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Research Update:

Italy-Based Iccrea Banca 'BB/B' Ratings Affirmed; Outlook Stable

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Overview

- As the reform of the cooperative sector in Italy progresses, 166 mutual banks (representing about 60% of the cooperative sector's assets) intend to group under Iccrea Banca SpA.
- Although the split of the Italian Banche di Credito Cooperativo (BCC) network negatively affects our view of the business profile of the new group, the financial metrics and fundamentals should not materially change. The cooperative reform, if properly implemented, should support a more resilient and cohesive group.
- We are affirming our long- and short-term counterparty credit ratings on Iccrea Banca and its core subsidiary Iccrea BancaImpresa SpA at 'BB/B'.
- The stable outlook on the Iccrea entities reflects our view that the new group will be able to maintain a conservative funding and liquidity profile, adequate capitalization levels, and a solid market position in Italy.

Rating Action

On July 11, 2017, S&P Global Ratings affirmed its 'BB/B' long- and short-term counterparty credit ratings on Italian bank Iccrea Banca SpA (IB) and its core subsidiary Iccrea BancaImpresa SpA. The outlook is stable.

Rationale

Unlike our previous base-case scenario, the cooperative banking sector is heading toward the creation of two national groups. Only about half of the Banche di Credito Cooperativo (BCC) network (166 out of more than 300 as of December 2016) expressed their intention to group under IB to form a more integrated institution. According to IB, its group will represent about 60% of the entire cooperative banking sector, holding €10.5 billion of total equity, €126 billion of assets, and more than 2,500 branches. The group will have a nationwide presence, without material concentration in a specific region, and will become the fifth largest Italian banking group by assets.

As we base our ratings on IB on the creditworthiness of the entire BCC network, a smaller perimeter will weigh on our rating assessment of IB. Specifically, the new entity will have a lower business potential and relevance to the domestic system. However, we also understand that, under the new structure, the bank should be able to preserve its financial strength and eventually reap the benefits of having a more cohesive group.

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We understand that finalizing the setup of the group, which is the result of an Italian government reform at the beginning of 2016, is still in progress. IB should be able to present its final plan to regulators by the end of 2017, with the aim of having the new entity operational in the second half of 2018.

The cooperative sector reform continues to represent an opportunity for the system because it should create more resilient groups. For the new Iccrea group, we will need to assess in particular the effectiveness of the joint and several guarantee and overall risk sharing among the group's participants, in addition to the ability of the holding entity to coordinate BCC members' operations, implement group strategy, and reap cost synergies.

Our ratings continue to factor in the BCC's business stability and strong retail customer base in Italy. It also reflects its stable and large retail funding base and limited exposure to short-term wholesale funding. However, weak asset quality constrains the network's creditworthiness and modest profitability limits organic capital generation.

Specifically, based on our estimate of the new group's capitalization and risk exposures, we expect that the BCC network's risk-adjusted capital ratio (RAC) will hover at about 6% in the next 12 months, constrained by subdued profitability with a declining net interest margin, lower contribution from the securities portfolio, a still-weak efficiency ratio above 70%, and high credit provisions. In our view, the BCC network's asset quality will remain a rating weakness in the light of its above domestic average nonperforming loan (NPL) ratio (20% as of December 2016), higher concentration in real estate (currently 20% of total loans), and NPL coverage of 45% versus 51% for the sector.

Outlook

The stable outlook on IB reflects our view that the BCCs participating in the new group will be able to maintain a strong liquidity position, limited reliance on wholesale funding, and a RAC ratio sustainably above 5%, while preserving their solid market position in the next 12 months.

An upgrade could follow a strengthening of the group's combined solvency and risk profiles. For example, this could happen if we expect the RAC ratio to increase comfortably above 7% or the asset quality to improve to a level more akin to the rest of the domestic sector. In addition, as a result of the sector reform, we would also need to observe the following in the new group:

- Significant tightening of the relationship between individual banks, with effective risk-sharing system among members;
- Better efficiency; and
- Improved corporate governance, enabling the bank to operate as a single group in the market.

We could lower the ratings on IB if the new group's capitalization declined over the next 12 months, leading to a RAC ratio below 5.0%, without a material improvement in asset quality. Similarly, this could happen if the group's funding and liquidity profile deteriorated to a level more in line with domestic peers, or if the group failed to agree on a joint strategy that enables strong risk governance and reaping of cost synergies.

Ratings Score Snapshot

Issuer Credit Rating	BB/Stable/B
SACP	bb
Anchor	bb+
Business Position	Adequate (0)
Capital and Earnings	Moderate (0)
Risk Position	Weak (-2)
Funding	Above Average (+1)
and Liquidity	Strong
Support	(0)
ALAC Support	(0)
GRE Support	(0)
Group Support	(0)
Sovereign Support	(0)
Additional Factors	(0)

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Iccrea Banca SpA, Dec. 16, 2016

Ratings List

Ratings Affirmed

Iccrea Banca SpA	
Iccrea BancaImpresa SpA	
Counterparty Credit Rating	BB/Stable/B
Iccrea Banca SpA	
Senior Unsecured	BB
Subordinated	B

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.