FITCH AFFIRMS MBANK AND MBANK HIPOTECZNY AT 'BBB'; OUTLOOK STABLE

Fitch Ratings-Warsaw/London-30 November 2018: Fitch Ratings has affirmed mBank SA's (mBank) and mBank Hipoteczny's (mBH) Long-Term Issuer Default Ratings (IDR) at 'BBB' with Stable Outlooks. The agency has also affirmed mBank's Viability Rating (VR) at 'bbb-'. A full list of rating actions is at the end of this rating action commentary.

The affirmation of mBank and mBH reflects Fitch's opinion that there is a high probability that both banks would be supported by mBank's 69.37%-owner, Commerzbank AG (BBB+/Stable/bbb+), either directly or through mBank. The affirmation of mBank's VR reflects that there have been no major changes to the bank's financial metrics over the past 12 months.

mBH is a full owned mortgage bank subsidiary of mBank. Fitch does not assign a VR to mBH due to its limited standalone franchise, which could not exist without the ownership of the parent mBank.

KEY RATING DRIVERS
IDRS, SUPPORT RATING (SR), NATIONAL RATINGS AND SENIOR DEBT
mBank's IDRs, SR, National Ratings and senior debt ratings are driven by our view that Commerzbank is highly likely to provide support to its subsidiary, if required. mBank is a strategically important subsidiary for its owner and this support provides a floor for the bank's Long-Term IDR at one notch below that of Commerzbank. The potential cost of support should be manageable for the parent in light of mBank's small size relative to Commerzbank (about 7% of Commerzbank's total assets as of end-3Q18). The Stable Outlook on mBank's Long-Term IDR mirrors that on Commerzbank.

mBank's Short-Term IDR of 'F2' is the higher of two corresponding with a 'BBB' Long-Term IDR because of Commerzbank's solid liquidity and our view that Commerzbank's propensity to support is more certain in the near term.

mBH's IDRs are equalised with those of its direct parent, mBank, as we view the subsidiary as core to mBank. Potential support for mBH could be provided either directly by Commerzbank, but most likely through mBank.

mFinance France is a special purpose vehicle used by mBank to issue Eurobonds, which are fully guaranteed by mBank. Guaranteed debt issued by mFinance France is rated at the same level as mBank's IDRs.

VR
mBank's VR is underpinned by its well-established domestic market franchise, conservative business model and risk appetite, and generally solid financial metrics. However, the bank's standalone credit profile is affected by high tail risks in its substantial legacy foreign currency (FC, primarily Swiss franc) retail mortgages. They accounted for 18% of all gross loans or 124% of Fitch Core Capital (FCC) at end-3Q18 and particularly drag on our assessment of the bank's asset quality and capitalisation.

FC mortgage holders are vulnerable to a potential sharp and prolonged weakening of the Polish zloty and an increase in the Swiss franc LIBOR. These exposures could also be a potential source risk of administrative or legal actions. According to the bank, most borrowers can withstand a moderate depreciation of the zloty, but in our view, defaults would likely generate high credit losses because most loans have high loan-to-value ratios. FC mortgages have performed well, despite a substantial weakening of the zloty since their origination (before 2009), supported by a favourable economic environment, wage increase and low Swiss franc LIBOR. At end-3Q18, the ratio of impaired Swiss franc mortgages was about 4%.

In our assessment of mBank's asset quality we consider its stable impaired loan ratios and prudent coverage of bad debts by loan loss allowances. The bank's underwriting standards are reasonable and commensurate with its business model and country risks. Default rates are low and loan impairment charges in new disbursements are contained in the current credit cycle. This reflects a relatively cautious approach to lending, but is also a function of a supportive economic environment. At end-3Q18, the bank's impaired loans equalled 4.7% of gross loans (sector average: about 6%) and were 72% covered by loan loss allowances. or 63% including allowances only for impaired loans.

mBank's capitalisation suffers from high concentration in FC mortgages, but also reflects a robust FCC ratio, modest unreserved impaired loans, solid recurring profitability and the bank's moderate risk appetite and business model. At end-3Q18, the bank's FCC ratio was 18.6% and has moderately shrunk in 9M18 due to credit expansion. mBank maintains a solid surplus of about 3.5% over its minimum Tier 1 capital ratio. The bank's regulatory floor for capital ratios comprises a material 3.5% buffer (set individually by the regulator) related to FC mortgages (75% of which must comprise Tier 1 capital).

mBank's stable funding and liquidity is underpinned by its solid core deposit profile without material concentration risk and diversified wholesale funding sources. mBank is one of a few frequent issuers in the region and we believe that established investor appetite for its debt is a rating strength. In our assessment of mBank's funding and liquidity we also take into consideration potential ordinary and liquidity support from its parent. At end-3Q18, the bank's gross loans/ customer deposits ratio equalled 99%. The bank's available liquidity fully covers its short-term refinancing needs. At end-1H18, highly liquid assets equalled about 17% of all assets.

mBank is a systemically important bank. It was ranked fourth by assets at end-3Q18 and its market shares in loans and deposits equalled about 6%. mBank operates a traditional universal banking model. Its well-established domestic retail and corporate franchise is underpinned by sophisticated and innovative mobile banking offer.

mBank's profitability is commensurate with its business models and the Polish operating environment. Profitability is sufficiently strong to support near-term growth and provide material loss-absorption capacity. In 9M18, the ratio of operating profit/risk-weighted assets equalled 2.4%. mBank's results in retail banking are dampened by low-yielding Swiss franc mortgages, but this is offset by its robust cost efficiency (due to lean branch network and high digitalisation).

RATING SENSITIVITIES
IDRS, SUPPORT RATING, NATIONAL RATINGS AND SENIOR DEBT
The ratings of mBank and mBH are sensitive to changes in Commerzbank's IDRs or our assessment of Commerzbank's propensity to provide support. We believe that the latter is likely to remain unchanged in the foreseeable future.

VR
mBank's VR could suffer from a large and sustained depreciation of the Polish zloty. This could result in significant deterioration of its capitalisation and deterioration of its FC loan portfolio quality. A marked and prolonged weakening in the Polish economy (not Fitch's base scenario) materially affecting the bank's asset quality, capitalisation and profitability, could also lead to mBank's VR being downgraded.

The bank's VR could be upgraded if the bank maintains its currently sound financial metrics and risks relating to FC mortgages are gradually reduced.

The rating actions are as follows:

mBank
Long-Term IDR: affirmed at 'BBB'; Outlook Stable
Short-Term IDR: affirmed at 'F2'
National Long-Term Rating: affirmed at 'AA-(pol)'; Outlook Stable
National Short-Term Rating: affirmed at 'F1+(pol)'
Viability Rating: affirmed at 'bbb-'
Support Rating: affirmed at '2'
Long-term senior unsecured debt rating: affirmed at 'BBB'
Short-term senior unsecured debt rating: affirmed at 'F2'
Long-term senior unsecured rating for eurobonds issued by mFinance France: affirmed at 'BBB'

mBank Hipoteczny
Long-Term IDR: affirmed at 'BBB'; Outlook Stable
Short-Term IDR: affirmed at 'F2'
National Long-Term Rating: affirmed at 'AA-(pol)'; Outlook Stable
National Short-Term Rating: affirmed at 'F1+(pol)'
Support Rating: affirmed at '2'

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 12 Oct 2018)
https://www.fitchratings.com/site/re/10044408
National Scale Ratings Criteria (pub. 18 Jul 2018)
https://www.fitchratings.com/site/re/10038626