Ratings Assigned To Mediobanca's Italian Covered Bond Program And First Issuance

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OVERVIEW

We have assigned 'A' ratings to Mediobanca's inaugural up to €5 billion covered bond program and to its first issuance under the program.At the same time, we placed the ratings on CreditWatch negative to reflect the CreditWatch negative placement of Mediobanca's issuer credit rating.The first issuance is a €1.5 billion covered bond with a four-year soft-bullet maturity, extendible by two years.A pool of Italian residential mortgage loans originated by CheBanca! secures the covered bond.

LONDON (Standard & Poor's) Dec. 14, 2011--Standard & Poor's Ratings Services today assigned its 'A' credit ratings to Mediobanca SpA's (Mediobanca; A/Watch Neg/A-1) inaugural Italian covered bond issuance ("obbligazioni bancarie garantite"; OBG) out of its new covered bond program. At the same time, we placed our ratings on the covered bond issuance and on the program on CreditWatch negative (see list below).

The first issuance out of the up to €5 billion program is a €1.5 billion Italian legislation-enabled covered bond with a four-year soft-bullet maturity, extendible by two years. A pool of Italian residential mortgages originated by CheBanca! SpA (CheBanca!) secures the bond.

Standard & Poor's ratings address timely payment of interest and ultimate payment of principal on or before legal final maturity of the bond.

PROGRAM SUMMARY

Under the terms of the €5 billion program, Mediobanca can issue OBGs that are direct, unsubordinated, unsecured, and unconditional issuer obligations. A special-purpose entity (SPE)--Mediobanca Covered Bond S.r.l.--guarantees these issuances. The SPE is an Art. 7-bis SPE as defined under Italian Securitization Law. Its sole purpose is to purchase assets and grant a guarantee on the OBG issued by Mediobanca. If Mediobanca becomes insolvent, the SPE will continue to make payments on the OBG as they become due.

CheBanca! has sold to the guarantor through a true legal sale an initial cover pool of assets, which consists entirely of Italian residential mortgage loans originated by CheBanca!. A subordinated loan granted by CheBanca! funds the purchase of the initial assets. Hedging agreements between the SPE and Mediobanca cover mismatches between the payments received on the mortgage loans and payments due under the guarantee on the covered bonds.

By law, the assets transferred to the SPE are segregated in favor of the OBG holders, the hedging counterparties, and other related transaction counterparties of the SPE. The seller granting the loan to the SPE to finance the purchase of the assets is subordinated to the above-mentioned entities.

RATING RATIONALE

We have applied our five-step approach for rating covered bonds (see "Revised

Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009). We have reviewed asset and projected cash flow information as of Sept. 30, 2011. Under step 1 of our criteria, we have classified the asset-liability maturity mismatch (ALMM) risk as "high".

In this ALMM classification, according to our criteria we assume a constant prepayment rate (CPR) which is based on the characteristics of the underlying mortgage loans. In this analysis, we have assumed a weighted-average CPR of 3% for the pool, based on an assumed 5% CPR on variable-rate mortgages, and a lower assumed CPR of 2.5% on loans where the inflation rate caps the increase in monthly payments (see description below).

In our view, the likelihood that these loans would prepay is lower than for variable-rate mortgage loans. Depending on the inflation rate, an increase in the interest rate could reduce scheduled principal payments. We would modify our CPR assumption based on the current inflation environment, measured using an average of the previous actual and current year's forecasted Italian Consumer Price Index (CPI), provided by our economic research analysts. If the inflation rate increases above 4%, we would increase our CPR assumption to 5%, in line with the assumption used for variable-rate mortgages in the cover pool. If the inflation rate decreases to below 0.5%, we would apply a CPR assumption of 0.5% on the inflation-linked mortgage loans.

Furthermore, under step 2 of our criteria, we have assigned a program category of "2". Under step 3 of our criteria, this results in a maximum potential rating uplift of four notches above the issuer credit rating (ICR) on Mediobanca, or a maximum achievable rating of 'AA+'.

In step 4, we analyze cash flows to determine the periodic asset-liability mismatches of a program and then apply market value stresses to the collateral pool. Where a cash flow shortfall occurs in our stressed simulations, we assume that this would be covered by a stressed asset sale. If a program can liquidate enough assets to meet such mismatches, while leaving sufficient collateral to service the remaining debt, it can achieve its maximum potential rating.

Our cash flow modeling takes into account credit and other structural risks of the assets and program stucture. The assets in the initial cover pool comprise only Italian residential mortgage loans. We have applied the assumptions underlying our criteria relating to the credit analysis of Italian residential mortgage-backed securities (see "Criteria For Rating Italian Residential Mortgage-Backed Securities," published on July 16, 2002, and "Update To The Criteria For Rating Italian Residential Mortgage-Backed Securities, published on Jan. 6, 2009). Applying these criteria, we have calculated a weighted-average foreclosure frequency (WAFF) of 15.19%, and a weighted-average loss severity (WALS) of 6.52%.

A particular feature of the initial cover pool is the inclusion of 82% of Italian variable interest rate mortgage products where the inflation rate caps increases in monthly payments. The lender will recalculate on an annual basis the monthly installments to be paid by the borrower. If interest rates decrease, the installment amount remains unchanged and the proportion of each payment allocated to principal increases, with the loan amortizing ahead of schedule. If interest rates increase, the inflation rate caps the increase in the monthly payment. If the interest rate increase exceeds the inflation rate, the proportion of the monthly payment allocated to principal decreases, causing the loan to amortize over a longer period.

The lender will recalculate the projected loan amortization schedule at each recalculation of the monthly installment. The loan can be extended for a maximum of typically five or eight years, depending on the product. If, at the end of this extension period, the loan has not fully amortized, the borrower is not required to repay the remaining outstanding balance and the lender faces a loss on the product.

We have analyzed the detailed characteristics of the loans included in the initial cover pool, in order to assess the potential loss on these products resulting from a stressed evolution of interest rates and inflation. In our cash flow analysis we have applied our principles of credit ratings criteria to calculate an assumed haircut on the balance inflation-linked mortgages, based on the characteristics of each individual loan (see "Principles Of Credit Ratings," published on Feb. 16, 2011).

In our calculation of the assumed loss on each loan, we consider the current scheduled maturity of the mortgage loan. The closer a loan's amortization is to extending to the final maturity, the higher the risk of a loss on the loan. If the projected maturity date is within five years of the maximum extension date, we assume a 60% haircut on the current outstanding balance of the loan. If the projected maturity date is more than 10 years prior to the maximum extension date, we assume no haircut. If the projected maturity is between five and 10 years prior to the maximum extension date, we assume a haircut between 0% and 45%, depending on the three characteristics listed below:

The first characteristic we consider is the seasoning of the loan. The more seasoned the loan, the lesser the risk of a loss on the product. If the seasoning of a loan is greater than 10 years, we assume no haircut. If the seasoning of a loan is 10 years or less, we assume a haircut between 0% and 45%, depending on the interest rate used to calculate the last monthly installment, and the current inflation environment, as described below.The interest rate used to calculate the last monthly installment: The higher the interest rate used to calculate the last installment, the lower the risk of a further increase in rates further extending the loan's amortization schedule. If the interest rate used to calculate the monthly installment at the last recalculation date is above 6%, we assume no haircut. If this rate is less than 6%, we assume a haircut between 0% and 45%, depending on the current inflation environment.We measure the current inflation environment as described above. The
higher the current rate of inflation, the lesser the risk that an increase in rates would extend the amortization schedule. If the current inflation rate is above 4%, we assume no haircut. If the current inflation rate is below 0.5%, we assume a haircut of 30% on loans where the interest rate (as described above) is above 3%, and 45% on loans where the interest rate is less than 3%. If the current inflation rate is between 0.5% and 4%, we assume a haircut of 20% on loans where the interest rate (as described above) is above 3%, and 30% on loans where the interest rate is 3% or below. In our current analysis we have considered the inflation rate to be in this last bucket.

We used the characteristics listed above to calculate a haircut assumed on each individual loan. We then calculated a weighted-average haircut on the cover pool based on the current outstanding balance. In our analysis we have applied a haircut of 21.5% on the current outstanding balance of the proportion of inflation-linked mortgages in the cover pool that do not default in our stressed simulations. This haircut is an additional stress to the credit stresses described in our criteria relating to the credit analysis of Italian residential mortgage-backed securities (see "Criteria For Rating Italian Residential Mortgage-Backed Securities," published on July 16, 2002, and "Update To The Criteria For Rating Italian Residential Mortgage-Backed Securities," published on Jan. 6, 2009).

In step 5, we assign the rating to the covered bond program by assessing whether the available credit enhancement is equal to or greater than the target credit enhancement for the maximum potential rating given in step 3.

The rating on the issuer is the floor to the covered bond rating. To determine the degree to which a covered bond rating may exceed the ICR, we assign the first notch of uplift if the available credit enhancement covers all credit risks related to the default of the cover pool assets. For any further elevation to the maximum potential rating, the remaining credit enhancement should be able to cover the market value risk arising from ongoing asset-liability mismatch.

For the initial cover pool of approximately €1.7 billion of mortgage assets, and the initial issuance of €1.5 billion, the level of overcollateralization provided is 12.4%. This overcollateralization is below the level which would be commensurate with the first notch of uplift above the ICR. We note that the haircut applied in our analysis to inflation-linked mortgages (as described above) is an important factor in this result. The 'A' rating assigned to the covered bond is equal to the ICR on Mediobanca.

CREDITWATCH PLACEMENT

The CreditWatch negative placement of our 'A' rating on Mediobanca's covered bond program and inaugural issuance reflects the CreditWatch negative placement of Mediobanca's ICR on Dec. 7, 2011 (see "Research Update: Italy-Based Mediobanca's 'A/A-1' Ratings Placed On Watch Negative Following Sovereign Action," published on Dec. 7, 2011). This followed a similar rating action on the sovereign (see "Italy's Unsolicited 'A/A-1' Ratings Placed On CreditWatch Negative," published on Dec. 5, 2011).

As indicated in our Dec. 7 publication, if we lower the sovereign rating by one notch, we would lower Mediobanca's long-term rating by one notch. If we lower the sovereign rating by two notches, we would lower Mediobanca's long-term counterparty rating by two notches. If we affirm the sovereign rating, there is likely to be no change in the rating on the covered bond. As there is no potential uplift of the covered bond rating above Mediobanca's ICR, a rating action on Mediobanca would result in a similar action on the covered bond.

We intend to resolve the counterparty CreditWatch placement on Mediobanca within four weeks of any associated resolution of the CreditWatch on the Republic of Italy, and would expect to resolve the CreditWatch placement on the covered bond as soon as possible thereafter.