Rating_Action: Moody's confirms OTP Bank's Baa1 deposit ratings, changes deposit outlook to stable

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Limassol, February 06, 2023 -- Moody's Investors Service (Moody's) has today confirmed the Baa1 long-term domestic and foreign currency bank deposit ratings of OTP Bank NyRt (OTP) and changed the outlook to stable from ratings under review. Concurrently, the rating agency confirmed the bank's ba1 Baseline Credit Assessment (BCA) and Adjusted BCA. Further, Moody's downgraded OTP's subordinated bond rating by one notch to Ba2 from Ba1, while it confirmed the bank's Ba3(hyb) junior subordinated bond rating and its Baa1 long-term domestic and foreign currency Counterparty Risk Ratings (CRRs).

Also, Moody's downgraded the backed long-term domestic currency issuer rating of OTP Jelzalogbank Zrt. (OTP Mortgage Bank) (OTP MB), OTP's fully owned mortgage bank, to Baa3 from Baa2 and changed the outlook to stable from ratings under review and confirmed the mortgage bank's Baa1 long-term domestic and foreign currency CRRs.

All other ratings and assessments were not affected by today's rating actions.

The rating actions are driven by the closing of OTP's acquisition of Nova Kreditna banka Maribor d.d. (NKBM), following the Slovenian competition authority's approval of the transaction, announced on 01 February 2023 [1] and concludes the ratings review initiated on 13 July 2021 and extended on 11 March 2022.

RATINGS RATIONALE

-- RATIONALE FOR CONFIRMING THE BCA

The confirmation of the bank's ba1 BCA reflects a worsening operating environment in many countries that OTP operates in, including Hungary, resulting from Russia's invasion of Ukraine and increasing challenges due to a high exposure to and reliance on gas supplies from Russia, as well as due to an additional announced acquisition in a weaker economy, Ipoteka Bank (deposits Ba3 stable, BCA b2) in Uzbekistan. OTP remains exposed to significant downside risks stemming from its operations in Russia and Ukraine, which offset the benefits from the bank's enlarged operations in lower risk Slovenia after the acquisition of NKBM. At the same time, the confirmation acknowledges the resilience in the bank's financial performance despite the more challenging environment.

OTP's asset quality has been resilient to the pandemic and managed to slightly lower its share of non-performing loans (NPLs), albeit it remains at the higher end of peers, above 5%. Moody's expects OTP's asset risk to benefit from NKBM's acquisition, given the latter's stronger asset quality. However this improvement will be offset by the agency's expectation of an increase in NPLs owing to the weakening operating environments.

With 13.2% Tangible Common Equity (TCE) ratio OTP's capitalization remains good but will at least temporarily drop because of NKBM's acquisition and remains at risk from a potential walk away from its Russian operations. OTP's profitability will improve in 2023 gradually benefitting from higher interest rates across almost all the markets it operates in, yet it will remain negatively affected by a Hungarian windfall tax in 2023 and vulnerable to a potential additional extension of government imposed caps on interest rates of certain mortgages and SME loans. The bank's largely deposit funded balanced sheet and sufficient liquid resources will remain broadly unchanged following the acquisition, and a relative strength of OTP.

--RATIONALE FOR THE DEPOSIT AND DEBT RATINGS

The rating actions taken on OTP's bank deposit and debt ratings reflect the confirmation of the bank's ba1 BCA and the application of Moody's Advanced Loss Given Failure (LGF) analysis. In its LGF analysis Moody's has considered the bank's current organic asset growth and funding plan and the common resolution perimeter agreed with the resolution authorities, which excludes few minor operations. Because a decision still needs to be made concerning the resolution approach of the newly acquired NKBM, the rating agency does not currently incorporate NKBM in OTP Bank's resolution perimeter and Advanced LGF analysis.

The confirmation of OTP's Baa1 long-term bank deposit ratings and CRRs continue to incorporate unchanged extremely low loss severity because of strong protection from more junior instruments outstanding, in relation to total balance sheet volume. Despite Moody's assumption of a moderate likelihood of support by the Government of Hungary (Baa2 stable) in case of need, OTP's long-term bank deposit and CR ratings do not benefit from uplift, because they are already rated higher than the government.

The downgrade to Ba2 from Ba1 on the bank's plain subordinated debt rating results from a reduced loss protection from more junior instruments in relation to the bank's balance sheet such that it results in a higher loss severity than previously assumed.

The confirmation of the Ba3(hyb) junior subordinated debt ratings incorporates an unchanged high loss severity for these instruments, which only benefit from equity at failure as loss protection.

OTP Jelzalogbank Zrt.

The downgrade of the bank's backed issuer rating by one notch to Baa3 reflects a materially lower risk protection for this instrument class compared to the rating agency's previous assessment and incorporating OTP's funding plan and maturities. The significant reduction in loss protection is partly offset by the agency's assumption of a moderate likelihood of support from the Government of Hungary for senior unsecured debt instruments, which results in one notch of rating uplift, compared with no uplift previously.

OTP MB's CRRs are aligned with the CRRs of its parent bank and its backed issuer rating is aligned with the senior unsecured debt rating that would have been assigned to its parent bank, based on the explicit and irrevocable guarantee provided by the parent bank for its mortgage bank's unsubordinated liabilities.

--RATIONALE FOR THE STABLE OUTLOOK

The stable outlook of OTP's long-term deposit ratings reflects Moody's view that the bank's combined credit profile will stay broadly unchanged over the next 12 to 18 months despite more difficult operating conditions. The stable outlook also captures the rating agency's expectation that OTP's credit profile will be resilient to further downside risks from the bank's exposure to

Russia and Ukraine.

The stable outlook on OTP MB's backed long-term issuer rating reflects Moody's view that OTP will achieve the volumes of loss absorbing debt envisioned in its current issuance plan over the next 12 to 18 months.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

OTP's and OTP MB's ratings could be upgraded in case of an upgrade of the bank's BCA. OTP's subordinated ratings and OTP MB's issuer ratings could be upgraded in case of a material increase in the volume of outstanding debt, such that it significantly reduces the loss severity for these instruments.

OTP's BCA could be upgraded if the bank's regional footprint sustainably shifts towards stronger economies, as measured by Moody's macro profile. The bank's BCA could also be upgraded in case of a joint improvement in the bank's key solvency and liquidity metrics.

OTP's and OTP MB's ratings could be downgraded in case of a downgrade of OTP's BCA. OTP's deposit ratings and OTP MP's issuer ratings could also be downgraded if the volume of outstanding debt instruments in relation to OTP's balance materially fall, such that the loss severity increases.

OTP'S BCA could be downgraded in case of a significant deterioration in the bank's combined solvency or if the bank's funding profile weakens.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at https://ratings.moodys.com/api/rmc-documents/71997. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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REFERENCES/CITATIONS

[1] https://www.otpgroup.info/static/sw/file/230201_CPA_012_e.pdf 01-Feb-2023

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