MOODY'S

Rating_Action: Moody's downgrades ratings of mBank, confirms ratings of Bank Millennium, concluding reviews

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Ratings of mBank's mortgage bank subsidiary were also downgraded

Frankfurt am Main, March 24, 2023 -- Moody's Investors Service (Moody's) today has downgraded the long-term deposit ratings of mBank S.A. (mBank) to Baa1 from A3 and changed the outlook to negative from ratings under review. The rating agency also downgraded the bank's Baseline Credit Assessment (BCA) to ba1 from baa3 and its Adjusted BCA to baa3 from baa2 while it affirmed its P-2 short-term deposit ratings.

Concurrently, Moody's has downgraded the long-term issuer ratings of mBank Hipoteczny S.A. (mBH) to Baa2 from Baa1 and changed the outlook to negative from ratings under review. The bank's P-2 short-term issuer ratings were affirmed.

At the same time, Moody's has confirmed Bank Millennium S.A.'s (BM) Baa3/P-3 long- and short-term deposits ratings and its (P)Ba2 junior senior unsecured MTN program ratings and changed the outlook on the long-term deposit ratings to negative from ratings under review. The rating agency further downgraded the bank's BCA to ba3 from ba2 and confirmed its Adjusted BCA at ba2.

Today's rating actions conclude the review for downgrade on mBank and mBH opened on 20 December 2022 and the review for downgrade on BM opened on 20 July 2022 and extended on 20 December 2022.

Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL475095 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

RECENT DEVELOPMENTS AFFECTING MBANK AND BM

Tail risks for mBank and BM have increased significantly in light of the opinion[1] of the Advocate General of the European Court of Justice (ECJ), which lifts the loss severity of current and future lawsuits related to the Polish banks' legacy Swiss franc mortgage loans. The opinion is not binding on the ECJ's final ruling, which Moody's expects in the second half of 2023 and will be subject to interpretation by Poland's domestic courts, which will ultimately deal with individual cases. Based on previous decisions, the rating agency expects the courts will largely follow the Advocate General's opinion. At the same time, court cases can be lengthy, allowing banks to build additional provisions for legal risks and strengthen their capital through earnings retention, unless auditors require immediate recognition of losses.

Reflecting potentially severe financial implications for both banks from rising customer relations risks compared to previous expectations and considering that their exposure to legacy Swiss franc mortgages in relation to their Tangible Common Equity is materially higher than for other Polish banks, Moody's has lowered the social issuer profile scores (IPS) assigned to both banks to very highly negative (S-5) from highly negative (S-4). Under Moody's framework for assessing environmental, social and governance (ESG) risks, the risks associated with legacy Swiss-franc mortgages are key social risks, captured under the assessment of exposure to conduct and customer relations risk.

DOWNGRADE OF MBANK'S BCA AND LONG-TERM RATINGS

The downgrade of mBank's long-term deposit ratings to Baa1 from A3 reflects the downgrade of the BCA to ba1 from baa3 due to significantly increased solvency risks stemming from the bank's legacy exposure to Swiss franc mortgages, impacting its stress capital resilience amid weaker operating conditions for Polish banks; the downgrade of the Adjusted BCA to baa3 from baa2 following an unchanged assumption of moderate affiliate support from the bank's parent, Germany's Commerzbank AG (deposits A1 stable, senior unsecured A2 stable, BCA baa2), which continues to result in one notch of uplift; unchanged results from both Moody's Advanced Loss Given Failure (LGF) analysis, yielding two notches of rating uplift from the Adjusted BCA, and low government support assumptions, not resulting in any rating uplift.

The downgrade of mBank's BCA to ba1 from baa3 considers that an already deteriorated capitalization, following two loss-making years, meets still rising risks from sizeable legacy Swiss franc exposures, which in an adverse scenario could significantly challenge the bank in meeting all of its capital requirements at all times, which is not viewed to be commensurate with an investment grade standalone creditworthiness. While the rating agency acknowledges that mBank operates a sound and profitable business model since it ceased excessive Swiss franc currency lending for its retail clients, present headwinds will continue to burden strong capital generation for some time. mBank remains among the most exposed banks to these risk factors in Poland.

Due to the aforementioned developments and its still sizable legacy Swiss franc mortgages, mBank continues to face high governance risks. Moody's reflects elevated and longer-term financial challenges, that are highlighting financial governance and strategy deficiencies, in a highly negative governance IPS of G-4 under its ESG framework. Finally, mBank's ESG Credit Impact Score remains CIS-4 (highly negative), reflecting the discernable impact of its high governance risks as well as rising social risks on the current ratings.

DOWNGRADE OF MBANK HIPOTECZNY S.A.'S RATINGS

mBH's issuer ratings and assessments are aligned with the issuer rating that would have been assigned to its parent mBank and its assessments, and reflect the agency's view that there is a low probability that mBank would de-prioritize meeting the debt obligations of mBH relative to meeting its own obligations for the parent or group entities.

The downgrade of mBH's long-term issuer ratings to Baa2 from Baa1 reflects the downgrade of the BCA and Adjusted BCA of its parent and unchanged results from Moody's Advanced LGF analysis, which considers the joint resolution perimeter of parent mBank and its subsidiary mBH. For the issuer ratings of mBH, which are derived from the senior unsecured debt instrument seniority, Moody's Advanced LGF analysis continues to result in two notches of rating uplift.

DOWNGRADE OF BANK MILLENNIUM S.A.'S BCA, CONFIRMATION OF DEPOSIT AND DEBT PROGRAM RATINGS

BM's long- and short-term deposit ratings were confirmed at Baa3/P-3, reflecting the downgrade of the bank's standalone BCA to ba3 from ba2 due to the increased pressure on its solvency profile from tail risks associated with its legacy Swiss franc mortgages; an unchanged ba2 Adjusted BCA due to the rating agency's assumption of moderate affiliate support from BM's parent Banco Comercial Portugues, S.A. (BCP, deposits Baa2 stable/senior unsecured Baa3 stable, BCA ba2) which now translates in a one notch uplift from the bank's standalone BCA, compared to previously no uplift, and unchanged results from both Moody's Advanced LGF analysis, yielding in two notches of rating uplift from the Adjusted BCA, and low government support assumptions, not resulting in any rating uplift.

The downgrade of BM's BCA to ba3 from ba2 reflects that the bank's capitalization, despite a successful recovery above regulatory required minima ahead of the initial plan, remains significantly vulnerable to rising tail risks. BM is the most exposed Moody's rated bank to these risks in the Polish market. While Moody's takes into account BM's profitable business model since it stopped Swiss franc mortgage lending, the rating agency believes that the bank's capacity to generate capital internally could remain impeded by current and potential future headwinds, as it already was during the last two years.

While Moody's acknowledges that BM has swiftly restored compliance with capital requirements before year-end 2022, the rating agency maintains a very highly negative governance IPS of G-5. This reflects BM's still sizeable exposure to heightened legal and significant financial challenges associated with its legacy Swiss franc mortgages, highlighting the longer-term repercussions of weaknesses in its financial governance and strategy. Consequently, BM's ESG Credit Impact Score remains CIS-5 (very highly negative), reflecting the significant negative impact of the bank's overall governance risks as well as rising social risks on the current ratings.

RATING OUTLOOKS

The negative outlooks on mBank's and BM's long-term deposits ratings (and mBH's long-term issuer ratings) reflect that the banks' credit profiles remain sensitive to heightened legal risks stemming from their legacy Swiss franc exposure, as well as other material adverse developments, which could erode their profitability. These risks, if materialized, could materially impact the banks' solvency, in particular any buffer to regulatory capital requirements. At present, the rating agency considers the loss severity of the banks' remaining Swiss franc mortgage portfolio while further legal risks could also arise from loans that have already been fully repaid, exerting additional pressure on the bank's solvency.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The ratings of mBank could be upgraded following an upgrade of its BCA and/or because of a clear and reliable commitment by its parent that it would provide support in case of need. A BCA upgrade of mBank would require a significant strengthening of its solvency profile. mBH's ratings would likely be upgraded following the upgrade of mBank's ratings.

The ratings of BM could be upgraded if there is a significant and sustained recovery of the bank's solvency profile, such that it justifies a multi-notch upgrade of the BCA. A one notch higher BCA would likely be offset by the loss of rating uplift from affiliate support, unless the Adjusted BCA of its parent was also upgraded.

The BCA's and ratings of mBank and BM could be downgraded if Swiss-franc mortgage tail risks materialize even beyond Moody's current expectations, for instance if also borrowers of loans already repaid increasingly sue the banks which would exert additional pressure on their solvency profile, potentially impeding both banks' efforts in restoring their capitalization in the short-term.

Furthermore, a meaningful decrease in BM's volume of subordinated debt instruments could lead to a downgrade of its junior senior unsecured MTN program ratings, provided that the loss severity significantly increases as a result of the reduced risk protection.

The ratings of mBH would likely be downgraded following a downgrade of mBank's ratings.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at https://ratings.moodys.com/api/rmc-documents/71997. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

The List of Affected Credit Ratings announced here are a mix of solicited and unsolicited credit ratings. For additional information, please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website https://ratings.moodys.com. Additionally, the List of Affected Credit Ratings includes additional disclosures that vary with regard to some of the ratings. Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL475095 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

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• Issuer Participation

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• Participation: Access to Internal Documents

• Lead Analyst

• Releasing Office

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

Items color coded in purple in this Press Release relate to unsolicited ratings for a rated entity which is non-participating.

REFERENCES/CITATIONS

[1] https://curia.europa.eu/jcms/upload/docs/application/pdf/2023-02/cp230036en.pdf

Please see https://ratings.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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