

PRESS RELEASE

NOVEMBER 14, 2022

DBRS Morningstar Confirms Banca Popolare di Sondrio at BBB (low), Stable Trend

BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) confirmed the ratings of Banca Popolare di Sondrio S.p.A. (BPS or the Bank), including the Long-Term Issuer Rating of BBB (low) and the Short-Term Issuer rating of R-2 (middle). The Bank's Deposit ratings were confirmed at BBB/R-2 (high), one notch above the IA, reflecting the legal framework in place in Italy, which has full depositor preference in bank insolvency and resolution proceedings. The trend on all ratings is Stable. DBRS Morningstar has also maintained the Intrinsic Assessment (IA) at BBB (low) and the Support Assessment at SA3. A full list of rating actions is included at the end of this press release.

KEY RATING CONSIDERATIONS

The confirmation of the ratings takes into account the Group's improved asset quality profile, evidenced by the lower stock of non-performing exposures (NPEs). We view that asset quality metrics are now more in line with domestic banks, although they remain higher than the European average. We also believe this provides more room to absorb the potential asset quality deterioration that might arise in the current environment. The confirmation also reflects our view that core profitability has improved overall, supported by sound operating efficiency and cost of risk normalisation. We expect profitability to benefit from higher net interest income resulting from rising interest rates, although inflation is likely to impact operating expenses as well as asset quality in the medium term.

The ratings incorporate the Bank's very modest national market position but solid franchise in the Lombardy region, especially in the province of Sondrio. BPS also has a long and proven earnings track record and a robust retail funding base. In addition, the ratings are underpinned by BPS's ample capital buffers above supervisory requirements.

RATING DRIVERS

An upgrade of the ratings would require further improvement in profitability metrics and continued improvement in asset quality while maintaining solid capital levels.

The ratings would be downgraded should the Bank's asset quality materially deteriorate. A sustained weakening of profitability metrics or capital could also lead to a downgrade.

RATING RATIONALE

Franchise Combined Building Block (BB) Assessment: Moderate

Established in 1871, Banca Popolare di Sondrio is a small to medium-sized bank based in Sondrio (Lombardy), with EUR 56.5 billion in total assets as of end- September 2022. The Bank's main activities include retail and commercial banking. The Bank has 3,440 employees and 371 branches, distributed across 8 Italian regions, primarily in Northern Italy. Outside Italy, BPS has a small

presence in retail and commercial banking in neighbouring Switzerland. BPS is the market leader for loans and deposits in the small province of Sondrio. However, the Bank's national market shares are more modest at around 2%. In addition, BPS has a leading market position in Italian public administration payment systems. BPS transformed from a cooperative bank into a joint-stock company at end-2021, as per the Italian law for the reform of the mutual banking sector.

Earnings Combined Building Block (BB) Assessment: Moderate

In DBRS Morningstar's view, profitability remains somewhat modest but has improved overall through a combination of the lower cost of risk and improving core revenues. Continued de-risking resulted in lower loan loss provisions on the income statement. Core revenues are starting to benefit from higher interest rates increasing net interest income, as well as stronger commissions brought by business diversification. We expect the Bank's NII to improve, given its high sensitivity to interest rate increases. The cost of risk should remain contained overall, as current default rates remain below the Bank's expectations, despite the current environment. However, we expect some negative impact from inflation and higher energy costs on operating expenses. BPS reported net attributable income of EUR 151.3 million in 9M 2022 compared to EUR 201.5 million in 9M 2021. This was mainly due to lower revenues from financial operations, affected by the current environment and higher operating expenses despite lower provisions. However, we note core revenues were up 16.1% YoY. The Bank's cost of risk remained stable YoY at 42 bps in 9M 2022.

Risk Combined Building Block (BB) Assessment: Moderate

In recent years, the Bank has made progress in reducing its NPEs, mostly through disposals and securitisations, but also organic workouts. This de-risking resulted in BPS's asset quality moving more in line with other Italian banks and providing a much better starting point for any potential deterioration the Bank might face in the current challenging environment. BPS's asset quality has continued to improve in 2021 and 9M 2022, following substantial NPL disposals in 2021. As a result, the total stock of gross non-performing exposures (NPEs) decreased to EUR 1.8 billion at end-September 2022, stable from end-2021 but down from EUR 2.3 billion at end-2020 and the gross NPE ratio improved to 5.2% from 5.8% at end-2021 and 7.5% at end-2020. The Group's total coverage ratio improved to 59.6% at end-September 2022 from 55.4% at end-2021, with total coverage of bad loans improving to 79.0% from 73.9% in the same periods.

Funding and Liquidity Combined Building Block (BB) Assessment: Good/Moderate

DBRS Morningstar views BPS's funding profile as solid, underpinned by its stable retail deposit franchise in its home market. At end-September 2022, customer deposits accounted for 71% of the bank's total funding; fairly stable since 2020. We also note that funding from central bank deposits remains elevated at 17%, due to TLTRO 3 funding which the Bank should start repaying in 2023. A key strength supporting the ratings is the Bank's solid liquidity position. BPS had EUR 5.8 billion of unencumbered securities, amply covering outstanding net short-term funding. Also, the Bank reported LCR and NSFR ratios well above the regulatory requirements at end-September 2022.

Capitalisation Combined Building Block (BB) Assessment: Good/Moderate

The Bank's capital ratios were further reinforced through issuances, which helped diversify the capital base and build-up the total loss absorption capacity. Furthermore, thanks to the de-risking process undertaken in previous years, we see BPS's capital as less pressured by the NPE stock, although we could expect some deterioration in coming quarters as a result of the current environment. The CET1 ratio (fully loaded) was 15.3% at end-September 2022 down from 15.7% at end-2021. The fully loaded total capital ratio stood at 17.9% at end-September 2022 compared to 18.8% at end-2021. We view positively that BPS maintains an ample buffer above its regulatory minimum capital requirements, including 679 bps above the CET1 and 449 bps over the Total Capital requirements.

Further details on the Scorecard Indicators and Building Block Assessments can be found at <https://www.dbrsmorningstar.com/research/405303>

There were no Environmental/ Social/ Governance factors that had a significant or relevant effect on the credit analysis

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings> (May 17, 2022).

Notes:

All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (June 23, 2022) <https://www.dbrsmorningstar.com/research/398692/global-methodology-for-rating-banks-and-banking-organisations>. In addition DBRS Morningstar uses the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings, <https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings> (May 17, 2022) in its consideration of ESG factors.

The sources of information used for this rating include Morningstar Inc. and Company Documents, BPS 9M 2022, H1 2022 and 2021 Press Releases, BPS H1 2022 Interim Report, BPS 2021 Annual Report and BPS H1 2022 and 2021 Pillar III Reports. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: <https://www.fca.org.uk/firms/credit-rating-agencies>.

The sensitivity analysis of the relevant key rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/405302>

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Initial Rating Date: November 18, 2019
Last Rating Date: November 15, 2021

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For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

Ratings

Banca Popolare di Sondrio S.p.A.

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
14-Nov-22	Long-Term Issuer Rating	Confirmed	BBB (low)	Stb	EU U
14-Nov-22	Short-Term Issuer Rating	Confirmed	R-2 (middle)	Stb	EU U
14-Nov-22	Long-Term Deposits	Confirmed	BBB	Stb	EU U
14-Nov-22	Long-Term Senior Debt	Confirmed	BBB (low)	Stb	EU U
14-Nov-22	Short-Term Debt	Confirmed	R-2 (middle)	Stb	EU U
14-Nov-22	Short-Term Deposits	Confirmed	R-2 (high)	Stb	EU U
14-Nov-22	Subordinated Debt	Confirmed	BB	Stb	EU U

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