

**mBank Hipoteczny SA (/gws/en/esp/issr/80361311)****Fitch Affirms mBank Hipoteczny's Mortgage Covered Bonds at 'A'; Positive Outlook**

Fitch Ratings-Frankfurt/London-22 June 2018: Fitch Ratings has affirmed mBank Hipoteczny's (mBH: BBB/Stable/F2) mortgage covered bond programme at 'A'. The Outlook is Positive.

**KEY RATING DRIVERS**

The mortgage covered bonds' 'A' rating is based on mBH's Long-Term Issuer Default Rating (IDR) of 'BBB', an unchanged payment continuity uplift (PCU) of four notches, a recovery uplift of one notch and the overcollateralisation (OC) that Fitch gives credit to of 35.1%, which provides more protection than the 'A' breakeven OC of 24.5%.

The programme's interest rate mismatch increased considerably following the issuance of a EUR300 million (PLN1.3 billion) 1.073% fixed-rate mortgage covered bond with a seven-year maturity issued in April 2018. This led to a roughly 2pp higher cash flow valuation component of 8.5%. The percentage of fixed rate bonds now accounts for 36% (up from 19%), secured by a 100% floating rate cover pool. This effect was partially offset by a reduction in the programme's open foreign currency position. It decreased to around 3% from 12%.

The slightly increased credit loss component of 13.7% remains the main driver of the 'A' breakeven OC. Higher loss rates for mBH's residential and commercial cover assets are partly offset by the increase of the residential asset share. As of end-March 2018, the Polish zloty-denominated residential sub-portfolio accounted for 52% of total cover assets compared with 47% last year. The asset disposal loss component of 2.0% predominantly reflects the programme's vulnerability to high prepayment rates on the cover assets.

The Positive Outlook reflects Fitch's continuing expectation of a growing share of residential mortgage loans carrying lower loss expectations. The pace of this increase has been slower than expected but Fitch expects it to pick up again over the next 12 months, with a beneficial impact on the cover pool's credit risk profile.

Fitch has assigned a PCU of four notches to mBH's programme, instead of the maximum eight notches for conditional pass-through repayment schemes. We have reduced the PCU to reflect the risk of interest payment suspension before the announcement of insolvency and the interest reserve invested in Polish sovereign bonds (A-/F2) being exposed to market value risk.

Fitch does not assign any IDR uplift to mBH's mortgage covered bond programme as information on the resolution strategies for Polish specialised mortgage banks remain insufficient and, consequently, the possibility for a separate resolution of mortgage and parent bank that could lead to an enforcement of the cover pool cannot be excluded.

**RATING SENSITIVITIES**

mBank Hipoteczny's (mBH) mortgage covered bonds could be upgraded if the share of residential assets further grows, which would lower the cover pool's credit risk, or if the overcollateralisation (OC) Fitch takes into account increases. Based on mBH's Issuer Default Rating (IDR) of 'BBB', a payment continuity uplift (PCU) of four notches and two notches potential recovery uplift, a maximum covered bond rating of 'AA-' could be achieved, given sufficient OC protection.

The 'A' rating of mBH's mortgage covered bonds would be vulnerable to a downgrade if (i) mBH's IDR was downgraded to 'BB' or lower; or (ii) the PCU assessment was reduced to one notch or lower; or (iii) the overcollateralisation (OC) that Fitch considers in its analysis drops below Fitch's 'A' breakeven OC of

24.5%.

Fitch rates mBH's covered bonds above Poland's sovereign rating (A-). For ratings above that of the sovereign, Fitch applies additional stresses to the assets' default and recovery rates, reflecting that the economic environment could be driven by severe stresses. A change in Poland's sovereign rating may also change the stresses applied to derive the portfolio's stressed loss levels. Consequently, an upgrade or downgrade of Poland's IDR may have an impact on the breakeven OC for the rating.

Fitch's breakeven OC for the covered bond rating will be affected, among other factors, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuance. Therefore, the breakeven OC to maintain the covered bond rating cannot be assumed to remain stable over time.

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**Applicable Criteria**

Bank Rating Criteria (pub. 23 Mar 2018) (<https://www.fitchratings.com/site/re/10023430>)

Commercial Real Estate Loans Securing Covered Bonds Rating Criteria (pub. 21 Nov 2017) (<https://www.fitchratings.com/site/re/906003>)

Covered Bonds Rating Criteria (pub. 02 Mar 2018) (<https://www.fitchratings.com/site/re/10021721>)

EMEA CMBS and CRE Loan Rating Criteria (pub. 19 Jun 2018)

(<https://www.fitchratings.com/site/re/10033002>)

EMEA RMBS Rating Criteria (pub. 01 May 2018) (<https://www.fitchratings.com/site/re/10028805>)

Fitch's Interest Rate Stress Assumptions for Structured Finance and Covered Bonds - Excel File (pub. 02 Feb 2018) (<https://www.fitchratings.com/site/re/10018863>)

Fitch's Foreign-Currency Stress Assumptions for Residual Foreign-Exchange Exposures in Covered Bonds and Structured Finance – Excel File (pub. 30 Oct 2017) (<https://www.fitchratings.com/site/re/10008156>)

Poland Residential Mortgage Bespoke Rating Criteria Addendum (pub. 18 Jun 2018)

(<https://www.fitchratings.com/site/re/10034698>)

SME Balance Sheet Securitisation Rating Criteria (pub. 23 Feb 2018)

(<https://www.fitchratings.com/site/re/10020825>)

Structured Finance and Covered Bonds Counterparty Rating Criteria (pub. 23 May 2017)

(<https://www.fitchratings.com/site/re/898537>)

Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum (pub. 31 May 2018) (<https://www.fitchratings.com/site/re/10029891>)

Structured Finance and Covered Bonds Country Risk Rating Criteria (pub. 18 Sep 2017)

(<https://www.fitchratings.com/site/re/903496>)

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub. 02 Feb 2018)

(<https://www.fitchratings.com/site/re/10018549>)

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