FITCH DOWNGRADES ICCREA BANCA TO 'BB+'; OUTLOOK STABLE

Fitch Ratings-Milan/London-18 January 2018: Fitch Ratings has downgraded Iccrea Banca's (IB) and its main subsidiary Iccrea BancaImpresa's (IBI) Long-Term Issuer Default Ratings (IDR) to 'BB+' from 'BBB-' and Viability Ratings (VR) to 'bb+' from 'bbb-'. The Outlooks on the Long-Term IDRs are Stable. A full list of rating actions is at the end of this rating action commentary.

The downgrade primarily reflects Fitch's view that the group's asset quality is weak and unlikely to improve materially in 2018. Fitch also believes that the group's capitalisation will remain under pressure from large unreserved impaired loans. Under the reform of the mutual banking sector in Italy, which is planned to be completed by end-2018, IB will become the parent of one of the new banking groups, including a large number of mutual banks.

KEY RATING DRIVERS

IDRS, VRS AND SENIOR DEBT

IB's and IBI's ratings reflect the group's strong franchise as a central institution for the Italian mutual banks (BCCs or BCC sector) and its adequately diversified business model. The ongoing BCC reform will result in a more cohesive sector and transform IB into a fully-fledged commercial banking group. We believe that it will take considerable time before the new group's profitability will benefit from increased synergies.

The ratings also reflect Fitch's view that profitability is below the peers' average and that asset quality will remain weak despite the group impaired loan reduction plans and with a still large portion of unreserved impaired loans weighing on its capitalisation.

Fitch assigns common VRs to IB and IBI to reflect the high integration between the two entities and the large size of IBI compared with its parent, IB. IB and IBI and their subsidiaries are supervised and regulated as a consolidated entity. Capital and liquidity are fungible across the group and all entities share the same brand, have highly integrated management and operate in the same jurisdiction.

During 2017 the stock of impaired loans stabilised. However, IB's gross impaired loans ratio of 18.8% at end-1H17 remains very high and compares weakly with European and also with the strongest domestic peers. Fitch expects some modest improvements in the ratio in 2018 and impaired loan reductions to continue once the mutual banking group is created, but these improvements will take time to materialise before they result in material asset quality improvements for the new group. Fitch therefore expects the new group will operate with higher impaired loan ratios than its stronger direct domestic peers for some time.

The group's Fitch Core Capital (FCC)/RWA ratio of 12.8% and transitional CET1 ratio of 12.3% at end-1H17 are maintained with moderate buffers over regulatory minimums and in line with domestic peers. However, capital encumbrance from unreserved impaired loans remains high at over 73% of FCC at end-1H17. Fitch believes that capital ratios should benefit from the consolidation of the mutual banks, which are generally well capitalised. Nevertheless, unreserved impaired loans will continue to weigh on capitalisation, which could come under further pressure from the planned comprehensive assessment that the ECB will undertake on the new banking group including a large number of BCCs.

IB's ability to generate profits is weak. Operating costs are high and loan impairment charges (LICs), largely on IBI's corporate exposures, have been weighing on the group's profitability. We expect the new banking group to realise synergies and exercise some pricing power in the areas where its franchise will be stronger. However, operating efficiency will take time to improve and could be subject to the integration costs.

IB's funding is generally stable and reflects its role of a central institution of the BCC sector. Our assessment of IB's liquidity benefits from ordinary support from the BCCs, which place a large proportion of their excess funding with IB. Customer deposits account for a limited proportion of IB's funding, but their weight will increase materially as the new banking group will include the deposit-funded mutual banks.

Fitch has withdrawn the rating on IBI's EMTN programme because the issuer has no debt outstanding under the programme and no longer plans to issue new debt under it.

SUPPORT RATING AND SUPPORT RATING FLOOR

The banks' Support Ratings and the Support Rating Floors reflect Fitch's view that senior creditors cannot rely on receiving full extraordinary support from the sovereign if a bank becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that requires senior creditors to participate in losses, if necessary, instead of, or ahead of, a bank receiving sovereign support.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

IB's subordinated debt is rated one notch below the VR for loss severity to reflect our expectation of below-average recovery prospects. No notching is applied for incremental non-performance risk because write-down of the notes will only occur once the point of non-viability is reached and there is no coupon flexibility before non-viability.

RATING SENSITIVITIES

IDRS, VRS AND SENIOR DEBT

IB will change fundamentally as a result of the creation of the new banking group, which will result in the consolidation of a number of mutual banks into IB. Fitch expects to review IB's and IBI's ratings when the new banking group has been created, which the group expects by end-2018.

The ratings could change if the group's financial profile and plans, particularly asset quality, differ materially from Fitch's current expectations. The ratings would also come under pressure if the group fails to improve profitability and are sensitive to the execution of the group's reorganisation.

The new banking group will be based on a mutual support scheme between IB, IBI and the member BCCs. If Fitch concludes that mutual support is sufficiently strong, IB's ratings could become based on our criteria for rating banking structures backed by mutual support schemes.

The ratings could, over time, benefit from progress in improving asset quality while maintaining adequate capitalisation and a sustainable return to operating profitability. The ratings could also benefit from the successful completion of the integration of the new banking group and creation and functioning of the necessary governance, risk and control functions as well as evidence of long-term competitive strengths.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the Support Ratings and upward revision of the Support Rating Floors would be contingent on a positive change in the sovereign's propensity to support the banks. In Fitch's view, this is highly unlikely, although not impossible.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The subordinated debt's rating is primarily sensitive to changes in the VR, from which it is notched. The rating is also sensitive to a change in the notes' notching, which could arise if Fitch changes its assessment of their non-performance relative to the risk captured in the VR or their expected loss severity.

The rating actions are as follows:

ICCREA Banca S.p.A.
Long-Term IDR: downgraded to 'BB+' from 'BBB-'; Outlook Stable
Short-Term IDR: downgraded to 'B' from 'F3'
VR: downgraded to 'bb+' from 'bbb-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
EMTN Programme: downgraded to 'BB+/B' from 'BBB-'/ 'F3'
Senior unsecured debt: downgraded to 'BB+' from 'BBB-'
Subordinated Tier 2 notes: downgraded to 'BB' from 'BB+'

ICCREA BancaImpresa S.p.A.
Long-Term IDR: downgraded to 'BB+' from 'BBB-'; Outlook Stable
Short-Term IDR: downgraded to 'B' from 'F3'
VR: downgraded to 'bb+' from 'bbb-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
EMTN Programme: downgraded to 'BB+' from 'BBB-' and withdrawn

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Additional information is available on www.fitchratings.com

Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051