

Credit Rating Announcement

08 April 2020

## Scope affirms issuer rating on Banca Popolare di Sondrio, outlook is changed to stable

**The change in the outlook reflects Scope's view that upside and downside risks to the BBB- rating are fairly balanced.**

The latest information on the rating, including rating reports and related methodologies, is available on this [LINK](#).

### Rating action

Scope affirms its BBB- issuer rating on Banca Popolare di Sondrio SCpA (BPS) and changes the outlook to stable from positive. The change in the outlook reflects Scope's view that upside and downside risks to the BBB- rating are fairly balanced.

### Rating rationale and rating change drivers

The sudden deterioration in the operating environment following the Covid 19 outbreak in Q1 2020 and the ensuing lockdown is likely to drive Italy into a recession, which could in turn put pressure on the bank's asset quality and profitability measures. Scope flags that a material worsening in BPS' operating performance in the medium term would be negative for the rating.

Among key positive rating change drivers, Scope flags the potential for a material acceleration in disposing of legacy non-performing loans. The derisking process of historical problem loans, which had already been accelerating in recent quarters, should continue in 2020 thanks to planned NPE sales, though we see increased risk of a timing slippage around these transactions as market appetite for NPE deals may be lower given the uncertain economic outlook.

The BBB- rating is based on BPS' focused franchise in the Italian region of Lombardy, one of the wealthiest areas in Europe. BPS is a medium-sized cooperative bank primarily operating in Milan and other provinces in Lombardy. The bank also has activities in Rome and a more marginal presence in several other northern Italian regions. BPS is the parent company of the BPS group, which includes a small bank in Switzerland (BPS Suisse), Banca della Nuova Terra and Factorit, a factoring joint venture with Banco BPM.

Like other Italian banks, BPS had seen a material deterioration in asset quality during the past decade, though ratios have improved. An acceleration of balance sheet derisking is planned for 2020, with the sale of EUR 1bn in NPLs planned for the first half of the year. This amount represents almost a quarter of the bank's total stock of NPEs. Once completed, such a sale would allow BPS to significantly reduce its NPE ratio, from the current 12.5% to c. 9.4%, partly addressing what Scope sees as a key weakness of the bank.

However, as Italy heads into a recession for 2020, downside risks to the group's asset quality have increased, despite official measures to support the real economy that will partly cushion the deterioration in borrowers' finances. We note that as part of the Italian government package to support credit flows, some business loans will be partly guaranteed, limiting the need for new provisions, at least in the short run.

The bank's capital ratios are strong, and have improved in 2019, also supported by the adoption of advanced internal-ratings-based models for credit risk. At the end of 2019, BPS reported a CET1 ratio of 15.7% and a total capital ratio of 18.6%. These levels are materially above the 2019 SREP requirements of 9.25% for CET1 and 12.75% for total capital. The ample headroom to requirements allows BPS strategic flexibility to further accelerate derisking if needed and to absorb higher loan loss provisions that may be needed in the current environment.

BPS' profitability is low but resilient, hovering around the mid-single-digit range. The bank maintained a solid earnings track record during the crisis and has displayed an ability to absorb bad-loan provisions through operating profitability.

Another key negative rating-change driver would be a rekindling of speculation about Italy's exit from the European Monetary Union. Such an event, which Scope sees as extremely unlikely, could result in a multiple-notch downgrade for BPS, as well as for other Italian banks.

### **Stress testing & cash flow analysis**

No stress testing was performed. No cash flow analysis was performed.

### **Methodology**

The methodology used for this rating(s) and/or rating outlook(s) (Bank Rating Methodology, published on 3 May 2019) is available on <https://www.scooperatings.com/#!/methodology/list>.

Information on the meaning of each rating category, including definitions of default and recoveries can be viewed in the "Rating Definitions - Credit Ratings and Ancillary Services" published on <https://www.scooperatings.com/#!/governance-and-policies/rating-scale>. Historical default rates of the entities rated by Scope Ratings can be viewed in the rating performance report on <https://www.scooperatings.com/#!/governance-and-policies/regulatory-ESMA>. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): <http://cerp.esma.europa.eu/cerp-web/statistics/defaults.xhtml>. A comprehensive clarification of Scope's definitions of default and rating notations can be found at <https://www.scooperatings.com/#!/governance-and-policies/rating-scale>. Guidance and information on how Environmental, Social or Governance factors (ESG factor) are incorporated into the rating can be found in the respective sections of the methodologies or guidance documents provided on <https://www.scooperatings.com/#!/methodology/list>.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

### **Solicitation, key sources and quality of information**

The rated entity and/or its agents participated in the rating process.

The following substantially material sources of information were used to prepare the credit rating: public domain, the rated entity and Scope internal sources.

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### **Regulatory disclosures**

This credit rating and/or rating outlook is issued by Scope Ratings GmbH, Lenéestraße 5, D-10785 Berlin, Tel +49 30 27891-0.

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The ratings/outlooks were first released by Scope on 10 September 2018. The ratings/outlooks were last updated on 20 November 2019.

### **Potential conflicts**

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Scope provided the following ancillary services to the rated entity and/or its agents within two years preceding this credit rating action: Credit Estimate.

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