

## **FITCH AFFIRMS ICCREA BANCA AT 'BBB-'; OUTLOOK EVOLVING**

Fitch Ratings-Milan/London-19 January 2017: Fitch Ratings has affirmed ICCREA Banca's (IB) and its main subsidiary ICCREA BancaImpresa's Long-Term Issuer Default Ratings (IDR) at 'BBB-', Short-Term IDRs at 'F3', Viability Ratings (VR) at 'bbb-', Support Ratings at '5' and Support Rating Floors at 'No Floor'.

The Outlooks on the Long-Term IDRs are Evolving, reflecting the expected impact on the group's structure, business model and risk profile from the upcoming reform of the Italian mutual sector, which is to be completed by 2018.

A full list of rating actions is at the end of this rating action commentary.

### **KEY RATING DRIVERS**

#### **IDRS, VRs AND SENIOR DEBT**

IB's and ICCREA BancaImpresa's IDRs are equalised and are based on a common VR, reflecting the high integration between the two entities, which renders their individual credit profiles difficult to meaningfully separate. It also reflects the large size of ICCREA BancaImpresa compared with its parent, IB.

IB and ICCREA BancaImpresa and all their subsidiaries are supervised and regulated as a consolidated entity. Capital and liquidity are fungible across the group, all entities share the same brand, have highly integrated management and operate in the same jurisdiction.

The common 'bbb-' VR reflect the group's key role within the Italian mutual banking sector, for which IB acts as the largest central institution, managing its liquidity and excess funding, as well as providing it with treasury services and access to the ECB. ICCREA BancaImpresa supplies corporate loans to the sector's customer base, largely SMEs.

IB benefits from the sector's strong and deep-rooted network, which has enabled the Banche di Credito Cooperativo (BCCs) to access large volumes of customer deposits, which it then places with IB for management. Our assessment of IB's and ICCREA BancaImpresa's capital and funding benefits from the ordinary support which is made available to them from the BCCs.

IB's risk-control framework has improved in recent years, following the adoption of a risk appetite framework and the reorganisation of internal functions. We believe that the establishment of a new banking group headed by IB should further bolster risk controls throughout the group's entities. However, asset quality remains weak, with gross impaired loans accounting for nearly 17% of total loans at end-June 2016, which is not fully mitigated by reduced inflows of new impaired loans and a reasonable loan impairment coverage at 50%.

Our assessment of asset quality will be highly affected by the reorganisation of the group and the consolidation of the various BCCs that will follow. It is too early at this stage to assess whether the overall impact will be positive or negative as it largely depends on the quality of the assets and the newly formed group's ability to reduce the stock of impaired loans in a timely fashion.

IB's capitalisation is sound, with a common equity Tier 1 ratio of 12.4% and a Fitch core capital ratio of 12.8% at end-1H16. However, the bank is more highly leveraged than most of its domestic peers, reflecting its business model with a large volume of low risk assets. Capital ratios have

decreased since end-2015 due to higher customer loans, which were only partly offset by the higher capital generated from the gain made on the disposal of its equity stake in Visa Europe. The burden of unreserved impaired loans remains significant at over 75% of Fitch core capital, which is weak by international standards.

IB has been posting losses on an operating level since end-December 2015, as the low-interest rate environment affected net interest income that represents almost two-thirds of its total operating revenues. At the same time, loan impairment charges have been negatively affected by the economic situation for SMEs in Italy, which form the majority of ICCREA BancaImpresa's client base. Fitch expects a gradual improvement in the group's profitability due to its stable ability to generate revenues. However, we expect improvements in revenue to be subject to potentially high costs as the group restructures and its governance functions are enhanced.

The reform of the BCC sector will involve nearly 320 mutual banks, which are required to decide by May 2017 whether to group under IB or other banking groups. We believe that apart from IB, the other two central institutions, Cassa Centrale Banca and Cassa Centrale Raffeisen based in the region of Trentino Alto Adige, are likely to become consolidating entities for a number of BCCs. The BCCs will be consolidated into cooperative banking groups headed by a joint-stock company with strong policy setting powers. The structure will benefit from the introduction of an Institutional Protection Scheme, similar to cooperative banking groups backed by mutual support schemes in other EU countries.

The Evolving Outlooks reflect our belief that in the long term this will likely be beneficial for the ratings of IB and ICCREA BancaImpresa as their franchise and business model will be enhanced, and their capitalisation and control structures will improve, leading to better corporate governance, performance and financial metrics. However, the outcome of the aggregation is still unknown and in the short term, the resulting consolidated asset quality, costs and execution risks could put pressure on the group's ratings.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

The '5' Support Ratings and SRFs of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign in the event that a bank becomes non-viable. The EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) for eurozone banks provide a framework for resolving banks that requires senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

#### SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The subordinated debt and other hybrid capital issued by IB and ICCREA BancaImpresa are notched down from the VRs in accordance with Fitch's criteria to reflect the different non-performance and relative loss severity risk profiles of these instruments.

The Subordinated Tier 2 debt issued by IB and the Lower Tier 2 debt issued by ICCREA BancaImpresa are rated one notch below the VRs, to reflect above average loss severity risk of these types of debt when compared to average recoveries.

The Upper Tier 2 subordinated debt issued by ICCREA BancaImpresa is rated three notches below the VR to reflect higher loss severity risk of these securities when compared with average recoveries (one notch) and incremental non-performance risk (two notches).

#### RATING SENSITIVITIES

##### IDRS, VRs AND SENIOR DEBT

As the ratings are based on the ICCREA group's instrumental role for the mutual sector in Italy, the Evolving Outlook reflects Fitch's view that the upcoming sector reform will materially change IB's

structure, operations, and financial profile. Consequently, the execution of the group's restructuring could potentially have positive, negative or neutral impacts on the ratings.

Fitch's base case is that asset quality for the group has begun to stabilise. However, evidence of failure to do so in the coming quarters could lead to a downgrade.

#### SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the SR and upward revision of the SRF would be contingent on a positive change in the sovereign's propensity to support ICCREA group. While not impossible, this is highly unlikely, in Fitch's view.

#### SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The subordinated debt ratings issued by ICCREA Banca and ICCREA BancaImpresa are broadly sensitive to the same considerations that might affect their VR. The ratings are 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 VRs.

The rating actions are as follows:

##### ICCREA Banca S.p.A.

Long-Term IDR: affirmed at 'BBB-'; Outlook Evolving

Short-Term IDR: affirmed at 'F3'

VR: affirmed at 'bbb-'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'No Floor'

EUR3bn EMTN Programme: Long-term rating affirmed at 'BBB-'

EUR3bn EMTN Programme: Short-term rating affirmed at 'F3'

Senior unsecured debt: affirmed at 'BBB-'

Subordinated Tier 2 notes: affirmed at 'BB+'

##### ICCREA BancaImpresa S.p.A.

Long-Term IDR: affirmed at 'BBB-'; Outlook Evolving

Short-Term IDR: affirmed at 'F3'

VR: affirmed at 'bbb-'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'No Floor'

Senior unsecured debt and EUR5bn EMTN Programme: affirmed at 'BBB-'

Subordinated lower Tier 2 notes (ISIN XS0287519663): affirmed at 'BB+'

Subordinated upper Tier 2 notes (ISIN XS0295539984): affirmed at 'BB-'

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## Applicable Criteria

Global Bank Rating Criteria (pub. 25 Nov 2016)

<https://www.fitchratings.com/site/re/891051>

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