

Rating Action: Moody's upgrades long-term ratings of Banco Popolare and Banca Popolare di Milano following merger approval

Global Credit Research - 20 Oct 2016

Outlook on Ba1 deposit ratings is stable and outlook on Ba2 senior unsecured rating is negative

London, 20 October 2016 -- Moody's Investors Service has today upgraded the following ratings and assessments of Banco Popolare Societa Cooperativa (Banco Popolare) and Banca Popolare di Milano S.C.a r.l. (BPM): (1) the long-term deposit ratings to Ba1 from Ba2; (2) the long-term senior debt ratings to Ba2 from Ba3; (3) the subordinated debt ratings to B2 from B3; (4) the preference stock to Caa1(hyb) from Caa2(hyb); (5) the banks' standalone baseline credit assessments (BCAs) and adjusted BCAs to b1 from b2; and (6) their long-term Counterparty Risk Assessments (CRAs) to Ba1(cr) from Ba2(cr). The outlook on the long-term deposit ratings is stable whilst the outlook on the senior unsecured debt ratings is negative. Ratings of Banco Popolare and BPM are aligned, as they have been prior to this action.

This rating action follows the announcement made on 15 October 2016 by Banco Popolare and BPM that their respective shareholders meetings have approved the merger of the two groups, which is expected to be completed on 1 January 2017. The new bank will be called Banco BPM SpA, to which both banks will transfer all of their assets and liabilities. The aforementioned upgrades reflect Moody's assessment of the credit profile of the combined Banco BPM group, which is driven by the new bank's adequate solvency levels when balanced against its credit risk profile and adequate liquidity position. The b1 BCAs of Banco Popolare and BPM also reflect the challenges the new bank will be facing given its large stock of problem loans and expected weak profitability. Moody's considers that in the next few years Banco BPM will need to continue cleaning up its balance sheet, in an environment where interest rates are expected to remain low.

Today's rating action concludes the review for upgrade on the banks' ratings that was initiated on 13 April 2016 (see press release "Moody's places Banco Popolare's and Banca Popolare di Milano's long-term ratings on review for upgrade following merger agreement" https://www.moodys.com/research/--PR_346911).

Banco Popolare and BPM's short-term deposit ratings of Not Prime and their short-term CRAs of Not Prime(cr) have been affirmed as part of today's rating action.

A list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

RATIONALE FOR UPGRADING THE BCA

The upgrade of the BCAs of Banco Popolare (total assets of EUR123.7 billion at end-June 2016) and BPM (total assets of EUR49.7 billion at end-June 2016) to b1 from b2 follows Moody's assessment of the credit profile of the new banking group, Banco BPM SpA, which will become the third largest Italian credit institution. This new banking group is expected to be created on 1 January 2017, and it will host all of the assets and liabilities of Banco Popolare and BPM. This in line with what the shareholders of both banks approved on 15 October 2016 and previously the relevant regulatory authorities.

In upgrading the BCAs of Banco Popolare and BPM, Moody's has taken into consideration the benefits stemming from the merger, namely (1) the EUR1 billion capital increase made by Banco Popolare in June 2016 and earmarked to increase provisions on problem loans; (2) significant cost synergies and broader revenue diversification; (3) adequate capital levels, with the fully-loaded Common Equity Tier 1 ratio expected to reach 12.9% by year-end 2019; and (4) an adequate liquidity position, with a combined liquidity coverage ratio (LCR) well above 100%.

The b1 BCA of the new Banco BPM group will nevertheless be constrained by its (1) high stock of problem loans mostly in respect of legacy issues at Banco Popolare, with a combined gross problem loan ratio of around 21% (based on Banco Popolare's and BPM's aggregated H1 2016 financials), comparing unfavorably with the system average of 18% at end-December 2015; and (2) weak profitability, as Banco BPM is likely to continue cleaning up its balance sheet in the years to come, while interest rates are expected to remain low.

Moody's considers that as a joint-stock company, the new bank's corporate governance will not be the constraint that it has historically been for BPM. However, the rating agency believes that some aspects of the merger will likely be challenging, potentially resulting in a more protracted integration process and delaying synergies.

RATIONALE FOR UPGRADING THE DEPOSIT AND SENIOR DEBT RATINGS

The upgrade of Banco Popolare's and BPM's long-term deposits to Ba1 and their senior debt ratings to Ba2 reflects: (1) the upgrade of the banks' BCAs and adjusted BCAs to b1 from b2; (2) the rating agency's Advanced Loss Given Failure (LGF) analysis, which results in three notches of uplift for the deposit ratings and two notches of uplift for the senior debt ratings; and (3) Moody's assessment of a low probability of government support for the new Banco BPM group, which results in no uplift for both the deposit and the senior debt ratings.

RATIONALE FOR UPGRADING THE COUNTERPARTY RISK ASSESSMENT

As part of today's rating action, Moody's has also upgraded to Ba1(cr) from Ba2(cr) the long-term CR Assessments of Banco Popolare and BPM, three notches above their adjusted BCAs of b1.

The upgrade of the CR Assessments follows the upgrade of the BCAs of Banco Popolare and BPM to b1 from b2. The CR Assessment is driven by standalone assessment of the combined Banco BPM group and by the considerable amount of bail-in-able debt and junior deposits likely to shield operating liabilities from losses, accounting for three notches of uplift relative to the BCA.

RATIONALE FOR THE OUTLOOKS

The outlook on the deposit ratings of Banco Popolare and BPM is stable as we anticipate that the credit profile of the combined Banco BPM group will remain resilient over the next 12-18 months. Despite the near-term challenges stemming from the integration of both banks, Moody's considers that the new group's solvency and liquidity will support its creditworthiness, mitigating pressures on both asset risk and profitability.

The outlook on the senior debt ratings of Banco Popolare and BPM is negative, however, because the stock of bail-in-able senior debt is likely to dwindle in the next 12-18 months, given the banks' funding plans and the likely maturities of retail bonds in particular. This would result in a higher loss-given-failure for this class of debt.

FACTORS THAT COULD LEAD TO AN UPGRADE/DOWNGRADE

The BCAs of Banco Popolare and BPM could be upgraded if the new Banco BPM group were to meet the financial targets set out in its integration plan, which assumes an improving trend in its asset risk metrics (mostly through problem loan disposals) while preserving profit generation capacity and capital. The BCAs could also be upgraded if the Banco BPM group reduces the stock of problem loans faster than anticipated whilst preserving its capital. An upgrade in the BCA would likely result in upgrades to all ratings.

A downgrade in the BCAs would drive a downgrade in all ratings. This in turn could be triggered by the group's failure to meet the group's targeted cost savings and synergies, or if there were a deterioration in the asset risk or capital.

The senior debt ratings would likely be downgraded following a reduction in the volume of senior debt outstanding.

LIST OF AFFECTED RATINGS

Issuer: Banco Popolare Societa Cooperativa

..Upgrades:

....Long-term Counterparty Risk Assessment, upgraded to Ba1(cr) from Ba2(cr)

....Long-term Deposit Ratings, upgraded to Ba1 Stable from Ba2 Rating under Review

....Long-term Issuer Rating, upgraded to Ba2 Negative from Ba3 Rating under Review

...Senior Unsecured Regular Bond/Debenture, upgraded to Ba2 Negative from Ba3 Rating under Review

...Senior Unsecured Medium-Term Note Program, upgraded to (P)Ba2 from (P)Ba3

...Subordinate Regular Bond/Debenture, upgraded to B2 from B3

...Subordinate Medium-Term Note Program, upgraded to (P)B2 from (P)B3

...Pref. Stock Non-cumulative, upgraded to Caa1(hyb) from Caa2(hyb)

...Adjusted Baseline Credit Assessment, upgraded to b1 from b2

...Baseline Credit Assessment, upgraded to b1 from b2

..Affirmations:

...Short-term Counterparty Risk Assessment, affirmed NP(cr)

...Short-term Deposit Ratings, affirmed NP

..Outlook Actions:

...Outlook changed to Stable(m) from Rating Under Review

Issuer: Banca Italease S.p.A.

..Upgrades:

...Backed Senior Unsecured Regular Bond/Debenture, upgraded to Ba2 Negative from Ba3 Rating under Review

..Outlook Actions:

...Outlook changed to Negative from Rating Under Review

Issuer: Banca Popolare di Milano S.C. a r.l.

..Upgrades:

...Long-term Counterparty Risk Assessment, upgraded to Ba1(cr) from Ba2(cr)

...Long-term Deposit Ratings, upgraded to Ba1 Stable from Ba2 Rating under Review

...Long-term Issuer Rating, upgraded to Ba2 Negative from Ba3 Rating Under Review

...Senior Unsecured Regular Bond/Debenture, upgraded to Ba2 Negative from Ba3 Rating Under Review

...Senior Unsecured Medium-Term Note Program, upgraded to (P)Ba2 from (P)Ba3

...Subordinate Regular Bond/Debenture, upgraded to B2 from B3

...Subordinate Medium-Term Note Program, upgraded to (P)B2 from (P)B3

...Pref. Stock Non-cumulative, upgraded to Caa1(hyb) from Caa2(hyb)

...Adjusted Baseline Credit Assessment, upgraded to b1 from b2

...Baseline Credit Assessment, upgraded to b1 from b2

..Affirmations:

...Short-term Counterparty Risk Assessment, affirmed NP(cr)

...Short-term Deposit Ratings, affirmed NP

...Other Short Term, affirmed (P)NP

..Outlook Actions:

...Outlook changed to Stable(m) from Rating Under Review

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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