



Rating Action: Moody's upgrades Bank of Cyprus' and Hellenic Bank's deposit ratings to Ba2, from Ba3, with positive outlooks

05 Oct 2022

Limassol, October 05, 2022 -- Moody's Investors Service ("Moody's") has today upgraded Bank of Cyprus Public Company Limited's (Bank of Cyprus) and Hellenic Bank Public Company Ltd's (Hellenic Bank) long-term ratings, including their long-term bank deposit ratings to Ba2, from Ba3, and their Baseline Credit Assessments (BCAs) to b1, from b2. The outlook on both banks' long-term deposit ratings remains positive.

A full list of affected ratings can be found at the end of this press release.

The main driver for today's rating upgrade is the resilience of the Cypriot economy, that is supporting the operating conditions of the banking system. This has led Moody's to raise the Macro Profile of Cyprus to "Moderate-", from "Weak+". The higher macro profile score also suggests lesser downside risks and severity of post-failure losses for Cypriot banks.

The positive outlooks reflect Moody's expectations that the two banks will strengthen their profitability, in the context of the higher interest rate environment, and will continue to improve their asset quality, despite potential new nonperforming loans (NPL) formation. The positive outlook on the banks' long-term deposit ratings also reflects a potential higher buffer from more junior instruments, as the clarity and certainty around their future debt issuances improves.

RATINGS RATIONALE

RAISING OF MACRO PROFILE TO MODERATE -

The driver for today's rating upgrades has been the resilience of the Cypriot economy and the gradual improvement in the credit conditions on the island, which in turn suggests a lower risk to the Cypriot banks' solvency profiles. As a result Moody's decided to raise the Macro Profile of Cyprus from Weak + to Moderate -. This also leads the rating agency to expect a lower severity of post-failure losses for Cypriot banks, meaning that potentially a lower portion of deposits and other liabilities could be at a risk of loss in a resolution.

Cyprus' economy has seen a stronger-than-expected resilience to Russia's invasion of Ukraine (Caa3 negative), and has recovered well from the pandemic shock, indicating no permanent damage, as non-tourism related services and authorities' support measures stabilised the economy and mitigated the impact of the shock. Moody's expects growth for Cyprus of 4.8% this year and 2% in 2023 respectively, which would be higher than the euro area average at 2.2% in 2022 and 0.9% in 2023. Thereafter, Cyprus' growth outlook remains solid with potential GDP growth estimated by Moody's to be in the range of 2.5-3.0%.

Moody's notes that credit conditions have improved in recent years, with a significant drop in system nonperforming exposures (NPEs) to 11.2% of total domestic loans and advances in June 2022, from a peak of 49.8% as of May 2016. The rating agency however notes that challenges

remain as a result of still-high levels of indebtedness and the legal framework governing foreclosures that remains vulnerable to frequent political interference.

BANK OF CYPRUS

--- Rationale for Upgrade of BCA

The upgrade of Bank of Cyprus' long-term ratings and assessments reflects the re-assessment of Cyprus' Macro profile to "Moderate-", that has in turn led to a one notch upgrade in its BCA and Adjusted BCA to b1, from b2. The higher Macro Profile has also had an impact on Moody's assessment of the bank's loss-given failure (LGF) analysis.

The higher BCA reflects the reduced risks to the bank's credit profile, due to the resilience in the Cypriot economy, but also the bank's continued asset quality improvements. Specifically, the bank has managed to significantly improve asset quality, as a result of organic and inorganic actions, with NPEs declining to a pro-forma 5.7% of gross loans as of June 2022, from 25% at year-end 2020, while maintaining a solid Common Equity Tier 1 (CET1) ratio of 14.2%, pro-forma for the latest NPE sale and the bank's voluntary staff exit scheme. The bank's profitability outlook has also strengthened, supported by the higher interest rate environment and the bank's cost-cutting initiatives.

While the b1 BCA also captures residual asset quality risks, including a significant stock of foreclosed assets and considerable near-term economic uncertainty, the Cypriot economy has shown resiliency in the aftermath of both the pandemic and the Russia-Ukraine military conflict.

--- Upgrade of long-term deposit and debt ratings

Bank of Cyprus' long-term deposit ratings have been upgraded to Ba2, from Ba3, and continue to be placed two notches above its BCA. This continues to capture the depositor preference in Cyprus law, over senior unsecured creditors, establishing full depositor preference in insolvency and by extension in resolution, rather than junior deposits ranking *pari passu* with senior unsecured claims.

The bank's senior unsecured ratings and junior senior unsecured programme ratings (including those on holding company senior unsecured programmes) have been upgraded by two notches to B1 and (P)B1, from B3 and (P)B3 respectively, and are now placed at the level of the BCA, from one notch below the BCA previously, as a result of the rating agency's re-assessment of operating conditions.

The operating environment has proven more resilient and credit risks are gradually receding, which leads Moody's to expect lower post-failure losses for Cypriot banks. Specifically, the higher Macro Profile lead Moody's to change its post-failure loss assumption to 8% from 13%, meaning that potentially a lower portion of deposits, senior unsecured debt and other liabilities could be at a risk of loss in a resolution.

All subordinated debt ratings of Bank of Cyprus Holdings Public Ltd Company have been upgraded by one notch to B2, from B3, and continue to be placed one notch below the Bank of Cyprus' BCA.

All of these ratings have been determined using Moody's banking methodology, under its Advanced LGF analysis as it is applied to countries subject to the EU's Bank Recovery and Resolution Directive, such as Cyprus. They also factor the bank's potential near term debt issuances.

--- Positive Outlook

The positive outlook on the long-term deposit and senior unsecured debt ratings reflects Moody's expectation that NPEs and foreclosed real estate assets will continue their downwards trajectory and profitability will strengthen further, supported by the higher interest rate environment and the bank's cost-cutting initiatives.

Moody's expects Bank of Cyprus' profitability to benefit from the increases in the European Central Bank (ECB)'s policy rate, primarily as the bank's significant cash balances with the central bank (around €9.9 billion or 38% of assets as of June 2022) reprice immediately. At the same time, deposits will reprice slower and by less, given the bank's excess liquidity. As a result, the bank expects to reach a return on tangible equity of over 10% in 2023, two years ahead of plan.

The positive outlook on the long-term deposit rating also reflects a potential higher buffer by more junior instruments, as the clarity and certainty around the bank's potential future debt issuances improves.

HELLENIC BANK

--- Rational for Upgrade of BCA

The upgrade of Hellenic Bank's long-term ratings and assessments reflects the re-assessment of Cyprus' Macro profile score one notch higher to "Moderate-", that has in turn led to a one notch upgrade in its BCA and Adjusted BCA to b1, from b2. The higher Macro Profile has also had an impact on Moody's assessment of the bank's LGF analysis.

The higher BCA reflects the reduced risks to the bank's credit profile, due to the resilience in the Cypriot economy, but also the bank's continued asset quality improvements. Specifically, Hellenic Bank's solvency benefits from the bank's solid capital buffers, with a CET1 capital ratio of 19.6% as of June 2022, and the material reduction in its legacy problem loans, with NPEs accounting for 10.2% of gross loans, or 3.6% excluding NPEs guaranteed by the government. These ratios are pro-forma for the bank's recent NPE sale transaction. The bank's profitability outlook has also strengthened, supported by the higher interest rate environment and the bank's ongoing initiatives to rationalize costs.

While the b1 BCA also captures residual asset quality risks, including considerable near-term economic uncertainty, the Cypriot economy has shown resiliency in the aftermath of both the pandemic and the Russia-Ukraine military conflict.

--- Upgrade of long-term deposit and debt ratings

Hellenic Bank's long-term deposit ratings have been upgraded to Ba2, from Ba3, and continue to be placed two notches above its BCA. This continues to capture the depositor preference in Cyprus law, over senior unsecured creditors, establishing full depositor preference in insolvency and by extension in resolution, rather than junior deposits ranking pari passu with senior unsecured claims.

Hellenic Bank's senior unsecured debt ratings and junior senior unsecured programme ratings have been upgraded by two notches to B1 and (P)B1, from B3 and (P)B3 respectively, and are now placed at the level of the BCA, from one notch below the BCA previously, as a result of the rating agency's re-assessment of operating conditions and as a result of the bank's potential near term debt issuances.

The operating environment has proven more resilient and credit risks are gradually receding, which leads Moody's to expect lower post-failure losses for Cypriot banks. Specifically, the higher Macro Profile lead Moody's to change its post-failure loss assumption to 8% from 13%, meaning that potentially a lower portion of deposits, senior unsecured debt and other liabilities could be at a risk of loss in a resolution.

Hellenic Bank's subordinated programme ratings have been upgraded by one notch to (P)B2, from (P)B3, and continue to be placed one notch below the BCA.

All of these ratings have been determined using Moody's banking methodology, under its Advanced LGF analysis as it is applied to countries subject to the EU's Bank Recovery and Resolution Directive, such as Cyprus. They also factor the bank's potential near term debt issuances.

--- Positive Outlook

The positive outlook on the long-term deposit and senior unsecured debt ratings reflects Moody's expectation that NPEs will continue their downwards trajectory and profitability will strengthen, supported by the higher interest rate environment.

Moody's expects Hellenic Bank's profitability will benefit from higher interest rates, given its large balances with the ECB of around €6.9 billion as of June 2022, equivalent to 36% of total assets, that will reprice immediately following any rises in interest rates. More gradually, the investment of its large portfolio of bonds, an additional 24% of assets, will also increase net interest income as maturing bonds are invested in higher yielding bonds with a similar credit quality. At the same time, deposits will reprice slower and by less, given excess liquidity. Hellenic Bank estimates that net interest income will increase by more than €130 million (or around 0.7% of assets before tax) by 2023 onwards.

The positive outlook on the long-term deposit rating also reflects a potential higher buffer by more junior instruments, depending on the bank's potential future debt issuances.

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

The banks' ratings could be upgraded if they manage to strengthen their profitability and to further reduce their NPEs and stock of real estate property, while maintaining solid capital metrics. Banks' deposit ratings could also benefit from increased clarity and certainty around banks' potential future debt issuances, raising the buffers available to absorb losses.

Given the positive outlook, it is unlikely that there will be a downgrade in the banks' ratings. The positive outlook may be changed to stable if recent asset quality and overall solvency improvements are reversed, or if Moody's determines that the currently expected profitability improvements fail to materialise.

LIST OF AFFECTED RATINGS

Issuer: Bank of Cyprus Holdings Public Ltd Company

..Upgrades:

....Senior Unsecured Medium-Term Note Program, Upgraded to (P)B1 from (P)B3

....Subordinate Medium-Term Note Program, Upgraded to (P)B2 from (P)B3

....Subordinate Regular Bond/Debenture, Upgraded to B2 from B3

..Outlook Action:

....No Outlook

Issuer: Bank of Cyprus Public Company Limited

..Upgrades:

....Adjusted Baseline Credit Assessment, Upgraded to b1 from b2

....Baseline Credit Assessment, Upgraded to b1 from b2

....Long-term Counterparty Risk Assessment, Upgraded to Ba1(cr) from Ba2(cr)

....Long-term Counterparty Risk Ratings, Upgraded to Ba1 from Ba2

....Long-term Bank Deposit Ratings, Upgraded to Ba2 from Ba3, Outlook Remains Positive

....Senior Unsecured Medium-Term Note Program, Upgraded to (P)B1 from (P)B3

....Junior Senior Unsecured Medium-Term Note Program, Upgraded to (P)B1 from (P)B3

....Senior Unsecured Regular Bond/Debenture, Upgraded to B1 from B3, Outlook Remains Positive

..Affirmations:

....Short-term Counterparty Risk Assessment, Affirmed NP(cr)

....Short-term Counterparty Risk Ratings, Affirmed NP

....Short-term Bank Deposit Ratings, Affirmed NP

..Outlook Action:

....Outlook, Remains Positive

Issuer: Hellenic Bank Public Company Ltd

..Upgrades:

....Adjusted Baseline Credit Assessment , Upgraded to b1 from b2

....Baseline Credit Assessment , Upgraded to b1 from b2

....Long-term Counterparty Risk Assessment, Upgraded to Ba1(cr) from Ba2(cr)

....Long-term Counterparty Risk Ratings, Upgraded to Ba1 from Ba2

....Long-term Bank Deposit Ratings, Upgraded to Ba2 from Ba3, Outlook Remains Positive

....Senior Unsecured Medium-Term Note Program, Upgraded to (P)B1 from (P)B3

....Junior Senior Unsecured Medium-Term Note Program, Upgraded to (P)B1 from (P)B3

....Subordinate Medium-Term Note Program, Upgraded to (P)B2 from (P)B3

....Senior Unsecured Regular Bond/Debenture, Upgraded to B1 from B3, Outlook Remains Positive

..Affirmations:

....Short-term Counterparty Risk Assessment, Affirmed NP(cr)

....Short-term Counterparty Risk Ratings, Affirmed NP

....Short-term Bank Deposit Ratings, Affirmed NP

..Outlook Action:

....Outlook, Remains Positive

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.

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