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Research Update:

Poland-Based Pekao Outlook Revised To Negative On Potential Government Support Review; 'BBB+/A-2' Ratings Affirmed

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Table Of Contents

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Overview

- We consider that potential extraordinary government support for systemically important subsidiaries of European cross-border banking groups will likely decrease if a single resolution framework is being implemented in the European Union.
- We are consequently revising our outlook on Pekao to negative from stable and affirming our 'BBB+/A-2' ratings.
- The negative outlook reflects the one-in-three possibility that we may lower the long-term rating on Pekao by the beginning of 2016 if we observe a greater likelihood that senior unsecured creditors of Pekao may incur losses if UniCredit SpA were to fail.

Rating Action

On June 30, 2015, Standard & Poor's Ratings Services revised its outlook on Poland-based Bank Polska Kasa Opieki S.A. (Pekao) to negative from stable. At the same time, we affirmed our 'BBB+/A-2' long- and short-term counterparty credit ratings on the bank.

Rationale

The outlook revision reflects our belief that there is a one-in-three possibility that the implementation of the EU Bank Recovery and Resolution Directive (BRRD) in Poland by the beginning of 2016 will decrease the likelihood of potential extraordinary government support for systemically important banks, including Pekao. 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, Pekao's parent, given that we believe 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.

We continue to consider Pekao to be a "core" subsidiary in the UniCredit group, for which it acts as a cornerstone of the group's activities in the strategically key markets of Central and Eastern Europe. We currently rate Pekao two notches above our 'bbb-' assessment of UniCredit's group credit

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profile and above our 'BBB-' long-term rating on UniCredit. Although subsidiaries are generally not rated higher than our group credit profile for a given group, they may receive a higher rating if they meet the conditions defined in our methodology, including being a highly systemically important entity in a country that we consider to be supportive toward its banking system. In Pekao's case, we rate it two notches higher than the group credit profile for UniCredit SpA to reflect our expectation that in a severe stress scenario, the Polish regulatory authorities would intervene to protect Pekao and preserve its creditworthiness. However, the implementation of BRRD in Poland could affect our view of this type of support in the future.

Our ratings on Pekao reflect our assessments of the bank's business position as "strong," capital and earnings as "strong," risk position as "adequate," funding as "average," as our criteria define these terms. Our view of Pekao's stand-alone credit profile (SACP) remains unchanged at 'bbb+'.

However, we now consider Pekao's superior liquidity metrics--as demonstrated by the bank's one-year liquidity ratio (broad liquid assets to short-term wholesale funding) of 4.8x as of March 31, 2015--to be commensurate with our "strong" liquidity assessment, versus "adequate" previously. In financial crises, Pekao would benefit from customers' flight to quality, and its strong liquidity coverage would allow it to withstand a lack of access to wholesale funding for more than 12 months as well as a moderate reduction in its customers' deposits, in our opinion.

We will continue to monitor any potential impact that the parent's lower creditworthiness might have on Pekao's SACP. In particular, any capital measures above Pekao's current dividend policy, specifically any extraordinary dividend payout, could negatively affect our projected risk-adjusted capital (RAC) ratio for Pekao. Our RAC ratio at year-end 2014 was a high 12.6%, and we project it will remain in the 11.5%-12.5% range over the next 12-18 months. In our projected RAC ratio for 2015, we incorporate our view that Pekao's dividend payout ratio will remain at a high 90% of net income.

We consider that Pekao has "high" systemic importance in the Polish banking sector, based on its position as the second-largest bank with market share of about 12% in customer deposits. Moreover, we assess the Polish government as "supportive" toward its banking sector under our criteria. As a result, we believe there is a "moderately high" likelihood that Pekao would receive extraordinary financial support from the Republic of Poland if needed. However, we do not include notches in the rating above the SACP to reflect potential support, in line with our criteria and given the level of our local currency sovereign credit rating on Poland.

We understand that the Polish government plans to transpose the BRRD into national law by the beginning of 2016. We consider the European Parliament's approval of the EU BRRD on April 15, 2014, a key milestone in this process. 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.

Outlook

The negative outlook on Pekao indicates our view of a one-in-three probability that implementation of EU BRRD in Poland by the beginning of 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 thought that Pekao:

- We consider the bank to be "insulated" (substantially protected from adverse parental effects or intervention) which we consider highly unlikely today; or
- We consider Pekao to be eligible for consideration of 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 ALAC buffers would need to be well above at least 5% of Standard & Poor's risk-weighted assets to consider a resolution bail-in credible.

We could revise the outlook to stable if we consider that potential extraordinary government support for Pekao'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.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB+/Negative/A-2	BBB+/Stable/A-2
SACP	bbb+	bbb+
Anchor	bbb-	bbb-
Business Position	Strong (+1)	Strong (+1)

Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Adequate (0)	Adequate(0)
Funding and Liquidity	Average and Strong(0)	Average and Adequate (0)
Support	(0)	(0)
ALAC Support	(0)	(0)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional Factors	(0)	(0)

Related Criteria And Research

Related Criteria

- Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- 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 and Methodology 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

Related Research

- Banking Industry Country Risk Assessment: Poland, June 29, 2015
- Banking Industry Country Risk Assessment Update, June 12, 2015
- Central And Eastern European Banks: Domestic Growth Is Taking The Edge Off , April 28, 2015
- Outlook On Poland Revised To Positive On Steady Economic Growth; Ratings Affirmed, Feb. 6, 2015
- Polish Bank Pekao 'BBB+/A-2' Ratings Affirmed Despite Downgrade Of Italian Parent UniCredit SpA; Outlook Stable, Dec. 22, 2014
- UniCredit Ratings Lowered To 'BBB-/A-3' On Increased Economic Risks In Italy; Outlook Stable, Dec. 18, 2014
- Standard & Poor's To Review Government Support In European Bank Ratings, March 4, 2014

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Bank Polska Kasa Opieki S.A.		
Counterparty Credit Rating	BBB+/Negative/A-2	BBB+/Stable/A-2

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