

CREDIT OPINION

12 April 2022

Update



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RATINGS

PKO Bank Hipoteczny S.A.

Domicile	Poland
Long Term CRR	A2
Long-term issuer rating	A3
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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PKO Bank Hipoteczny S.A.

Update to credit analysis

Summary

PKO Bank Hipoteczny S.A.'s (PKO BH) ratings and assessments are aligned with those of its parent, [Powszechna Kasa Oszczednosci Bank Polski S.A.](#) (PKO BP, A2/A3 stable, baa2)¹, reflecting our view that there is a low probability that PKO BP would de-prioritize meeting the debt obligations of PKO BH relative to meeting its own obligations in circumstances of financial stress for the parent or group entities.

Our assessment is driven by PKO BP's full ownership; PKO BH's high strategic importance as the group's covered bond issuing vehicle, which is required per the Polish legal framework for mortgage covered bonds; and PKO BH's small size and absence of an independent franchise, which leads to a high degree of financial links and operational integration within the group. PKO BP has committed to maintain the capital and liquidity of its subsidiary at satisfactory levels, meeting all regulatory requirements.

Credit strengths

- » High strategic fit and operational integration within the group
- » PKO BP's commitment to support PKO BH's capitalisation and liquidity

Credit challenges

- » Limited standalone franchise

Outlook

The outlook on PKO BH's issuer rating is stable, in line with the stable outlook on PKO BP's long-term deposit and senior debt ratings.

Factors that could lead to an upgrade

PKO BH's issuer rating, Counterparty Risk (CR) Assessment and Counterparty Risk Ratings (CRRs) could be upgraded following an upgrade of the respective ratings of its parent bank.

Factors that could lead to a downgrade

A downgrade of PKO BP's ratings would result in a similar action on the ratings and assessment of PKO BH. We could also downgrade PKO BH's ratings in case the relationship with its parent changes to an extent that would significantly reduce the level of integration between the two, leading to a withdrawal of the parent's commitment to support the mortgage bank's liquidity and capital buffers.

Key indicators

Exhibit 1

PKO Bank Hipoteczny S.A. (Unconsolidated Financials) [1]

	12-21 ²	12-20 ²	12-19 ²	12-18 ²	12-17 ²	CAGR/Avg. ³
Total Assets (PLN Billion)	25.6	27.3	27.3	22.1	16.9	11.0 ⁴
Total Assets (USD Million)	6,320.1	7,329.7	7,196.0	5,883.6	4,864.3	6.8 ⁴
Tangible Common Equity (PLN Billion)	2.0	1.9	1.9	1.4	1.2	13.1 ⁴
Tangible Common Equity (USD Million)	502.8	521.3	491.0	377.9	358.3	8.8 ⁴
Problem Loans / Gross Loans (%)	0.3	0.1	0.1	0.0	0.0	0.1 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	20.7	18.4	16.6	15.2	15.6	17.3 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	2.7	1.3	0.9	0.6	0.2	1.2 ⁵
Net Interest Margin (%)	1.1	1.2	1.3	1.3	1.2	1.2 ⁵
PPI / Average RWA (%)	1.4	1.5	1.4	1.5	1.2	1.4 ⁶
Net Income / Tangible Assets (%)	0.4	0.3	0.3	0.4	0.3	0.3 ⁵
Cost / Income Ratio (%)	51.8	50.6	51.7	46.5	49.8	50.1 ⁵
Market Funds / Tangible Banking Assets (%)	72.8	67.9	62.6	63.5	66.4	66.6 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	7.5	4.5	4.6	3.8	4.9	5.1 ⁵
Gross Loans / Due to Customers (%)	346529.3	376158.6	529453.3	484027.1	764532.7	500140.2 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Profile

PKO Bank Hipoteczny S.A. (PKO BH) is the mortgage banking subsidiary of PKO BP — the largest commercial bank in [Poland](#) (A2 stable). PKO BH specialises in granting residential mortgage loans to individuals and acquiring receivables with respect to residential mortgage loans granted by PKO BP, which are primarily financed with the proceeds of mortgage covered bond issuances. As of 31 December 2021, the bank sold its mortgage loans through PKO BP's distribution network of around 975 branches, and 447 agents and intermediaries.

PKO BH is the largest mortgage bank in Poland in terms of total assets, which totalled PLN25.6 billion (€5.6 billion) as of December 2021. As of December 2021, PKO BH had a market share of 63% in the Polish covered bond market.

In addition to being subject to similar licensing procedures, regulatory supervision and monitoring as commercial banks, mortgage banks in Poland have to comply with additional regulations targeting this specific type of institution.

Detailed credit considerations

High strategic fit and operational integration within the group

PKO BH was established and started operations in April 2015 with the aim to provide the PKO BP group with access to covered bonds, which — under Polish regulations — can only be issued through mortgage banks. The group benefits from the mortgage bank in the form of a reduced maturity mismatch between assets and liabilities because of the issuance of covered bonds, diversified sources of funding and lower cost of wholesale funding.

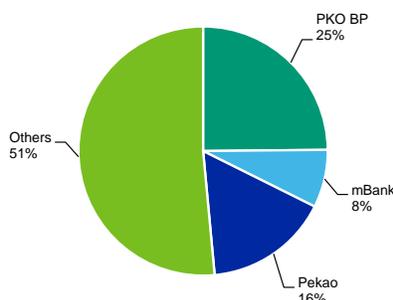
PKO BH originates mortgages using the parent bank's credit policies and the group's distribution network and IT infrastructure. Post-sale services are provided by PKO BP based on an outsourcing agreement. Additionally, PKO BH only accepts the transfer of local-currency mortgages from PKO BP. Consequently, PKO BH does not have exposure to foreign-currency mortgages, which [carry high legal and social risks](#), and is not affected by the higher risk weight assigned to foreign-currency mortgages.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

PKO BH is a strategic part of the PKO BP group and a visible part of its business. PKO BH's operations are highly integrated within the group, and it uses the same logo and branding as the PKO BP group. Although the mortgage bank uses the group's infrastructure and IT resources, and relies on the group for post-sale services, it operates under an independent board and the credit decision process of the mortgage bank is independent from that of PKO BP.

Exhibit 2

PKO BP has a significant share of domestic-currency residential mortgages in Poland As of the end of December 2021



Sources: Banks' reports and NBP

PKO BH is the largest issuer of covered bonds in Poland. As Exhibit 3 shows, PKO BH has, to date, successfully placed multiple covered bond issuances, both on the domestic and international debt markets. In 2021, the mortgage bank did not make any issuances because of the group's strong liquidity and its ample access to lower-cost deposits. In 2019, PKO BH carried out five issues of covered bonds, including the first two green covered bond issues in Poland (domestic bond issues of PLN250 million each). As of December 2021, PKO BH had covered bonds outstanding with a nominal value of around PLN13.1 billion, down from PLN17.2 billion as of December 2020.

Exhibit 3

PKO BH's covered bond outstanding by period By original issuance currency



Sources: Company and Moody's Investors Service

PKO BP's commitment to support its subsidiary

PKO BP has made a public commitment to maintain the capital and liquidity ratios of its subsidiary at satisfactory levels and within the limits required by the relevant banking regulation. In case of a breach of the regulatory requirements, the Polish Financial Supervision Authority (PFSA) has the necessary powers under the Banking Act to require PKO BP to recapitalise or provide liquidity to its subsidiary. In case of refusal, the PFSA can intervene by limiting voting rights and dividend payments.

PKO BH's total capital ratio was 20.9% as of December 2021, up from 18.7% as of the end of December 2020 and significantly higher than the 16.6% as of year-end 2019, and its leverage ratio was 8.0% as of December 2021. PKO BH must also comply with the

minimum liquidity ratio defined by the PFSA and with the liquidity coverage ratio defined by the EU's Capital Requirements Regulation. In addition, the bank is no longer exempted from paying bank tax because the size of its assets has grown above the threshold specified in the bank tax law.

ESG considerations

In line with our general view of the banking sector, PKO BH has low exposure to environmental risks. See our [environmental risks heat map](#) for further information.

Overall, we expect banks to face moderate social risks. These risks include considerations in relation to the rapid and widening spread of the pandemic because of the substantial implications for public health and safety, and the deteriorating global economic outlook, which are creating a severe and extensive credit shock across many sectors, regions and markets. See our [social risks heat map](#) for further information.

For Polish banks, we have identified rising legal risks related to foreign-currency mortgages as a key social risk. At this stage, there is high uncertainty surrounding [how the borrower-friendly judgement of the European Court of Justice will affect Polish banks](#). However, the sector is exposed to the risk of significant potential losses and reputational damage because of the growing number of lawsuits that the banks face from their customers who claim their contracts contained abusive terms. PKO BH has no exposure to foreign-currency mortgages, although its parent bank, PKO BP, has moderate exposure. During last fall, PKO BP launched a scheme offering the option to all Swiss-franc mortgage borrowers to convert their loan to a local-currency mortgage according to terms [proposed in December 2020 by the head of the PFSA](#). The scheme was approved by PKO BP's shareholders in April 2021 and resulted in PKO BP reporting a loss for 2020.

Corporate governance is highly relevant for PKO BH, as it is to all entities in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, whereas governance strengths can benefit its credit profile. Governance risks are mostly internal rather than externally driven. For PKO BH, we do not have any particular governance concern. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Counterparty Risk Ratings (CRRs)

PKO BH's CRRs are A2/P-1

PKO BH's CRRs are aligned with PKO BP's A2/P-1 CRRs. In our view, it is unlikely that PKO BP would prioritise its own obligations over those of PKO BH in circumstances where the parent itself faces significant difficulties. We also take into account the parent bank's public commitment to support its mortgage bank subsidiary.

Counterparty Risk (CR) Assessment

Because the CR Assessment captures the probability of default on certain senior operational obligations, rather than expected loss, we focus purely on subordination and take no account of the volume of the instrument class.

PKO BH's CR Assessment is A2(cr)/P-1(cr)

PKO BH's CR Assessment is aligned with PKO BP's A2(cr)/P-1(cr) CR Assessment, based on our view that it is unlikely that PKO BP would prioritise its own obligations over those of PKO BH in circumstances where the parent itself faces significant difficulties.

Ratings

Exhibit 4

Category	Moody's Rating
PKO BANK HIPOTECZNY S.A.	
Outlook	Stable
Counterparty Risk Rating	A2/P-1
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Issuer Rating	A3
ST Issuer Rating	P-2
PARENT: POWSZECHNA KASA OSZCZEDNOSCI	
BANK POLSKI S.A.	
Outlook	Stable
Counterparty Risk Rating	A2/P-1
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Senior Unsecured	A3
Other Short Term	(P)P-2

Source: Moody's Investors Service

Endnotes

¹ The ratings shown in this report refer to the bank's deposit ratings, senior unsecured debt ratings and Baseline Credit Assessment.

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