Credit Rating Announcement 09 March 2022

Scope affirms BBB+ issuer rating on OTP Bank with Stable Outlook

The affirmation reflects Scope's expectation that OTP will be able to manage the impacts from the turmoil in Eastern Europe.

Rating action

Scope Ratings GmbH (Scope) has today affirmed OTP Bank nyrt.'s issuer rating of BBB+ with a Stable Outlook.

Scope has also affirmed the ratings on the following debt categories:

- Preferred senior unsecured debt rating at BBB+, Stable
- Non-preferred senior unsecured debt rating at BBB, Stable
- Tier 2 debt rating at BB+, Stable

Rating rationale

The affirmation reflects Scope's view that the turmoil in Eastern Europe is unlikely to materially weaken OTP's credit quality. Scope estimates that under a severe scenario, in which the group decides to divest from both its Russian and Ukrainian subsidiaries, OTP's minimum buffer to capital requirements would remain high at around 500bps (net of the proposed 2019 and 2020 dividend). Most of the impact would derive from the write-off of OTP's equity stakes because net intragroup funding provided to the two banks is limited. As of YE 2021, the group's exposure to Russia and Ukraine outside the two subsidiaries' perimeter was not material, except for about HUF 100bn of Russian government bonds (around 60bps of CET1 capital).

While the loss of two of its most profitable franchises would detract from OTP's earnings capability and business model diversification, Scope believes the group could continue to deliver double-digit ROEs even without the contribution of the two units. As of YE 2021, the Russian and Ukrainian subsidiaries combined made up 6.5% of the group's total assets, 7.8% of total loans, and 13.2% of shareholders' equity. In 2021, the two contributed 16% of OTP's profits. In a November 2021 rating action release[1], Scope had indicated that risks stemming from Russian and Ukrainian operations were limited from a credit perspective.

OTP's ratings continue to be based on the group's resilient business model, which is built on a dominant market position in Hungary and a high degree of geographical diversification. Less than half of the group's total assets are domestic. This broad geographical diversification allows OTP to not only counterbalance the volatility of its Hungarian operations but also to exploit higher margins and growth in less developed banking markets.

The ratings also consider OTP's appetite for acquisitions in Central and Eastern Europe (CEE). Scope acknowledges the group's strong execution record and the boost these acquisitions provide to OTP's growth. Nevertheless, the rating agency also notes the challenges that accompany acquisitions, especially if they are made in large numbers.

Scope assesses OTP's long-term sustainability as 'developing'. While the rating agency acknowledges the group's efforts to accelerate its digitalisation and lead its peer group in the CEE region, it also notes that OTP only launched an ESG programme in 2020. Scope believes there is still room to improve the management of emerging ESG-D challenges. The progress made so far does not yet warrant a rating uplift (ESG factor).

The ratings benefit from OTP's excellent profitability. In the past five years, the group's return on equity averaged around 17%, backed by the sound economic growth in CEE countries. Such returns are uncommon among large European banks. In 2021, the group reported a return on average equity of 17%, in line with the five-year average.

Although OTP's non-performing loan ratio is higher than international peers', Scope considers it manageable in view of the high coverage. The Covid crisis has had a minimal impact on the group's credit portfolio. OTP's headline asset quality metrics have improved in the past quarters, mainly thanks to strong loan growth. This trend could be challenged if the economic fallout from the Russo-Ukrainian crisis proves greater than currently expected.

High capital buffers and a solid funding profile are additional strengths that back OTP's ratings. Despite dividend pay-outs and acquisitions, the group's capital ratios have steadily increased over the years due to strong earnings. The positive results in the EBA 2021 stress test further demonstrate the group's solidity.

OTP is primarily funded through deposits thanks to its strong positioning in retail markets, especially in Hungary and Bulgaria. The group's subsidiaries are funded in the respective local currency, minimising currency mismatches between assets and liabilities.

One or more key drivers for the credit rating action are considered ESG factors.

Outlook and rating-change drivers

The Outlook is Stable, reflecting Scope's view that OTP's credit profile will remain unchanged in the next 12 to 18 months.

What could move the rating up:

- Significant improvement in managing emerging ESG-D challenges relative to peers

What could move the rating down:

- Significant deterioration in the group's asset quality or profitability, which could arise from an economic downturn in CEE

- While Scope considers that the write-off of the current direct exposures to Russian and Ukraine would not jeopardise OTP's capital position, further material erosion would be viewed negatively

- Evidence that OTP is willing to provide more support to its subsidiaries in Russia and Ukraine and thus, bear potentially higher losses

Rating driver references

1. 15 November 2021 –first-time rating

Stress testing & cash flow analysis

No stress testing was performed. No cash flow analysis was performed.

Methodology

The methodologies used for these Credit Ratings and/or Outlooks, (Financial Institutions Rating Methodology, 28 January 2022; Bank Capital Instruments Rating Methodology, 30 April 2021), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

Scope Ratings GmbH and Scope Ratings UK Limited apply the same methodologies/models and key rating assumptions for their credit rating services, while Scope Hamburg GmbH's methodologies/models and key rating assumptions are different from those of Scope Ratings GmbH and Scope Ratings UK Limited.

Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.

The following substantially material sources of information were used to prepare the Credit Ratings: public domain and the Rated Entity.

Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and/or Outlooks and the principal grounds on which the Credit Ratings and/or Outlooks are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlooks are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlooks are UK-endorsed.

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The Credit Ratings/Outlooks were first released by Scope Ratings on 15 November 2021.

Potential conflicts

See www.scoperatings.com under Governance & Policies/EU Regulation/Disclosures for a list of potential conflicts of interest related to the issuance of Credit Ratings.

Conditions of use/exclusion of liability

About Scope Group

With more than 250 employees operating from offices in Berlin, Frankfurt, Hamburg, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG and fund analysis. Based on forward-looking and innovative methodologies, Scope offers a European perspective that contributes to greater diversity of opinion for institutional investors worldwide. **Scope Ratings** is the largest European credit rating agency, registered in accordance with EU and UK rating agency regulation, offering opinion-driven and non-mechanistic credit risk analysis. **Scope ESG Analysis** provides tools for analysing and reporting on ESG impact and risk, as well as second-party opinions on green, social and sustainable bonds. **Scope Fund Analysis** rates more than 10,000 funds and asset managers across all major asset classes. The shareholders of Scope Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several European countries. More on www.scopegroup.com

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