PETRUSADVISERS

EUROPEAN CENTRAL BANK ("**ECB**")
C/o Mr Andrea Enria, Chair of the Supervisory Board (ECB Banking Supervision)
60640 Frankfurt am Main
Germany

Cc: Mr Patrick Amis, Director general for specialised institutions and less significant institutions

London, 30 June 2023

Dear Mr Enria,

Petrus Advisers stands for highest ESG standards as only fair and sustainable business practices can be profitable in the long-term. Following the failure of Silicon Valley Bank and Signature Bank as well as the last-minute rescues of Credit Suisse and First Republic Bank, market participants have been reluctant to invest in European banks (Euro Stoxx Banks trading at a ~40% discount vs. average valuations[1] and at a ~25% discount to US banks[2]). As a prominent investor in European financial institutions, we are convinced that European banks are well positioned.

Following the turmoil in US and European banks in March 2023, we have however diligently scrutinised all our bank investments regarding their business strategy and execution, as well as ethical problems as many of those became apparent in the banks that have failed since March. We are writing to you, because it appears to us, that you have not spent the time to find the red flags we have discovered through our research since March. Our findings are concerning BAWAG Group AG ("**BAWAG**").

It is in fact shocking to what extent BAWAG's management team has driven the bank into a corner of instability. With visible cracks in a non-sustainable business model, a small group of agents have enriched themselves on the back of their clients, the bank's stakeholders and its entire community. With a total shareholder return of some 3.6%[3] since the IPO – which compares to inflation of c. 4% per year and a cost of capital of at least 10% – BAWAG's leadership has been destroying shareholder value. At the same time, we are worried that regulators might turn a blind eye on BAWAG's ignoring of the most basic rules of corporate governance. We have identified the following red flags that are of relevance from a regulatory perspective:

(1) Doubtful loan book quality

Banks play an important role in their societies by providing credit to retail and corporate customers. BAWAG however has essentially phased out its credit origination capabilities through a nonsensical cost cutting programme. While organic asset growth has been negative since 2020, BAWAG has dramatically increased its commercial real estate ("CRE") exposure in the US (from EUR ~0.7bn per Dec-2020 to EUR ~2.3bn per Mar-2023) and has exposure to other countries at the heart of the current crisis in CRE (e.g. Nordics) venturing far away from its home market into markets that BAWAG´s teams obviously do not understand well. Most of BAWAG's 'new lending' comes from acquisitions of loan books and structured products sources in the London market by a work-from-home CIO. This has very little to do with the raison

[1] Based on 20Y average NTM P/E multiple for the SX7E. Factset as per 26-Jun-2023.
[2] Based on delta in NTM P/E multiples. Reference index for US banks is the Dow Jones U.S. Banks Index.
[3] Annualised TSR since IPO assuming no dividend reinvestment (pre-tax).

d'être of banks, and we question regulatory approvals for any further share buybacks and franchise erosion. A bank should not be run like a credit hedge fund.

(2) Deposit flight

Despite strong inflation over the last quarters, BAWAG has lost 7% of its nominal retail deposit base since year-end 2021. Adjusted for inflation, the bank´s foundation is visibly running out, its loan-to-deposit-ratio has meanwhile escalated to become the worst in the relevant European index[4]. BAWAG´s implied significant market share loss is not a surprise given the degrading product offering and diminishing customer service quality. BAWAG's remaining clients are angry, as evidenced by our open-source research into increasingly direct customer complaints[5] and the group's rapid shrinkage of its traditional geographical core-footprint. BAWAG ruthlessly terminated various "unprofitable" clients, many of which lost access to the payments system, which in turn has led to consumer protection organisations voicing protest[6].

(3) Corporate governance issues

Since its IPO, BAWAG's management team has not generated any real value for shareholders, yet, has paid itself more than EUR 200m in compensation. The latest EBA high earners report showed that all five bankers in Austria earning more than EUR 6m in 2021 were BAWAG managers – despite BAWAG being significantly smaller and less profitable than Raiffeisen Bank International and Erste Group. BAWAG's CEO is in fact one of the highest paid bank executives in Europe and earns more than entire management teams of competing European banks. His compensation is a staggering 12 times as high as the average of other banks in the Euro Stoxx Banks when compared to profitability[7].

Two out of six supervisory board members (incl. the Chairman and the Chairwoman of the ESG committee) were until recently BAWAG employees. We are very concerned about ensuing conflicts of interest and the independence of the supervisory board, as it is supposed to control the management's compensation, investments into their own stock and related party lending bonanzas.

(4) Excesses and potentially rule-breaking lending to related parties

In 2022 alone, the management team took out loans of EUR 26m from BAWAG[8]. The combined related-party lending to management totals EUR 36m per year-end 2022. According to the company, these are mortgage loans. When we inquired about the terms, conditions and usage of these loans at the 2023 AGM, the company refused to provide clear answers. After the horrifying experience at Silicon Valley Bank – where related-party lending also tripled last year[9] – we believe that creating transparency and an independent assessment of the adequacy of related-party lending is an important task for regulators. You don't seem to see it that way in this case.

(5) Chief Risk Officer ("CRO") lacks relevant qualifications

Recent obvious risk management mistakes and work-from-home in risk departments across regional banks in the US have put more spotlight on the CRO-role at banks. Nepotism, lack of competence, and work-from-home in risk management are clear red flags: BAWAG's CRO has no relevant risk management experience. While his CV on BAWAG's website talks about risk management responsibility in a role between 2009-2011, his LinkedIn profile does not mention risk management at all. Apart from the fact that

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[4] BAWAG has a LDR of 109% per Q1'23 which is the highest in the Euro Stoxx banks except for Nordea (that has a difference business model).
[5] BAWAG has a worse Trustpilot score than Erste Bank, Bank Austria and bank99 with 95% of people giving BAWAG the lowest possible rating.
[6] https://www.arbeiterkammer.at/beratung/konsument/AchtungFalle/Hilfe_es_klappt_nicht_mit_dem_Service_der_Bank.html#heading_Viele_Beschwerden_von_BAWAG_Kund_innen
[7] CEO compensation / profit before tax (2022 figures, in bps). BAWAG's compensation does not include LTIP payments.
[8] Page 172 and 176 BAWAG annual report 2022.
[9] https://www.bloomberg.com/news/articles/2023-03-21/svb-s-loans-to-insiders-tripled-to-219-million-before-it-failed

he is not even based on the ground in Austria, he is a former private equity colleague of BAWAG's CEO[10]. How is it possible that a person with this background is allowed to take on the CRO-role of a EUR 50bn+ balance sheet bank in Europe?

Petrus Advisers are advocates of active regulation, but also recognise the self-regulation of the markets, above all through the active engagement of shareholders and also effective intervention by the regulator where necessary. The collapse of BAWAG's share price since March 2023 should not have escaped your attention and should be understood as a clear warning sign from the market. At BAWAG, many things seem disproportionate and empty. The bank is moving further and further away from sustainability, social responsibility and fairness. You have not only tolerated BAWAG's flawed business practices, but even encouraged them by approving the recent extensive share buybacks. European banks need to prove to the capital market that they are on the right track after a decade of substantial underperformance. Regulators should therefore, in our opinion, use their authority to ensure that banks do not deviate from the path of honesty, but curb excesses and ensure fair competitive conditions where all teams play by the same rules and work in the interest of their clients.

Sincerely,

Klaus Umek
Managing Partner

Till Hufnagel
Partner

[10] The two worked together at General Electric and Cerberus between 1999 and 2012.