

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

BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) confirmed the ratings of Banca Popolare di Sondrio S.C.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). This follows a full annual review of the Group's ratings. 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 the Bank's long-term and short-term ratings remains Negative. DBRS Morningstar has also maintained the Intrinsic Assessment (IA) of the Bank is BBB (low) and the Support Assessment is SA3. See a full list of ratings at the end of this press release.

KEY RATING CONSIDERATIONS

In maintaining the Negative trend, we incorporate the heightened risks and uncertainty to the Italian economy caused by the global pandemic (COVID-19) and its future implications for Italy's operating environment and our expectation that it will likely affect the Bank's revenues, cost of risk, and asset quality. In particular, we expect asset quality to deteriorate in 2021, following the end of moratoria. Downward rating pressure would intensify should the economic crisis be prolonged.

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), thanks to the securitisation of EUR 1 billion of NPLs in Q2 2020. The ratings also incorporate the Bank's small national position but solid franchise in the region of Lombardy, especially in the province of Sondrio, with a long and proven track record and its robust retail funding base. In addition, ratings are underpinned by BPS's ample capital buffers over the supervisory requirements. However, the ratings also take into account the Bank's modest, albeit resilient, profitability, the still high stock of NPEs compared to the European average and the challenges associated with the Bank's pending legal transformation into a joint-stock company by end-2021.

RATING DRIVERS

Any upgrade is unlikely in the short-term given the Negative trend. However, the trend on the Long-Term ratings could revert to Stable if the Bank were able to demonstrate limited earnings and asset quality impact from the global COVID-19 pandemic.

A downgrade would be driven by a significant deterioration of the Bank's profitability and asset quality. A material deterioration of capital buffers could also lead to a downgrade.

RATING RATIONALE

BPS is a medium-sized mutual bank (Banca Popolare) focused on retail and commercial banking. Based in Sondrio (Lombardy), the Bank had EUR 47.5 billion in total assets as of end-September 2020 and 366 branches, primarily in the North of Italy. Outside Italy, BPS has a small presence in retail and commercial banking in neighboring 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 Italy in the sector of payment systems with public administration and in the delivery of services for the internationalisation of enterprises. BPS' legal structure is expected to be transformed into a joint-stock company by end-2021 as per the Italian law for the reform of the mutual banking sector, which was confirmed by the Italian State Council and the European Court of Justice.

DBRS Morningstar sees the Bank's profitability as modest, due to ongoing revenue pressure and a high cost of risk, despite its good operating efficiency compared to its domestic peers. In 9M 2020, net attributable income was EUR 64.5 million, a decline of 47.7% year-on-year (YoY), mostly driven by lower results from financial operations on the back of challenging market conditions. NII was up by 6.4% YoY in 9M 2020, supported by growth of new lending as well as a reduction in funding costs which compensated for the negative impact of the ultra-low interest rate environment, whilst fees and commissions remained fairly stable YoY. Whilst operating expenses remained under control YoY thanks to the Bank's focus on cost control, the cost-income ratio deteriorated to 65.2% in 9M 2020 from 57.1% for the same period a year ago. Loan loss provisions (LLP) were up 3.4% in 9M 2020 YoY to EUR 133.9 million, absorbing 64.1% of Income before Provisions and Taxes (IBPT). The Bank's cost of risk stood at 59 bps in 9M 2020 as compared to 63 bps in 9M 2019, below most domestic peers. However, DBRS Morningstar views that the Bank will increase provisioning in relation with the COVID-19 crisis.

BPS holds a large albeit declining stock of NPEs. As a result, the total stock of NPEs decreased to EUR 2.8 billion at end-September 2020 from EUR 3.7 billion at end-2019 and the Gross NPE ratio decreased to 9.0% from 12.6% at end-2019. In addition, the Bank plans the completion of a new NPE transaction for EUR 400 million by the end of 2020. Nonetheless, we expect asset quality to deteriorate in 2021 due to the economic impact of the COVID-19 pandemic, although this could be partially mitigated by the Italian government and the European authorities' support measures.

The Bank has a solid funding and liquidity position, underpinned by its large and stable deposit retail franchise. At end-September 2019, total customer deposits accounted for 70% of the bank total funding compared to 80% at end-2019. This is due to the increase in central bank deposits, especially TLTRO III amid the COVID-19 crisis, which now account for about 20% of total funding. At end-June 2020, the Bank's liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) were well above regulatory requirements.

DBRS Morningstar views the Bank's capital remains pressured by the still large stock of unreserved NPEs but considers the Bank has sound cushions over minimum regulatory requirements. In September 2020, the CET1 ratio (fully loaded) was to 16.3% up from 15.7% at end-2019 and 11.9% at end-2018, as the Bank was authorised to use AIRB models for regulatory purposes since May 2019. Also, the Phased-in CET1 ratio was 16.3% and the phased-in total capital ratio stood at 18.7% at end-September 2020, which provide around 630 bps and 520 bps of cushions over the minimum requirements of 10.0% and 13.5%.

ESG CONSIDERATIONS

DBRS Morningstar views the Corporate/Transaction Governance ESG subfactor as material to the credit rating. It is included in the Governance category. BPS' legal structure is expected to change, as the Bank is required to transform by end-2021 into a joint-stock company as per the law on the Italian mutual banking sector from 2015.

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework and its methodologies can be found at: <https://www.dbrsmorningstar.com/research/357792>.

The Grid Summary Grades for BPS are as follows: Franchise Strength – Good/Moderate; Earnings – Moderate/Weak; Risk Profile – Weak; Funding/Liquidity – Good/Moderate; Capitalisation – Moderate.

Notes:

All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (8 June 2020) <https://www.dbrsmorningstar.com/research/362170/global-methodology-for-rating-banks-and-banking-organisations>.

For more information regarding rating methodologies and Coronavirus Disease (COVID-19), please see the following DBRS Morningstar press release: <https://www.dbrsmorningstar.com/research/357883>.

The sources of information used for this rating include Company Documents, BPS H1 2020 Interim Report, BPS 9M 2020 Press Release and S&P Global Market Intelligence. 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.

Generally, the conditions that lead to the assignment of a Negative or Positive trend are 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: <http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>.

The sensitivity analysis of the relevant key rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/370043>.

Ratings assigned by DBRS Ratings GmbH are subject to EU and U.S. regulations only.

Lead Analyst: Arnaud Journois, Vice President – Global Financial Institutions Group

Rating Committee Chair: Elisabeth Rudman - Managing Director, Head of European FIG - Global FIG

Initial Rating Date: November 18, 2019

Last Rating Date: April 2, 2020

DBRS Ratings GmbH

Neue Mainzer Straße 75

Tel. +49 (69) 8088 3500

60311 Frankfurt am Main Deutschland







Geschäftsführer: Detlef Scholz

Amtsgericht Frankfurt am Main, HRB 110259

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

Ratings

Banca Popolare di Sondrio S.C.p.A.

Date Issued	Debt Rated	Action	Rating	Trend	Issued
16-Nov-20	Long-Term Issuer Rating	Confirmed	BBB (low)	Neg	
16-Nov-20	Short-Term Issuer Rating	Confirmed	R-2 (middle)	Neg	
16-Nov-20	Long-Term Deposits	Confirmed	BBB	Neg	
16-Nov-20	Long-Term Senior Debt	Confirmed	BBB (low)	Neg	
16-Nov-20	Short-Term Debt	Confirmed	R-2 (middle)	Neg	
16-Nov-20	Short-Term Deposits	Confirmed	R-2 (high)	Neg	

ALL DBRS RATINGS ARE SUBJECT TO DISCLAIMERS AND CERTAIN LIMITATIONS. PLEASE READ THESE [DISCLAIMERS AND LIMITATIONS](#). ADDITIONAL INFORMATION REGARDING DBRS RATINGS, INCLUDING DEFINITIONS, POLICIES AND METHODOLOGIES, ARE AVAILABLE ON WWW.DBRS.COM.

Contacts

Arnaud Journois

Vice President - European Financial Institutions

+49 69 8088 3526

arnaud.journois@dbrsmorningstar.com

Elisabeth Rudman

Managing Director, Head of European FIG - Global FIG

+44 20 7855 6655

elisabeth.rudman@dbrsmorningstar.com

The DBRS group of companies consists of DBRS, Inc. (Delaware, U.S.)(NRSRO, DRO affiliate); DBRS Limited (Ontario, Canada)(DRO, NRSRO affiliate); DBRS Ratings GmbH (Frankfurt, Germany)(CRA, NRSRO affiliate, DRO affiliate); and DBRS Ratings Limited (England and Wales)(CRA, NRSRO affiliate, DRO affiliate). Morningstar Credit Ratings, LLC is a NRSRO affiliate of DBRS, Inc. For more information on regulatory registrations, recognitions and approvals of DBRS group of companies and Morningstar Credit Ratings, LLC, please see: <http://www.dbrsmorningstar.com/research/highlights.pdf>.

The DBRS group and Morningstar Credit Ratings, LLC are wholly-owned subsidiaries of Morningstar, Inc.© 2020 Morningstar. All Rights Reserved.

The information upon which DBRS ratings and other types of credit opinions and reports are based is obtained by DBRS from sources DBRS believes to be reliable. DBRS does not audit the information it receives in connection with the analytical process, and it does not and cannot independently verify that information in every instance. The extent of any factual investigation or independent verification depends on facts and circumstances. DBRS ratings, other types of credit opinions, reports and any other information provided by DBRS are provided "as is" and without representation or warranty of any kind. DBRS hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall DBRS or its directors, officers, employees, independent contractors, agents and representatives (collectively, DBRS Representatives) be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting therefrom, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of ratings and rating reports or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of DBRS or any DBRS Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. No DBRS entity is an investment advisor. DBRS does not provide investment, financial or other advice. Ratings, other types of credit opinions, other analysis and research issued or published by DBRS are, and must be construed solely as, statements of opinion and not statements of fact as to credit worthiness, investment, financial or other advice or recommendations to purchase, sell or hold any securities. A report with respect to a DBRS rating or other credit opinion is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. DBRS may receive compensation for its ratings and other credit opinions from, among others, issuers, insurers, guarantors and/or underwriters of debt securities. DBRS is not responsible for the content or operation of third party websites accessed through hypertext or other computer links and DBRS shall have no liability to any person or entity for the use of such third party websites. This publication may not be reproduced, retransmitted or distributed in any form without the prior written consent of DBRS. ALL DBRS RATINGS AND OTHER TYPES OF CREDIT OPINIONS ARE SUBJECT TO DISCLAIMERS AND CERTAIN LIMITATIONS. PLEASE READ THESE DISCLAIMERS AND LIMITATIONS AT <http://www.dbrsmorningstar.com/about/disclaimer>. ADDITIONAL INFORMATION REGARDING DBRS RATINGS AND OTHER TYPES OF CREDIT OPINIONS, INCLUDING DEFINITIONS, POLICIES AND METHODOLOGIES, ARE AVAILABLE ON <http://www.dbrsmorningstar.com>.