FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Banco BPM at 'BBB-'; Outlook Stable

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Fitch Ratings - Milan - 05 Apr 2023: Fitch Ratings has affirmed Banco BPM S.p.A.'s (BBPM) Long-Term Issuer Default Rating (IDR) at 'BBB-' with a Stable Outlook and Viability Rating (VR) at 'bbb-'. A full list of rating actions is below.

KEY RATING DRIVERS

Third-Largest Domestic Bank: BBPM's ratings reflect its second-tier domestic franchise, with a stronger presence in wealthy northern Italy, good business diversification by product and gradual improvement in core profitability and asset quality.

Adequate Business Diversification, Clear Strategy: BBPM's ratings reflect its stable business model, which is skewed towards commercial banking but fairly diversified into wealth management and insurance businesses. The strategy is clear and consistent with BBPM's business model, although it may be prone to shifts if value-accretive opportunities of inorganic growth materialise.

Disciplined Risk Approach: BBPM's risk appetite is commensurate with its business model, reflecting medium-term performance expectations. The risk control framework is aligned with market standards and is applied across the group with sound risk governance. Our risk profile assessment considers an average market risk appetite for a commercial bank, although exposure to Italian sovereign bonds is fairly high at 1.3x common equity Tier 1 (CET1) capital at end-2022, which we expect to remain largely stable over the next three years.

Above-Average Impaired Loans: Continued progress in impaired loan reduction in 2022 led to an early delivery of the 2024 impaired loan ratio target of 4.8%. Despite this achievement, which benefited from the benign credit environment over the past two years and effective risk controls, the bank's 4.5% impaired loans ratio at end-2022 remains above its domestic and similarly rated international peers. We expect the bank's impaired loans to remain reasonably stable over the next two years.

Rising Rates Benefit Profitability: BBPM's operating profitability has improved over the past three years reflecting good revenue diversification into fee-intensive activities, improved cost efficiency and lower loan impairment charges (LICs).

In 2023, we expect rising interest rates coupled with moderate deposit pass-through to support operating revenue. This should mitigate the expected increase in LICs due to the economic slowdown, while operating costs should remain under control despite inflation. We expect the bank to generate operating profit above 1.5% of risk-weighted assets (RWAs).

Adequate Capital Buffers: We expect BBPM to operate with a CET1 ratio around 14% in the next two years, which is above the guidance provided by its largest domestic peers, but broadly in line with European averages. To some extent this mitigates downside risks from the capital encumbrance by unreserved impaired loans, which we estimate to remain above 20%, a higher level than at similarly rated peers. We also expect the bank to maintain adequate capital buffers above regulatory requirements, thanks to improving internal capital generation as earnings continue to recover.

Stable and Diversified Funding Profile: BBPM's liabilities structure benefits from stable and granular retail deposits. Total deposits represent close to two-thirds of the bank's total funding, which is lower than domestic peers. BBPM's established capital markets access across its whole liability structure benefits the bank's fairly diversified funding profile. BBPM has sound liquidity metrics.

RATING SENSITIVITIES

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

BBPM's ratings are sensitive to a significant weakening of the operating environment in Italy, due for example, to much slower economic growth than our forecasts, and persistently high inflation, which could result in higher default rates and lead to deterioration of the bank's asset quality and capital metrics.

The ratings would likely be downgraded if the impaired loans ratio increases above 6% and operating profit falls below 1% of RWAs without the prospect of recovery in the short term. This is especially if the CET1 ratio falls below 14% and capital encumbrance by unreserved impaired loans rises on a sustained basis to levels materially above industry average.

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

There is limited rating upside, unless the bank's risk profile and financial metrics improve materially. In particular, it would require the impaired loans ratio to remain consistently and materially below 4%, capital encumbrance by unreserved impaired loans to improve to levels materially below 20% and operating profit to rise above 2% of RWAs without more risk-taking, while maintaining the CET1 ratio at around 14%.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

DEPOSIT RATINGS

BBPM's long-term deposit rating is one notch above its Long-Term IDR reflecting full depositor preference in Italy and our belief that the bank has sufficient combined buffers of junior and senior debt, resulting in a lower probability of default on deposits relative to its Long-Term IDR. The one-notch uplift also reflects our expectation that the bank will maintain sufficient buffers to comply with minimum requirement for own funds and eligible liabilities (MREL).

The short-term deposit rating of 'F3' is the baseline option for a 'BBB' long-term deposit rating, because the funding and liquidity score is not high enough to achieve a higher equivalent short-term rating.

SENIOR PREFERRED AND SENIOR NON-PREFERRED DEBT

BBPM's senior preferred (SP) debt is rated in line with the bank's Long-Term IDR because we expect them to use SP debt to meet its MREL.

For the same reason, senior non-preferred (SNP) notes are rated one notch below the bank's Long-Term IDR. This is to reflect the risk of below average recoveries arising from the use of senior-preferred debt to meet resolution buffer requirements, and the combined buffer of additional Tier 1, Tier 2 and SNP debt being unlikely to exceed 10% of RWAs.

No Support

BBPM's Government Support Rating (GSR) of 'no support' (ns) reflects Fitch's view that although external extraordinary sovereign support is possible, it cannot be relied on.

Senior creditors can no longer expect to receive full extraordinary support from the sovereign in the event that the bank becomes nonviable. This is because the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that requires senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

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

BBPM's long- and short-term senior debt and deposit ratings would be downgraded if the Long-Term IDR was downgraded.

The deposit ratings could be downgraded by one notch and be aligned with the IDRs in the event of a reduction in the size of the senior and junior debt buffers that would result in lower protection for deposits, so that these would no longer have a lower probability of default relative to the IDRs. We view this as unlikely in light of current and future MREL requirements.

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

BBPM's senior debt and deposit ratings would be upgraded if the Long-Term IDR was upgraded.

BBPM's senior debt ratings could also be upgraded if the bank was expected to meet the resolution buffer requirements of the consolidated entity exclusively with SNP and more junior instruments, or if we expect resolution buffers represented by SNP and more junior instruments to be at least 10% of RWAs on a sustained basis, neither of which is currently the case nor do we expect in the future.

An upgrade of the GSR would be contingent on a positive change in the sovereign's propensity to support the bank. In Fitch's view, this is highly unlikely, although not impossible.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

Banca Akros S.p.A.'s (Akros) IDRs are equalised with those of its parent. The IDRs are driven by potential support from BBPM, as reflected in its Shareholder Support Rating (SSR) of 'bbb-', underlining full ownership, integration with its parent and its role in the group as the specialised arm offering investment banking products to BBPM's customer base. Fitch does not deem it appropriate to assign a VR to Akros because its high integration with the parent results in a non-meaningful standalone franchise.

Akros' Derivative Counterparty Rating (DCR) is at the same level as the Long-Term IDR because in Italy derivative counterparties have no preferential legal status over other senior obligations in a resolution.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

Akros's IDRs, DCR and SSR are primarily sensitive to changes in BBPM's IDRs. In addition, the ratings could be downgraded if the subsidiary's strategic importance to BBPM reduced, which we currently do not expect.

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

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.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Akros's ratings are driven by shareholder support from BBPM.

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.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Banco BPM S.p.A.	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
	ST IDR	F3	Affirmed	F3
	Viability	bbb-	Affirmed	bbb-
	Government Support	ns	Affirmed	ns
long-term deposits	LT	BBB	Affirmed	BBB
Senior preferred	LT	BBB-	Affirmed	BBB-
Senior non-preferred	LT	BB+	Affirmed	BB+
short-term deposits	ST	F3	Affirmed	F3
Banca Akros S.p.A.	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
	ST IDR	F3	Affirmed	F3

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Banca Akros S.p.A.	EU Issued, UK Endorsed
Banco BPM S.p.A.	EU Issued, UK Endorsed

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Banks Europe Italy
