FITCH AFFIRMS MEDIOBANCA AT 'BBB'/STABLE

Fitch Ratings-Milan/London-09 March 2018: Fitch Ratings has affirmed Mediobanca S.p.A.'s Long-Term Issuer Default Rating (IDR) at 'BBB' and Viability Rating (VR) at 'bbb'. The Outlook on the Long-Term IDR is Stable. Fitch has also assigned Mediobanca's senior non-preferred notes issued under the bank's EUR40 billion euro medium-term note programme a 'BBB' long-term rating. A full list of ratings is at the end of this rating action commentary.

KEY RATING DRIVERS

VR, IDRs, DCR and SENIOR DEBT RATINGS

Mediobanca's IDRs and VR reflect the group's adequate capitalisation and leverage, which are commensurate with the bank's risk profile and are supported by sound internal capital generation. The ratings also reflect relatively strong asset quality by Italian bank standards, with a gross impaired loans ratio of about 5% at end-2017, which compares adequately with international peers.

Mediobanca's regulatory capital and Fitch Core Capital (FCC) ratios are adequate given risk concentration in the bank's equity and credit exposures, and its business mix, which includes some volatile activities. At end-2017, Mediobanca's phased-in common equity Tier 1 ratio was 12.9% (equivalent to a pro forma ratio of 14.3% once the benefits of the AIRB adoption are considered) and its FCC ratio 16.8%. Leverage is low by international standards. The group's impaired loans ratio and unreserved impaired loans in relation to FCC are much better than domestic averages.

Mediobanca benefits from a strong franchise in specialised businesses in Italy. This provides it with business and revenue diversification, which has resulted in growing revenue over the past four years. Mediobanca has maintained a strong franchise in Italian corporate and investment banking, and consumer finance over several business cycles. It has also diversified geographically in selected western and south-eastern European countries, where it has a direct branch presence.

The bank is developing its wealth management franchise in line with its stated strategic plans, including through acquisitions of alternative asset managers and in enlarging its distribution capabilities in this business. Further growth in the wealth management and consumer finance segments is moderately reshaping the bank's business mix as the size of its corporate and investment banking operations is stable.

Fitch believes the group's risk appetite remains conservative given the risks inherent to its businesses and is underpinned by coherent underwriting standards. Corporate and investment banking activities result in high single-name concentration but the bank maintains concentration limits on large credit exposures. Mediobanca continues to reduce its equity participations in line with its stated plans. Fitch expects the group's overall risk appetite and profile to remain broadly stable in the medium term.

Mediobanca's earnings and profitability are sensitive to economic and interest-rate cycles. Profitability is average compared with global standards. Our overall assessment of profitability also reflects the benefits that derive from diversified revenue streams by businesses. Proceeds from the bank's large equity stake in Italian insurer Assicurazioni Generali S.p.A. (A-/Stable) remain an important contributor to operating profit. Revenue growth in recent years has been driven by the bank's steadily growing consumer business and more recently by the expansion of its wealth management activities.

The business devotion to generate fees and the investments in enlarging wealth management activities should contribute further to the robustness of fee and commission income, and bring increased stability to its revenue. Lower loan impairment charges than domestic peers and a reasonably efficient cost structure complement Mediobanca's profitability profile.

Funding and liquidity at Mediobanca are generally stable. Funding has become more balanced by source in recent years and its historical bias towards wholesale and third-party retail bonds has reduced with wealth management activities and related customer deposits gaining more importance. The group mainly funds itself through bonds (institutional and retail) and retail deposits, which contributed an almost equal amount to total funding at end-2017. Wholesale bonds sold to institutional investors accounted for about 16% of total funding (as calculated by Fitch), as do bonds placed with retail investors.

Mediobanca's short-term liquidity profile is good and supported by good access to central bank facilities. The group's liquidity position has remained comfortable. The bank trimmed down its treasury portfolio in late 2017 by reducing its exposure to Italian sovereign debt and maturities for the next three years are manageable. Liquidity is underpinned by a large amount of unencumbered securities that can be easily repoed or used for central bank refinancing.

Mediobanca's DCR is at the same level as the Long-Term IDR because in Italy derivative counterparties have no preferential legal status over other senior obligations in a resolution.

Mediobanca's Short-Term IDR of 'F2', the higher of the two possible ratings for a 'BBB' Long-Term IDR under our criteria, reflects that the bank's short-term liquidity profile is supported by good access to central bank facilities given the ECB's accommodative policy.

The senior non-preferred notes are rated in line with Mediobanca's Long-Term IDR and existing senior debt rating. Fitch views the probability of default on the senior non-preferred notes as the same as the probability of default of the bank. The senior non-preferred notes are a new senior debt class under Italian law, introduced at end-2017 with Italy's 2018 Budget Law, which amended the ranking of banks' obligations in a liquidation procedure.

The senior non-preferred notes are subordinated to existing senior debt (which have become preferred senior obligations of the bank), but senior to subordinated debt. The new senior non-preferred notes can be bailed in before senior preferred debt in the event of resolution under the EU's Bank Recovery and Resolution Directive (BRRD).

The introduction of this new debt class does not affect the 'BBB' Long-Term senior debt rating. Fitch requires a high burden of proof under its criteria to notch senior debt up or down a bank's IDR based on recovery prospects, particularly at high rating levels. This is because the structure of a bank's balance sheet is likely to be very different at the point of failure and that default is unlikely to result in liquidation for systemically important banks. Fitch also believes the difference in default risk between the senior preferred and senior non-preferred debt will initially be very small until the bank has larger buffers of senior non-preferred and junior debt.

The ratings of the programme apply only to senior non preferred issuances issued by Mediobanca. There is no assurance that notes issued under the programme will be assigned a rating, or that the rating assigned to a specific issue under the programme will have the same rating as the programme.

The ratings of the senior debt issued by Mediobanca International (Luxemburg) SA are equalised with the parent's Long-Term IDR since the debt is unconditionally and irrevocably guaranteed by Mediobanca, and Fitch expects the parent to honour this guarantee.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)
Mediobanca's SR and SRF reflect Fitch's view that senior creditors cannot rely on receiving full extraordinary support from the sovereign in the event that the bank becomes non-viable. The BRRD and the Single Resolution Mechanism (SRM) for eurozone banks provide a framework for resolving banks that require senior creditors participating in losses, if necessary, instead of, or ahead of, a bank receiving sovereign support.

SUBORDINATED DEBT
Mediobanca's subordinated debt is rated one notch below its VR to reflect below-average recovery prospects for the notes.

RATING SENSITIVITIES
VR, IDRS, DCR AND SENIOR DEBT RATINGS
Mediobanca's ratings are primarily sensitive to the operating environment in Italy and to Italy's sovereign rating. Any upgrade of the ratings would first require an upgrade of Italy's sovereign rating.

Increased risk appetite, such as expanding higher-risk activities without an equivalent evolution of its risk controls framework, increasing concentration risk, or a less rigorous approach to pricing consumer finance risks or asset-quality deterioration could lead to a downgrade. Deterioration of group liquidity and funding could also result in a downgrade.

Fitch would downgrade the bank's Short-Term IDR if the Long-Term IDR is downgraded or if we perceive a weakening of its funding and liquidity profile.

Over time, a build-up of senior non-preferred notes in combination with Mediobanca's qualifying junior debt (QJD) could result in a level of protection for senior preferred notes warranting a long-term rating one notch higher than the bank's Long-Term IDR and senior non-preferred debt ratings. For the senior preferred notes to achieve one-notch uplift, the buffer of QJD and senior non-preferred debt would need to exceed our estimate of a "recapitalisation amount". This amount is likely to be around or above the bank's minimum pillar 1 total capital requirement. Fitch estimates that, at end-2017, Mediobanca's QJD buffer was equal to about 3.5% of risk-weighted assets (RWAs).

We would start to consider rating senior preferred debt one notch above senior non-preferred debt once the buffer of QJD and senior non-preferred debt reaches 8% of RWAs. However, any uplift above Italy's sovereign rating would only be possible were Fitch to conclude that the bank's Long-Term IDR would be rated above Italy if all of its QJD and senior non-preferred debt was in the form of FCC.

SUPPORT RATING AND SUPPORT RATING FLOOR
An upgrade of the SR and upward revision of the SRF would be contingent on a positive change in the sovereign's propensity to support the banks. In Fitch's view, this is highly unlikely.

A change in the sovereign's propensity to provide support to the banking sector in general would not necessarily mean that the propensity to provide support to Mediobanca increases to the same extent, because of its limited retail deposit franchise and lending market shares.

SUBORDINATED DEBT
The subordinated debt rating is primarily sensitive to the same factors that would affect the bank's VR. The rating is also sensitive to a change in notching if Fitch changes its assessment of loss severity or non-performance risk.

The rating actions are as follows:

Mediobanca S.p.A.
Long-Term IDR: affirmed at 'BBB'; Outlook Stable
Short-Term IDR: affirmed at 'F2'
Viability Rating: affirmed at 'bbb'
Support Rating; affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Derivative Counterparty Rating: affirmed at 'BBB(dcr)'
Senior unsecured debt: affirmed at 'BBB'/'F2'
Senior non-preferred long-term debt: 'BBB' assigned
Market-linked senior unsecured notes: affirmed at 'BBBemr'
Subordinated debt: affirmed at 'BBB-'

Mediobanca International (Luxemburg) SA
Senior unsecured debt: affirmed at 'BBB'/'F2'

The ratings of Mediobanca's senior non-preferred notes are assigned under the Exposure Draft: Bank Rating Criteria (see "Fitch Publishes Bank Rating Criteria Exposure Draft" dated 12 December 2017).

Contact:

Primary Analyst
Francesca Vasciminno
Senior Director
+39 02 879 087 225
Fitch Italia S.p.A.
Via Privata Maria Teresa, 8
20123 Milan

Secondary Analyst
Valeria Pasto
Associate Director
+39 02 879 087 298

Committee Chairperson
Patrick Rioual
Senior Director
+49 69 768 076 123

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Exposure Draft: Bank Rating Criteria (pub. 12 Dec 2017)
https://www.fitchratings.com/site/re/904081
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051