MOODY'S INVESTORS SERVICE

CREDIT OPINION
16 December 2021

Update

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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Long Term Debt	Withdrawn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Outlook	Rating(s) WithDrawn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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Banca Sella Holding S.p.A.

Update to credit analysis

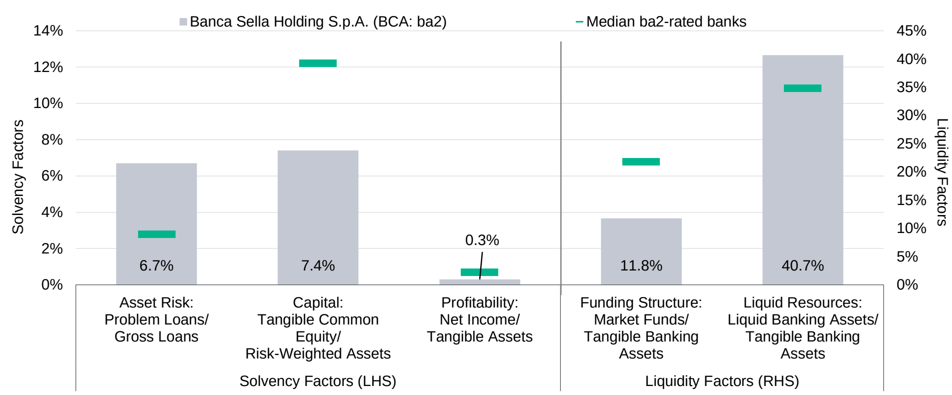
Summary

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

Sella's BCA reflects the bank's still-large stock of nonperforming loans (NPLs) and asset-quality pressure stemming from the deterioration in the operating environment in Italy. Sella's profitability and capitalisation are modest, whereas its liquidity is robust.

The outlook on Sella's long-term deposit ratings is negative, reflecting our expectation that the bank's asset quality and profitability could be significantly hurt by the coronavirus pandemic-induced economic crisis.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

Credit strengths

» Good regulatory capital buffer

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

Credit challenges

» High exposure to small and medium-sized enterprises (SMEs), which could result in additional problem loans after the loan moratoria have expired in December 2021

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

» Weak recurrent profitability

Outlook

The outlook on Sella's long-term deposit ratings is negative. This reflects the deteriorated operating environment in Italy because of the pandemic and the associated risks to the bank's standalone credit profile, particularly the likely rise in problem loans to SMEs, falling profitability and potentially declining capital over the next 12-18 months.

Factors that could lead to an upgrade

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

However, the deposit ratings could be upgraded if the bank were to issue more senior unsecured or subordinated debt, or both.

Factors that could lead to a downgrade

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

The BCA and Adjusted BCA could be downgraded if the operating environment were to deteriorate significantly, leading to a deterioration in the bank's asset quality, capital and profitability above our expectations.

Key indicators

Exhibit 2

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

	06-21[2]	12-20[2]	12-19[2]	12-18[2]	12-17[2]	CAGR/Avg.[3]
Total Assets (EUR Million)	20,144.5	17,846.1	15,004.1	14,283.4	13,797.1	11.4[4]
Total Assets (USD Million)	23,889.5	21,835.7	16,842.1	16,328.0	16,567.5	11.0[4]
Tangible Common Equity (EUR Million)	738.0	767.5	757.8	748.9	820.7	(3.0)[4]
Tangible Common Equity (USD Million)	875.2	939.1	850.6	856.1	985.5	(3.3)[4]
Problem Loans / Gross Loans (%)	5.2	5.7	6.9	9.2	11.8	7.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	7.4	8.0	7.9	8.3	9.9	8.3[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	47.7	47.5	54.0	64.2	74.2	57.5[5]
Net Interest Margin (%)	1.3	1.5	1.7	1.7	1.7	1.6[5]
PPI / Average RWA (%)	1.8	1.3	1.3	1.2	1.9	1.5[6]
Net Income / Tangible Assets (%)	0.6	0.2	0.3	0.2	0.4	0.4[5]
Cost / Income Ratio (%)	78.6	82.9	82.4	83.3	74.9	80.4[5]
Market Funds / Tangible Banking Assets (%)	15.5	11.8	4.4	7.6	9.7	9.8[5]
Liquid Banking Assets / Tangible Banking Assets (%)	44.6	40.7	34.4	35.4	34.8	38.0[5]
Gross Loans / Due to Customers (%)	65.6	65.4	69.8	74.6	81.4	71.4[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. (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 28 subsidiaries.

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

The group reported total consolidated assets of €20.1 billion as of June 2021.

Sella operates in Italy through a network of more than 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. (18).

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.

Detailed credit considerations

Large stock of problem loans

We assign an Asset Risk score of ba3, in line with the initial Macro-Adjusted score. This score reflects opposite trends. From one hand, Sella's NPL ratio was 5.2% as of June 2021, an improvement from 6.9% as of December 2019. On the other hand, we expect Sella to continue to dispose of a share of its problem loans. However, recoveries on, and disposal of these loans, which were planned for upcoming years, might not be fully achieved. Inflows of problem loans are likely to increase in 2022 and 2023. The expiry of pandemic-related repayment moratoria in December 2021 could lead to an uptick in NPLs. We expect the great majority of Sella's loans under moratoriums (13% of the loan portfolio as of December 2020) to expire by year-end 2021, in line with other Italian financial institutions. The new definition of default applied from January 2021 will also strain the NPL ratio in case of far-reaching implications of the pandemic.

Sella's problem loan ratio compares unfavourably with the Italian banking system average of 3.7% as of June 2021 and the European average of 2.3% over the same period[1].

The bank's loan book shows good diversification in terms of sectors, but it is highly concentrated in the SME segment, which is more at risk in the current economic environment. The bank's loan book included around 40% of SME exposures, more than twice the Italian banking system average (17% as of June 2021[2]).

Weak capitalisation despite increased regulatory capital buffer

Sella's Common Equity Tier 1 (CET1) capital ratio of 12.3% as of June 2021 (phased-in and based on the Basel 3 standardised approach). This compares unfavourably with the European Union (EU) average, which is 3.5 percentage points higher according to the European Banking Authority as of June 2021[3].

However, Sella's capital ratio benefited from the disposal of problem loans and the partial sale of one subsidiary (Hype) announced on 22 September 2020. Like many other banks, Sella took advantage of the “Quick fix” Capital Requirements Regulations (CRR2) amendments published in June 2020[4], which improved its CET1 ratio. The lower capital charge on some IT software and on SME loans were, to a lesser degree, the main sources of gains.

Sella also expects to adopt in the third quarter of 2022 an internal ratings-based model for the computation of risk-weighted assets (RWA), which will improve its regulatory capital ratio. We expect the bank to use this benefit for business development. Higher capital charge on credit risk related to the economic effects of the pandemic will also dent these potential gains on RWA.

Sella's tangible common equity (TCE)/RWA, our preferred measure of capital, is significantly lower than the CET1 ratio, and we assign a Capital score of b1. The TCE ratio was 7.4% as of June 2021 (slightly lower than 8% as of year-end 2020), given the bank's high exposure to Italian government bond holdings[5], which accounted for more than 2x Sella's equity.

Domestic government bond holdings remained roughly stable at €3.6 billion as of June 2021 with respect to December 2020, thanks to its market maker activity now close to pre-pandemic levels. These holdings represented 14% of the bank's total assets, in line with the domestic sovereign debt average of Italian banks' total assets as of June 2021. Sella's higher relative exposure is mainly driven by the excess of deposits over loans. As of December 2020, of these government debt holdings, 30% of the total government exposure had a maturity of less than six months, in line with Sella's market-making activities of these instruments. We consider Sella's government debt holdings' average maturity exposure in June 2021 to draw near the December 2020 value.

However, the bank's capital ratio remains well above the 7.28% CET1 prudential regulatory requirement set by the Bank of Italy. 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 Supervisory Review and Evaluation Process (SREP). The bank has no Pillar II guidance.

Weak profitability will continue to be strained because of low interest rates and high cost of risk

We assigned a Profitability score of b2, one notch below the initial Macro-Adjusted score. We expect Sella's already-weak profitability to be strained further in the current low interest rate environment and in view of high cost of risk because of the pandemic-induced crisis. Despite the bank's cost of risk standing at 39 basis points (bps) as of June 2021 compared with 72 bps as of December 2020, we anticipate an on-going inflows of problem loans and NPLs disposals to require continuous significant provisioning.

Our adjusted return on assets for Sella was 0.6% in June 2021, with a still-high cost-to-income ratio of 79%. The bank reported a net income of €104 million for the first half of 2021, more than 5x higher than the €20 million reported in June 2020. This improvement was mainly the result of a €57.4 million profit as a result of the disposal of the 50% share capital in Hype as part of the efforts to create a joint venture with Fabrick and illimity Bank S.p.A (illimity). Sella expects this partial sale to result in lower losses in the next two or three years and some increase in dividends received from its equity shares in illimity. As of June 2021, Sella made a €3.4 million gain on the joint-venture with illimity. Sella received illimity's equity shares as the main part of the settlement of this transaction.

The bank's performance also improved because of a 15.2% rise in net fees and income thanks to increased business activity ranging from traditional banking to Corporate and Investment Banking (CIB) growth and electronic payments systems, and a more than 2x rise in income from NPL disposal.

Operating costs increased by 10% in June 2021, from a year earlier. According to the bank, this rise took account of evolving needs underpinned by the business plan and some investments in expanding smartworking practices, as well as its COVID-related health measures.

Compared with banks of similar size, Sella's revenue is well diversified; fee and commission income represented around 50% of its revenue as of December 2020, and increased to €174 million in June 2021 from €151 million a year earlier.

Strong retail funding profile and large stock of liquid assets

Funding is one of the strengths of Sella with a loan-to-deposit ratio of 65.6% as of June 2021. The baa1 Funding Structure score, in line with the initial Macro-Adjusted score, reflects the bank's strong retail deposit base as well as its constant excess of liquidity, which has so far limited its market access to medium-term funding programmes, wholesale bonds or securitisation.

As of June 2021, Sella's wholesale funding represented a small part of its funding needs. The increase in market funding to 15% 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. As of June 2021, the bank had €1.9 billion in ECB TLTRO III funding. We expect this funding structure to remain at least constant over the next two years. Sella had redeposited at the ECB all the TLTRO borrowed funds.

So far, the bank has not publicly communicated its policy on the Minimum Requirement for own funds and Eligible Liabilities (MREL).

The bank's Liquid Resources score is baa1, one notch below the initial Macro-Adjusted score, and also a key strength. Sella's liquidity benefits from a large stock of short-dated Italian government bonds, which represented 41% of tangible banking assets as of December 2020. The structural excess liquidity is mainly invested in highly liquid domestic sovereign debt. The bank's asset encumbrance represented 21% of its liquid assets as of the same date. There were no major changes in liquid assets stock as of June 2021.

As of June 2021, the bank reported a liquidity coverage ratio of 210% and a net stable funding ratio of 134%.

ESG considerations

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

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

Governance is highly relevant for 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 Sella, we do not have any particular governance concern.

However, Sella is almost entirely owned by the Sella family, which appoints all the board members. Although this setup could potentially affect the independence of management, 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 (See New "fit and proper" board criteria will reinforce Italian bank governance). Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Loss Given Failure (LGF) analysis

Sella is subject to the EU Bank Recovery and Resolution Directive, which is 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 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, the subordinated and senior unsecured debt and the volume of junior deposits.

Government support

There is a low likelihood of government support for 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 Sella being significantly smaller than the country's two largest banks.

Counterparty Risk (CR) Assessment

The CR Assessment of Baa2 is positioned three notches above the bank's standalone BCA, 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)

The long-term CRRs of Baa2 are positioned three notches above the bank's standalone BCA. 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		6.7%	ba3	↔	ba3	Expected trend	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)		7.4%	b2	↔	b1	Expected trend	Risk-weighted capitalisation
Profitability							
Net Income / Tangible Assets		0.3%	b1	↔	b2	Expected trend	Return on assets
Combined Solvency Score			b1		b1		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		11.8%	baa1	↔	baa1	Expected trend	Extent of market funding reliance
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		40.7%	a3	↔	baa1	Stock of liquid assets	Asset encumbrance
Combined Liquidity Score			baa1		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	4,630	23.2%	6,111	30.6%
Deposits	14,523	72.7%	13,042	65.3%
Preferred deposits	10,747	53.8%	10,210	51.1%
Junior deposits	3,776	18.9%	2,832	14.2%
Senior unsecured bank debt	2	0.0%	2	0.0%
Dated subordinated bank debt	216	1.1%	216	1.1%
Equity	599	3.0%	599	3.0%
Total Tangible Banking Assets	19,970	100.0%	19,970	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	18.3%	18.3%	18.3%	18.3%	3	3	3	3	0	baa2
Counterparty Risk Assessment	18.3%	18.3%	18.3%	18.3%	3	3	3	3	0	baa2 (cr)
Deposits	18.3%	4.1%	18.3%	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 European Banking Authority, Risk Dashboard, Q2 2021.

2 European Banking Authority, Risk Dashboard, Q2 2021.

3 European Banking Authority, Risk Dashboard, Q2 2021.

4 See EU solvency rule amendments will improve banks' capital ratios and support economy, June 2021.

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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