



RATING ACTION COMMENTARY

Fitch Upgrades Finlombarda to 'BBB', Outlook Negative

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Fitch Ratings - Milan - 08 Apr 2020: Fitch Ratings has upgraded Finlombarda's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) to 'BBB' from 'BBB-' and the Short-Term Foreign-Currency IDR to 'F2' from 'F3'. The Outlook is Negative.

The most recently available issuer data from Italian Government-Related Entities (GREs) did not indicate performance impairment, but material changes in revenue and cost profiles are occurring across the sector. These are likely to worsen in the coming weeks and months as economic activity suffers and government restrictions are maintained or increased. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in the sector for their severity and duration. We will incorporate revised qualitative and quantitative inputs based on performance expectations and our assessment of key risks, including extraordinary support.

KEY RATING DRIVERS

Overriding Regional Government Guarantees

Finlombarda's upgrade and subsequent equalisation to Fitch's internal assessment of the Region of Lombardy is reflective of the government's guarantee on more than

75% of Finlombarda's financial liabilities in application of one of the three overriding factors of the GRE methodology. Finlombarda's share of debt guaranteed by the Region of Lombardy has risen above 75% at the beginning of 2020 amid draw-down of European Investment Bank (EIB) loans. Fitch expects a growing role for Finlombarda in the aftermath of the coronavirus pandemic by way of stronger demand for loans at favourable concessionary terms, in order to ease strains for small to medium enterprises (SMEs).

The assessment of Lombardy's support to Finlombarda is as follows:

Status, Ownership and Control Assessed as Very Strong

Fitch Ratings believes this rating factor very strongly supports the likelihood of the Region of Lombardy taking over Finlombarda's liabilities if necessary to prevent its default, as Finlombarda carries out near-governmental functions. Finlombarda has been included in the public sector perimeter since 2019, according to Eurostat parameters. This highlights Finlombarda's role of "in-house provider" of developmental financial services for the region and its support of the local economy and SMEs, either via direct lending or through the provision of regional/EU funds administered on behalf of the region. Finlombarda is fully owned, enabling Lombardy to appoint its board of directors and approve budgets, business plans and financial statements, while retaining control of strategic decisions and routine checks of the adherence of Finlombarda's operations to regional guidelines.

The evolving national legislation on local and regional governments' companies exposes in-house providers to bankruptcy, but the liquidation process of regional companies, such as ASAM (BBB-/Rating Watch Positive, rating Withdrawn in May 2018), suggest the procedure will ultimately imply the ordinate transfer of liabilities, as well as assets, to the region. The same legislation requires the activation of early warning indicators of deteriorating credit quality, such as abnormal growth of non-performing loans and aims of preventing financial distress by eventually prompting government support.

Support Track Record and Expectations Assessed as Very Strong

The assessment reflects ongoing fee revenue from the region, which is calibrated to ensure Finlombarda's minimum profitability over time. As a financial intermediary, Finlombarda is subject to capital requirements and alerts from the regulator if the equity falls towards minimum levels are conducive to maintaining financial viability.

Support is also demonstrated by cash equity increases in 2014 and planned for subsequent years if needed to support balance-sheet expansion, as well as regional guarantees on borrowing from the European Investment Bank.

When part of a recovery plan, national legislation tends to allow for equity injections for loss-making GREs. Fitch believes in-house providers may have further leeway when they carry out near-governmental functions as EU state aid rules may not apply. Finlombarda's activity is channelled into sectors selected in agreement with the region as lending often implies forms of subsidisation, either on interest or via capital grants or partial guarantees in the case of borrowers' non-performance.

Socio-Political Implications of Default Assessed as Moderate

Fitch's assessment reflects the limited size of Finlombarda's activity, which involves about a dozen bond investors, the EIB as a main bank lender, and about 3,000 borrowers. Although Finlombarda's lending activity could ultimately be carried out by other intermediaries, the coronavirus pandemic may prevent this from being a possibility for the region when taking into account its foreseeable efforts to contain damages to Lombardy's network of SMEs. A default could also disrupt the functioning of some regional responsibilities, such as the disbursement of EU funds to SMEs for consultancy and screening services.

Financial Implications of Default Assessed as Strong

The assessment balances the perception of Finlombarda as Lombardy's proxy funding agency against Fitch's expectations that a default by Finlombarda would have a limited impact on Lombardy's borrowing capacity. Fitch believes that Lombardy may be shielded from the consequences of Finlombarda's default - if that entailed denied market access - by the ongoing policy role of Cassa Depositi and Prestiti (BBB/Negative), which is required to fund local and regional governments uniformly, regardless of Finlombarda's default.

Operations

Finlombarda is broadening its range of activities to become a "lender of last resort" for regional enterprises and for the national and international development of local SMEs. Fitch expects the increased lending to SMEs, regional companies and other entities to over double to EUR600 million by 2022 from nearly EUR300 million 2019, increasing total assets to EUR0.75 billion. Counterparty risk is mitigated by

exposure to regionally controlled companies, some of which had their borrowing guaranteed by the region to help limit Finlombarda's regulatory capital absorption. Fitch believes, however, that the stressed condition of SMEs will lead to a surge of non-performing loans, with the total reaching almost 20%. Non-performing loans accounted for about 4% of loans in 2019, down from 11% in 2017. These figures are when bond and loan lending to SMEs are considered together. The interest margin and net fee commission from the region are seen by Fitch to be at around EUR10 million each, with revenue covering staff costs and impairment of loans, keeping the income statement roughly in balance over the medium term.

DERIVATION SUMMARY

Fitch classifies Finlombarda as a GRE of the region of Lombardy under its GRE criteria and believes that the region would provide extraordinary support to Finlombarda to avoid its default and/or even the acceleration of the repayment of Finlombarda's entire outstanding debt, triggered by guarantees on EIB loans and cross-default clauses on loans and listed bonds. The overriding factor of the high share of guaranteed debt supersedes the one-notch rating differential, which stems from the assessment of the strength of linkage of Finlombarda with Lombardy and from Lombardy's willingness to provide extraordinary support to Finlombarda if required. The subsequent score of 35 results in a single-notch differential with the region's IDR amid a standalone credit profile of 'bb-' which, at four notches away from Lombardy's assessment, is not a rating driver.

KEY ASSUMPTIONS

Fitch assumes that draw-down on Finlombarda's EMTN programme will double compared with the outstanding EUR50 million that is due for repayment in September 2022, yet will remain below the maximum EUR200 million of allowed draw-down.

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade: Finlombarda's rating could be downgraded if the share of

regional guaranteed debt unexpectedly decreases below 75% over the medium term, unless offset by other supporting factors, including a standalone credit profile not more than three notches away from the internal assessment of the Region of Lombardy.

If the internal assessment of the Region of Lombardy is downgraded, Finlombarda could also be downgraded.

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

If the internal assessment of the Region of Lombardy is upgraded, Finlombarda could also be upgraded.

BEST/WORST CASE RATING SCENARIO

Best/Worst Case Rating Scenarios - Public Finance:

Ratings of Public Finance 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 three 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

<https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Liquidity generated by operations is underpinned by liquid assets of about EUR150 million in 2019, not expected to fall below EUR50 million-EUR100 million over the medium term.

Bullet EUR50 million bond due in 2022

Amortising loans from EIB

SUMMARY OF FINANCIAL ADJUSTMENTS

None

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

Linked to Fitch's internal assessment of the Region of Lombardy

ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Finlombarda S.p.A.	LT IDR	BBB 	Upgrade
●	ST IDR	F2	Upgrade
●	LC LT IDR	BBB 	Upgrade

ENTITY/DEBT	RATING		
● senior unsecured	LT	BBB	Upgrade
VIEW ADDITIONAL RATING DETAILS	ST	F2	Upgrade

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[Rating Criteria for International Local and Regional Governments \(pub. 13 Sep 2019\) \(including rating assumption sensitivity\)](#)

[Government-Related Entities Rating Criteria \(pub. 13 Nov 2019\)](#)

ADDITIONAL DISCLOSURES

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Finlombarda S.p.A.

EU Issued

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