

Research Update:

Hungary-Based OTP Bank Ratings Affirmed Despite Escalating Ukraine Conflict; Outlook Remains Stable

March 3, 2022

Overview

- Russia's military intervention in Ukraine will have negative market implications for foreign banks in both countries following the imposition of unprecedented international sanctions and the disruption to the financial system.
- We expect OTP Bank to experience a material worsening of its asset quality in both countries possibly with some reduction in capitalization, but we think it will demonstrate resilience.
- We therefore revised down our assessment of the bank's stand-alone credit profile (SACP) to 'bbb' from 'bbb+'. At the same time, we affirmed our 'BBB' long-term and 'A-2' short-term issuer credit ratings.
- The stable outlook reflects our view that over the next 12 to 24 months the bank will withstand additional fallout from the escalating Russia-Ukraine conflict, not least given its otherwise good earnings generation across the broader central and eastern Europe (CEE) region.

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Rating Action

On March 3, 2022, S&P Global Ratings affirmed its 'BBB' long-term and 'A-2' short-term issuer credit ratings on OTP Bank and OTP Mortgage Bank. The outlook is stable.

Rationale

OTP's businesses in Ukraine and Russia are important contributors to the group's profits and risk profile. Despite their riskier business models and sub-par asset quality compared to the rest of the group, OTP's operations in Russia and Ukraine are meaningful in a group context. They each accounted for about 7% of group earnings in the first nine months of 2021, and 4% of group net loans. Due to their strong deposit franchise, both subsidiaries are mostly funded in the local market, not from OTP.

We expect the bank's asset quality in Ukraine and Russia to deteriorate significantly, with a possible moderate reduction in capitalization. OTP's loan book in Russia and Ukraine is biased toward retail customers, with some corporate exposures. Under our base case, we anticipate that an economic downturn in both countries and the effect of sanctions in Russia will lead to rising nonperforming loans and much weaker profitability with a new provisions build-up of 1.5%-2.0% in 2022. We expect that OTP will be able to absorb these costs via its earnings from other markets and given its comparably strong performance during the pandemic. In our view, this will lead to slightly lower but still satisfactory capitalization, with its S&P Global Ratings risk-adjusted capital (RAC) ratio likely to be 7.25%-7.75% through end-2023.

We remain mindful of downside risks and potential second-round effects for OTP's operations.

Russia is an important trading partner and energy supplier in Eastern Europe. We will look for signs of slowing business or asset quality deterioration in the neighboring countries in which OTP is active such as Moldova, Hungary, Romania, and Bulgaria. There are also downside risks to our base case for the Russian and Ukraine operations whether from asset quality or if, in an extreme scenario, a situation arises in which OTP is forced to close or walk away from its subsidiaries, leading to increased write-offs and a significant alteration to its geographic footprint.

We revised down OTP Bank's SACP to 'bbb' from 'bbb+'. This reflects a slight weakening of its creditworthiness under our base case relative to previous expectations and the significant uncertainties that bring downside risk to our base-case assumptions for asset quality. The SACP revision also reflects that these events have weakened comparability with the bank's 'BBB+' rated peers.

Despite the revision to the SACP, we continue to rate OTP in line with our sovereign rating on Hungary (BBB/Stable/A-2). While OTP has one of the most geographically diverse footprints of any European banking group, for now we would not rate it above the sovereign because we doubt that it would survive in a hypothetical sovereign default scenario. In time, we could revise this stance if our modeling suggests that its resilience has substantially improved, whether aided by further diversification, stronger capitalization, or improved resolvability with associated stronger subordinated buffers.

Outlook

The stable outlook on OTP reflects our view that over the next 12 to 24 months the bank will withstand the fallout from the escalating Russia-Ukraine conflict given its otherwise good earnings generation across broader CEE, and its solid funding. At the same time, we expect that the group will ensure sufficient capitalization in case of further acquisitions and increasing credit losses.

Downside scenario

We could downgrade the bank if we took a similar rating action on Hungary or if we see a material deterioration in the bank's stand-alone creditworthiness. This could follow from a confluence of potential negative developments, including for example, a substantial loss of its equity investments in Russia or Ukraine or credit losses that far exceed our current projections, particularly if there are spillover effects on its wider markets. Such effects could weaken its asset quality and/or reduce capitalization well beyond our base case. In addition, we remain mindful that OTP has been acquisitive in recent years and that further acquisitions, particularly in higher

risk countries, could increase its risk profile and lower its capitalization.

Upside scenario

An upgrade is currently highly unlikely because it would need to be preceded by a similar rating action on Hungary and would also require a strengthening in OTP's own creditworthiness.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB/Stable/A-2	BBB/Stable/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)	Adequate (0)
Funding and	Strong and	Strong and
Liquidity	Strong (+1)	Strong (+1)
Credit Rating Adjustment	0	0
Support	0	0
ALAC Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	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

- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Central And Eastern European Bank Ratings Affirmed Under Revised FI Criteria, Jan. 27, 2022
- ESG Credit Indicator Report Card: EMEA Banks, Jan. 19, 2022
- Banking Industry Country Risk Assessment: Hungary, Oct. 18, 2021
- Potential Acquisition of Uzbek Ipoteka Bank Expands OTP Bank's Geographical Footprint But Adds To Risks, Sept. 30, 2021
- Ratings On Two Hungarian Banks Affirmed On Reduced Economic Risk, Aug. 18, 2021
- OTP Bank Strengthens Its Franchise By Acquiring Slovenian Bank Nova KBM, June 21, 2021

Ratings List

Ratings Affirmed

OTP Bank PLC

OTP Mortgage Bank

Issuer Credit Rating	BBB/Stable/A-2
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Resolution Counterparty Rating	BBB/--/A-2
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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