

Rating Action: Moody's downgrades Banca del Mezzogiorno's senior unsecured debt rating to Ba3 from Ba1, outlook stable

15 Nov 2021

Baseline Credit Assessment downgraded to b1 from ba3, long-term deposit ratings confirmed

Paris, November 15, 2021 -- Moody's Investors Service ("Moody's") has today downgraded Banca del Mezzogiorno - MCC S.p.A.'s (Banca del Mezzogiorno) long-term issuer and senior unsecured debt ratings to Ba3 from Ba1, and the bank's Baseline Credit Assessment (BCA) and Adjusted BCA to b1 from ba3.

Moreover, Moody's confirmed Banca del Mezzogiorno's Baa3 long-term deposit and long-term Counterparty Risk Ratings (CRRs) as well as its Baa3(cr) long-term Counterparty Risk (CR) Assessment. Moody's also confirmed Banca del Mezzogiorno's short-term deposit ratings and CRRs at Prime-3 and its short-term CR Assessment at Prime-3(cr).

The outlook on the long-term deposits, issuer and senior unsecured debt ratings is stable.

Today's rating action concludes the review for downgrade on Banca del Mezzogiorno's ratings and assessments initiated on 31 December 2019 following the Italian government decision to involve Banca del Mezzogiorno in Banca Popolare di Bari's (BPB) rescue. (see "Moody's places Banca del Mezzogiorno's long term ratings under review for downgrade "; https://www.moodys.com/research/--PR_415723) and which was extended twice, on 10 November 2020 and 28 May 2021.

The full list of affected ratings is at the end of the press release.

RATINGS RATIONALE

-- BCA and ADJUSTED BCA

The downgrade of Banca del Mezzogiorno's BCA and Adjusted BCA to b1 from ba3 reflects the bank's weakened credit profile following the transformational acquisition of the failing bank BPB despite a capital injection and non-performing loan sales as part of the takeover. Banca del Mezzogiorno's lending book increased to €8.6 billion as of June 2021 from €1.6 billion as of year-end 2019. The problem loan ratio as of June 2021 was around 8% of gross loans for the combined entity compared to an already high 6.65% at year-end 2020, despite BPB's sale of a significant share of its non-performing loans prior to its acquisition. The increase in the cost of risk up to 1.5% of gross loans as of June 2021 from 0.3% in 2020 was mainly driven by BPB's lending book.

The downgrade also reflects Moody's expectation that Banca del Mezzogiorno will report a loss in 2021 and 2022, mostly driven by a high level of loan loss provisions and the restructuring costs related to the acquisition of BPB. Despite the capital injection of €1170 million from the national deposit guarantee fund (FITD) and €430 million from the Italian Ministry of Finance, the bank's Common Equity Tier 1 capital ratio of 14.6% as of June 2021 will be materially reduced owing to the aforementioned losses. Against the backdrop of government policies towards the development of southern Italy, Banca del Mezzogiorno is encouraged to grow its lending activity to small companies, which generally exhibit a higher risk profile thereby weighing on Banca del Mezzogiorno's capital ratios. Banca del Mezzogiorno's commercial expansion will be supported by Italy's GDP growth of 6.4% in 2021 and 4.3% in 2022 according to Moody's.

Banca del Mezzogiorno's liquidity will remain solid thanks to an excess of deposits over lending needs and extended use of European Central Bank's (ECB) Targeted Long-Term Refinancing Operations (TLTRO) programme. As of June 2021, Banca del Mezzogiorno had redeposited at the ECB 90% of the TLTRO borrowed funds. The acquisition of BPB has also transformed Banca del Mezzogiorno's funding structure, which will consist of retail deposits to a large extent.

The acquisition of BPB has fundamentally changed Banca del Mezzogiorno's risk profile. Prior to the acquisition, Banca del Mezzogiorno, was a small specialized entity focusing on secured lending backed by public guarantees and it has become a universal bank of a much larger size. The merger of two entities that

exhibit very different business profiles involves management challenges all the more so since BPB failure revealed numerous shortcomings that Banca del Mezzogiorno will have to tackle going forward. Lastly, the new entity will have to outline a new strategy encompassing a wide range of activities, which will also entail significant challenges. As a result, we apply a one notch negative adjustment for corporate behavior, which results in a b1 BCA from the financial profile of ba3.

-- SENIOR UNSECURED DEBT AND ISSUER RATINGS DOWNGRADES

The downgrade of Banca del Mezzogiorno's senior unsecured debt and issuer ratings to Ba3 from Ba1 derives from the downgrade of the bank's BCA. It also reflects the higher expected loss of these instruments in a resolution scenario according to Moody's Advanced Loss Given Failure (LGF) analysis. Following the acquisition of BPB, which was predominantly retail-funded, the share of senior debt relative to the combined entity's total assets has materially reduced, lowering the rating uplift to zero notch from two notches.

In addition, Moody's assigns a moderate probability of support from the Italian government to Banca del Mezzogiorno's senior creditors which now results in a one-notch rating uplift to Ba3 for the senior unsecured debt rating. The Italian government, which controls Banca del Mezzogiorno through the national agency for investment and economic development, Invitalia S.p.A. (Baa3 stable) expects the bank to support the development of southern Italy. The Italian government allocated €430 million to Banca del Mezzogiorno for the acquisition of BPB, which is the most important bank operating in the south of the country.

-- CONFIRMATION OF DEPOSIT RATINGS, CRRs, CR ASSESSMENT

The confirmation of the Baa3 deposit ratings, CRR and Baa3(cr) CR Assessment, reflects the one-notch downgrade of the BCA, which is offset by a one-notch uplift stemming from the assumption of moderate government support. The loss given failure of deposits remains unchanged thanks to the increase in junior deposits coming from BPB. As a result, deposit ratings, CRR and CR Assessment benefit from a three-notch uplift from the Adjusted BCA of b1.

OUTLOOK RATIONALE

The stable outlook on the long-term deposits, issuer and senior unsecured debt ratings of Banca del Mezzogiorno reflects Moody's view that the bank's credit profile will remain broadly unchanged over the next 12 to 18 months. In particular, the rating agency considers that the bank's solvency will largely absorb the restructuring costs of BPB and the deterioration of asset quality of the combined entity. Moody's also expects that the liquidity buffers will remain high.

The outlook also factors in the expected stability of the liability structure of the bank and hence of the loss given failure of all instruments.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Banca del Mezzogiorno's deposit and long-term issuer as well senior unsecured ratings could be upgraded following an improvement in asset quality or profitability driving a better solvency.

The issuer and senior unsecured ratings could also be upgraded if the bank were to issue more bail-in-able debt.

Conversely, Banca del Mezzogiorno's deposit and long-term issuer as well unsecured debt ratings could be downgraded if the restructuring of BPB and growth strategy were to result in a weakening of the creditworthiness of the combined entity, prompted in particular by a deterioration of its asset quality or capitalization, or both.

Banca del Mezzogiorno's long-term issuer and senior unsecured debt ratings could also be downgraded in case the buffer of bail-in-able debt were to be further reduced.

LIST OF AFFECTED RATINGS

Issuer: Banca del Mezzogiorno - MCC S.p.A.

..Confirmations:

....Long-term Counterparty Risk Ratings, confirmed at Baa3

...Short-term Counterparty Risk Ratings, confirmed at P-3

...Long-term Bank Deposits, confirmed at Baa3, outlook changed to Stable from Ratings under Review

...Short-term Bank Deposits, confirmed at P-3

...Long-term Counterparty Risk Assessment, confirmed at Baa3(cr)

...Short-term Counterparty Risk Assessment, confirmed at P-3(cr)

..Downgrades:

...Baseline Credit Assessment, downgraded to b1 from ba3

...Adjusted Baseline Credit Assessment, downgraded to b1 from ba3

...Long-term Issuer Ratings, downgraded to Ba3 from Ba1, outlook changed to Stable from Ratings under Review

...Senior Unsecured Regular Bond/Debenture, downgraded to Ba3 from Ba1, outlook changed to Stable from Ratings under Review

..Outlook Action:

...Outlook changed to Stable from Ratings under Review

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1269625. Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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