

RATING ACTION COMMENTARY

Fitch Affirms 5 Mid-Sized Italian Banks' OBG Programmes; Outlooks Stable

Fri 26 Feb, 2021 - 3:29 AM ET

Fitch Ratings - Milan - 26 Feb 2021: Fitch Ratings has affirmed the Italian mortgage covered bonds (Obbligazioni Bancarie Garantite, OBG) issued by Banca Popolare dell'Alto Adige S.p.A. (BPAA, BB+/Negative/B), Banca Popolare di Sondrio-Società Cooperativa per Azioni (BPS, BB+/Negative/B), Banco di Desio e della Brianza S.p.A. (Desio, BB+/Stable/B) and Credito Emiliano S.p.A. (Credem, BBB-/Stable/F3) at 'AA-' with Stable Outlooks. Fitch has also affirmed the OBG issued by Banca Carige S.p.A. - Cassa di Risparmio di Genova e Imperia (Carige, B-/Negative/B) at 'BBB+' with a Stable Outlook.

The rating actions follow a periodic review of the OBG programmes.

KEY RATING DRIVERS

The covered bonds' ratings are based on the respective bank's Long-Term Issuer Default Rating (IDR) and the various uplifts above the IDR granted to each programme. It also considers the overcollateralisation (OC) protection provided through the programmes' asset percentages (AP).

The OBG programmes of BPAA, BPS, Desio and Credem are rated at the level of Fitch's Country Ceiling of 'AA-' for Italy, which acts as a cap for the ratings. The Stable Outlooks mirror that on Italy's IDR.

The 'AA-' ratings of the covered bonds are six (Credem) and seven notches (BPAA, Desio and BPS) above the respective bank's Long-Term IDR. This is out of a maximum achievable uplift of 10 notches for these programmes, consisting of a resolution uplift of two notches, a payment continuity uplift (PCU) of six notches and a recovery uplift of two notches. The AP that Fitch relies upon in its analysis (79% for BPAA, 78.74% for BPS, and 80% for Credem and Desio) provides more protection than the respective 'AA-' break-even AP, which has been revised to 80.0% from 82.5% for BPAA's OBG, to 80.5% from 82.0% for BPS's OBG, to 81.0% from 82.0% for Desio's OBG, and is unchanged at 85.5% for Credem's OBG.

Carige's 'BBB+' covered bonds' rating is eight notches above the bank's Long-Term IDR. This is out of a maximum achievable uplift of nine notches, consisting of a resolution uplift of two notches, a PCU of four notches and a recovery uplift of three notches. The programme's 81.97% AP that Fitch relies upon in its analysis provides more protection than Fitch's unchanged 'BBB+' break-even AP of 89.5%. The Stable Outlook reflects that the OBG rating has a one-notch cushion against a downgrade of Carige's IDR.

Fitch considers in its analysis the levels of AP the issuers publicly disclosed in the programmes' investor reports in December 2020.

OC Protection

The revision of the 'AA-' break-even AP for BPS's, BPAA's and Desio's OBG is driven by higher refinancing spread levels (RSL) for Italian residential mortgage loans than previously (356bp at 'A' timely payment rating level from 336bp previously; see: "Fitch Updates Covered Bonds Rating Criteria" dated 30 June 2020 at www.fitchratings.com). In periods of extraordinary market volatility and to provide a margin of safety against unprecedented events, the Covered Bonds Rating Criteria allows for a qualitative overlay above the standard RSL and this is currently in place for Italian cover assets.

For BPAA, the revision also factors in the increased net present value difference between the assets and the covered bonds due to a larger proportion of fixed rate assets. Including optional loans currently fixed-rate and floating with cap loans, which Fitch models as fixed-rate in a rising interest rate scenario, they make up 44% of the cover pool vs 39% last year.

The 'AA-' break-even AP for Credem is unchanged at 85.5% following the application of a criteria variation (see below) that resulted in no changes to the maturity mismatches. The 'BBB+' break-even AP for Carige is unchanged at 89.5% as the maturity mismatches and the portfolio composition are largely unchanged compared with the last review.

The asset and liability mismatch (ALM) loss component of Fitch break-even OC for the OBG ratings are 23.1% for BPAA, 22.0% for BPS, 21.1% for Desio, 15.0% for Credem and 10.3% for Carige. For Carige's OBG, the ALM loss is positively affected by the additional OC that the bank puts aside in the asset coverage test to account for potential set-off exposures.

The cover pools are composed of prime residential mortgage loans originated in Italy. Carige's cover pool also includes also 2.9% secured loans granted to small and medium enterprises as of September 2020.

The credit loss component of Fitch break-even OC for the OBG ratings represents 1.7% for Carige and 2.0% for BPAA's, BPS's, Desio's and Credem's covered bonds, driven by the application of the portfolio loss floor (for Carige the portfolio loss floor applies only to the share of cover pool composed of residential mortgage loans).

Uplifts

The resolution uplift of two notches reflects the covered bonds' exemption from bail-in, the low risk of under-collateralisation at the point of resolution and the banks' Long-Term IDRs which are driven by their respective Viability Ratings.

The PCU of six notches for BPAA, BPS, Desio and Credem's soft-bullet programme reflects the 12 months' protection for principal payments and the available protection for interest payments of at least three months.

Carige's covered bonds have a 15-month of principal maturity extension. However, the PCU is four notches, lower than the standard uplift typically granted to soft-bullet programmes. This is due to the programme's cover pool-specific alternative management, which in Fitch's view poses a high risk to payment continuity on the covered bonds if the source of payments switches from the issuer to the cover pool. The programmes are eligible for Fitch maximum recovery uplift as no particular limitations to recovery expectations apply. It is two notches for the OBG of BPAA, BPS, Desio and Credem as their timely payment rating level (A) is in investment grade range. The recovery uplift is three notches for Carige's OBG as their timely payment rating level (BB+) is non-investment grade.

For Carige, the cover pool-specific alternative management is reflected in the ESG Relevance Score of 5 for governance factors. This has a negative impact on the credit profile, and is highly relevant to the rating, resulting in the payment continuity uplift being reduced by two notches.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The OBG issued by BPS, BPAA, Desio and Credem could be upgraded if Italy's Country Ceiling was upgraded by at least one notch. In this case, any upgrade would be subject to the AP that Fitch relies upon being sufficient to withstand stresses associated with the higher rating. Credem's covered bonds will remain capped at 'AA' given the counterparty replacement language, which is commensurate with a timely payment rating level up to 'A+'.

OBG issued by Carige would be upgraded if Carige's IDR was upgraded by at least one notch, provided the AP that Fitch relies upon is sufficient to withstand stresses associated with a higher rating scenario.

All else being equal, a revision of the Carige OBG's PCU to the standard six notches for a soft-bullet programme (from the current four notches) would lead to an upgrade of the 'BBB+' covered bonds rating by two notches, provided the AP that Fitch relies upon is sufficient to withstand stresses associated with the higher rating scenario.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

BPAA's, BPS's, Desio's and Credem's covered bonds' ratings would be downgraded if (i) the respective bank's Long-Term IDR was downgraded to 'B' or below; or (ii) the AP that Fitch relies upon in its analysis increases above the respective Fitch 'AA-' break-even AP.

Carige's covered bonds rating would be downgraded if (i) Carige's Long-Term IDR was downgraded to 'CCC' or below (should the recourse to the cover pool upon default of senior unsecured obligations be unlikely); or (ii) the AP that Fitch relies upon in its analysis increases above Fitch's 'BBB+' break-even AP of 89.5%.

Fitch expects the coronavirus containment measures to negatively impact the performance of Italian residential and SME secured loans. However, all OBG programmes benefit from a cushion between the AP that Fitch relies upon in its analysis and Fitch's break-even AP for the rating. Nevertheless, the agency expects the AP cushion to reduce as a consequence of the coronavirus crisis.

In addition, all programmes benefit from a cushion against an IDR downgrade: one notch for Carige's OBG, three notches for BPAA's, BPS's and Desio's OBG and four notches for Credem's OBG.

Fitch's break-even AP for the covered bond ratings will be affected, among other factors, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuance. Therefore, the break-even AP to maintain the covered bonds' ratings cannot be assumed to remain stable over time.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a

three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>]

CRITERIA VARIATION

Fitch's analysis of BPS's cover pool varied from the agency's European RMBS Rating Criteria. Fitch applied a probability of default adjustment of 1.6 instead of 2.0 to loans granted to SAE 614/615 borrowers (artisans and family-run businesses, as coded by the Bank of Italy) based on the observed levels of default rates, which in Fitch's view warrants a smaller adjustment than that envisaged by the criteria. The application of this variation has no impact on the OBG rating.

Fitch's analysis of Credem's OBG varied from the agency's Covered Bonds Rating Criteria. Fitch modelled the programme's cash flows assuming the renewal of a covered bond maturing in 2021, according to the potential issuance plan stated in the issuer's investor presentation of its FY20 results. Fitch's Covered Bonds Rating Criteria allow modeling additional issuance for programmes with one single bond outstanding. However, Credem's programme has more than one issuance outstanding. The rationale for this variation is to maintain a stable break-even AP for the rating, given that a new issuance has an effect on the maturity mismatches between the amortising assets and the soft-bullet liabilities and consequently on the break-even AP for the rating of this programme. The application of this variation has an impact on the OBG rating of two notches.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Banca Carige S.p.A. - Cassa di Risparmio di Genova e Imperia, Mortgage OBG: Transaction Parties & Operational Risk: 5

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
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ENTITY/DEBT	RATING	PRIOR
Banca Popolare di Sondrio-Societa' Cooperativa per Azioni		
● senior secured, Mortgage Covered	LT AA- Rating Outlook Stable	Affirmed
		AA- Rating Outlook Stable

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Additional information is available on www.fitchratings.com**APPLICABLE CRITERIA**[Structured Finance and Covered Bonds Counterparty Rating Criteria \(pub. 29 Jan 2020\)](#)[Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(pub. 29 Jan 2020\)](#)[Bank Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)[Fitch's Covered Bonds Refinancing Spread Level Assumptions - Supplementary Data File \(pub. 30 Jun 2020\)](#)[Structured Finance and Covered Bonds Country Risk Rating Criteria \(pub. 23 Sep 2020\)](#)[Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(pub. 13 Nov 2020\)](#)[Covered Bonds Rating Criteria \(pub. 18 Nov 2020\) \(including rating assumption sensitivity\)](#)[European RMBS Rating Criteria \(pub. 22 Dec 2020\) \(including rating assumption sensitivity\)](#)[SME Balance Sheet Securitisation Rating Criteria \(pub. 29 Jan 2021\) \(including rating assumption sensitivity\)](#)**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Covered Bonds Cash Flow Model, v2.0.1 (1)

Portfolio Credit Model, v2.12.0 (1)

ResiGlobal Model: Europe, v1.6.4 (1)

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Banca Popolare dell'Alto Adige S.p.A.

EU,UK Endorsed

Banca Popolare di Sondrio-Societa' Cooperativa per Azioni

EU,UK Endorsed

Banco di Desio e della Brianza S.p.A.

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Credito Emiliano S.p.A.

EU,UK Endorsed

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