

Research Update:

# OTP Bank Downgraded To 'BBB-/A-3' Following Similar Action On Hungary; Outlook Stable

January 30, 2023

## Overview

- On Jan. 27, 2023, S&P Global Ratings lowered its ratings on Hungary to 'BBB-/A-3' from 'BBB/A-2' as persistently high inflation, exchange rate volatility, and external pressures challenge the government's fiscal consolidation plan and ongoing disagreements with the EU delay funds.
- We continue to cap our issuer credit ratings on OTP Bank at the level of our foreign currency sovereign ratings on Hungary, because we consider it unlikely that the bank would have sufficient capital resources to withstand a hypothetical sovereign default scenario and avoid a default on its senior preferred instruments.
- We therefore lowered our issuer credit ratings on OTP Bank and its core subsidiary OTP Mortgage Bank to 'BBB-/A-3' from 'BBB/A-2'.
- The stable outlook reflects our expectation that OTP will maintain its sound business and financial profiles amid a challenging operating environment.

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## Rating Action

On Jan. 30, 2023, S&P Global Ratings lowered its long- and short-term issuer credit ratings on OTP Bank PLC and its core subsidiary OTP Mortgage Bank to 'BBB-/A-3' from 'BBB/A-2'. The outlook on the long-term ratings is stable.

We also lowered our long- and short-term resolution counterparty ratings (RCRs) to 'BBB-/A-3' from 'BBB/A-2'.

In addition, we downgraded all of OTP Bank's senior preferred debt by one notch.

## Rationale

On Jan. 27, 2023, we downgraded Hungary to 'BBB-/A-3' from 'BBB/A-2'.

This reflects the challenges the government faces in achieving fiscal consolidation, following a series of economic shocks amid the COVID-19 pandemic and the Russia-Ukraine war, which have

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impaired policy flexibility. External deficits have markedly increased, mainly due to higher energy prices, and current accounts are expected to remain in deficit over the coming years. The timely availability of EU funds also continues to pose a risk to Hungary's growth outlook over the next few years. Political disagreements between the Hungarian government and the EU have been ongoing for several months and resulted in delays to specific EU funds to Hungary. However, discussions between the Hungarian government and the European Commission at the end of last year have given us confidence that it is unlikely Hungary will face a substantial cut to EU funds (see "Hungary Downgraded To 'BBB-/A-3' From 'BBB/A-2' On Inflation And External Pressures; Outlook Stable," published Jan. 27, 2023, on RatingsDirect).

We consequently lowered our ratings on OTP Bank and its core subsidiary OTP Mortgage Bank because they remain capped by our sovereign rating on Hungary.

We do not rate OTP bank above our foreign currency sovereign rating on Hungary because we do not believe its loss absorbing capacity would be sufficient to withstand a hypothetical sovereign default scenario. This reflects the bank's strong domestic footprint, with about 45% of its business in the home market, and a particularly large domestic government debt portfolio that we expect to suffer sharp losses in a hypothetical default scenario. In our base case, we expect that a sovereign default would likely trigger resolution measures for OTP Bank, leading to the conversion of bail-in-able instruments to absorb losses, in addition to capital instruments. However, we think that the bank's buffers are insufficient to restore its consolidated minimum capital requirement to retain its banking license. This also reflects that OTP Bank currently does not have to comply with any subordination specifications for its minimum requirement for own funds and eligible liabilities (MREL) and has therefore not issued any senior nonpreferred instruments that would be available to protect senior creditors in a resolution. However, subordination requirements will apply from December 2024. Overall, we do not see an appreciable likelihood that OTP Bank would ensure full and timely payments on senior preferred debt amid a hypothetical default of the Hungarian sovereign. In time, we could revise this stance if our assessment suggests that its resilience has substantially improved, whether aided by further geographical diversification, a materially reduced domestic government debt portfolio, stronger capitalization, or improved resolvability with associated stronger subordinated buffers.

Our 'bbb' stand-alone credit profile (SACP) on OTP Bank is higher than the sovereign rating.

In our view, the bank demonstrates solid profitability based on diversified business operations across Central Eastern Europe (CEE) and the Commonwealth of Independent States (CIS), with a dominant market position in several countries. We expect OTP Bank's strong revenue capacity, also thanks to rising interest rates, will continue to provide solid buffers against inflationary pressure and further asset quality deterioration. However, disruptions and credit losses at its Russian and Ukrainian operations continue to weigh on performance. In addition, a further deterioration of Hungarian customers' creditworthiness, as highlighted in our negative trend on our Banking Industry Country Risk Assessment economic risk for Hungary, may pressure its SACP if it materializes (see "Bulletin: Hungarian Banks Face High Risks Of Asset Quality Deterioration; BICRA Economic Risk Trend Now Negative," published Dec. 12, 2022).

We also cap the RCR on OTP at the sovereign rating on Hungary.

This reflects that OTP has not yet built sufficient buffers of instruments, including senior preferred obligations, that we believe would protect RCR liabilities in the hypothetical scenario of stress linked to a sovereign default. Notably, while OTP Bank has bail-in-able senior liabilities, such as corporate deposits or uninsured retail deposits, that rank junior to RCR liabilities, we remain mindful that financial stability might not be assured if these liabilities are bailed-in. RCR liabilities are bank liabilities specified in Hungarian legislation as being explicitly excluded from bail-in, including insured deposits and secured liabilities.

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We equalize our ratings on OTP Mortgage Bank with those on OTP Bank because of its integral position in the group's strategy.

Our view of OTP Mortgage Bank's core status is based on OTP Bank's full ownership and the very close organizational and operational integration with the parent. Notably, OTP Mortgage Bank specializes in financing residential mortgages originated by OTP Bank.

### Outlook

The stable outlook reflects our view that, over the next 12-24 months, OTP Bank will withstand further second-round effects from the Russia-Ukraine war given its solid earnings across the CEE and CIS regions, which provide a buffer for inflationary and asset quality deterioration, as well as its solid funding profile.

### Downside scenario

We would downgrade OTP Bank if we took a similar rating action on Hungary, which we currently consider unlikely.

If we revise down our SACP by one notch this would currently not translate into a lowering our issuer credit ratings on OTP Bank or issue ratings on its hybrid instruments. We could revise down the SACP, if, for example:

- OTP Bank experiences a substantial loss from its equity investments or material reputational risks affecting its franchise, stemming from its business operations in Russia or Ukraine; or
- We see a material weakening of OTP Bank's earnings capacity or higher-than anticipated credit losses, materially hitting the group's capitalization.

### Upside scenario

A positive rating action appears unlikely and would hinge upon a similar action on Hungary, or if OTP improves its prospects of withstanding a sovereign default, for example, by building loss-absorbing buffers or reducing its exposure to government securities.

### Ratings Score Snapshot

	To	From
<b>Issuer Credit Rating</b>	<b>BBB-/Stable/A-3</b>	<b>BBB/Negative/A-2</b>
Resolution Counterparty Ratings	BBB-/A-3	BBB/A-2
SACP	bbb	bbb
Anchor	bbb-	bbb-
Business position	Strong (+1)	Strong (+1)
Capital and earnings	Adequate (0)	Adequate (0)
Risk position	Moderate (-1)	Moderate (-1)
Funding	Strong and	Strong and
Liquidity	Strong (+1)	Strong (+1)

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	To	From
<b>Issuer Credit Rating</b>	<b>BBB-/Stable/A-3</b>	<b>BBB/Negative/A-2</b>
Comparable ratings analysis	0	0
Support	(0)	(0)
ALAC support	(0)	(0)
GRE support	(0)	(0)
Group support	(0)	(0)
Sovereign support	(0)	(0)
Additional factors	(-1)	(0)

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

## ESG credit indicators: E-2, S-2, G-2

### Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

### Related Research

- Hungary Downgraded To 'BBB-/A-3' From 'BBB/A-2' On Inflation And External Pressures; Outlook Stable, Jan. 27, 2023
- Bulletin: Hungarian Banks Face High Risks Of Asset Quality Deterioration; BICRA Economic Risk Trend Now Negative, Dec. 12, 2022

## Ratings List

### Downgraded; Outlook Action

	To	From
<b>OTP Bank PLC</b>		

### OTP Mortgage Bank

Issuer Credit Rating	BBB-/Stable/A-3	BBB/Negative/A-2
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### Downgraded

	To	From
<b>OTP Bank PLC</b>		

### OTP Mortgage Bank

Resolution Counterparty Rating	BBB/--/A-3	BBB/--/A-2
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### OTP Bank PLC

Senior Unsecured	BBB-	BBB
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