Credit Rating Announcement

22 November 2024

Scope affirms OTP Bank's BBB+ issuer rating with Stable Outlook

Rating affirmation reflects the group's robust operating performance and strong prudential metrics.

Rating action

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

The full list of rating actions and rated entities is at the end of this rating action release.

Key rating drivers

Business model assessment: Resilient low. OTP combines a broad franchise in Central Eastern Europe with a leading market position in Hungary and strong market shares in most of the other markets in which it operates. High geographic diversification offsets the moderate volatility of the group's Hungarian operations and provides higher margins and growth opportunities in less developed banking markets. The group's most recent transactions were the acquisition of Nova KBM in Slovenia to become the one of the country's largest banks and the acquisition of Ipokeka Bank in Uzbekistan, which ranks fifth in the local market by size.

OTP has demonstrated a disciplined acquisition strategy and strong execution record, which allowed the group to grow at a rapid pace in the past years. Scope will carefully monitor further deals to assess the strategic fit and associated integration risks.

OTP is one of the few remaining European banks operating in Russia. It is still active in consumer lending and collects new deposits, while it has ceased corporate lending. Although credit quality and profitability remain robust, reputational and legal risks from Russian operations linger. Scope estimates that the capital impact of a disorderly exit from the market would be positive today, as OTP has been able to withdraw maturing intra-group funding and upstream retained earnings[1] since the start of the war.

Operating environment assessment: Moderately supportive low. Hungary (moderately supportive high) is one of the largest economies in CEE, with a high economic growth potential supported by foreign investments and EU funding. However, GDP per capita is still relatively low compared to the EU average. The banking sector is moderately concentrated and has been well performing since the second half of the 2010s. Hungarian banks are supervised by the Hungarian central bank and are subject to the EU framework for banking and financial regulation.

The group is present in similarly supportive markets, such as Slovenia and Croatia. However, the operations in weaker environments, including Bulgaria, Serbia, Russia, and Ukraine, weigh on the overall assessment.

Scope arrives at an initial mapping of **bbb-** based on a combined assessment of the issuer's operating environment and business model.

Long-term sustainability assessment (ESG factor): Developing. The assessment reflects the group's ongoing efforts in the ESG and digital areas. Following the pandemic, the group has increased its digitalisation efforts, aiming to provide market-leading digital solutions and to increase group-wide efficiency. In the past 5 years, digital penetration has been increasing along with changing client preferences; in 2023, digital channels accounted for 64% of all retail transactions, up from 52% in 2020.

OTP has also launched an ESG strategy which contains interim goals for 2025. In 2023, the group carried out its first climate change stress test; results show a higher exposure to transition risk due to its presence in more carbon-intensive economies than for EU peers, while physical risk seems contained.

Scope notes that regarding ESG matters, the group may face increasingly higher expectations and stricter regulations as it becomes a larger and more relevant player in the euro area.

The long-term sustainability assessment leads to an adjusted rating anchor of **bbb-**.

Earnings capacity and risk exposures assessment: Supportive (+1 notch). OTP exhibits superior earnings generation compared to national and international peers. Profitability is driven by high interest margins and economic growth in the CEE region, as well as by the group's market power in most of the countries in which it operates. Strong revenues allow the group to easily absorb cost inflation and the impact of levies or other direct market interventions imposed by CEE governments (particularly in Hungary).

Scope expects the group to continue to deliver excellent results on the back of rapidly growing CEE economies. However, profitability will gradually decline from very high levels as central banks cut interest rates and cost of risk normalises. At present, the main downside risk is a potential worsening of the geopolitical crisis affecting public confidence, the economy, and financial markets in Europe.

Asset quality has improved further in recent quarters thanks to low NPL inflows and the deconsolidation of the Romanian subsidiary. As of September 2024, its Stage 3 loan ratio stood at 4%, a historical low. After the initial impact of the war, OTP has successfully managed to stabilise both the portfolio size and credit quality in Russia and Ukraine.

The group has a concentrated but manageable exposure to the Hungarian sovereign. As of Q3 2024, the domestic bond portfolio accounted for around 64% of the group's Tier 1 capital and had a low average maturity. Scope estimates that the group would be able to withstand a full write-down on its domestic government portfolio and remain prudentially viable, which is supportive to our current positioning of the group's rating above that of its home sovereign. In line with Scope's Financial Institutions Rating Methodology, the issuer rating is not mechanically capped at the level of the sovereign.

Financial viability management assessment: Comfortable (+1 notch). High capital buffers and a solid funding profile are additional strengths supporting OTP's ratings. Strong earnings generation allows the group to grow both organically and through M&A, while preserving healthy buffers to solvency requirements. Given the group's growth strategy, share buybacks or dividends are not a priority. In the medium term, Scope expects the group to maintain a CET1 ratio in the 15-17% range, consistent with the balance of a prudent capital policy and growth appetite.

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 their respective local currencies, minimising currency mismatches between assets and liabilities. Since 2022, the group has increased the issuance of bonds on international markets to fulfil its MREL requirements.

One or more key drivers of the credit rating action are considered an ESG factor.

Outlook and rating sensitivities

The **Stable Outlook** reflects Scope's view that the risks to the current rating are balanced.

The **upside scenario** for the ratings and Outlooks is:

1. A progressive rebalancing of the group's operations towards stronger markets, either through M&A or organic growth, could lead to an upgrade of the Operating Environment assessment.

The **downside scenarios** for the ratings and Outlook are (individually or collectively):

1. A material worsening in the group's asset quality and earnings, or a substantive increase in the exposure to domestic sovereign risk, would have a negative impact on the Earnings Capacity and Risk Exposures assessment.

2. Downgrade of the Financial Viability Management assessment following a material erosion of the group's capital buffers.

Debt ratings

Preferred senior unsecured debt: BBB+. The rating is aligned with the issuer rating and applies to senior unsecured debt ranking above other classes of senior unsecured debt.

Non-preferred senior unsecured debt: BBB. The rating is one notch lower than the issuer rating, reflecting statutory subordination.

Tier 2 debt: BB+. The rating is three notches below the issuer rating, in line with our standard approach for Tier 2 debt instruments, without additional notching.

Environmental, social and governance (ESG) factors

Please refer to the 'long-term sustainability assessment' under the 'key rating drivers' section above for the ESG analysis.

All rating actions and rated entities

OTP Bank Nyrt.

Issuer rating: BBB+/Stable, rating affirmation

Preferred senior unsecured debt rating: BBB+/Stable, rating affirmation

Non-preferred senior unsecured debt rating: BBB/Stable, rating affirmation

Tier 2 debt rating: BB+/Stable, rating affirmation

1. OTP has received RUB 37.1bn in dividends to date, with a further RUB 4.7bn subject to approval by the central bank.

Stress testing & cash flow analysis

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

Methodology

The methodology used for these Credit Ratings and Outlooks, (Financial Institutions Rating Methodology, 6 February 2024), is available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
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, the Rated Entity, and Scope Ratings' internal sources.
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 these 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 and/or Outlooks 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. The Credit Ratings/Outlooks were last updated on 28 November 2023.

Potential conflicts

See www.scoperatings.com under Governance & Policies/Regulatory for a list of potential conflicts of interest disclosures related to the issuance of Credit Ratings, as well as a list of Ancillary Services and certain non-Credit Rating Agency services provided to Rated Entities and/or Related Third Parties.

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With more than 300 employees operating from offices in Berlin, Frankfurt, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG analysis and fund research. 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 registered in accordance with the EU rating regulation and operating in the European Union with ECAI status. Scope Ratings is the only European rating agency accepted by the ECB for the Eurosystem Credit Assessment Framework (ECAF). 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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