

December 7, 2011

Research Update:

Italy-Based Banca Carige Downgraded To 'BBB' On Bank Criteria Change; Placed On Watch Negative After Sovereign Action

Primary Credit Analyst:

Francesca Sacchi, Milan +39 02 72111-272; francesca_sacchi@standardandpoors.com

Secondary Contact:

Taos Fudji, Milan (39) 02-72111-276; taos_fudji@standardandpoors.com

Table Of Contents

- Overview
- Rating Action
- Rationale
- CreditWatch
- Ratings Score Snapshot
- Related Criteria And Research
- Ratings List

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Overview

- Following a review under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we lowered our long-term counterparty credit rating to 'BBB' from 'BBB+' on Banca Carige SpA (Carige).
- We also lowered the subordinated debt rating to 'BBB-' from 'BBB'.
- On Dec. 5, 2011, we placed the long- and short-term sovereign credit ratings on the Republic of Italy on CreditWatch with negative implications.
- As a result, we are also placing all of the counterparty and issue ratings on Carige on CreditWatch with negative implications, including the bank's senior unsecured issues, subordinated Lower Tier II, and Upper Tier II issues.
- Our ratings on Italy-based Carige reflect our 'bbb+' anchor and what we view as the bank's adequate business position, moderate capital and earnings, adequate risk position, average funding, and adequate liquidity.
- The negative CreditWatch placement reflects the possibility that a sovereign downgrade and our view of a worsening of Carige's stand-alone credit profile (SACP) may result in a downgrade of the bank.
- We intend to resolve the CreditWatch on Carige after the Credit Watch on the Republic of Italy is resolved and when we are able to assess the impact of the sovereign rating action on the ratings on the bank.

Rating Action

As previously announced on Dec. 7, 2011, Standard & Poor's Ratings Services lowered its long-term counterparty credit Banca Carige SpA to 'BBB' from 'BBB+'.

In addition, we lowered the rating on Carige's subordinated debt to 'BBB-' from 'BBB'.

At the same time, we placed all of the counterparty and issue ratings on Carige on CreditWatch with negative implications, including the bank's senior unsecured issues, subordinated Lower Tier II, and Upper Tier II issues, following a similar rating action on the Republic of Italy on Dec. 5, 2011.

Rationale

The negative CreditWatch placement reflects the possibility that a sovereign downgrade and our view of a worsening of Carige's SACP may affect the ratings on Carige.

Standard & Poor's bases its ratings on Carige on our 'bbb+' anchor as well as what we view as Carige's "adequate" business position, "moderate" capital and earnings, "adequate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms.

The stand-alone credit profile (SACP) for Carige is 'bbb'.

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating (ICR). The 'bbb+' anchor draws on our view of the economic risk and industry risk in Italy where Carige mostly operates. We view Italy as a diversified and competitive economy with moderate credit risk. But Italy's public debt is very high. The imbalances in domestic asset prices and the buildup of leverage are low. With regard to industry risk, systemwide funding is a strength, we believe, because Italian banks generally rely to a limited degree on long- and short-term wholesale funding, be it domestic or cross-border. Regulatory standards are in line with those of Western European peers.

Carige is an Italy-based midsize savings bank. Our "adequate" assessment of its business position reflects what we see as the bank's strong retail franchise in Liguria, its stronghold where it enjoys a high 28% market share in customer deposits, and where half of its loan portfolio is concentrated. Despite the strong regional focus, the bank has expanded its franchise outside Liguria since 2000 through organic growth and the acquisition of small local banks and branch networks. We see that management has a successful track record of integrating them, while preserving the bank's good efficiency. However, the limited national coverage (only 1.2% of market share in customer deposits) somewhat constrains geographic diversification. We consider Carige's revenues to be well balanced, and most come from the commercial and retail banking business.

We consider Carige's capital and earnings as "moderate." Our assessment reflects our expectation that Carige's risk-adjusted capital (RAC) ratio before diversification adjustments will comfortably exceed 5% by end-2012. We assume that the management will strengthen capital beyond earnings retention. In our estimate, we are also assigning no equity content to Carige's existing Tier 1 issuance, according to Standard & Poor's revised criteria for hybrids (see "Bank Hybrid Capital Methodology And Assumptions," published on Nov. 1, 2011). Given the negative effect on revenues of weakening demand for loans and banking products, as well as an increase in the cost of funding, we expect that Carige's preprovision operating income will likely decrease by more than 10% between 2010 and 2012. However, earnings capacity is "adequate," in our

view, with a three-year average earnings buffer of about 70 basis points.

In our opinion, Carige's risk position is "adequate." The bank's gross nonperforming assets (NPAs) increased to 9.7% on June 30, 2011, from 8.5% at year-end 2010, based on end-2010 gross customer loans. Given the weak domestic economic prospects, we expect that Carige's asset quality will deteriorate at a similar pace as the Italian banking average, with new NPA inflows around 1.6% of customer loans in 2012, and that the bank's gross NPA ratio will likely exceed 10% in 2012. We believe Carige suffers from some risk concentrations. Single-name concentration is higher than peers' and we see some concentration in sectors such as Italian shipping and local real estate as being among the largest credit exposures. Positively, Carige benefits from a higher-than-peer portion of residential mortgages in its loan mix (28% at mid-2011) that has historically limited credit losses, given high collateralization, and counterbalances the bank's low NPA coverage.

Carige's funding is "average" and its liquidity position is "adequate," in our opinion. The bank's funding profile features a large and stable customer deposit base, accounting for 66% of total funding, which allows the bank to limit recourse to wholesale funding. Carige reported a 123% of loan-to-deposit ratio on Sept. 30, 2011, which compares favorably with other regional bank peers'. Adequate liquidity is sustained by €3 billion of Italian government bonds and a further €1.4 billion of other eligible assets.

We consider Carige to have "moderate" systemic importance, the government to be "supportive" of the Italian banking sector, and the likelihood of extraordinary government support in the future for Carige as "moderate." For that reason, we do not incorporate any notches for government support into the ICR.

According to our revised criteria regarding hybrid debt, we have not lowered our 'BB+' rating on Carige's junior subordinated debt (Upper Tier 2 notes). This reflects our view that activation of the principal write-down for an Upper Tier 2 note can occur only when the bank's capital has declined below the minimum defined by civil law, which is well below the minimum regulatory capital that would trigger the principal write-down for a hybrid Tier 1 note.

CreditWatch

We intend to resolve the CreditWatch after the CreditWatch on the Republic of Italy is resolved and when we will be able to assess the impact of our view of a possible worsening of Carige's SACP on the ratings on the bank. This is because of the indirect links we see between the creditworthiness of the Republic of Italy and the economic and industry conditions for banks operating in Italy, which can affect the anchor, and our assessments of business position, capital and earnings, risk position, and funding and liquidity.

We could affirm the ratings or lower them by not more than two notches, depending on the outcome of the sovereign rating action and our assessment of

Carige's SACP.

We could also lower the ratings on Carige if we perceive that the bank will not strengthen capital in line with our expectations.

Ratings Score Snapshot

Issuer Credit Rating	BBB/A-2
SACP	bbb
Anchor	bbb+
Business Position	Adequate (0)
Capital and Earnings	Moderate (-1)
Risk Position	Adequate (0)
Funding and Liquidity	Average and adequate (0)
Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

- 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
- Italy's Unsolicited 'A/A-1' Ratings Placed On CreditWatch Negative, Dec. 5, 2011
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Banca Carige SpA		
Counterparty Credit Rating	BBB/Watch Neg/A-2	BBB+/Negative/A-2
Certificate Of Deposit	BBB/Watch Neg/A-2	BBB+/A-2
Junior Subordinated (1 issue)	BB+/Watch Neg	BB+
Senior Unsecured (2 issues)	BBB/Watch Neg	BBB+
Subordinated (3 issues)	BBB-/Watch Neg	BBB

Additional Contact:

Financial Institutions Ratings Europe;FIG_Europe@standardandpoors.com

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