Financial Institutions Ratings

Intesa Sanpaolo S.p.A. – AT1 rating report

Security Ratings	
Outlook	Stable
7.7% USD 1.0bn perpetual AT 1 notes (September 2015) temporary write-down on 5.125% trigger	BB+
7% EUR 1.25bn perpetual AT 1 notes (January 2016) temporary write-down on 5.125% trigger	BB+

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This rating was not solicited by the issuer; the analysis is based solely on public information.

Rating rationale

We assign a rating of BB+, with a stable outlook, to Intesa 7.7% USD 1.0bn Additional Tier 1 notes issued in September 2015 and to the 7% EUR 1.25bn AT1 notes issued in February 2016. The ratings are based on the following considerations:

- Issuer Credit Strength Rating (ICSR): A-, stable outlook
- Minimum notches down from the ICSR: 4
- Additional notches: 0

Please refer to Scope's *Bank Capital Instruments Rating Methodology* published in July 2015 for more details about the minimum notching for AT1 securities.

The lack of additional notching for these securities reflects the following considerations:

1) Intesa has a very strong capital position, and on our estimates will have a buffer of over EUR22.4bn to the trigger at group level. Despite the notes carry a separate trigger on the parent company CET1 ratio, we deem it irrelevant given the parent company is very well capitalised.
2) We do not see a need to add further notches for coupon cancellation risks. The buffers to both the Pillar 1 CBR and the total SREP requirements are significant and we estimate that Intesa has ample distributable items, which should not represent a constraint to coupon payments.

ICSR

On October 20 Scope Ratings upgraded the Issuer Credit-Strength Rating (ICSR) of Intesa Sanpaolo SpA to A-, with a stable outlook. The rating upgrade reflects the bank's increased profitability, as well as expectations of an improvement in asset quality trends in the coming years on the back of a more favourable macroeconomic landscape, currently affecting the rating negatively. The short-term rating is S-2, with Stable Outlook.

The ratings are driven by Intesa's strong capital position and resilient profitability despite the challenging operating environment in Italy, where 80% of the loan portfolio is based. The group has been the leading retail and commercial bank in Italy since the merger of Intesa BCI and San Paolo IMI in 2007. Group earnings and asset quality have suffered from the weak domestic economic environment, but pre-provision profitability has been resilient and the group has remained profitable if we exclude large writedowns of goodwill in 2011 and 2013.

Although it has operations in Central and Eastern Europe (CEE), Intesa's primarily domestic-based operations combined with significant holdings in Italian sovereign debt, mean it is particularly exposed to market confidence in Italian banks and Italy in general.

Summary terms – 7.70% USD1bn, Sept. 2015

Issuer	Intesa Sanpaolo S.p.a.
Issue Date	17-Sept-15
Amount	USD1bn
Coupon	- 7.70% from 17/09/2015 to 17/09/2025, then 5y US Mid-Swap + 5.462% - Paid Semi-annually (March 17 and Sept. 17)
Format	- Non-Cumulative Temporary Write-Down Deeply Subordinated Fixed Rate Resettable Notes (Perpetual) - Redeemable at the option of the bank, subject to regulator consent, in case of change in capital treatment or tax treatment; - Redeemable at the sole option of the bank, subject to regulator consent, from first call date (17 Sept. 2025)
ISIN	US46115HAU14 / US46115HAV96 / IT0005136251 / IT0005136269
Capital Treatment	Additional Tier 1
Coupon cancellation features	- Fully discretionary; - Mandatory if (i) there are insufficient Distributable Items; (ii) a distribution would cause the Maximum Distributable Amount (issuer or group) to be exceeded
Principal Loss absorption features	-Temporary Write-down upon Trigger Event: reduce the current principal amount of each note by the relevant write-down amount (pro rata with other notes and equal Loss absorbing instruments). A write-up can occur at the Issuer discretion, subject to the MDA limit. - Permanent writedown or conversion to Equity at the PoNV
Triggers for Principal Loss absorption	- CRD4 transitional CET1 Ratio (Group) < 5.125% or - CRD4 transitional CET1 Ratio (Intesa Sanpaolo Spa) < 5.125%

Source: Prospectus. Scope Ratings

Summary terms – 7.0% EUR1.25bn, Jan. 2016

Issuer	Intesa Sanpaolo S.p.a.
Issue Date	19-Jan-16
Amount	EUR1.25bn
Coupon	- 7.0% from 19/01/2016 to 19/01/2021, then 5y Mid-Swap + 6.884% - Paid Semi-annually (Jan. 19 and July 19)
Format	- Non-Cumulative Temporary Write-Down Deeply Subordinated Fixed Rate Resettable Notes (Perpetual) - Redeemable at the option of the bank, subject to regulator consent, in case of regulatory event (change in classification) or change in tax treatment; - Redeemable at the sole option of the bank, subject to regulator consent, from first reset date (19 Jan. 2021)
ISIN	XS1346815787
Capital Treatment	Additional Tier 1
Coupon cancellation features	- Fully discretionary; - Mandatory if (i) there are insufficient Distributable Items**; (ii) a distribution would cause the Maximum Distributable Amount (issuer or group) to be exceeded
Principal Loss absorption features	- Temporary Write-down upon Trigger Event: reduce the current principal amount of each note by the relevant write-down amount (pro rata with other notes and equal Loss absorbing instruments). A write-up can occur at the Issuer discretion, after a positive net income is recorded, subject to the MDA limit. - Permanent writedown or conversion to Equity at the PoNV
Triggers for Principal Loss absorption	- CRD4 transitional CET1 Ratio (Group) < 5.125% or - CRD4 transitional CET1 Ratio (Intesa Sanpaolo Spa) < 5.125%

Source: Prospectus. Scope Ratings

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and are subject to distribution restrictions.

We see no need for further notching for coupon cancellation risk due to the comfortable distance to CBR and SREP requirements, the availability of sufficient available distributable items and the significant managerial flexibility to adjust dividend policy if needed.

Available Distributable Items

The concept of Available Distributable Items (ADI) is defined in the CRR (Art.4.1-128) as “the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution’s by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statuses of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts”.

In the AT1 offering document, the bank discloses ADI at around EUR 24bn, which is lower than Scope’s calculation of EUR 26bn. Our understanding is the bank must have made some more conservative assumptions with respect to some of the reserves. It is worth highlighting that our calculation excludes part of the share premium account (EUR 2.34bn) related to the merger reserve. For a more detailed calculation of Intesa’s ADI please refer to our recent research report *“Identifying and Calculating Available Distributable Items (ADI): The Example of Italian Banks”*

Combined Buffer Requirement

The CRD4-CRR restrictions on discretionary distributions are based on transitional CET1 requirements. At this time, we know that Intesa is subject to the 2.5% capital conservation buffer, which in Italy applies since 2014. Not being a G-SIB, the bank is not subject to a global systemic buffer requirement; however, given its systemic importance in Italy, it is identified as domestically systemically important in Italy. Bank of Italy has set the other systemically important institution (O-SII) buffer for Intesa at 0% as Intesa’s SREP capital requirement already includes a 1% charge for systemic risk. Currently, the countercyclical buffer rate for Italy is also set at 0%.

Moreover, Intesa has disclosed a SREP CET1 requirement of 9.5%. The EBA opinion, published on December 2015, has clarified that the combined buffer requirement sits on top of the Pillar 2 requirements. (see “*EBA Opinion 24/2015: Clarity added to the MDA debate”).*

Distance-to-CBR estimate	2016E	2017E	2018E	2019E
Minimum CET1 - Pillar 1	4.5%	4.5%	4.5%	4.5%
Pillar 2 Add-on	5.0%	5.0%	5.0%	5.0%
SREP total requirement (incl CCB)	9.5%	9.5%	9.5%	9.5%
Combined buffer requirement:				
- Capital conservation (already included in SREP requirement)	2.5%	2.5%	2.5%	2.5%
- Systemic [1]	0.0%	0.0%	0.0%	0.0%
- Countercyclical [2]	0.0%	0.0%	0.0%	0.0%
Required CET1 associated with distribution restrictions (SREP+CBR)	9.5%	9.5%	9.5%	9.5%
Intesa CET1 Ratio	13.0%	12.9%	12.7%	12.6%
Distance-to-CBR	3.5%	3.4%	3.2%	3.1%

Source: Scope Ratings

1) Intesa has been identified as systemically important in Italy with a buffer of 0%

2) A countercyclical buffer of up to 2.5% may apply in the future

Intesa’s solvency position is very strong: its CET1 ratio in December 2015 stood at 13%, giving Intesa a distance to CBR, including the Pillar 2 requirement, of 3.5% - which is high. While this distance is in our view set to decline over time, especially if new buffer requirements are announced, we note that management has significant flexibility to adjust if needed, as the current business plan includes a generous dividend policy, which are also factored in our estimates of capital buildup.

Key risk: principal loss absorption

We see no need for further notching for principal loss absorption risk due to the comfortable distance to triggers as well as the significant managerial flexibility to adjust dividend policy if needed.

The mechanism for loss absorption is temporary write-down. The securities have 5.125% CET1 triggers, where CET1 capital is based on transitional rules. The triggers apply both to Intesa Sanpaolo group and Intesa parent company. However, the parent company had a CET1 ratio of 20.8% at the end of 2014 and we believe the risk of the two reference entities having a material divergence in capital evolution is immaterial; as Intesa's operations are almost entirely based in the EU, the risk of regulatory ring-fencing of capital is very remote.

Distance to trigger

We forecast the distance to trigger for the Group to stand at 7.9% in 2015. Based on our estimates of capital formation at Intesa, this distance is set to decline slightly in percentage of RWAs. In Euro terms, the distance to trigger is very material at EUR 22.4bn, and will indeed grow over time thanks to the bank strong organic generation capital generation and despite generous dividend payments.

Distance-to-Trigger	2015	2016E	2017E	2018E	2019E
Trigger CET1 Transitional - Intesa Sanpaolo SPA SA	5.125%	5.125%	5.125%	5.125%	5.125%
Trigger CET1 Transitional - Intesa Group	5.125%	5.125%	5.125%	5.125%	5.125%
CET1 Ratio - Intesa Group	13.0%	13.0%	12.9%	12.7%	12.6%
CET1 Ratio - Intesa Sanpaolo SPA[1]	na	na	na	na	na
Distance-to-Trigger Intesa Sanpaolo SPA	na	na	na	na	na
Distance-to-Trigger Intesa Group	**7.9%**	**7.9%**	**7.7%**	**7.6%**	**7.4%**
Distance-to-Trigger Intesa Group, in Euros	**22,390**	**22,865**	**22,859**	**22,876**	**22,913**

Source: Scope Ratings Estimates, Intesa
1 Intesa Sanpaolo SPA CET1 ratio was 20.8% in 2014

Regulatory Disclosures

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund.

The rating analysis has been prepared by Marco Troiano, Director

Responsible for approving the rating: Sam Theodore, Managing Director

Date	Rating action	Rating
25.02.2016	First Assignment	BB+, Stable

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

Information on interests and conflicts of interest

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Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The methodologies applicable for this rating "Bank Rating Methodology" (May 2015) & "Forecasting Bank Financials Methodology" (March 2015) & "Bank Capital Instruments Rating Methodology" (July 2015) are available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's credit rating, definitions of rating symbols and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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