

Rating Action: Moody's takes rating actions on Italian banks following Italy's downgrade to A2

Global Credit Research - 05 Oct 2011

Milan, October 05, 2011 -- Moody's Investors Service has today downgraded the senior debt and deposit ratings of Italian banks and Italian government-related financial institutions (GRIs), by between one and three notches. These rating actions follow yesterday's downgrade of the Republic of Italy's government bond rating to A2 from Aa2. The rating action also incorporates a readjustment of our support assumptions for Italian banks to reflect a weakening of the support environment for banks.

These rating actions conclude the reviews for downgrade initiated on 23 June 2011, which were triggered by the review for possible downgrade of the Republic of Italy's ratings on 17 June 2011. The banks' financial strength ratings (BFSRs), which were not part of the review, have not been affected by the rating action on the Republic of Italy, except in the case of UniCredit and Intesa Sanpaolo. For these banks, separate press releases are being issued that detail the actions being taken with regard to their respective BFSRs.

A full list of all the affected ratings can be found at the following link: http://www.moody.com/viewresearchdoc.aspx?docid=PBC_136445. Please find the press release on the sovereign rating action including the key rating rationale here: http://www.moody.com/viewresearchdoc.aspx?docid=PR_227333.

RATINGS RATIONALE

The key driver of today's rating actions is the downgrade of the Republic of Italy to A2 from Aa2. The downgrade implies that the government has less financial flexibility and would likely face more challenging and difficult policy choices if multiple institutions were to need its financial support at the same time.

The other consideration behind today's rating actions is the increased uncertainty over the medium term regarding the willingness of European Union member states to support senior creditors of institutions; this uncertainty is heightened for banks below the first tier in their domestic markets. This had already prompted Moody's to reduce the levels of support in other European countries. Today's rating actions are consistent with this broader reassessment. Please refer to the "Systemic Support for Banks" link on the Topics page of www.moody.com for related articles.

It is important to note that Moody's continues to assume that support will be forthcoming for Italian banks if support is needed. However, today's action removes the extraordinarily high systemic support of up to 4 notches assumed earlier in the crisis for the weaker institutions, returning support uplifts to a level more appropriate with the evolving support environment. The debt and deposit ratings of many Italian banks continue to have one or two notches of rating lift over their baseline credit assessments (i.e., standalone financial strength) due to their importance to the banking system, and therefore high likelihood of support.

Moody's believes that Italian banks can be categorised into three groups that differ by how much "systemic uplift" they may be expected to receive based on the size and nature of their franchises.

? Group 1: Banks with a very high likelihood of support, which receive up to two notches of systemic uplift. This group comprises the country's largest banks with high national market shares in key banking products: Unicredit, Intesa San Paolo and Banca Monte dei Paschi di Siena. The ratings of Intesa Sanpaolo are constrained at the rating level of the Italian government despite having one of the highest stand alone financial strength ratings in Italy (C+ mapping to an A2 on the long-term scale) given the high correlation with the Italian government's credit worthiness. This is as a result of the bank's direct exposure to Italian government debt and the very domestic focus of its business model.

? Group 2: Banks with a moderate to high likelihood of support. This group receives up to one notch ratings uplift and comprises eight smaller national banks or larger multi-regional banks with lower, but still significant domestic market share. This group comprises Banca Carige, Banca delle Marche, Banca Popolare di Milano, Banca Sella Holding, Banco Popolare, Credito Emiliano, Credito Valtellinese and Unione di Banche Italiane (UBI).

? Group 3: Banks with a low or no likelihood of support which receive no systemic uplift. The rating agency believes that there is insufficient certainty surrounding the likelihood and extent of support available over the medium term to most banks with low domestic market shares to warrant any uplift of their standalone credit strength.

? Furthermore, 17 banks are either subsidiaries of larger Italian banks, the ratings of which already incorporate an uplift due to systemic support, or of cooperative groups. As such, they may receive parental or cooperative support, and their ratings have, in most cases, been affected indirectly by the impact on their parent's/cooperative's ratings.

Two GRIs (Cassa Depositi e Prestiti and ISMEA) have been downgraded to A2, i.e., to the same level as the Italian government, given their government ownership and the strong financial and operational linkages with the government.

RATINGS RATIONALE FOR SENIOR SUBORDINATED AND TIER III DEBT

Moody's has downgraded the senior subordinated debt ratings of 18 Italian banks and the Tier III debt of 13 Italian banks (the latter being rated one notch below these banks' senior subordinated debt), in line with the downgrade of these banks' senior unsecured debt ratings. This rating approach implies that if a bank's senior debt rating benefits from an assumption of systemic support, its subordinated debt and Tier III debt will benefit similarly. Moody's does, however, intend to reassess its systemic support assumptions for subordinated debt and Tier III debt in Italy, alongside other European countries, during the remainder of this year in response to prospective European banking legislation. This reassessment is not captured in today's rating actions.

WHAT COULD CHANGE THE RATINGS UP

An improvement in the banks' standalone BFSRs could exert upward pressure on the banks' debt and deposit ratings; please refer to

www.moodys.com for a more detailed discussion of each individual bank's key rating drivers. However, in the current difficult operating environment, the opportunity for this appears very limited. An upgrade of the Italian government bond rating could also exert upward pressure on the banks' debt and deposit ratings; however, this too is unlikely given the negative outlook on the ratings of the Italian government.

WHAT COULD CHANGE THE RATINGS DOWN

The ratings of those banks that continue to benefit from systemic support remain linked to the creditworthiness of the Italian government and to a further reduction in Moody's systemic support assumptions. In that context, any further developments relating to the legislation governing the resolution powers regarding banks -- i.e., developments that increase the likelihood of senior creditors incurring losses -- could exert downward pressure on the deposit and debt ratings of those banks which currently benefit from systemic support. Any downgrades of the BFSRs on the individual banks -- for example in the case of further escalating funding difficulties - could also lead to additional negative rating pressures, particularly given the reduced level of systemic support.

PRINCIPAL METHODOLOGIES

The principal methodologies used in this rating were Bank Financial Strength Ratings: Global Methodology published in February 2007, and Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology published in March 2007. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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