FITCH DOWNGRADES BANCO POPOLARE'S VR TO 'BB'; AFFIRMS IDR AT 'BBB'

Fitch Ratings-Milan/London-07 April 2015: Fitch Ratings has downgraded Banco Popolare's (Popolare) Viability Rating (VR) to 'bb' from 'bb+'. Fitch has affirmed Popolare's Long-term and Short-term Issuer Default Ratings (IDRs), and those of its subsidiaries, at 'BBB'/'F3'. The Outlook on the Long-term IDRs is Negative. The ratings of subsidiary bank, Banca Italease, have been affirmed and withdrawn following its merger into the parent.

KEY RATING DRIVERS AND RATING SENSITIVITIES -IDRs, SENIOR DEBT, SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)
Popolare's IDRs and senior debt ratings are driven by the bank's SR and SRF and consider Fitch's assessment of the high likelihood of support being made available to Popolare from the Italian authorities in case of need. They reflect Popolare's domestic systemic importance.

The ratings are sensitive to Fitch's assumptions around either the ability or propensity of Italy to provide timely support.

Fitch has assessed that the propensity of the Italian state to provide support is weakening and the ratings are therefore primarily sensitive to further progress made in implementing the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) for eurozone banks. The directive requires 'bail in' of creditors by 2016 before an insolvent bank can be recapitalised with state funds. A functioning SRM and progress on making banks 'resolvable' without jeopardising the wider financial system are areas of focus for eurozone policymakers. Once these are operational they will become an overriding rating factor, as the likelihood of banks' senior creditors receiving full support from the sovereign if ever required, despite their systemic importance, will diminish substantially, unless mitigating factors emerge.

The Negative Outlook on the Long-term IDR reflects this view of reducing likelihood of support from the sovereign. As the BRRD is enacted into EU legislation and progress on establishing the SRM is made, Fitch expects to downgrade Popolare's SR to '5' and revise the SRF down to 'No Floor' during 2Q15. At this point, Popolare's Long-term and Short-term IDRs and senior debt ratings would likely be downgraded to the level of its VR.

The IDRs will also factor in Fitch's assessment of the level of protection offered to Popolare's senior creditors by outstanding loss absorbing junior instruments and will also consider the bank's plans to raise junior debt.

The Italian state's ability to provide timely support to the banks is dependent upon its creditworthiness, reflected in its Long-term IDR of 'BBB+'/Stable. A downgrade of Italy's sovereign rating would reflect a weakened ability of the state to provide support and therefore likely result in the downward revision of the large Italian banks' SRFs.

KEY RATING DRIVERS - VR
The downgrade of Popolare's VR to 'bb' is the result of pressure on capital exerted by both the very high level of unreserved impaired loans, which at end-2014 accounted for almost 200% of FCC, and weak internal capital generation. In Fitch's opinion, these pressures on capital render it highly vulnerable to severe shocks, and not commensurate with the bank's risk profile. It is thus a high factor in determining the bank's VR.

Gross impaired loans grew by 15% during 2014 to EUR19.5bn, accounting for a high 24% of gross loans. The combination of rising impaired loans and higher coverage levels led Popolare to book EUR3.6bn of LICs in 2014 (4.5% of gross loans), which was the main driver of the EUR2.7bn operating loss reported in the year. The net loss reported in 2014 was EUR1.9bn, which in Fitch's opinion erodes the benefits of the EUR1.5bn capital raised in April 2014.

A large portion (EUR1.6m) of the additional LICs booked in 2014 emerged from the ECB Asset Quality Review and is not expected to recur. Nonetheless, in Fitch's opinion, Popolare's structural profitability is weak. The bank has been reporting operating losses since 2010 and we expect only a gradual turnaround in profitability at least until 2016.

RATING SENSITIVITIES - VR
The VR would come under further pressure if assets deteriorated significantly in 2015, causing additional losses to erode capital further.

An upgrade of the VR would require a significant reduction in the level of unreserved impaired loans relative to FCC. A turnaround in operating performance would also be necessary.

KEY RATING DRIVERS AND SENSITIVITIES - SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
Subordinated debt and other hybrid capital issued by Popolare, and by its subsidiaries, are all notched down from Popolare's VR, in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles. Their ratings are primarily sensitive to any change in Popolare's VR, which drives the ratings.

Following the downgrade of Popolare's VR, the long-term ratings of its subordinated and hybrid debt and the long-term rating of the subordinated debt originally issued by its subsidiary Banca Italease (transferred to Popolare when Banca Italease was merged into Popolare on 16 March 2015) have also been downgraded by one notch. 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 subsidiary, Banca Aletti & C. S.p.A., are based on Fitch's view that Popolare would support it, if needed. Fitch considers Banca Aletti as a core subsidiary given its role in the group.

Fitch has affirmed and simultaneously withdrawn the ratings of Popolare's subsidiary, Banca Italease. The withdrawal follows the latter's merger into the parent bank on 16 March 2015. The ratings have been withdrawn because the legal entity ceased to exist. The outstanding debt issued by Banca Italease continues to be rated and is being transferred under the parent.

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 'bb+'
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 and withdrawn
Short-term IDR: affirmed at 'F3' and withdrawn
Support Rating: affirmed at '2' and withdrawn
Senior debt: affirmed at 'BBB' and transferred to Popolare
Market-linked securities: affirmed at 'BBBemr' and transferred to Popolare
Lower Tier 2 subordinated debt: downgraded to 'BB-' from 'BB' and transferred to Popolare
Trust preferred securities (ISIN: XS0255673070): affirmed at 'C' and transferred to Popolare

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'

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Applicable criteria, Global Bank Rating Criteria, dated 20 March 2015 are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Global Bank Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501

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