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### Research Update:

## Ratings On Eurofidi Scpa Affirmed At 'BBB/A-2' Despite Weaker Italian Banking Sector; Outlook Negative

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### Table Of Contents

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Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

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## Overview

- In our view, the domestic environment for Italian banks has worsened since July 2011 owing to weaker economic prospects and the higher cost of funding resulting from increasing yields on Italy's sovereign debt.
- As a result, we have revised down our Banking Industry Country Risk Assessment (BICRA) on the Republic of Italy to Group 3 from Group 2 on a scale of 1 to 10 (1 being the highest). A BICRA reflects our view of the strengths and weaknesses of a country's banking industry.
- We believe Eurofidi's extensive use of credit-risk mitigation instruments and low sensitivity to banking funding trends offset a potential increase in the bank's nonperforming guaranteed loans.
- We are therefore affirming the 'BBB/A-2' ratings on Eurofidi Scpa.
- The negative outlook reflects our opinion that there is material downside risk for our expectations about asset quality for Italian banks.

## Rating Action

On Oct. 18, 2011, Standard & Poor's Ratings Services affirmed its 'BBB' long-term counterparty credit rating on Italy-based Eurofidi Scpa. At the same time, we affirmed the 'A-2' short-term counterparty credit rating. The outlook is negative.

## Rationale

The affirmation reflects our opinion that the deteriorating operating environment we expect for the Italian banking sector will only modestly challenge Eurofidi's financial profile.

We expect Italian banks' profitability will remain constrained over the next two years, given the structural increase in the cost of funding, weaker capital markets, and reduced prospects for credit growth. In our opinion, the slowdown in domestic economic growth in 2012 could also impede the recovery in Eurofidi's asset quality more than we previously expected (see "Italian Banks Are Facing A Tricky Recovery," published April 14, 2011). That said, we expect nonperforming assets to remain below the peaks of 2009 and 2010.

We believe Eurofidi's business model is less sensitive than the commercial banks to our revised expectations for the Italian banking sector's profitability and funding profiles. We see the bank's moderate asset quality deterioration as offset by its extensive use of risk-mitigation instruments,

such as the Fondo Centrale di Garanzia provided by the Italian government.

We base our ratings on Eurofidi (an Italian mutual credit guarantee company or "confidi") on our assessment of the company's stand-alone credit profile (SACP), as well as on its opinion that there is a "moderately high" likelihood that the Italian Region of Piedmont (not rated) would provide timely and sufficient extraordinary support to Eurofidi if needed. Consequently, we factor one notch for extraordinary support into the long-term rating.

We consider Eurofidi to be a government-related entity (GRE). In accordance with our criteria for GREs, we base our view of a moderately high likelihood of extraordinary government support on our assessment of Eurofidi's:

- "Important" role in the Piedmont economy given that it implements regional economic plans and supports local small and midsize enterprises (SMEs); and
- "Strong" link with Piedmont, as its largest shareholder with an 18.5% stake. Piedmont is actively involved in Eurofidi's strategy and provides strong capital support.

Eurofidi's SACP reflects the company's business ties with the major Italian banks, good new business inflows, extensive use of credit risk mitigation instruments, and adequate capital position. The main offsetting factor is its deteriorating guarantee portfolio. This stems from prolonged difficult domestic economic conditions that particularly affect the SMEs to which Eurofidi offers loan guarantees. We anticipate a further deterioration in Eurofidi's guarantee quality, which raises the risk of higher losses in coming years, potentially eroding available reserves and the company's capital position.

## Outlook

The negative outlook incorporates the possibility that we could lower the ratings on Eurofidi in the event of any of the following:

- Material deterioration in guaranteed loans, which might lead to payment on "sofferenze" (defaulted loans) and provisions in line with the peak in 2009;
- A major slowdown in Eurofidi's new business inflow, which might diminish its capacity to pay outstanding and future sofferenze; and
- Any material and unexpected erosion in Eurofidi's capital.

In addition, any weakening in the link between Piedmont and Eurofidi could pressure the ratings.

We could revise the outlook on Eurofidi to stable if we saw that the company adequately weathered the worsened economic environment and ensuing deterioration in its guarantee portfolio. If it managed this, it would be able to limit the financial impact of likely higher guarantee losses by using risk-mitigation instruments and shareholder and regional contributions. Eurofidi would also be able to maintain an adequate capital base, in line with our expectations for the rating level.

## Related Criteria And Research

### Related criteria

- Bank Rating Analysis Methodology Profile, March 18, 2004
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

### Related research

- Italian Banks' Recovery Shifts Into Reverse As Italy's Sovereign Risk Escalates, Oct. 18, 2011
- Italy Unsolicited Ratings Lowered To 'A/A-1' On Weaker Growth Prospects, Uncertain Policy Environment; Outlook Negative, Sept. 19, 2011.

## Ratings List

Ratings Affirmed

Eurofidi Scpa

Counterparty Credit Rating

BBB/Negative/A-2

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