

IBL Banca S.p.A

Issuer Rating Report



Overview

Scope Ratings has assigned an Issuer Rating of BBB to IBL Banca SpA, with Negative Outlook. The rating was affirmed on November 30, when the outlook was changed to Negative from Stable.

Highlights

- ✓ The rating is based on the low-risk business model of IBL, a leader in the Italian market for payroll and pension deducted loans (PDL), which is a high-margin, low-risk personal loan product with a long history in Italy.
- ✓ These loans have a complex structure, which involve several players and a long origination process. IBL seems to have mastered the vertical value chain entirely, evidenced by the bank's negligible credit-loss levels and high profitability.
- ✓ The ratings also take account of the large exposure to Italian government bonds, mostly financed via short-term repos. This represents a large risk concentration, underpinning the negative outlook.
- ✓ Aside from repo funding for the government bond portfolio, IBL funds itself through deposits and securitisations of its loan book, which recently have mostly been retained and used as collateral for ECB term repo operations.
- ✓ IBL's capital position is adequate, despite the high regulatory risk-weighting of PDL loans.
- ✓ We also highlight the key man risk regarding Mr. Mario Giordano, the bank's CEO since 1998.

Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- Market leader in Italian payroll and pension deductible loans;
- Very low asset risk due to the intrinsic characteristics of the product offering;
- Very strong financial fundamentals, including capital, asset quality and profitability;
- IBL's material exposure to Italian sovereign risk;
- IBL's funding relies on savings deposits, which are price-sensitive, and on central bank funding;
- Closely held and controlled by management.

Ratings & Outlook

Issuer Rating	BBB
Outlook	Negative

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  Bloomberg: SCOP

Rating change drivers



Volatility in the value of government bonds portfolio. Even a temporary decline in the value of government bonds could erode the group's liquidity: selling the bonds would translate into permanent losses, while financing the position could require higher margins.



A material reduction in the large carry trade in government securities. At over one-fourth of the balance sheet and over three times the CET1 capital base, the bank's Italian sovereign exposure represents a material risk against which almost no capital is retained. IBL's carry trade on government bonds, while adding to profitability, does not belong in its core business and expertise, in our view, and detracts from the credit.



Material deviation in the group's strategy from the low-risk core business and into riskier segments. A key strength of IBL is the focus on a high-margin, low-risk market niche. Any material strategic change towards the aggressive targeting of riskier lending segments would be negative for the rating.



Negative impacts on profitability from replacing central bank funding with private funding. IBL management is focused on diversifying funding sources, including reducing the reliance on central bank funding. We see a risk that, in time, the normalisation of funding conditions could negatively affect funding costs.

Rating drivers (details)

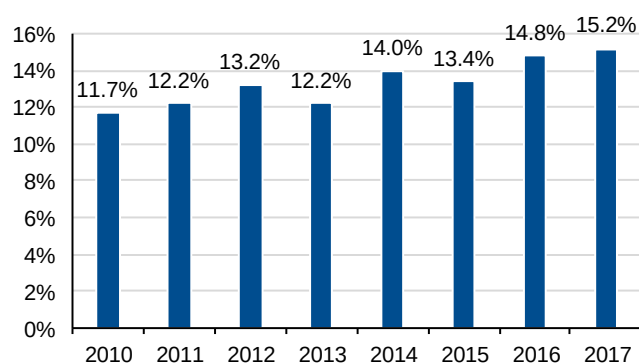
Market leader in Italian payroll and pension deductible loans

IBL Banca SpA is the parent company of the IBL banking group, whose fully owned subsidiaries manage the services, real estate and the distribution of insurance for the entire group.

IBL is essentially a specialised lender that offers personal finance loans to Italian individuals, particularly Italian payroll or pension deductible loans (PDL) including 'cessioni del quinto dello stipendio' (CQS), 'cessioni del quinto della pensione' (CQP) and 'deleghe di pagamento' (DP). The group is a market leader in Italy for PDLs, with a solid 15.2% market share in PDL loan origination.

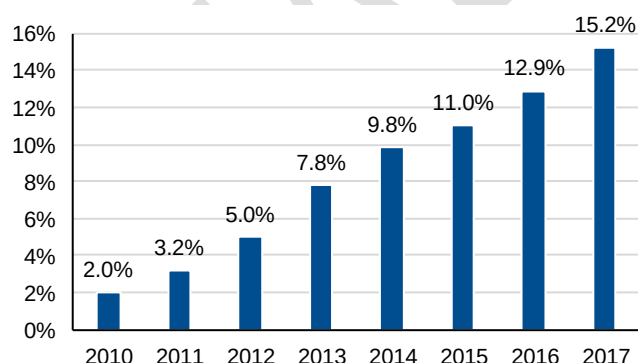
IBL also offers saving and insurance products, and payment cards.

Figure 1: IBL's market share, new business



Source: Company data, Scope Ratings.

Figure 2: IBL's market share, stock



Source: Company data, Scope Ratings.

IBL's distribution model comprises 49 branches, plus a further 825 branches via distribution agreements with banking partners such as Credito Valtellinese. The bank also makes use of a network of 77 agents, promoters and intermediaries, as well as an online channel.

Historically, IBL operated on an originate-to-distribute model, largely due to limited financial resources. After obtaining a banking licence in 2004 and acquiring 30 Citifinancial branches, IBL started to accumulate deposits, and since 2012 it has completed several capital increases, for a total of EUR 62.5m. This afforded the bank financial firepower to transition to a more balance sheet-intensive model, also helped by readily available liquidity in wholesale markets and by the central bank. Today, the bank's business model aims to retain loans on balance sheet, funding them through a mix of retail deposits and ECB TLTRO funding backed by asset-backed securities.

In 2015, IBL planned an IPO, with a view to raise further capital to fund faster growth and potential acquisitions but abandoned these plans due to adverse market conditions. More recently, management has stated that they are no longer considering opening up capital, despite interest from private equity players.

Very low asset risk, due to the intrinsic characteristics of the product offering

CDQ and CDP loans are inherently low risk: historically rooted in post-unification Italy to help public-sector employees gain access to credit, CDQ was more formally regulated in 1950 by law 180/1950 together with a wider reform of personal credit. However, it remained reserved for public-sector employees.

From 2004 the product was extended to private-sector employees. In the process, several limitations were removed, such as a minimum job tenure; while more flexibility was provided on loan duration.

Today, the main characteristics of this product are:

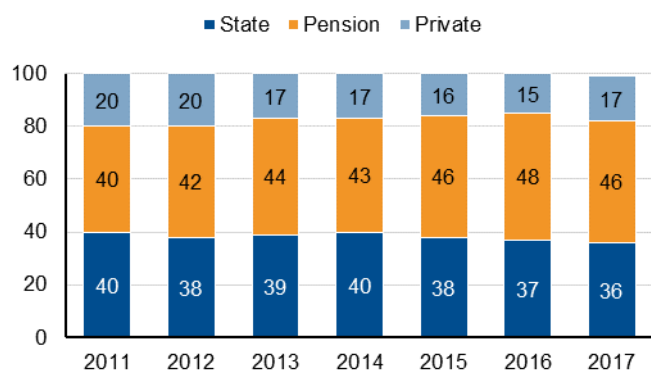
- A target population of public- or private-sector employees and pensioners;
- A duration of 24-120 months;
- No maximum amount – it depends on the borrower's salary, with the average ticket being c. EUR 20,000; for IBL, the maximum amount is EUR 75.000
- Monthly repayments – up to 20% of salary/pension including capital, interest and all fees;
- Direct deductions from payroll;
- Compulsory insurance for loss of employment and death.
- The ease at which it is obtained – no need for a specific purpose, credit decision made in the branch (or by agent, or online), even available to individuals with poor credit records.

These loans are essentially consumer credit products with an extremely low credit risk (the actual credit risk stems from the employer, or the insurance company if the employee is fired or dies).

Also known as “doppio quinto”, a DP loan is similar to a CQS loan (only for employees) but can be up to 40% of the salary amount, in some cases even 50%, and requires acceptance of a framework agreement by the employer (making it unavailable to some employees and to all pensioners). Government agencies typically have a framework agreement in place.

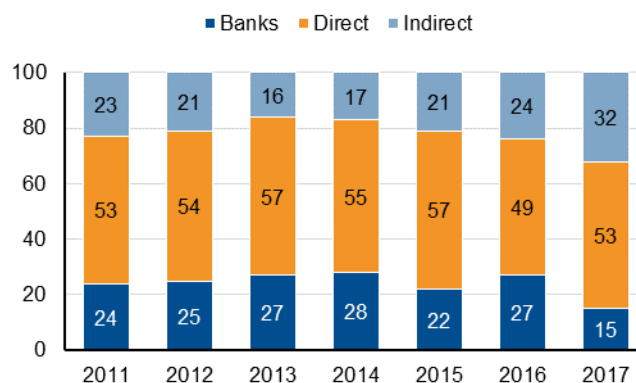
It is worth noting that the small average tickets ensure that the bank's portfolio is very granular, with no large concentration at individual borrower level. However, concentration risk can be present in terms of either the employer or the insurance counterparty.

Figure 3: Pension deductible loans represent an increasing share of the market



Source: Assofin, Scope Ratings.

Figure 4: New originations, split by distribution channel



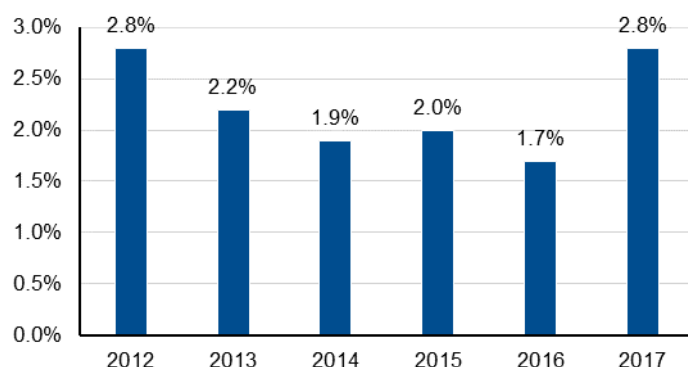
Source: Company data, Scope Ratings.

Very strong financial fundamentals, including capital, asset quality and profitability

Due to the products' inherently low-risk nature, IBL's loan quality is very strong, both in absolute and relative terms. The NPE ratio is a low 2.8% as of Q3 2017 and exclusively comprises past-due loans, with no loans classified as 'unlikely to pay' or 'bad'. The increase in 2017 is due to acquisition of a EUR 300m portfolio of CQS and DP loans from Barclays.

The good asset performance is reflected by the negligible cost of risk, 13 bps of loans in 2017.

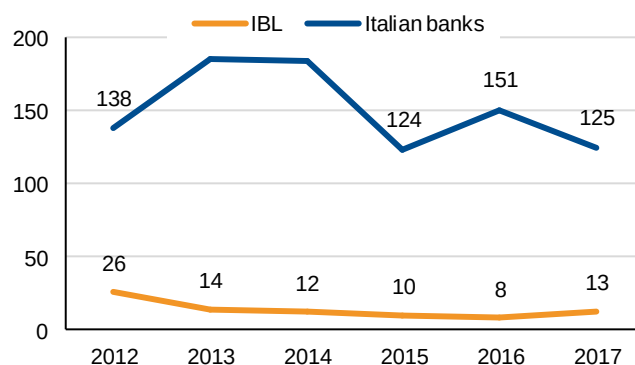
Figure 5: IBL's historical NPE ratio*



Source: Company data, Scope Ratings.

Note: excluding the acquisition of the Barclays portfolio the 2017 NPE ratio would stand at 2.1%

Figure 6: IBL's cost of risk is much lower than that of Italian banks (bps)*



Source: Company data, Scope Ratings.

Note: excluding the acquisition of the Barclays portfolio the 2017 cost of risk would stand at 9 bps

Profitability is solid. In 2017, return on assets was in excess of 1% and return of equity greater than 20%, better than most European banks. With a CET1 ratio of 11.6% at the end of 2017, we see IBL as well capitalised. Indeed, despite the very low risk of Italian PDL loans, they are assimilated to consumer credit products, and carry a very high risk-weight of 75% under the standardised approach (which IBL utilises).

IBL has also issued EUR 21m in AT1 notes and EUR 60m in Tier 2 notes, close to 1% and 2% of RWAs, respectively.

IBL's material exposure to Italian sovereign risk

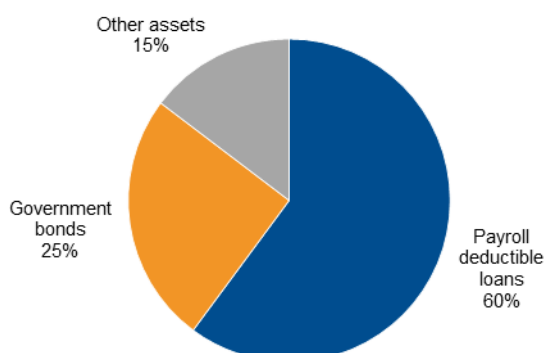
While almost all loans are either CQS, CQP or DP types, a large component of IBL's balance sheet comprises Italian government bonds, which boost income but represent a potential risk. Over the past five years, capital gains on government bonds have been a significant source of trading gains for IBL, helping it to recapitalize and to finance business growth.

As of Q4 2017, the Italian government bond portfolio stood at approx. EUR 1bn, over three times the group's CET1 capital, which we consider to be very high. This exposure has been declining over the past few quarters but remains material.

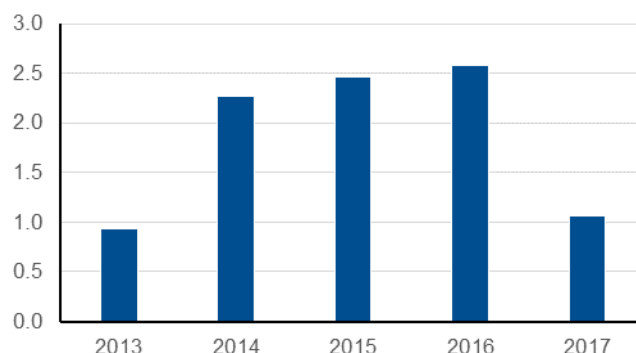
Italy's public debt level relative to gross domestic product (GDP), already very high, has been marginally increasing in recent years. Italy has kept public deficits more under control, however, thanks to consistent primary surpluses and low interest rates.

We deem Italian government bonds to be safe assets (Scope rates Italian debt at A-/Stable Outlook), yet we highlight scenarios which may lead to a deterioration in the sustainability of Italian public finances.

A large part of the government portfolio is funded via repos, mainly on the Italian telematic market for government bonds (MTS).

Figure 7: Total asset split (2017)


Source: Company data, Scope Ratings.

Figure 8: Evolution of IBL's government bond exposure (EUR bn)


Source: Company data, Scope Ratings.

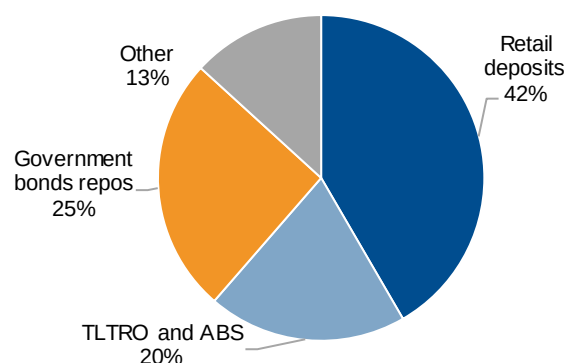
IBL funding is reliant on savings deposits, which are costly and price-sensitive, and on central bank funding

IBL's core business of payroll deductible loans is funded primarily via deposits (both sight and term) and via the ECB's TLTRO funding (against collateral in the form of asset-backed securities backed by CQS loans). As of Q4 2017, deposits stood at EUR 1.75bn, 42% of total funding, almost equally split between term and sight. To its customer base, IBL has consistently offered rates significantly above the market, as the bank targets very affluent clientele with a secondary account offering for savings and corporates. In 2017, the average cost of customer funding was approx.1.5%, stable compared to the previous year.

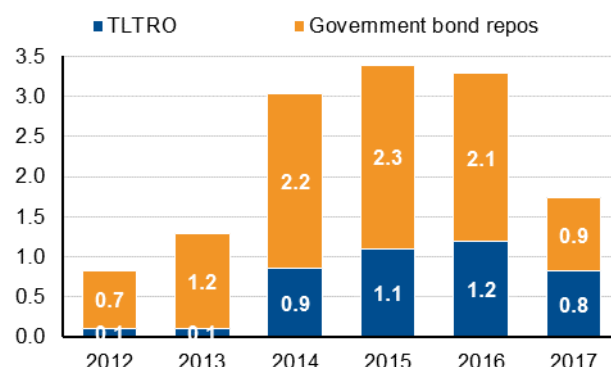
In the current interest rate environment, such rates have been attracting significant demand from retail customers, with deposit volumes growing over 21% in 2017. Looking ahead, IBL is considering limiting the use of this relatively expensive funding channel, and further diversify its funding sources.

One key instrument IBL is looking to use is securitisation. In 2017, it set up a new securitisation vehicle (Marzio Finance srl), tasked with issuing several tranches of asset-backed securities. In Q3 2017, Marzio acquired EUR 433m in CQS loans from IBL and issued securitised notes, which were placed with IBL and partly used as collateral for the ECB refinancing operations.

The government bond portfolio is mainly funded via repos, 25% of total funding as of Q4 2017. These include both bilateral repos with banking counterparts and repos on the MTS market, and are mostly executed at negative rates, producing a small income for IBL.

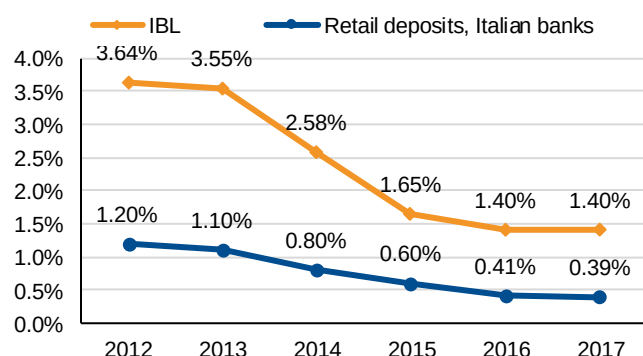
Figure 9: IBL funding split (2017)


Source: Company data, Scope Ratings.

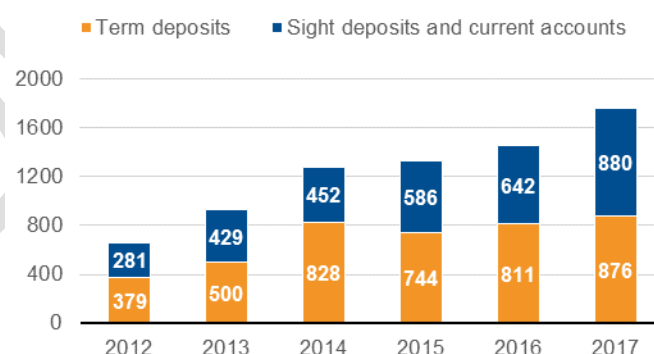
Figure 10: Wholesale funding, historical evolution (EUR bn)


Source: Company data, Scope Ratings.

IBL drew EUR 1.1bn in TLTRO auctions between 2014 and 2015: most (EUR 1.085bn) will have to be reimbursed over the course of 2018. An additional EUR 60m in TLTRO2 funds has to be reimbursed in 2020/2021. Already in September 2017 IBL reimbursed EUR 500m, partly by using excess liquidity it had placed with banking counterparts, but also by rolling some funding into shorter-term MRO (EUR 240m). The bank now plans to increasingly place its securitisations with private investors.

Figure 11: Cost of retail deposits, IBL vs Italian banking system


Source: Company data, Scope Ratings.
 Note: 2017 data refers to Q3

Figure 12: Retail deposits, historical evolution (EUR m)


Source: Company data, Scope Ratings.

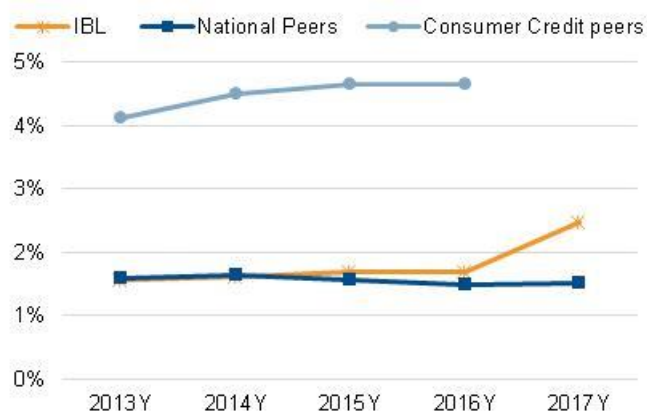
Closely held and controlled by management

Mario Giordano, the bank's CEO since 1998 (at the time, it was called Istituto Finanziario del Lavoro), controls 50% of the shares through the holding company Delta 6. Giordano has led the group through several transformation cycles, including the acquisition of a banking license in 2004, and the more recent move from an 'originate to distribute' model to a balance sheet model. His partners, the D'Amelio family, control the other 50% through their holding company Sant'anna srl and sit on the Board of Directors.

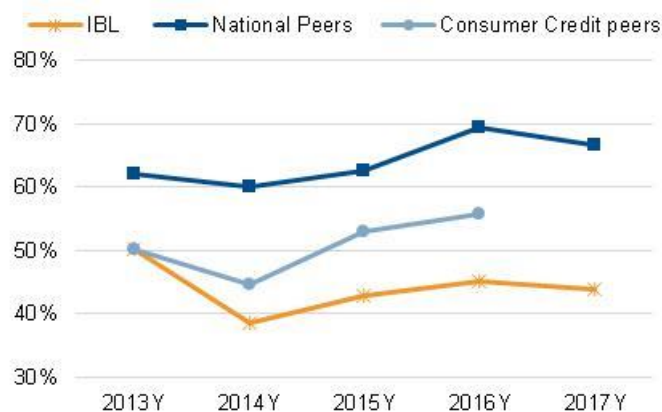
We believe Giordano represents a key man risk for the bank. His departure would add significant uncertainty both in terms of governance and strategy.

I. Appendix: Peer comparison

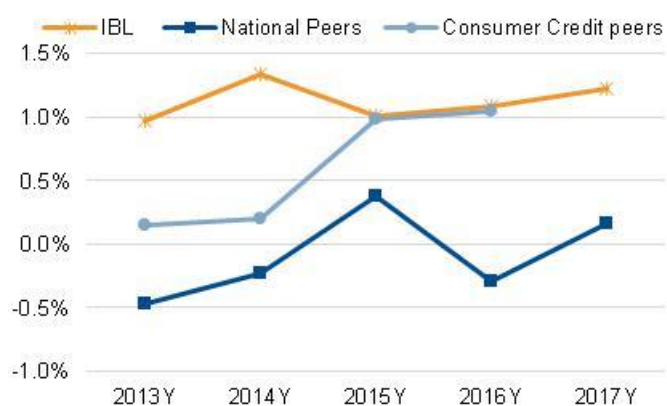
Net interest margin (%)



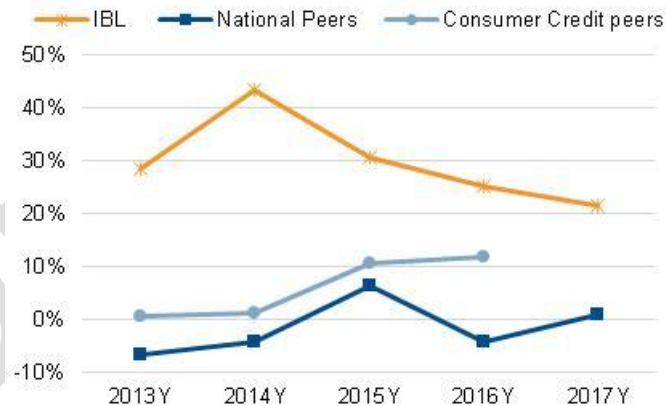
Cost-income ratio (%)



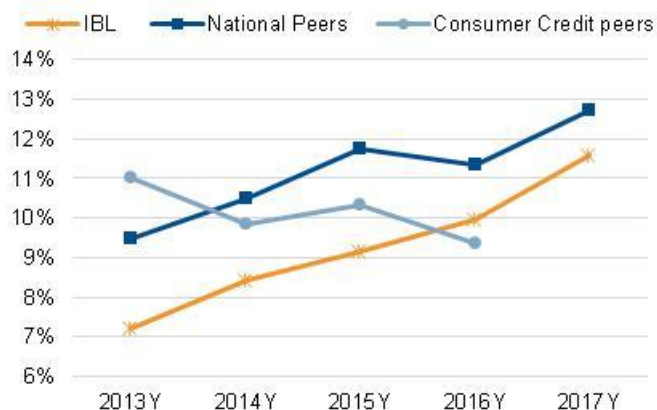
ROAA (%)



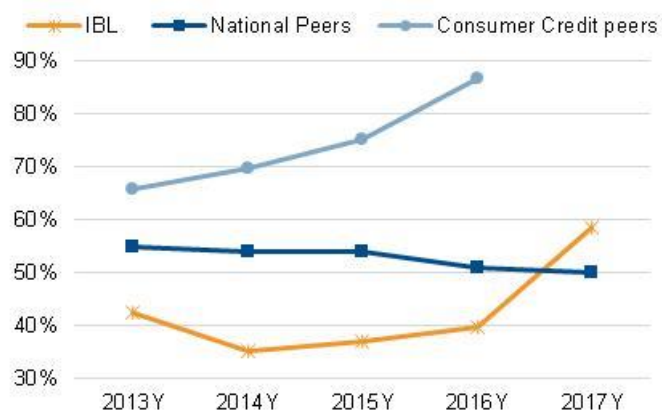
Return on average equity (ROAE) (%)



CET1 ratio (% , transitional basis)



Asset risk intensity (RWAs % total assets)



Source: SNL
National peers: Istituto Bancario del Lavoro, Unicredit, Intesa, Banca Monte dei Paschi, Banca Carige, Banca Popolare di Sondrio, Banco BPM; BPER Banca, Credito Emiliano, Credito Valtellinese, Mediobanca, UBI Banca.
Credit consumer peers: Agos Ducato SpA, BCC CreditoConsumo, Consel SpA, Creditis Servizi finanziari, Fidelity SpA, Findomestic Banca, PrestiNuova, Prestitalia.

II. Appendix: Selected Financial Information – Istituto Bancario del Lavoro SpA

	2014Y	2015Y	2016Y	2017Y	2018H1
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	564	372	376	285	NA
Total securities	2,315	2,508	2,619	1,083	NA
of which, derivatives	36	28	32	17	NA
Net loans to customers	1,618	2,031	2,316	2,591	2,700
Other assets	171	252	248	248	NA
Total assets	4,668	5,162	5,559	4,207	6,100
Liabilities					
Interbank liabilities	857	1,100	1,534	1,008	NA
Senior debt	0	1	1	1	NA
Derivatives	41	28	45	26	NA
Deposits from customers	3,459	3,619	3,545	2,654	3,700
Subordinated debt	59	65	60	60	NA
Other liabilities	NA	NA	NA	NA	NA
Total liabilities	4,530	4,942	5,316	3,892	5,770
Ordinary equity	138	220	242	315	NA
Equity hybrids	0	0	0	0	0
Minority interests	0	0	0	0	NA
Total liabilities and equity	4,668	5,162	5,559	4,207	6,100
<i>Core tier 1/Common equity tier 1 capital</i>	138	175	219	286	NA
Income statement summary (EUR m)					
Net interest income	58	80	87	115	56
Net fee & commission income	33	31	30	14	NA
Net trading income	37	25	48	36	NA
Other income	0	0	1	1	NA
Operating income	129	136	166	167	82
Operating expense	50	58	75	74	NA
Pre-provision income	79	78	91	94	NA
Credit and other financial impairments	2	2	2	4	NA
Other impairments	0	0	0	0	0
Non-recurring items	NA	NA	NA	NA	NA
Pre-tax profit	77	76	89	89	44
Discontinued operations	0	0	0	0	0
Other after-tax items	0	0	0	0	0
Income tax expense	26	24	28	29	14
Net profit attributable to minority interests	0	0	0	0	0
Net profit attributable to parent	50	52	61	60	30

Source: SNL, Scope Ratings

III. Appendix: Selected Financial Information – Istituto Bancario del Lavoro SpA

	2014Y	2015Y	2016Y	2017Y	2018H1
Funding and liquidity					
Net loans/deposits (%)	46.8%	56.1%	65.3%	97.7%	73.0%
Liquidity coverage ratio (%)	NA	140.0%	NA	NA	NA
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/assets (%)	34.7%	39.3%	41.7%	61.6%	44.3%
NPLs/net loans (%)	2.2%	1.9%	1.9%	3.0%	NA
Loan-loss reserves/NPLs (%)	21.3%	23.2%	24.0%	18.5%	NA
Net loan growth (%)	30.6%	25.5%	14.0%	11.9%	8.4%
NPLs/tangible equity and reserves (%)	24.6%	17.0%	17.9%	23.4%	NA
Asset growth (%)	61.4%	10.6%	7.7%	-24.3%	90.0%
Earnings and profitability					
Net interest margin (%)	1.6%	1.7%	1.7%	2.5%	NA
Net interest income/average RWAs (%)	4.1%	4.5%	4.2%	4.9%	NA
Net interest income/operating income (%)	45.3%	58.8%	52.3%	69.1%	68.1%
Net fees & commissions/operating income (%)	25.8%	23.0%	18.2%	8.5%	NA
Cost/income ratio (%)	38.7%	42.8%	45.1%	44.0%	NA
Operating expenses/average RWAs (%)	3.5%	3.3%	3.6%	3.2%	NA
Pre-impairment operating profit/average RWAs (%)	5.5%	4.4%	4.4%	4.0%	NA
Impairment on financial assets /pre-impairment income (%)	2.9%	2.3%	2.3%	4.6%	NA
Loan-loss provision charges/net loans (%)	0.1%	0.1%	0.1%	0.2%	NA
Pre-tax profit/average RWAs (%)	5.3%	4.3%	4.3%	3.8%	NA
Return on average assets (%)	1.3%	1.0%	1.1%	1.2%	1.1%
Return on average RWAs (%)	3.5%	2.9%	3.0%	2.6%	NA
Return on average equity (%)	43.4%	30.6%	25.2%	21.6%	18.3%
Capital and risk protection					
Common equity tier 1 ratio (% , fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (% , transitional)	8.4%	9.1%	10.0%	11.6%	12.0%
Tier 1 capital ratio (% , transitional)	8.4%	10.2%	10.9%	12.4%	NA
Total capital ratio (% , transitional)	8.8%	13.1%	12.8%	13.8%	14.0%
Leverage ratio (%)	NA	3.8%	4.4%	7.3%	NA
Asset risk intensity (RWAs/total assets, %)	35.1%	37.1%	39.6%	58.7%	NA
Market indicators					
Price/book (x)	NA	NA	NA	NA	NA
Price/tangible book (x)	NA	NA	NA	NA	NA
Dividend payout ratio (%)	NA	NA	NA	NA	NA

Source: SNL, Scope Ratings



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