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Research Update:

Italian Bank FGA Capital 'BB+/B' Ratings Affirmed Despite Increased Economic Risks In Italy; Outlook Stable

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Overview

- In our view, economic prospects in Italy are likely to be weaker than we had previously anticipated and weak overall in the next couple of years. We believe this will likely continue to dampen Italian banks' asset quality and profitability, and, specifically, may lead to high credit losses in the Italian banking system over the next two years significantly exceeding our previous expectations.
- Italian bank FGA Capital's (FGAC) wide geographic diversification, sound capital position, and resilient asset quality should enable it to absorb the impact of the heightened economic risks we now see in Italy while preserving its current creditworthiness.
- We are therefore affirming our 'BB+/B' long- and short-term counterparty credit ratings on FGAC.
- The stable outlook reflects our belief that FGAC should be able to maintain its strong solvency and resilient asset quality over the next two years.

Rating Action

On Dec. 18, 2014, Standard & Poor's Ratings Services affirmed the 'BB+/B' long- and short-term counterparty credit ratings on Italian bank FGA Capital (FGAC). The outlook is stable.

Rationale

The affirmation of our ratings on FGAC reflects our belief that its geographical diversification, strong capital position, and resilient asset quality will enable it to absorb the impact of the heightened economic risks we now see in Italy, and preserve its current creditworthiness.

Persistently weak economic conditions in Italy are likely, in our opinion, to continue to undermine the creditworthiness of the private sector and, consequently, banks' asset quality and profitability prospects. We therefore believe that Italian banks' credit losses will likely be high over the next couple of years, significantly exceeding our previous expectations, and that they will start to normalize only in the medium-to-long term. In this context, our expectations for losses in the banks' credit portfolios are affected by our view that problematic assets will likely continue to grow and credit

recovery processes will remain long. We forecast that cumulative credit losses for the Italian banking sector will account for about 4.0%-4.5% of total loans in 2014-2016, with peak losses of about 1.5%-1.8% on average in both 2014 and 2015, with a gradual decline from 2016.

We therefore consider that the likely impact of the ongoing economic correction on the Italian banking system will be more severe than anticipated, reflecting higher economic risk for Italian banks than previously.

FGAC's stand-alone credit profile (SACP) is unchanged at 'bb' as we believe that the impact of the increased economic risks that FGAC faces in Italy is counterbalanced by the benefits of having about 60% of its lending outside Italy in countries with lower economic risks.

In this context, we incorporate in FGAC's 'bbb-' anchor a weighted average of the economic risks we see in the markets in which the bank operates. The anchor is the starting point in assigning an issuer credit rating to a bank.

Despite the heightening economic risk in Italy, which in our view has had a negative impact on FGAC's overall solvency, we believe that FGAC should be able to preserve its capital position at a level that we consider to be "strong" for the next two years. We anticipate that FGAC's RAC ratio will be between 11.2%-11.7% by the end of 2016. Furthermore, we consider that FGAC's geographic diversification outside Italy and highly granular, low-risk retail lending will enable it to preserve its satisfactory asset quality through the full economic cycle. This is reflected in our "adequate" assessment of FGAC's risk position.

Our assessments of all other FGAC's rating factors, including its business profile and its funding and liquidity position, remain unchanged.

Our current assessment of FGAC's funding and liquidity reflects the material ongoing support the entity receives from its parent, Credit Agricole (CASA).

The long-term rating on FGAC is one notch higher than its SACP, reflecting our view that FGAC is a "moderately strategic" subsidiary of CASA.

Outlook

The stable outlook reflects our belief that FGAC should be able to preserve its strong solvency and resilient asset quality metrics over the next two years. It also reflects our view that CASA will continue to provide sufficient funding and liquidity support to FGAC.

We could also lower the rating on FGAC if we perceive that CASA's commitment to support FGAC has diminished, which, in our view, could negatively affect FGAC's funding and business position, among other factors.

We consider an upgrade to be unlikely over the next 12-18 months. We could

consider a positive rating action if we anticipate a material improvement of the economic conditions in Italy or FGAC's geographic diversification improves further, providing that its asset quality metrics remain as resilient as they have been during the economic downturn.

Ratings Score Snapshot

Issuer Credit Rating	BB+/Stable/B
SACP	bb
Anchor	bbb-
Business Position	Weak (-3)
Capital and Earnings	Strong (+1)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	+1
GRE Support	0
Group Support	+1
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

Related Criteria

- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Sept. 18, 2014
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Ratings On Italian Banks Lowered On Rising Economic Risk And Sovereign Downgrade, Dec. 18, 2014
- Ratings On Italy Lowered To 'BBB-/A-3'; Outlook Stable, Dec. 5, 2014

Ratings List

Ratings Affirmed

FGA Capital SpA

Counterparty Credit Rating

BB+/Stable/B

FGA Capital Ireland PLC

Senior Unsecured*

BB+

*Guaranteed by FGA Capital SpA.

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