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Ratings

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Research Update:

Italy-Based FinecoBank S.p.a. Assigned 'BBB/A-2' Ratings; Outlook Negative

July 4, 2019

Overview

- Italy-based FinecoBank benefits from an agile, digitally advanced, and diversified business model that focus on asset-gathering activities and online retail brokerage services.
- This gives Fineco a competitive edge and supports the bank's profitability, ample liquidity, and capital build up capacities.
- In addition, the bank has low exposure to credit risk and a good track record in managing operational risks.
- We are assigning our 'BBB/A-2' long- and short-term ratings to Fineco.
- The outlook is negative, mirroring that on the Republic of Italy, since we think Fineco would not be able to withstand a hypothetical scenario of sovereign stress.

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Rating Action

On July 4, S&P Global Ratings assigned its 'BBB/A-2' long- and short-term issuer credit ratings to Italy-based financial institution FinecoBank. The outlook is negative.

Rationale

The ratings on Fineco primarily reflect our view that the bank will continue to benefit from its agile, digitally advanced, and diversified business model. It also reflects the bank's lower-than-domestic-peers' exposure to the high credit risk we see in Italy. We also expect Fineco to maintain strong control of the operational risks to which it is exposed, given its deep focus on asset gathering, private banking, brokerage, and online banking services. We view positively the bank's asset-light business model and good franchise in these segments, especially when considering the regulatory and consumer behavior challenges the industry is facing.

We anticipate that Fineco's profitability will remain significantly higher than domestic traditional commercial banks'--which still represent the bulk of the Italian banking sector--while the bank maintains prudent credit and operational risk management. Recurring return on equity for Fineco is likely to exceed 20%-25% in the coming two to three years, compared to the 5%-6% we expect for traditional banks. This stems from the bank's stronger operating performance and materially lower credit losses, since lending activities are marginal. Fineco's operating performance benefits from the commissions deriving from its dominating position in online brokerage, strong and increasing presence in wealth management, and relatively low fixed cost bases. Compared to other traditional banks, we think it is less exposed to the weakening economic environment, prolonged low interest rates, and interest margin pressure. Furthermore, unlike Fineco, traditional banks have needed to heavily decrease the size of their large branch networks and reduce staff costs, and will need to continue to do so as digitalization progresses in retail banking. We view Fineco's business model as well suited to the seminal and disruptive changes the banking industry is facing in terms of availability of digitalized banking offers and evolving customer preferences. In our view, these strengths offset the bank's small absolute size--approximately €25 billion of assets--and modest business diversification.

Furthermore, Fineco's relatively modest lending activity focuses primarily on low-risk segments such as residential mortgages and Lombard loans, and it is not exposed to lending to riskier small and midsize enterprises.

Fineco's sound earning prospects support its ability to generate capital, although this will depend on the bank's dividend policy in the coming years. We anticipate that Fineco's risk-adjusted capital (RAC) will exceed 7% in 2020 and 2021, taking into account our forecast of net profit ranging between €220 million-250 million per year and a dividend payout of 80%. This compares to the pro forma 5.8% RAC ratio we calculate as of year-end 2018. The improvement also stems from the gradual run-off of Unicredit bonds and expected replacement with high-quality assets. We note that Fineco's competitive advantage and the loyalty of its client base ensure steady flows of fees and commissions.

That said, we recognize that it will be difficult for Fineco to maintain its innovative edge. This is because some other banks in Italy may be catching up gradually in the digital and asset-light business model race, after focusing on managing down their nonperforming exposures in recent years. We also think Fineco's future creditworthiness will depend on the bank's ability to continue to manage its operational risk, given the nature of its business model, the importance of its reputation, and ability to maintain the high quality of its online services.

Outlook

The negative outlook on Fineco reflects that on the sovereign. This is because we think Fineco would be unlikely to continue to fulfill its obligations in a timely manner in the event of an Italian sovereign default, given the domestic concentration of its securities portfolio.

Downside scenario

We would lower the rating on Fineco if we were to take a similar action on the sovereign. We could also lower the rating on Fineco if we were to conclude that the bank's ability to manage its operational risk had diminished. We may also consider a downgrade if we were to observe an unfavorable evolution in the bank's franchise, which could reveal a weakening of the bank's competitive advantage and therefore an inability to maintain an above-average risk-adjusted profitability. Finally, we could also downgrade Fineco if it were to assume a higher level of credit risk than we currently expect.

Upside scenario

We could revise the outlook on Fineco to stable if were to take a similar action on the Republic of Italy, providing that our view of the bank's creditworthiness remains unchanged.

Ratings Score Snapshot

FinecoBank S.p.a. - Ratings Score Snapshot

Issuer Credit Rating	BBB/Negative/A-2
SACP	bbb
Anchor	bbb-
Business Position	Adequate (0)
Capital and Earnings	Adequate (0)
Risk Position	Strong (+1)
Funding and	Adequate and (0)
Liquidity	Average
Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Unicredit SpA, June 28, 2019
- The Future Of Banking: Will Retail Banks Trip Over Tech Disruption? May 14, 2019
- Italy 'BBB/A-2' Ratings Affirmed; Outlook Negative, April 26, 2019

Ratings List

New Rating	
FinecoBank S.p.a.	
Issuer Credit Rating	BBB/Negative/A-2