Fitch Downgrades Mediocredito Trentino Alto Adige S.p.A. to 'BB-'; Stable Outlook

Ratings Endorsement Policy

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Fitch Ratings-Milan/London-13 March 2015: Fitch Ratings has downgraded Mediocredito Trentino Alto Adige S.p.A.'s (MTAA) Long-Term Issuer Default Rating (IDR) to 'BB-' from 'BBB+'. The Outlook is Stable. At the same time, Fitch has downgraded MTAA's Short-Term IDR to 'B' from 'F2' and the Support Rating (SR) to '4' from '2'. MTAA's Viability Rating (VR) has been affirmed at 'bb-'.

The downgrades reflect a revision of Fitch's assessment of the likelihood of extraordinary support from the bank's public shareholders. MTAA's Long-term IDR has been downgraded to the level of its VR and therefore now reflects the bank's standalone creditworthiness. MTAA's Long-Term IDR was previously based on support.

KEY RATING DRIVERS AND SENSITIVITIES - SR

The downgrade of MTAA's SR to '4' follows the revision of Fitch's assessment of the probability of extraordinary support if needed from the bank's three main public shareholders - the Autonomous Province of Trento (A/Stable/F1), the Autonomous Province of Bolzano (A/Stable/F1) and the Region of Trentino Alto Adige, which jointly hold a 52.5% stake in the bank. Fitch believes that in the event of severe stress, there would be significant uncertainties about the adequacy of support made available because of potential limitations arising from the Bank Recovery and Resolution Directive and EU state-aid considerations.

The SR of '4' continues to reflect MTAA's important role for the public sector in its home region and Fitch's opinion that some potential remains for public shareholders to provide extraordinary support, either directly or through their network of subsidiaries, affiliates and regional relationships in general without triggering state-aid considerations, or from January 2016, the need for bail-in of senior creditors (once BRRD's bail-in tool is effective). The provinces consider MTAA as a vehicle for pursuing their economic policies. Fitch believes MTAA will remain a key institution for the funding of the local corporate sector's investments. MTAA's franchise and commercial presence also benefits from the close links with the local mutual banking sector (Banche di Credito Cooperativo; BCC) which holds 36.6% of MTAA's capital. MTAA provides products and services, typically medium- to longer-term loans to clients of the BCCs.

Given the agreement between the shareholders, Fitch believes it would be difficult for a capital increase from the bank's public shareholders to be made if the private shareholders did not also participate without triggering state aid and bail-in considerations. Fitch also understands that the capital injection from the public shareholders cannot exceed the proportion they already jointly hold in the bank and that ownership by private shareholders must remain material. In Fitch's view, it would be difficult to argue the private investor test condition for extraordinary public sector support if private investors demonstrated that they were unwilling to support.

MTAA's SR remains sensitive to a change in the strategic importance of MTAA to its public shareholders, including the hypothetical case of a change in the ownership structure. The ability of the main shareholders to support MTAA is indicated by their Long-term IDRs, which (with the exception of unrated Autonomous Region of Trentino Alto Adige) are two notches higher than Italy's sovereign rating, reflecting their strong financial flexibility.

KEY RATING DRIVERS - IDRs and VR

MTAA's IDRs are now driven by its VR. The VR of 'bb-' primarily reflects MTAA's company profile, with its small size and limited franchise dominating its financial profile. The bank's weak asset quality, with the bulk of impaired loans originated in the past outside the bank's home region of Trentino Alto Adige, also constrains the rating, although this is showing signs of stabilisation. The VR also reflects MTAA's weak profitability, which Fitch expects to marginally recover in the medium term. Its dependence on wholesale funding is at least partly mitigated by access to ordinary liquidity from its shareholders, and its acceptable capitalisation is beneficial for the rating.

MTAA operates as a provider of longer-term lending to the corporate sector. Asset quality deterioration slowed down materially in 2014 but overall asset quality remains weak. MTAA's gross impaired loans increased only slightly to 15.9% of gross loans at end-1H14 (14.9% at end-2013), although the riskiest component (sofferenze) surged to a high 59% of the stock of impaired loans. Loan loss reserve coverage at 35% at the same date remains weak, in Fitch's view. Including coverage offered by collateral, management assesses total problem loans to be fully covered at end-2014, but collateral is in the form of real estate and remains exposed to the risks of a drop in value and long disposal processes. The absence of a domestic secondary market for the disposals of doubtful loans and long court proceedings add to the difficulties of managing increasing stocks of impaired loans for Italian banks.

Lending to real estate and construction sectors has been reducing progressively, signalling a more prudent risk appetite. Sovereign exposure was a material 19% of total assets at end-1H14.

The profitability of MTAA's core lending business continued to suffer in 2014. Gains on the disposal of available-for-sale securities supported the bank's operating profitability, but Fitch considers this a volatile source of income. Fitch expects marginal improvements in profitability in 2015, reflecting an expected moderate economic recovery of the bank's home territory - where growth tends to be higher than the national average - and the stabilisation of asset quality. MTAA's weak profitability partly reflects its role as a regional development bank and vehicle for the provision of long-term financing to BCCs' clients. Earnings sources are not diversified as medium and long-term lending remains the bank's main business.

The bank relies on wholesale funding, which on average accounted for about 90% of non-equity funding in the past two years. ECB funding, totalling roughly a quarter of total assets at end-2014, is mainly long term. Liquidity is underpinned by a portfolio of unencumbered ECB eligible assets corresponding to about 10% of the bank's total assets, which we consider sufficient. In addition, Fitch expects that the bank's public and private shareholders would provide ordinary support to underpin liquidity if needed. This could take the form of deposits or purchase of bonds issued by MTAA, directly or through the provinces' subsidiaries, which include Cassa del Trentino (A/Stable/F1).

The bank's capitalisation with a Fitch core capital/risk-weighted assets ratio of 15.6% at end-1H14, was only just acceptable given its small size and the encumbrance of core capital by unreserved impaired loans (equal to 71% at the same date).

RATING SENSITIVITIES - VR
The Stable Outlook reflects Fitch's expectations that asset quality has stabilised, reducing earnings pressure from loan impairment charges. MTAA's IDRs and VR may be upgraded if there is a material improvement in asset quality. Conversely higher than expected deterioration of asset quality with growing loan impairment charges would lead to a downgrade.

The VR is also sensitive to changes in the bank's liquidity. Weaker ordinary access to funding from public sector shareholders or the local mutual sector, materially challenging the bank's funding structure and costs, would put the VR under pressure.

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Applicable criteria 'Global Financial Institutions Rating Criteria' dated 31 January 2014, 'Rating FI Subsidiaries and Holding Companies' dated 10 August 2012 and 'Evaluating Corporate Governance' dated 12 December 2012 are available on www.fitchratings.com.

Applicable Criteria and Related Research:
Global Financial Institutions Rating Criteria
Rating FI Subsidiaries and Holding Companies
Evaluating Corporate Governance

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