MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns provisional (P)Aa3 to PKO Bank Hipoteczny S.A.'s Mortgage Covered Bonds

Global Credit Research - 08 Sep 2015

London, 08 September 2015 -- Moody's Investors Service, ("Moody's") has today assigned a provisional (P)Aa3 long-term rating to the mortgage covered bonds to be issued by PKO Bank Hipoteczny S.A. (the issuer, long term issuer rating Baa1; counterparty risk (CR) assessment A3(cr)) which are governed by the Polish Covered Bond legal framework.

RATINGS RATIONALE

A covered bond benefits from (1) the issuer's promise to pay interest and principal on the bonds; and (2) following a CB anchor event, the economic benefit of a collateral pool (the cover pool). The ratings therefore reflect the following factors:

(1) The credit strength of PKO Bank Hipoteczny S.A. (long term issuer rating Baa1; counterparty risk (CR) assessment A3(cr)) and a CB anchor of CR assessment plus 1 notch.

(2) Following a CB anchor event the value of the cover pool. The stressed level of losses on the cover pool assets following a CB anchor event (cover pool losses) for this transaction is 31%.

Moody's considered the following factors in its analysis of the cover pool's value:

a) The credit quality of the assets backing the covered bonds: The mortgage covered bonds are backed by Polish residential mortgage loans. The collateral score for the cover pool is 11.1%.

b) The legal framework of the programme. Moody's analysis is based on the Polish covered bond legal framework currently in effect. Amendments to the existing framework were voted by the Parliament and signed by the Polish President in August 2015 and are expected to come into force on 1st January 2016. In due course Moody's may update its analysis to reflect these amendments.

Notable aspects of the Polish covered bond legislation include (1) the fact that covered bond holders have a priority security claim over the cover pool assets before other creditors; (2) the restriction on issuing covered bonds to a maximum of 60% of the total mortgage lending value of properties securing the mortgage loans; (3) the eligibility criteria for the cover assets, which include, inter alia, that loans must be first-ranking mortgages with a loan-to-value (LTV) limit of 100%; and (4) the statutory par test, by which the total nominal value of outstanding covered bonds must not exceed the sum of total nominal value of mortgage loans in the pool.

c) The exposure to market risk, which is 23.6% for this cover pool.

d) The over-collateralisation (OC) in the cover pool. The expected OC is still to be determined however PKO Bank Hipoteczny S.A. provides 0% on a "committed" basis (see Key Rating Assumptions/Factors, below).

The TPI assigned to this transaction is "Improbable". Moody's TPI framework does not constrain the rating. The bonds country ceiling for Poland is set at Aa3, which constrains the ratings assigned to the covered bonds.

The provisional rating that Moody's has assigned addresses the expected loss posed to investors. Moody's ratings address only the credit risks associated with the transaction. Moody's did not address other non-credit risks, but these may have a significant effect on yield to investors.

Moody's issues provisional ratings in advance of the final sale of securities and these ratings only represent Moody's preliminary opinion. Upon a conclusive review of the transaction and associated documentation Moody's will endeavour to assign a definitive rating to the covered bonds.

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The CB anchor for this programme is CR assessment plus 1 notch. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's may use a CB anchor of CR assessment plus one notch in the European Union or otherwise where an operational resolution regime is particularly likely to ensure continuity of covered bond payments.

The cover pool losses for this issuer mortgage covered bonds are 31%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 23.6% and collateral risk of 7.5%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality.

Moody's derives collateral risk from the collateral score, which for this programme is currently 11.1%.

PKO Bank Hipoteczny S.A. provides 0% on a "committed" basis. The minimum OC level consistent with the Aa3 rating target is 0%, of which the issuer should provide 0% in a "committed" form. These numbers show that Moody's is not relying on "uncommitted" OC in its expected loss analysis.

All numbers in this section are based on Moody's most recent modelling (based on data, as per July 2015).

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

Factors that would lead to an upgrade or downgrade of the rating:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "Improbable", the TPI Leeway for PKO Bank Hipoteczny S.A.'s mortgage covered bonds is 2 notches. This implies that Moody's might downgrade the covered bonds because of a TPI cap, if it lowers the CB anchor by 3 notches, all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in this rating was "Moody's Approach to Rating Covered Bonds" published in August 2015. Please see the Credit Policy page on www.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 of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

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