

Scope affirms Banca Popolare di Sondrio's BBB issuer rating, revises Outlook to Positive

The Outlook revision reflects the upside potential to BPS' issuer rating in case of a business combination with BPER.

Rating action

Scope Ratings GmbH (Scope) has affirmed Banca Popolare di Sondrio SpA (BPS)'s issuer rating of BBB and revised the Outlook to Positive, from Stable.

The full list of rating actions and rated entities is at the end of this rating action release.

On 6 February, BPER launched an unsolicited voluntary public exchange offer on all ordinary shares of BPS, aimed at acquiring control of the latter. Subject to regulatory approvals, the offer period will be carried out between June and July 2025. BPER envisages the closing and merger of BPS by the year-end. The offer is subject to a minimum acceptance threshold of 50% + 1 share of BPS's share capital. The condition could be waived, provided that the purchased stake, upon completion of the Offer, is higher than 35% of BPS' share capital.

Scope deems the potential transaction to be positive for BPS's issuer rating, reflecting the strengthening of the business model of a BPS-BPER combination. The new group would hold total assets of almost EUR 200bn, revenues above EUR 7bn, a cost/income ratio below 50% and net income in excess of EUR 2bn. BPER is expected to maintain adequate capital buffers, with a pro-forma CET1 ratio of 15.3%, and a solid liquidity position: a pro-forma Liquidity Coverage Ratio of 169% and a Net Stable Funding Ratio of 134%.

Scope expects the BPER's bid to succeed, considering the low acceptance threshold and BPS' shareholding structure, with the presence of a core shareholder – Unipol -, which holds 19.7% of BPS and backs the offer. The solid industrial rationale for the transaction, underpinned by the complementarity of the two banks' branch footprints, similar roots as former "popolari" banks, and common product factories, is another key consideration.

Key rating drivers

Business model assessment: Consistent (Low). The issuer rating is anchored by the Consistent (Low) business model assessment. BPS has an established retail and commercial banking franchise in Lombardy, with total assets of EUR 57bn as of December 2024. Although its national market share is low, BPS enjoys a dominant position in its home province of Sondrio and has a significant market presence in the provinces of Lecco and Como. This supports moderately stable and predictable revenues and earnings over the cycle.

The group's business model is based on traditional commercial banking activities mainly for local entrepreneurs and households. Over the years, BPS has developed solid customer relationships, especially in its home province of Sondrio. The group includes BPS Suisse, a small bank in Switzerland specialised in retail mortgages, and Factorit, Italy's fourth largest factoring company. Together, the two subsidiaries represent almost 30% of the group's loan book. The group also owns BNT Banca, which provides low-risk, payroll-deductible loans to individuals.

Under the new three-year standalone plan presented in March, the group's business model would not change. BPS would continue to leverage on its local presence and customer proximity, focusing particularly on increasing loan volumes (CAGR of 3.3% until 2027) and the penetration in wealth management and bancassurance (CAGR of 11% and 19% respectively).

Operating environment assessment: Supportive (Low). Italy (Supportive low) is the group's main market, representing more than 90% of total revenues. It is the EU's third largest economy and second largest manufacturer, with a significant average trade surplus over the past decade. The average GDP per capita is in line with the EU average. High level of public debt may constrain the government's ability to deploy countercyclical measures in downturns in the context of the rigid European fiscal framework. The banking sector is performing strongly, with high margins and low cost of risk driving high profitability in 2023 and 2024. Following a decade of balance sheet cleanup, NPLs are no longer a credit concern and appear well under control.

Italy is part of the European Banking Union, which has brought about a significant strengthening and harmonisation in bank regulation and supervision under the ECB's Single Supervisory Mechanism, which we consider to be supportive of financial stability. The European Central Bank also shares with national central banks the role of lender of last resort, which limits illiquidity risks to the banks.

Scope arrives at an initial mapping of bbb- based on a combined assessment of the issuer's operating environment and business model.

Long-term sustainability assessment (ESG factor): Developing. The assessment reflects Scope's view that the issuer is embracing changes to ensure the long-term sustainability of its business model. Progress made may be tangible but does not warrant further credit differentiation.

Scope acknowledges the group's improvements in corporate governance in recent years, including the reorganisation of the management structure. The assessment considers BPS' increased efforts to manage environmental risks; as detailed in its 2025-27 plan, BPS targets EUR 2.4bn in new financing with positive environmental and social impact and EUR 1bn in new green/social/sustainable bonds. BPS has already set emission reduction targets by 2030 on four sectors (power, oil & gas, agriculture, and transport).

Scope also recognises BPS' cooperative roots and its attention to the territories where it operates, indicating strong social responsibility and responsiveness to the interests of various stakeholders.

As digital banking gains momentum, particularly among the younger generation, competition from larger incumbents and new players could be a challenge for BPS in the long term. Positively, the group has committed to tripling its investments over the next three years to enhance digital penetration, digital onboarding of new clients and new sales mechanisms.

The long-term sustainability assessment leads to an adjusted rating anchor of **bbb-**.

Earnings capacity and risk exposures assessment: Neutral. The assessment reflects Scope's view that

the group's earnings capacity may be variable over economic cycles but is sufficient to cover expected losses. Asset quality is broadly in line with peers. Risks are unlikely to generate losses capable of undermining the issuer's viability.

While low by international standards, profitability was better than the average for Italian banks over the past decade due to stable revenue, good cost efficiency, moderate loan losses and the lack of large restructuring costs. And in a higher interest rate environment, BPS' earnings significantly improved thanks to wider commercial spreads and higher bond yields. In addition, BPS has seen steady growth in fee and commission income (+ 8% YoY in 2024). With a cleaner balance sheet, the cost of risk has fallen, although it remains higher than that of larger domestic peers. In 2024, the group's return on risk-weighted assets was 2.5%.

Scope expects the group's profitability to remain robust in the short-medium term, barring a marked fall in interest rates. By 2027, the group expects a return on equity above 14%, underpinned by resilient net interest income, growing fees, contained cost inflation and a cost of risk declining to below 40 bps.

As of December 2024, BPS' asset quality was solid. Its gross NPE ratios stood at 2.9%, pro forma a EUR 109m (net) asset disposal. Over the past year, loan default remained close to record lows, at 1.1%. Performing loan coverage increased to 0.85% as of YE 2024 (from 0.73% in the year before), which provide a cushion in case of a macroeconomic downturn.

Scope does not foresee a change in asset quality trend in the coming quarters, as the Italian economy grows, albeit modestly, and unemployment rate remains well below historical average. By 2027, BPS envisages a gross NPL ratio of 2.6% and a default rate below 1%.

Financial viability management assessment: Comfortable (+1 notch). The assessment reflects Scope's view that the issuer's maintains comfortable buffer to relevant regulatory requirements and Scope expects it to continue to do so. The issuer's financial viability is largely resilient to tail-risk events.

BPS displays healthy capital buffers (470 bps above minimum requirements), reflecting strong capital generation and prudent management of financial viability. MREL requirements are also comfortably met. Although management has committed to a higher pay-out ratio of 85% going forward, the CET1 ratio will be maintained above 14.5%.

BPS is primarily funded by customer deposits, which is credit positive. The deposit base remained stable in 2023, when some customers shifted to more remunerative options, including Italian government bonds. In 2024, deposit volumes grew markedly; current account were up 5.3% YoY, while time deposits increased by 25% YoY.

BPS fully repaid the remaining TLTRO III funds to the ECB in 2024. In new three-year plan, the group expects bigger bond issuance to finance growth.

One or more key drivers of the credit rating action are considered an ESG factor.

Outlook and rating sensitivities

The **Positive Outlook** reflects Scope's view that the risks to the current rating are tilted to the upside.

The **upside scenarios** for the rating and Outlook are (individually or collectively):

1. High acceptance of the BPER exchange offer, with BPS becoming a subsidiary of a stronger group.

2. Evidence of a structurally higher profitability without a significant increase in the risk profile over the medium/long term could lead to an upgrade of the Earnings Capacity and Risk Exposure assessment.

The **downside scenarios** for the rating and Outlook are (individually or collectively):

1. BPER's failure to secure a controlling majority of BPS could lead Scope to revise the Outlook to Stable.
2. A material increase in non-performing loans linked to weaker operating conditions could lead to a downgrade of the Earnings Capacity and Risk Exposures assessment.
3. A significant reduction in capital buffers could lead to a lower Financial Viability Management assessment.

Environmental, social and governance (ESG) factors

Please refer to the 'long-term sustainability assessment' under the 'key rating drivers' section above for the ESG analysis.

All rating actions and rated entities

Banca Popolare di Sondrio SpA

Issuer rating: BBB/Positive, Outlook change

Stress testing & cash flow analysis

No stress testing was performed. No cash flow analysis was performed.

Methodology

The methodology used for this Credit Rating and/or Outlook, (Financial Institutions Rating Methodology, 10 January 2025), is available on <https://scoperatings.com/governance-and-policies/rating-governance/methodologies>.

Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on <https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales>. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at <https://scoperatings.com/governance-and-policies/regulatory/eu-regulation>. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): <http://cerp.esma.europa.eu/cerp-web/statistics/defaults.xhtml>. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at <https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales>. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on <https://scoperatings.com/governance-and-policies/rating-governance/methodologies>.

The Outlook indicates the most likely direction of the Credit Rating if the Credit Rating were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.

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The Credit Rating/Outlook was first released by Scope Ratings on 10 September 2018. The Credit Rating/Outlook was last updated on 17 April 2024.

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