MOODY'S INVESTORS SERVICE

CREDIT OPINION
6 April 2020

Update

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RATINGS

Banca Sella Holding S.p.A.

Domicile	Italy
Long Term CRR	Baa2 , Possible Downgrade
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Long Term Debt	Withdrawn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Outlook	Rating(s) WithDrawn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 , Possible Downgrade
Type	LT Bank Deposits - Fgn Curr
Outlook	Rating(s) Under Review

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.

Contacts

Gaia Di Piero +44.207.772.1766
Associate Analyst
gaia.dipiero@moodys.com

Alain Laurin +33.1.5330.1059
Associate Managing Director
alain.laurin@moodys.com

Nick Hill +33.1.5330.1029
MD-Banking
nick.hill@moodys.com

Banca Sella Holding S.p.A.

Update to credit analysis

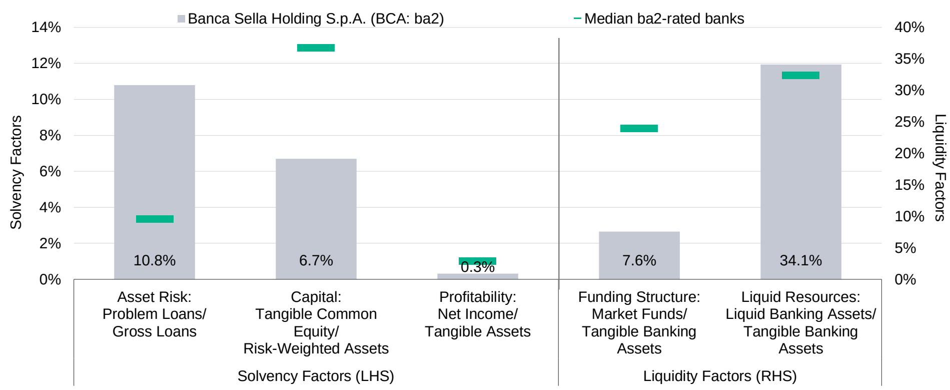
Summary

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 rating.

Banca Sella's BCA reflects the bank's still-large stock of problem loans in the European context, its modest profitability, and its strong liquidity and retail funding profiles.

All ratings and assessments are under review for downgrade to reflect the high likelihood of increased risks following the coronavirus outbreak, which will have far-reaching implications for the Italian economy.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

Credit strengths

» Strong retail funding profile and large stock of liquid assets

» Satisfactory regulatory capital buffer

Credit challenges

» Large stock of problem loans

» High exposure to small and medium-sized enterprises (SMEs) especially at risk because of the coronavirus outbreak

» Weak profitability

Outlook

Banca Sella's rating and assessment are under review for downgrade to reflect the high likelihood of increased risks following the sharp decrease in activity which aims to restrict social interaction and slow down the spread of the coronavirus outbreak. We expect a deterioration in the operating environment, a rise in problem loans, declining capital and falling profitability. Banca Sella's high exposure to SMEs is likely to weaken its creditworthiness.

During the review period, we will seek more clarity on the impact of the coronavirus outbreak on Banca Sella's financial profile. The review will address the following issues: (1) the increasing risk of default in the SME loan book, (2) the impact of the six-month bank loan moratoria for SMEs introduced by Italian government on 17 March 2020 (in the so-called law decree “Decreto Cura Italia”) on the bank's profitability, and (3) potential tensions on bank's liquidity.

Factors that could lead to an upgrade

There is no upward rating pressure as of now, reflected by the review for downgrade. However, if, upon the conclusion of the review, we concluded that Banca Sella's creditworthiness were to remain broadly unchanged, its ratings and assessments could be confirmed.

Factors that could lead to a downgrade

Banca Sella’s BCA could be downgraded if it were to incur a material increase in the stock of problem loans or a reduced capital in the near future.

The deposit rating could be downgraded following a downgrade of the bank's BCA, a reduction in subordinated debt or a reduction in the stock of junior deposits, increasing deposits' loss given failure.

Alternatively the review could be closed and the bank's deposit outlook could be changed to negative if the impact of the coronavirus outbreak were to be materially softer than currently anticipated and would materialize over a longer term horizon i.e. in 2021.

Key indicators

Exhibit 2
Banca Sella Holding S.p.A. (Consolidated Financials) [1]

	06-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (EUR Million)	15,081.9	14,280.3	13,797.1	13,298.4	12,450.9	5.6[4]
Total Assets (USD Million)	17,175.2	16,324.5	16,567.5	14,026.5	13,525.3	7.1[4]
Tangible Common Equity (EUR Million)	625.4	747.6	820.7	778.7	699.9	(3.2)[4]
Tangible Common Equity (USD Million)	712.2	854.7	985.5	821.3	760.3	(1.9)[4]
Problem Loans / Gross Loans (%)	8.2	9.2	11.8	14.0	14.3	11.5[5]
Tangible Common Equity / Risk Weighted Assets (%)	6.7	8.2	9.9	9.3	8.1	8.5[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	67.4	64.2	74.2	83.5	92.8	76.4[5]
Net Interest Margin (%)	1.8	1.7	1.7	1.9	1.9	1.8[5]
PPI / Average RWA (%)	1.5	1.2	1.9	1.5	1.9	1.6[6]
Net Income / Tangible Assets (%)	0.3	0.2	0.4	0.3	0.2	0.3[5]
Cost / Income Ratio (%)	80.3	83.5	74.9	78.4	73.0	78.0[5]
Market Funds / Tangible Banking Assets (%)	7.9	7.6	9.7	8.2	10.5	8.8[5]
Liquid Banking Assets / Tangible Banking Assets (%)	37.2	34.1	34.8	33.7	27.8	33.5[5]
Gross Loans / Due to Customers (%)	71.7	74.7	81.4	82.0	92.9	80.5[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 due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel III periods presented.
Source: Moody's Investors Service; Company Filings

Profile

Banca Sella Holding S.p.A. (Banca Sella) provides a 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 €15 billion as of June 2019.

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. It acquired its current name in March 2008. The group is almost fully owned by the Sella family.

Detailed credit considerations

Large stock of problem loans could increase with the coronavirus outbreak

We view Banca Sella's Asset Risk as a key weakness, and we score it b2, which is consistent with an anticipated higher problem loan[1] ratio above its current level of 8.2% as of June 2019.

Banca Sella's current problem loan ratio is in line with the average Italian banking system NPL ratio, but compares negatively with the European average of 2.9%.[2]It is likely to increase in 2020 because of the unfolding of the coronavirus crisis and also because recoveries on, and disposals of NPL which were planned for 2020 might not be achieved.

Weak capitalisation despite regulatory capital buffer

We consider Banca Sella's capital buffer limited, taking into account the bank's risk profile and its Common Equity Tier 1 (CET1) capital ratio as of December 2019 namely 11.4% (phased-in) and 10.9% (on a fully loaded basis) compared to 11.3% (phased-in) and 10.7% (on a fully loaded basis) as of December 2018. Banca Sella opted for the transitional regime for the first-time adoption of IFRS 9.[3]

The bank's CET1 ratio remains well above the 7.28% CET1 prudential regulatory requirement for 2020 (made of 4.5% Pillar I requirement, capital conservation buffer of 2.5% and 0.28% Pillar II based on the European Central Bank's Supervisory Review and Evaluation Process (SREP). However, compared with its European Union (EU) peers, Banca Sella's CET1 ratio is low.

We assign a Capital score of b1, two notches above the initial macro-adjusted score to reflect some benefits stemming from the expected adoption of the internal rating based models for the computation of risk-weighted assets (RWA) in 2021. However, our tangible common equity (TCE) ratio was 6.7% as of June 2019, compared with 8.2% as of December 2018. This decline was mainly driven by a higher exposure to the Italian sovereign bonds, which reached €2.8 billion at December 2019 from €2 billion one year earlier, which represents 19% of the bank's total assets. The exposure to the Italian government consist of securities with short maturity (up to 1 year), which account for almost 50% of the entire Italian sovereign bonds portfolio.

The difference between CET1 and our TCE capital ratios is primarily driven by our adjustment to the risk weight applied to the bank's exposures to the Italian government (50% versus 0% in bank's calculations). [4]

Weak profitability will suffer from deteriorating environment

We expect Italian Banca Sella's already weak profitability to face further strain as lending volumes decline and because the cost of risk stemming from the expected asset-quality deterioration will increase. Our profitability score is b1, aligned with the initial macro-adjusted score. The provisions to cover problem loans seem limited (under 50%) in a such adverse economic environment and could hit the bank's profitability if the cost of credit risk were to increase significantly.

The bank's return on assets was 0.3% in June 2019, maintaining a high cost-to-income ratio (80.3%). The bank's reported net income was €34 million as of year-end 2019 compared with €24 million a year earlier, mainly as a result of higher fees and commissions and trading profits. Compared with banks of similar size, Banca Sella's revenue is well diversified because fees and commissions represented more than 50% of its net profit as of year-end 2019. Also, unlike many Italian banks, Banca Sella has relatively fared 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

The baa1 Funding Structure score, one notch below the initial macro-adjusted score, reflects the bank's limited market access to medium-term funding programmes, wholesale bonds or securitisation.

As of December 2019, Banca Sella's wholesale funding represented less than 5% of the bank's tangible banking assets, which mainly consists of the funding provided by the European Central Bank's TLTRO III facility (€300 million). The liquidity coverage ratio of 191% and the net stable funding ratio of 137% offer some buffer in case of temporary liquidity stress.

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

The bank's Liquid Resources score is baa2, one notch below 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 represent 37% of tangible banking assets as of June 2019 with an asset encumbrance of 6% at the same date.

Environmental, social and governance 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 heat map for further information.

We regard the coronavirus outbreak 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 company'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: (1) there is sufficient transparency of the ownership structure — the bank's holdings are incorporated in Italy as opposed to less-transparent jurisdictions; (2) related-party exposures are limited and publicly disclosed according to international best practices; and (3) other non-banking businesses of the Sella family are non- material, reducing the potential conflict of interests between the bank and other activities. 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% and 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. We do not believe Banca Sella to be sufficiently systemically important to justify any government uplift to its rating.

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 (1) 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 (2) 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	10.8%	b2	←→	b2	Expected trend	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	6.7%	b3	←→	b1	Expected trend	
Profitability						
Net Income / Tangible Assets	0.3%	b1	←→	b1	Expected trend	
Combined Solvency Score		b2		b1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	7.6%	a3	←→	baa1	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	34.1%	baa1	←→	baa2	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	2,231	14.9%	3,450	23.1%
Deposits	11,952	80.0%	10,733	71.9%
Preferred deposits	8,845	59.2%	8,402	56.3%
Junior deposits	3,108	20.8%	2,331	15.6%
Equity	448	3.0%	448	3.0%
Total Tangible Banking Assets	14,631	100.0%	14,933	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	20.6%	20.6%	20.6%	20.6%	3	3	3	3	0	baa2
Counterparty Risk Assessment	20.6%	20.6%	20.6%	20.6%	3	3	3	3	0	baa2 (cr)
Deposits	20.6%	4.9%	20.6%	5.0%	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 RUR Possible Downgrade	Baa2 RUR Possible Downgrade
Counterparty Risk Assessment	3	0	baa2 (cr)	0	Baa2(cr) RUR Possible Downgrade	
Deposits	2	0	baa3	0	Baa3 RUR Possible Downgrade	Baa3 RUR Possible Downgrade

[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	Rating(s) Under Review
Counterparty Risk Rating	Baa2/P-2[1]
Bank Deposits	Baa3/P-3[1]
Baseline Credit Assessment	ba2[2]
Adjusted Baseline Credit Assessment	ba2[2]
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)[1]

[1] Rating(s) within this class was/were placed on review on March 26 2020 [2] Placed under review for possible downgrade on March 26 2020
Source: Moody's Investors Service

Endnotes

1 Problem loans are the sum of three categories (from worst to best): (1) bad loans (in Italian, sofferenze); (2) unlikely to pay (inadempienze probabili); and (3) past due — by more than 90 days (esposizioni scadute e/o sconfinanti). For further details, please refer to our Sector In-Depth titled Italian Banks Implement New Problem Loan Definition; Our View on Asset Risk Is Unchanged, published in October 2015.

2 Source: European Banking Authority, Risk Dashboard Q3/2019.

3 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 impact on CET1 ratio until 2023.

4 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.

REPORT NUMBER 1220604

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