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CREDIT OPINION
28 October 2020

Update

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Banca Sella Holding S.p.A.

Update to credit analysis

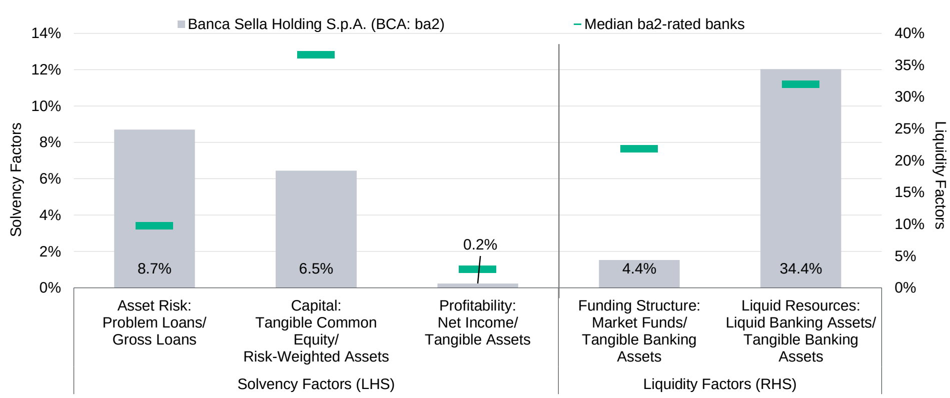
Summary

Banca Sella Holding S.p.A.'s (Banca Sella) Baa3 deposit rating is driven by the bank's ba2 standalone Baseline Credit Assessment (BCA) and very low loss given failure under our Loss Given Failure (LGF) analysis, which results in a two-notch uplift for its deposit ratings.

Banca Sella's BCA reflects the bank's still-large stock of non performing loans (NPL) compared to the European average NPL, its modest profitability, and its good liquidity and retail funding profiles.

The outlook on Banca Sella's long-term deposit rating is negative, reflecting our expectation that the bank's asset quality and profitability could be significantly affected by the economic recession.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

RATINGS

Banca Sella Holding S.p.A.

Domicile	Biella, Italy
Long Term CRR	Baa2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Withdrawn
Type	Senior Unsecured - Dom Curr
Outlook	Rating(s) WithDrawn
Long Term Deposit	Baa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Credit strengths

» Strong retail funding profile and a large stock of liquid assets

» Good regulatory capital buffer

Credit challenges

» High exposure to small and medium-sized enterprises (SMEs), which will be further affected by the increasing problem loans because of the economic recession

» High exposure to domestic government debt, which is affected by high volatility in prices

» Weak recurrent profitability

Outlook

The outlook on Banca Sella's long-term deposits ratings is negative.

This reflects the deteriorating operating environment in Italy because of the coronavirus pandemic and the associated downside risks to the bank's stand-alone credit profile, particularly the likely rise in problem loans to small and medium-sized companies, falling profitability and potentially declining capital.

Factors that could lead to an upgrade

An upgrade of Banca Sella's BCA is unlikely given the negative outlook.

However, the deposits ratings could be upgraded if the bank were to issue more bail-in-able debt.

Factors that could lead to a downgrade

A downgrade of Banca Sella's BCA and Adjusted BCA of ba2 would likely lead to a downgrade of all its ratings and assessments.

The BCA and Adjusted BCA could be downgraded in case of a material deterioration in the operating environment leading to a worsening of the bank's asset quality, capital, and profitability.

Key indicators

Exhibit 2

Banca Sella Holding S.p.A. (Consolidated Financials) [1]

	06-20[2]	12-19[2]	12-18[2]	12-17[2]	12-16[2]	CAGR/Avg.[3]
Total Assets (EUR Million)	16,948.6	15,004.1	14,283.4	13,797.1	13,298.4	7.2[4]
Total Assets (USD Million)	19,035.8	16,842.1	16,328.0	16,567.5	14,026.5	9.1[4]
Tangible Common Equity (EUR Million)	635.2	757.8	748.9	820.7	778.7	(5.7)[4]
Tangible Common Equity (USD Million)	713.4	850.6	856.1	985.5	821.3	(3.9)[4]
Problem Loans / Gross Loans (%)	7.0	6.9	9.2	11.8	14.0	9.8[5]
Tangible Common Equity / Risk Weighted Assets (%)	6.5	7.9	8.3	9.9	9.3	8.4[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	60.6	54.0	64.2	74.2	83.5	67.3[5]
Net Interest Margin (%)	1.6	1.7	1.7	1.7	1.9	1.7[5]
PPI / Average RWA (%)	1.5	1.3	1.2	1.9	1.5	1.5[6]
Net Income / Tangible Assets (%)	0.2	0.3	0.2	0.4	0.3	0.3[5]
Cost / Income Ratio (%)	80.0	82.4	83.3	74.9	78.4	79.8[5]
Market Funds / Tangible Banking Assets (%)	11.3	4.4	7.6	9.7	8.2	8.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	42.9	34.4	35.4	34.8	33.7	36.2[5]
Gross Loans / Due to Customers (%)	66.4	69.8	74.6	81.4	82.0	74.8[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Profile

Banca Sella Holding S.p.A. (Banca Sella) provides a broad range of financial services, including commercial banking, leasing, insurance, asset management, fund management, private banking, payment systems, brokerage and consumer finance through 24 subsidiaries.

The group reported total consolidated assets of €16.9 billion as of June 2020.

Banca Sella operates in Italy through a network of 300 branches, including its head office and the branches of its subsidiaries, Banca Sella S.p.A. (283) and Banca Patrimoni Sella & C. S.p.A. (16).

Banca Sella was set up in 1886 with the formation of Banca Gaudenzio Sella & Co., a limited partnership established by members of the Sella family. Its current name was adopted in March 2008. The group is almost fully owned by the Sella family.

Banca Sella also benefits from a significant market share in payment services in Italy, relative to its size.

Detailed credit considerations

Large stock of problem loans could increase because of the coronavirus pandemic

We view Banca Sella's asset risk as a key weakness, and we assign an Asset Risk score of b1, which is consistent with our expectation of a higher problem loan ratio than the current level of 7% as of June 2020. The bank targets a problem loan ratio of around 6% by year-end 2020, mainly because of some disposals. However, problem loans are likely to increase in 2021 because of the coronavirus pandemic, and also because recoveries on, and disposals of these loans, which were planned for 2021, might not be achieved.

Banca Sella's current problem loan ratio is slightly higher than the Italian banking system average ratio (6.1%[1]) but compares more negatively with the European average of 2.9% as of the same date[2].

Sella's loan book shows good diversification in terms of sectors, but it is highly concentrated in the SME segment. We consider SMEs to be more at risk in the current economic downturn. The bank's loan book included around 40% of SME exposures, close to two times the Italian banking average[3].

Weak capitalisation despite regulatory capital buffer

Banca Sella's capital is modest with a Common Equity Tier 1 (CET1) ratio at 11.6% as of June 2020 (on a phased-in and standardized approach). This compares unfavourably with the European Union (EU) average, 3.4 percentage points above according to the European Banking Authority.

Banca Sella's capital ratio will however benefit from the disposal of problem loans as well as partial sale of two subsidiaries announced on 22 September 2020 ("Fabrik" and "Hype") on top of regulatory measures yet to be booked. These include (i) a more favorable prudential treatment of investments in softwares and the adoption of internal ratings-based model for the computation of risk weighted assets (RWA) expected in 2021. However, we anticipate these potential gains on RWA to be mainly offset by the higher capital charge on credit risk in the current economic downturn and the phased-in application of the transitional regime for the first-time adoption of IFRS 9[4].

Moody's preferred measure of Banca Sella's Tangible Common Equity (TCE) / RWA is materially lower than the CET1 capital ratio and we assign a Capital score of b1. The TCE ratio was at 6.5% as of June 2020 given the bank's high exposure to Italian government bonds holdings[5], accounting for more than three times Banca Sella's equity.

Domestic government bond holdings reached €3.6 billion as of June 2020 from €2.9 billion in December 2019, representing 21% of the bank's total assets. Of these holdings, 70% are classified into the amortised cost IFRS 9 category (limiting the effect of prices variations on CET1 capital) and 30% of the total exposure has maturity of less than six months.

However, the bank's capital ratio remains well above the 7.28% CET1 prudential regulatory requirement for 2020. This included a 4.5% Pillar I requirement, a capital conservation buffer of 2.5% and a 0.28% Pillar II requirement based on the European Central Bank's Supervisory Review and Evaluation Process (SREP).

Weak profitability will suffer from lower interest incomes and increased cost of risks

We expect Banca Sella's already weak profitability to face further strain in the current lower interest rate environment and in view of higher cost of risk (at 87 bps as of June 2020 compared to 54 bps as of December 2019) because of bank's expected asset-quality deterioration. We assigned a Profitability score of b2, aligned with the initial Macro-Adjusted score.

The bank's return on assets was 0.2% in June 2020, with a still-high cost-to-income ratio (80%). The bank's reported net income of €20 million in the first half of 2020 is broadly in line with the €22 million reported a year earlier. Higher trading revenue partly offset the increase in administrative costs related to the bank's investment in Fabrick and loan-loss provisions.

Pending authorisation on the Fabrick/Illimity transaction would add a one-off gain worth €30 million in 2020 or 2021 depending on timing. Banca Sella also expects that Fabrick will generate lower losses in the next two or three years and some increase in dividends received from its equity shares received from Illimity.

Compared with banks of similar size, Banca Sella's revenue is well diversified because fees and commissions represented 50% of its revenue as of June 2020. Also, unlike many Italian banks, Banca Sella has fared relatively well during the great financial crisis, as reflected in the absence of losses during this period.

Strong retail funding profile and large stock of liquid assets

Funding is one of the strengths of Banca Sella. Our baa1 Funding Structure score, two notches below the initial Macro-Adjusted score, reflects the bank's strong retail deposit base and limited market access to medium-term funding programmes, wholesale bonds or securitisation.

As of June 2020, Banca Sella's wholesale funding represented a small part of its funding needs. The increase in market funding to 11% from 4% as of December 2019 was mainly driven by the increased use of the European Central Bank's targeted longer-term refinancing operations (TLTRO III) facility (€1.15 billion compared with €0.3 billion). We expect this funding structure to remain at least constant over the next two years.

So far, the bank has not publicly communicated its policy on Minimum Requirement for own funds and Eligible Liabilities (MREL), for which it is still awaiting confirmation from the Single Resolution Board.

The bank's Liquid Resources score is baa1, in line with the initial Macro-Adjusted score and also a key strength, reflecting a large stock of liquid assets (largely Italian government bonds with short maturities), which represented 43% of tangible banking assets as of June 2020. The bank's asset encumbrance represented 18% of its liquid assets as of the same date.

As of June 2020, the bank reported a liquidity coverage ratio (LCR) of 211% and a net stable funding ratio (NSFR) of 134%, which offer some buffer in case of temporary liquidity stress.

ESG considerations

In line with our general view for the banking sector, Banca Sella has low exposure to environmental risks and moderate exposure to social risks. See our environmental risk heat map for further information.

We regard the coronavirus pandemic as a social risk under our ESG framework, given the substantial implications for public health and safety.

Governance is highly relevant for Bank Sella, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for Banca Sella, we do not have any particular governance concern.

However, Banca Sella is almost entirely owned by the Sella family, which appoints all the board members. Although this setup could potentially affect the independence of risk management and controls, it is neutral for the bank's rating, taking into account the following mitigating factors: there is sufficient transparency of the ownership structure — the bank's holdings are incorporated in Italy as opposed to less-transparent jurisdictions; related-party exposures are limited and publicly disclosed according to international best practices; other non-banking businesses of the Sella family are nonmaterial, reducing the potential conflict of interests between the bank and other activities; and five of the 13 members on the board are independent members. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Loss Given Failure (LGF) analysis

Banca Sella is subject to the EU Bank Recovery and Resolution Directive, which we consider an operational resolution regime. Our analysis assumes residual TCE of 3%, post-failure losses of 8% of tangible banking assets, a 25% runoff in junior wholesale deposits, a 5% runoff in preferred deposits and 26% of junior deposits over total deposits. These are in line with our standard assumptions. Furthermore, we take into account the full depositor preference, whereby junior deposits are preferred over senior debt creditors in accordance with a law decree introducing full depositor preference in Italy starting from 2019.

Our LGF analysis indicates that Banca Sella's deposits are likely to face very low loss given failure, leading to an uplift of two notches above the Adjusted BCA. This is because of the loss absorption provided by the residual equity that we expect in resolution, subordinated debt and senior unsecured debt, and the volume of junior deposits, and it is supported by the combination of deposit volume and subordination.

Government support

There is a low likelihood of government support for Banca Sella's debt and rated wholesale deposits in the event of its failure, which results in no uplift. This probability reflects the bank's position in the Italian market, with Banca Sella being significantly smaller than the country's two largest banks.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit rating in that they consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquid facilities.

Banca Sella's CR Assessment is positioned at Baa2(cr)/P-2(cr)

The CR Assessment is positioned three notches above the bank's standalone BCA of ba2, based on the substantial buffer against default provided by substantial subordinated instruments to the senior obligations represented by the CR Assessment. The low probability of government support does not result in any further uplift.

Counterparty Risk Ratings (CRRs)

Our CRRs are opinions on the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event that such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivative transactions and the uncollateralised portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

Banca Sella's CRRs are positioned at Baa2/P-2

The long-term CRRs are positioned three notches above the bank's standalone BCA of ba2. The uplift derives from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. The low probability of government support does not result in any further uplift.

Rating methodology and scorecard factors

Exhibit 3

Banca Sella Holding S.p.A.

Macro Factors		
Weighted Macro Profile	**Moderate +**	**100%**

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	8.7%	b1	↔	b1	Expected trend	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	6.5%	b3	↑↑	b1	Expected trend	Risk-weighted capitalisation
Profitability						
Net Income / Tangible Assets	0.2%	b2	↔	b2	Expected trend	Return on assets
Combined Solvency Score		b2		b1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	4.4%	a2	↓↓	baa1	Expected trend	Extent of market funding reliance
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	34.4%	baa1	↔	baa1	Stock of liquid assets	Asset encumbrance
Combined Liquidity Score		a3		baa1		
Financial Profile				ba2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Baa3		
BCA Scorecard-indicated Outcome - Range				ba1 - ba3		
Assigned BCA				ba2		
Affiliate Support notching				0		
Adjusted BCA				ba2		

Balance Sheet	**in-scope (EUR Million)**	**% in-scope**	**at-failure (EUR Million)**	**% at-failure**
Other liabilities	3,420	20.4%	4,743	28.3%
Deposits	12,634	75.3%	11,346	67.6%
Preferred deposits	9,349	55.7%	8,882	52.9%
Junior deposits	3,285	19.6%	2,464	14.7%
Equity	503	3.0%	503	3.0%
Total Tangible Banking Assets	16,557	100.0%	16,783	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	18.8%	18.8%	18.8%	18.8%	3	3	3	3	0	baa2
Counterparty Risk Assessment	18.8%	18.8%	18.8%	18.8%	3	3	3	3	0	baa2 (cr)
Deposits	18.8%	4.1%	18.8%	4.1%	2	2	2	2	0	baa3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	baa2	0	Baa2	Baa2
Counterparty Risk Assessment	3	0	baa2 (cr)	0	Baa2(cr)	
Deposits	2	0	baa3	0	Baa3	Baa3

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
BANCA SELLA HOLDING S.P.A.	
Outlook	Negative
Counterparty Risk Rating	Baa2/P-2
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)

Source: Moody's Investors Service

Endnotes

1 Bank of Italy.

2 European Banking Authority, Risk Dashboard, Q2 2020.

3 European Banking Authority, The EU banking sector: First insights into the COVID-19 impacts.

4 Under the IFRS 9 accounting standard, which was effective from 1 January 2018, loan-loss provisioning requirements are based on expected losses rather than incurred losses, and must be recognised at an earlier stage. As with other accounting standard changes, banks had to absorb the costs related to the first-time adoption of IFRS 9 through equity rather than the income statement. Furthermore, under European law, banks were given the option of phasing in the effect on CET1 ratio until 2023.

5 See Moody's Adjustment to Increase the Risk Weightings of Sovereign Debt Securities in the Analysis of Banks: Frequently Asked Questions, published in September 2013.

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