a similar rating action on Pekao. The sovereign rating does not act as ceiling for our bank ratings; such cases are rare as banks are leveraged institutions and dependent on the sovereign government for liquidity and other forms of system support. For a bank to be rated above the sovereign, Standard & Poor's would need to assess the bank as having sufficient creditworthiness to withstand a hypothetical sovereign default scenario, including sufficient liquidity to service debt and a positive equity position commensurate with the regulatory capital minimums.

Furthermore, we understand that the Polish government will transpose the bank resolution and recovery directive (BRRD) into national law in early 2016. The BRRD is set to introduce the mandatory bail-in of a minimum amount of eligible liabilities, potentially including certain senior unsecured obligations, before governments could provide solvency support. Accordingly, we believe that potential extraordinary government support available to banks' senior unsecured bondholders will likely diminish within our two-year rating horizon. If we perceive that support for senior unsecured creditors is less predictable under the new legislative framework in Poland, we would most likely revise our assessment of Polish government support to private-sector commercial banks to uncertain from supportive currently, as defined by our criteria.

In addition, a potential introduction of a single resolution framework for cross-border banking groups, such as the UniCredit group within the EU, could lead to a greater likelihood that Pekao's senior unsecured creditors may incur losses if the parent were to fail. In this scenario, we would be unlikely to rate Pekao higher than UniCredit SpA (BBB-/Stable/A-3), Pekao's parent, given our view that the subsidiary would be unlikely to continue operating without defaulting on its senior unsecured obligations in the event of a resolution of the parent.

Our ratings on Pekao reflect the 'bbb-' anchor that we apply to commercial banks operating in Poland and our assessments of the bank's business position as strong, capital and earnings as strong, risk position as adequate, funding as average, and liquidity as strong, as our criteria define these terms. Our view of Pekao's SACP remains unchanged at 'bbb+', the highest of the banks we rate in Poland. The counterparty credit rating is at the same level as the SACP.

Outlook

The negative outlook on Pekao indicates our view of a one-in-three probability that implementation of EU BRRD in Poland in early 2016 will decrease the potential extraordinary government support for systemically important banks as

well as that of a potential introduction of single resolution framework for cross-border banking groups, such as UniCredit SpA, within the EU that could lead to an increased bail-in risk on the subsidiary in the event of a resolution of the parent.

If we did not factor in systemic support from the Polish government, we would rate Pekao above its parent UniCredit SpA only if we considered Pekao to be:

- Insulated (substantially protected from adverse parental effects or intervention), which we currently consider highly unlikely; or
- Eligible for consideration of additional loss-absorbing capacity (ALAC) once Poland has adopted the BRRD, and we consider it to have an effective resolution regime where Pekao is subject to a separate resolution process from its parent.

The negative outlook also incorporates the possibility of a downgrade following a further negative rating action on Poland. If we lowered long-term foreign-currency rating on Poland, which now carries a negative outlook, we would likely cap the ratings on Pekao at the level of the sovereign rating.

We could revise the outlook on Pekao to stable if we consider that potential extraordinary government support for the bank's senior unsecured creditors is unchanged in practice, despite the introduction of bail-in powers and international efforts to increase banks' resolvability; or if we consider Pekao to be subject to a separate resolution process from its parent and having a sufficient buffer of subordinated instruments eligible for ALAC, fully offsetting the increased bail-in risks.

An outlook revision would also hinge on a similar rating action on the sovereign.

Ratings Score Snapshot

Issuer Credit Rating	BBB+/Negative/A-2
SACP	bbb+
Anchor	bbb-
Business Position	Strong (+1)
Capital and Earnings	Strong (+1)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Strong (0)
Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

Related Criteria

- Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Ratings Above The Sovereign–Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related Research

- Poland Foreign Currency Rating Lowered To 'BBB+' On Weakening Institutions; Outlook Negative, Jan. 15, 2016
- Banking Industry Country Risk Assessment Update, January 14, 2016
- Bank Polska Kasa Opieki S.A., Aug. 25, 2015
- Poland-Based Pekao Outlook Revised To Negative On Potential Government Support Review; 'BBB+/A-2' Ratings Affirmed, June 30, 2015
- Banking Industry Country Risk Assessment: Poland, June 30, 2015
- Central And Eastern European Banks: Domestic Growth Is Taking The Edge Off , April 28, 2015

Ratings List

Ratings Affirmed

Bank Polska Kasa Opieki S.A.
Counterparty Credit Rating

BBB+/Negative/A-2

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