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Research Update:

Italian Veneto Banca 'BB/B' Ratings Affirmed And Removed From CreditWatch Negative Following Review; Outlook Negative

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Overview

- Following the appointment of a new board of directors, we believe Veneto Banca SCPA should be able to successfully complete the announced capital-enhancing actions over the coming four months and, as a result, significantly boost its solvency levels.
- In our view, the successful completion of these actions would be sufficient to offset the effect of deteriorating asset quality on the bank's financial profile.
- We are therefore affirming our current 'BB' long-term rating on Veneto Banca and removing it from CreditWatch negative, where it was originally placed on April 14, 2014. At the same time, we are affirming our 'B' short-term rating.
- The negative outlook reflects the possibility that we could lower the ratings if the economic conditions in which Italian banks operate deteriorate further and this, combined with weaker-than-expected capital generation, were to negatively affect our view of the bank's capital position.

Rating Action

On June 17, 2014, Standard & Poor's Ratings Services affirmed its 'BB' long-term counterparty credit rating on Italy-based Veneto Banca SCPA and removed it from CreditWatch negative, where it was originally placed on April 14, 2014. We also affirmed our 'B' short-term rating. The outlook is negative.

At the same time, we affirmed and removed from CreditWatch negative our 'B-' issue ratings on Veneto Banca's subordinated debt, and our 'CCC' issue ratings on the bank's preferred stock.

Rationale

The rating actions primarily reflect our view that Veneto Banca is likely to be able to successfully complete the capital-enhancing actions that it announced on March 25, 2014. In this context, we note that Veneto Banca has completed all of the actions required to address the Bank of Italy's concerns regarding the bank's governance and strategy, including the appointment of a new board of directors. We believe Veneto Banca also benefits from the strength of its franchise, as well as the loyalty of its shareholders and

customer base. In our view, the combination of these factors reduces the execution risk of the announced capital-strengthening measures. The successful completion of these actions would be sufficient to offset the effect of deteriorating asset quality on our view of the bank's risk position.

We understand that the Bank of Italy explicitly required Veneto Banca to take several actions aimed at changing several features of its governance structure. These actions included the appointment of a completely new board of directors, a few organizational changes, and some internal restructuring aimed at streamlining the bank's organization. While we consider that the need for the Bank of Italy to request such changes might have negatively affected Veneto Banca's reputation, we believe that the proven strength of its franchise, as well as the loyalty of its customer and shareholder base, reduce the execution risk of its announced capital plan.

We therefore believe that, in the next few months, Veneto Banca will likely be able to complete all of its capital-enhancing actions. These actions mainly include the conversion of a €350 million convertible bond into equity and a capital increase of about €500 million through a rights issue (which is expected to be completed by early October).

The successful completion of these measures should, in our opinion, allow Veneto Banca to absorb the sizable credit losses on its capital base and to enhance its total solvency level. We estimate that, as a result, Veneto Banca's risk-adjusted capital (RAC) ratio before diversification would stand in the 5.5%-6.0% range by the end of 2014. We are therefore revising Veneto Banca's capital and earnings assessment to "moderate" from "weak." In addition, Veneto Banca is also aiming to sell its stake in Banca Intermobiliare. However, this process could take longer than anticipated and we are not incorporating the benefit of this potential sale in our assessment of Veneto Banca's capital position.

At the same time, we expect that asset quality will continue to deteriorate in coming quarters, and that Veneto Banca is likely to accumulate a higher level of problematic assets than we previously incorporated into the ratings. We think that the total problematic assets that Veneto Banca will accumulate during the full economic cycle is likely to exceed 20% of its total loans, before stabilizing. Our estimates take into account the continued performance deterioration in Veneto Banca's asset quality over the past 18 months. We also consider that the total NPL coverage level, at about 33% as of year-end 2013, remains modest overall, when compared with domestic and international standards. The combined effect of increasing problem assets and lower coverage of loan-loss reserves makes Veneto Banca, in our view, highly vulnerable to higher credit losses. We have therefore revised our assessment of the bank's risk position to "weak" from "moderate."

We continue to assess Veneto Banca's liquidity profile as being "moderate," taking into account the fact that, in our view, it still relies on substantial short-term funding sources, despite some improvement. These sources include liquidity facilities provided by the European Central Bank's (ECB) long-term

refinancing operation (LTRO). In our view, Veneto Banca remains dependent on the completion of several liquidity-enhancing actions--including continued access to the wholesale market at affordable prices--in order to reach what we consider to be an adequate liquidity position on a sustainable basis by the time the LTRO expires. We continue to incorporate one notch of short-term support into our 'BB' long-term rating on Veneto Banca to reflect our view that its ongoing access to the ECB's LTRO gives it time to implement the plans that will help it to rebalance its liquidity profile to a more sustainable position.

As a result of the factors above, our assessment of Veneto Banca's stand alone credit profile (SACP) remains unchanged, at 'b+'.

Our ratings on Veneto Banca continue to incorporate one notch of uplift on the SACP. This accounts for potential extraordinary government support, based on our view of the bank's "moderate" systemic importance and Italy's supportive stance toward its banking system.

Outlook

The negative outlook reflects the possibility that we could lower our ratings on Veneto Banca if any of the following conditions were to occur:

- The economic conditions in which Italian banks operate deteriorate further and this, combined with weaker-than-expected capital generation were to negatively affect our view of the bank's capital position;
- Veneto Banca were ultimately unable to complete its plan to reduce its exposure to funding from the ECB and correct its funding imbalances. Under this scenario, we would be unlikely to consider that the bank would be able to achieve an "adequate" liquidity position according to our criteria by the time the ECB LTRO expires; or
- If we were to envisage any evidence of unexpected corporate governance issues, particularly if regulatory authorities were to request Veneto Banca to take additional significant restructuring actions.

We do not currently expect to revise the outlook on Veneto Banca to stable. However, we could do so if the bank were to successfully deliver its business and financial plans, and if we were to believe that downside risks to the economic operating environment in Italy--and subsequently to our assessment of Veneto Banca's capital--were easing.

In addition, we could lower our ratings on Veneto Banca by one notch by year-end 2015 if we were to consider that extraordinary government support is less predictable under the EU's new legislative framework. We could remove the notch of uplift for potential extraordinary support, which we currently incorporate into the ratings, shortly before the January 2016 introduction of bail-in powers under the EU's Bank Resolution and Recovery Directive (BRRD) for senior unsecured liabilities. The BRRD's bail-in powers indicate to us that EU governments will be less willing to bail out senior unsecured bank creditors, even though it may take several more years to eliminate concerns

about financial stability and the resolvability of systemically important banks.

In addition to potential changes in the SACP and government support, we will review other relevant rating factors when taking any rating actions. These might include any measures that Veneto Banca might take that provide substantial additional flexibility to absorb losses while a going-concern and mitigate bail-in risks to senior unsecured creditors.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BB/Negative/B	BB/Watch Neg/B
SACP	b+	b+
Anchor	bbb-	bbb-
Business Position	Adequate (0)	Adequate (0)
Capital And Earnings	Moderate (-1)	Weak (-2)
Risk Position	Weak (-2)	Moderate (-1)
Funding	Average (-1)	Average (-1)
Liquidity	Moderate	Moderate
Support	(+2)	(+2)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(+2)	(+2)
Additional Factors	(0)	(0)

Related Criteria And Research

Related criteria

- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related research

- S&P Publishes Latest Banking Industry Country Risk Assessment On Italy, June 17, 2014
- Banking Industry Country Risk Assessment: Italy, June 17, 2014

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Veneto Banca SCPA Counterparty Credit Rating	BB/Negative/B	BB/Watch Neg/B
Veneto Banca SCPA Senior Unsecured	BB	BB/Watch Neg
Subordinated	B-	B-/Watch Neg

Ratings Affirmed

Veneto Banca SCPA Preferred Stock	CCC
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