

26 JAN 2022

Fitch Affirms 4 Mid-Sized Italian Banks' OBG Programmes; Outlooks Stable

Fitch Ratings - Milan - 26 Jan 2022: 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 per Azioni (BPS, BB+/Stable/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.

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 Ratings (IDR) and the various uplifts above the IDR granted to each programme. They also consider the over-collateralisation (OC) protection provided through the programmes' asset percentages (AP).

All the OBG programmes are rated at their maximum achievable rating in line with Italy's Country Ceiling of 'AA', which acts as a rating cap for the programmes of BPAA, BPS and Desio. For Credem's OBG, the documented counterparty provisions on the account bank support a maximum timely payment rating level of 'A+' for the covered bonds, therefore constraining the programme's rating with counterparty risk. The Stable Outlook on the OBG ratings mirrors that on Italy's IDR.

The 'AA' ratings of the covered bonds are six (Credem) and eight notches (BPAA, Desio and BPS) above the respective banks' Long-Term IDRs. 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 80.5% (from 81.5%) for BPAA's OBG, to 83% (from 82%) for BPS's OBG, to 81% (from 82.5%) for Desio's OBG, to 84.5% (from 86.5%) for Credem's OBG.

Fitch considers in its analysis the levels of AP the issuers publicly disclosed in the programmes' investor reports as of September 2021.

OC Protection

The revision of the 'AA' break-even AP for Credem's and Desio's OBG factors in the increased net present value difference between the assets and the covered bonds, due to a larger proportion of fixed-rate assets as well as the reduction of the available excess spread over the life of the programmes. For BPAA, the revision is driven by the combined effect of the lower excess spread

available and the longer weighted average life of the assets compared with a year ago. All these changes are the result of transfers of newly originated assets to the underlying portfolios in 2021.

Furthermore, the 'AA' break-even APs for BPAA, BPS and Desio have been adjusted to factor in the additional OC that the issuers put aside in the programme tests to account for set-off exposures. Fitch believes that the set-off risk is a secondary risk driver for all the programmes and remedial actions (including sizing of the loss via deductions in the programme tests) will occur upon the loss of 'BB-' deposit ratings, while all the issuers have deposit ratings higher than 'BB-'. This OC adjustment drives the change in BPS's OBG 'AA' break-even AP.

All the covered bonds have soft-bullet amortisation profiles, so the break-even AP for their ratings is driven by the ALM (assets/liabilities mismatch) loss component, which is 21.9% for BPAA, 17.7% for BPS, 21.3% for Desio and 16.1% for Credem. This is followed by the credit loss component for the OBG ratings of 2.5% for all the programmes, driven by the application of the portfolio loss floor. The cover pools are composed of prime residential mortgage loans originated in Italy.

Uplifts

The resolution uplifts for all the programmes reflect exemption from bail-in of fully collateralised OBG, the low risk of under-collateralisation at the point of resolution and our view that a bank resolution will not result in enforcement against the cover pool. The two-notch resolution uplift also considers that the banks' Long-Term IDRs are driven by the banks' Viability Ratings.

The PCU of six notches reflects the OBGs' 12 months' protection for principal payments and the available protection for interest payments of at least three months.

The programmes are eligible for Fitch's maximum recovery uplift of two notches as no particular limitations to recovery expectations apply and also because the timely payment rating level is investment-grade.

RATING SENSITIVITIES

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

The OBG issued by BPS, BPAA, Desio could be upgraded if Italy's Country Ceiling is upgraded by at least one notch. This is provided that the AP that Fitch relies upon is sufficient to withstand stresses associated with the higher rating.

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

All the covered bonds' ratings would be downgraded if (i) Italy's 'AA' Country Ceiling is downgraded by at least one notch; (ii) the respective banks' Long-Term IDRs are downgraded to 'B+' or below; or (iii) the AP that Fitch relies upon in its analysis increases above the respective Fitch 'AA' break-even AP.

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.

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

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	RECOVERY	PRIOR
Banca			

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Popolare di Sondrio - Societa per Azioni			
<ul style="list-style-type: none"> senior secured, Mortgage Covered Bonds, Obbligazioni Bancarie Garantite 	AA 	Affirmed	AA 
Banco di Desio e della Brianza S.p.A.			
<ul style="list-style-type: none"> senior secured, Mortgage Covered Bonds, Obbligazioni Bancarie Garantite 	AA 	Affirmed	AA 
Banca Popolare dell'Alto Adige S.p.A.			
<ul style="list-style-type: none"> senior secured, 	AA 	Affirmed	AA 

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Mortgage Covered Bonds, Obbligazioni Bancarie Garantite			
Credito Emiliano S.p.A.			
• senior secured, Mortgage Covered Bonds, Obbligazioni Bancarie Garantite	LT AA 	Affirmed	AA 

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[Bank Rating Criteria \(pub.12 Nov 2021\) \(including rating assumption sensitivity\)](#)

[Covered Bonds Rating Criteria \(pub.02 Jun 2021\) \(including rating assumption sensitivity\)](#)

[European RMBS Rating Criteria \(pub.17 Dec 2021\) \(including rating assumption sensitivity\)](#)

[Fitch's Covered Bonds Refinancing Spread Level \(RSL\) Assumptions - Supplementary Data File \(pub.02 Jun 2021\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria \(pub.04 Nov 2021\)](#)

[Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(pub.04 Nov 2021\)](#)

[Structured Finance and Covered Bonds Country Risk Rating Criteria \(pub.28 Oct 2021\)](#)

[Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(pub.20 Sep 2021\)](#)

Applicable Models

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

Covered Bonds Cash Flow Model, v2.0.2 [\(1\)](#)

ResiGlobal Model: Europe, v1.7.3 [\(1\)](#)

Additional Disclosures

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