

FITCH AFFIRMS BANCO POPOLARE AT 'BBB'/ NEGATIVE; DOWNGRADES VR TO 'BB+'

Fitch Ratings-London/Milan-19 May 2014: Fitch Ratings has affirmed Banco Popolare's (Popolare) and its rated subsidiaries' Long-term Issuer Default Ratings (IDRs) at 'BBB' with Negative Outlook. At the same time it has downgraded Popolare's VR to 'bb+' from 'bbb-'.

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

KEY RATING DRIVERS - IDRs, SENIOR DEBT, SR AND SRF

Popolare's Long-term IDR is at its Support Rating Floor (SRF) and therefore based on Fitch's expectation of support from the Italian authorities. The affirmation of the SRF reflects Fitch's view that there is a high probability that Popolare would receive support, in case of need, from the Italian government given its systemic importance domestically.

The Negative Outlook reflects a likely downward revision of the SRF on weakening state support as further progress is made globally in implementing the legislative and practical aspects of enabling effective bank resolution frameworks. A lower SRF would result in downgrades of the Long-term IDR and the long-term senior debt ratings to the level of the bank's VR, unless mitigating factors arise in the meantime. Mitigating factors could include an upgrade of Popolare's VR to the level of the bank's current SRF, the existence of large buffers of junior debt or corporate actions.

RATING SENSITIVITIES - IDRs, SENIOR DEBT, SR AND SRF

Popolare's ratings are sensitive to a weakening of Fitch's assumptions around the ability or propensity of Italy to provide timely support to the bank.

Of these, the greatest sensitivity is to a weakening of support propensity in respect of the national implementation of the provisions of the Bank Recovery and Resolution Directive (BRRD).

In Banking Union countries, including Italy, the Single Supervisory Mechanism will reduce national influence over supervision and licensing decisions in favour of the European Central Bank (ECB). While still involving multiple parties in resolution decisions, the Single Resolution Mechanism will also result in a dilution of national influence over resolution decisions.

Overall, Fitch's base case is for sufficient progress to be made for Popolare's Support Rating to be downgraded to '5' and its SRF to be revised downwards to 'No Floor' within the next one to two years. The timing will be influenced by Fitch's continuing analysis of progress made on bank resolution and could also be influenced by idiosyncratic events.

The Italian state's ability to provide timely support to Popolare is dependent on its creditworthiness, as reflected in its Long-term IDR of 'BBB+' with a Stable Outlook. A downgrade of Italy's sovereign rating would reflect a weakened ability of the state to provide support and therefore likely result in a downward revision of Popolare's SRF.

KEY RATING DRIVERS - VR

The downgrade of Popolare's VR reflects the bank's weakened asset quality, resulting in a high level of equity encumbered by unreserved impaired loans and a high vulnerability to negative movement in asset prices. Furthermore, the small loss reported in 1Q14 testifies to the still fragile earnings outlook. These two elements, in Fitch's opinion, more than offset the positive impact of the recent capital strengthening following its EUR1.5bn new share issue.

Credit deterioration experienced in 4Q13 led the bank to report an operating loss of over EUR800m for FY13, including loan impairment charges of about EUR1.9bn (EUR1bn of which were booked in 4Q13). Gross impaired loans reached EUR17.8bn, equal to a high 19.6% of total gross loans at end-1Q14 (14.5% at end-2012). Unreserved impaired loans at end-2013 accounted for a high 150% of Fitch Core Capital (including the new EUR1.5bn capital). Coverage of gross impaired loans remains fairly low at just above 30%. However, the low coverage partly reflects the large proportion of loans backed by collateral and the group's write-off practices.

Popolare's profitability remains structurally weak, which means that the bank is not yet able to generate sufficient profits internally to compensate for further losses that may arise from its large stock of unreserved impaired loans or unexpected shocks. As a result, capital may be eroded by further losses unless impaired loans are dealt with swiftly and effectively. Management plans to address the bank's weak profitability under its recently announced strategic plan for the coming years.

The bank completed a EUR1.5bn new share issue in April 2014. It is also implementing measures to reduce the impact of deductions of non-controlling interests, through its merger with two banks subsidiaries, Credito Bergamasco and Banca Italease. The combination of these measures translates into a pro-forma fully-phased Basel III CET1 ratio of 11.2% at end-1Q14, which is now more in line with the estimated ratios of its direct peers.

RATING SENSITIVITIES - VR

The bank's VR would come under additional pressure if there is further prolonged deterioration in asset quality, or a sharp fall in real estate values in Italy.

A sustained strengthening of operating performance or significant asset quality improvements may result in an upgrade of the VR.

KEY RATING DRIVERS AND SENSITIVITIES - SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid capital issued by Popolare and its subsidiaries are all notched down from Popolare's VR (as the bank's subsidiaries are not assigned a VR), in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles, which vary considerably. Their ratings are primarily sensitive to a change in the VRs, which drive the debt ratings.

The 'C' Long-term rating of Banca Italease's trust preferred securities reflects their non-performance and Fitch's expectation that the securities are unlikely to resume coupon payments in the near future.

SUBSIDIARY AND AFFILIATED COMPANY KEY RATING DRIVERS AND SENSITIVITIES

The ratings of Popolare's subsidiaries, Credito Bergamasco, Banca Aletti & C. S.p.A and Banca Italease, are based on Fitch's view that Popolare would support them, if needed. Fitch considers Credito Bergamasco and Banca Aletti as core subsidiaries given their roles in the group. Credito Bergamasco will be merged into the parent by end-1H14, upon which Fitch will assess and withdraw Credito Bergamasco's ratings.

Fitch believes that Popolare would also provide support to Banca Italease, if needed, as failure to do so would pose a significant reputation risk to the group. Banca Italease will also be merged into the parent by end-2014. Similarly to Credito Bergamasco, Fitch will assess and withdraw Banca Italease's ratings once the merger is completed.

As the ratings of the subsidiaries are based on their parent's Long-term IDR, the ratings are sensitive to changes in Popolare's Long-term IDR. The subsidiaries' ratings are also sensitive to changes in the parent's propensity to provide support, which Fitch currently does not expect.

The rating actions are as follows:

Popolare:

Long-term IDR: affirmed at 'BBB'; Outlook Negative

Short-term IDR: affirmed at 'F3'

Viability Rating: downgraded to 'bb+' from 'bbb-'

Support Rating: affirmed at '2'

Support Rating Floor: affirmed at 'BBB'

Senior debt (including programme ratings): affirmed at 'BBB'/F3'

Commercial paper: affirmed at 'F3'

Lower Tier 2 subordinated debt: downgraded to 'BB' from 'BB+'

Preferred stock and junior subordinated debt: downgraded to 'B' from 'B+'

Banca Italease:

Long-term IDR: affirmed at 'BBB'; Outlook Negative

Short-term IDR: affirmed at 'F3'

Support Rating: affirmed at '2'

Senior debt and programme ratings: affirmed at 'BBB'

Market-linked securities: affirmed at 'BBBemr'

Lower Tier 2 subordinated debt: downgraded to 'BB' from 'BB+'

Trust preferred securities: affirmed at 'C'

Banca Aletti & C. S.p.A.:

Long-term IDR: affirmed at 'BBB'; Outlook Negative

Short-term IDR: affirmed at 'F3'

Support Rating: affirmed at '2'

Credito Bergamasco:

Long-term IDR: affirmed at 'BBB'; Outlook Negative

Short-term IDR: affirmed at 'F3'

Support Rating: affirmed at '2'

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Applicable criteria, Global Financial Institutions Rating Criteria, dated 31 January 2014, , Assessing and Rating Bank Subordinated and Hybrid Securities, dated 31 January 2014, , are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=732397

Assessing and Rating Bank Subordinated and Hybrid Securities Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=732137

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