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BNL Upgraded, UniCredit Outlook Revised To Stable On Improved Ability To Withstand Sovereign Distress Scenario

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OVERVIEW

- Improved resolvability, potential support from parent companies within the eurozone, and growing loss-absorption capacity from capital and subordinated debt could help some of the systemically important Italian banks to withstand hypothetical sovereign distress scenarios.
- We also see a potential improvement in these banks' resilience to withstand a hypothetical default of the Italian sovereign from their efforts to reduce their domestic exposures.
- We are raising the long-term issuer credit rating (ICR) on Banca Nazionale del Lavoro SpA to 'BBB+' from 'BBB' and affirming the short-term rating of 'A-2'. The outlook remains negative.
- We are revising the outlook on UniCredit SpA to stable from negative and affirming the ratings on the bank, including the 'BBB' long-term ICR.

MILAN (S&P Global Ratings) July 15, 2019--S&P Global Ratings said today that it took the following rating actions on four major Italian banks:

- We raised the long-term issuer credit rating (ICR) on French BNP Paribas' core Italian subsidiary Banca Nazionale del Lavoro SpA (BNL) to 'BBB+' from 'BBB' and the long-term resolution counterparty credit rating (RCR) on BNL to 'A-' from 'BBB+'. We affirmed the 'A-2' short-term ICR and RCR on the bank. The outlook is negative.
- We revised the outlook on UniCredit SpA to stable from negative and affirmed all our ratings on the bank, including the 'BBB' long-term ICR.
- We affirmed all our ratings on Mediobanca SpA and Intesa Sanpaolo SpA, including our 'BBB/A-2' long- and short-term ICRs. Our outlooks on both banks remain negative.

The rating actions follow our review of major Italian banks amid progress in the implementation of the EU bank resolution framework, banks' continued risk reductions in problematic assets, and efforts to diversify their investments in liquid securities. In particular, we considered whether these measures could reduce the historically tight correlation between the creditworthiness of these banks and that of the Republic of Italy. In our view, UniCredit, Mediobanca, and Intesa Sanpaolo are improving their resilience to withstand a hypothetical default of the Italian sovereign. For BNL, the rating actions primarily reflect parental support.

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In the case of UniCredit, all else being equal, we could rate it one notch above our long-term ratings on Italy. In particular, this takes into account UniCredit's ongoing build-up of additional resources of subordinated bail-inable capital buffers and its superior geographic diversification. However, we would most likely still lower our issue ratings on the subordinated and hybrid capital instruments issued by UniCredit, including senior nonpreferred instruments, if we downgraded Italy. This reflects our assumption that a hypothetical default of the sovereign would most likely trigger a resolution of UniCredit, including the write-down or equity conversion of these instruments.

In the case of BNL, which we now rate one notch above the long-term ratings on Italy, we consider in particular the incentives for BNL's parent, BNP Paribas (A+/Stable/A-1), to support BNL, given BNP Paribas' sustained funding commitments and our view that BNL would be a material subsidiary in the context of BNP Paribas' broader single-point-of-entry resolution strategy.

We are maintaining our negative outlooks on Intesa Sanpaolo and Mediobanca in line with the negative outlook on Italy. This mainly reflects less visibility on the timing and level of additional subordinated bail-in capacity, and these banks' stronger reliance on their domestic franchise and resources than UniCredit and BNL. However, further improvements in building subordinated buffers and risk diversification might lead to an outlook revision to stable.

The four banks are in a better position than their peers

Our review focused on BNL, UniCredit, Mediobanca, and Intesa Sanpaolo because we think they are in a better position than their domestic peers to weather the effects of a potential weakening in the economic and market environment in Italy. For UniCredit, Intesa Sanpaolo, and Mediobanca, this is reflected in their stand-alone credit profiles (SACPs) of 'bbb', the same level as our long-term ratings on Italy. Moreover, while we see growing risks for the profitability and funding profiles of Italian banks generally, we anticipate that the SACPs of UniCredit, Intesa Sanpaolo, and Mediobanca could be relatively resilient. For BNL, its resilience is supported by being an integral part of a much stronger, France-based, international banking group.

Specifically, we consider that UniCredit will continue to benefit from much stronger geographic diversification outside Italy than any of its domestic peers, sound liquidity, and the material progress it has made in reducing its stock of nonperforming exposures (NPEs) in Italy and in strengthening its capitalization. For Intesa Sanpaolo, we project that it will continue to outperform its peers thanks to its revenue diversification, in particular its domestic leadership in wealth management, better efficiency, and large domestic retail funding base. For Mediobanca, we anticipate that it continues to benefit from a diverse set of business lines, and higher capital and profitability and stricter control of credit risk than its domestic peers.

There is a high correlation between the banks' creditworthiness and domestic sovereign risk

Despite the aforementioned strengths, we continue to see the correlation between the banks' creditworthiness and Italy's creditworthiness as a potentially significant constraint on our ratings on these banks. Banks are typically exposed to the sovereign risk of their country of domicile in multiple ways, including exposure to the domestic economy and large sovereign debt holdings. Notably, banks tend to hold relatively limited capital against sovereign exposures, which the regulatory framework tends to treat as almost risk-free. Therefore, globally, for domestic banks that are not part of a large foreign group, it is very rare in practice that we would rate them above their home sovereign.

We could rate an institution above the sovereign if we consider that its stand-alone creditworthiness is higher than the sovereign rating and there is an appreciable likelihood that it would not default if the sovereign were to default. In particular, we might consider rating banks above their respective sovereign ratings if we believe their capitalization and liquidity could withstand a hypothetical sovereign default scenario (see "Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions," published Nov. 19, 2013). Our stress test scenario assumes that Italy would remain in the Monetary Union. For the domestic subsidiaries of stronger foreign banks, we may also consider a higher rating if we believe that the parent would provide timely and sufficient support in the event of extreme and remote sovereign distress.

The implementation of resolution tools might support the banks' ability to potentially withstand sovereign distress

In this context, the regulatory requirement for systemic EU banks to build up subordinated bail-inable liabilities might provide additional resources for Italian banks to protect their senior unsecured (preferred) debt from a default. Although we assume that the immediate and consequential effects of a sovereign default would weigh heavily on domestic banks, we assume that the eurozone resolution authorities would most likely use their resolution powers to restore the solvency of systemic banks. In particular, this would entail the write-down or conversion into equity of nondeferrable subordinated debt (tier 2) and senior nonpreferred liabilities.

If we expect that subordinated instruments would provide sufficient capacity to absorb the potential losses and substantially restore capitalization without the senior preferred bondholders being bailed in, we could set the ICR on a bank above the sovereign rating.

In assessing the results of our hypothetical sovereign default scenario, and being mindful also of the related threat to financial and macroeconomic stability, we assume that the EU regulators might, if necessary, apply some forbearance compared to the banks' current regulatory capital requirements including buffer add-ons. However, we also assume that the European Central Bank (ECB), as the main regulator in the eurozone, would not allow financial institutions to operate post-resolution with total regulatory capital below 8%, the legal minimum to continue operating.

We also assess the banks' ability to maintain sufficient liquidity in the case of a sovereign default. On this front, we believe these large banks would be able to withstand the effects of sovereign distress, given their existing liquidity buffers and likely support from the ECB.

Global systemically important financial institutions like UniCredit are most advanced in building subordinated bail-in buffers

Global systemically important financial institutions (SIFIs), like UniCredit or BNP Paribas, are typically more advanced in issuing subordinated bail-inable liabilities and have provided better visibility on their issuance plans and resolution strategies than other systemic banks. This is partly because they are subject to the global total loss-absorbing capital (TLAC) standard, which requires an accelerated build-up of these resources and sets minimum subordination standards. On the other hand, we observe that the other systemic banks in Italy are largely using senior (preferred) unsecured bonds to build up buffers for the minimum requirement for own funds and eligible liabilities.

UniCredit

We consider that UniCredit's issuance of over €15 billion of subordinated instruments in the past two years, combined with the ongoing clean-up of its domestic balance sheet, have significantly enhanced its ability to potentially withstand a sovereign distress scenario. In addition, UniCredit is one of the global SIFIs that is geographically diversified outside Italy--which accounts for roughly over 50% of its total exposures--and is subject to more advanced resolution planning, in our view.

As a global SIFI, UniCredit has been building up buffers of subordinated liabilities to comply with its TLAC requirement. In 2019 alone, it has already issued €7.2 billion of instruments. We expect this to continue in the coming 12-18 months. These issuances, paired with ongoing capital actions, such as the recently completed disposal of its 35% stake in Fineco Bank and the sales of some real estate assets, provide more cushion to cover the potential high losses from a hypothetical scenario of sovereign default.

Furthermore, we anticipate that UniCredit's clearly formulated strategy and associated further financial measures to reduce its risky exposure to Italy could reduce its future losses. Those actions include the acceleration of the run-down of the legacy portfolio of NPEs in Italy to close to €10 billion by year-end 2019 (compared to €17.7 billion in March 2019) and the plan to gradually align its holding of Italian government securities with the levels of domestic and international peers.

In our base-case scenario, a sovereign default would most likely trigger the resolution of UniCredit, the Italian parent company. We expect that the conversion of the loss-absorbing subordinated instruments to equity would be sufficient to adequately recapitalize UniCredit. Still, we expect that the authorities would require the group to restore its consolidated minimum capital requirement as well. We believe this is likely to happen as the group proceeds with the ongoing actions in the coming months.

BNL

BNL is a core group member of BNP Paribas, operating in the eurozone and under the same regulatory and supervisory framework. Our rating actions on BNL primarily reflect our expectation of extraordinary support from the parent BNP Paribas in any potential stress scenario triggered by a sovereign default in Italy. In particular, we see improved visibility on how the resolution of a large group like BNP Paribas might work in a stress scenario, and on the group's continued commitment to BNL.

Specifically, the parent has continued to provide material funding resources to BNL for years, despite the more challenging macroeconomic environment in Italy. As a result, the bank does not access wholesale markets for funding to complement its deposit base. This provides a strong incentive for BNP to support its subsidiary, in our view.

In addition, we expect that BNL would be a material subsidiary in the context of BNP's broader single-point-of-entry resolution strategy.

As a result, we now rate BNL one notch above Italy. We set the RCRs on BNL one notch above our 'BBB+' long-term ICRs, in line with our methodology and jurisdictional assessment on Italy.

Outlooks

BNL

The negative outlook on BNL mirrors that on Italy and reflects that we may lower our long-term ratings on the bank following a similar action on the sovereign credit rating over the next 12-24 months. This reflects our view that we would not rate BNL more than one notch above the sovereign rating.

Conversely, we could revise the outlook to stable if we took this action on Italy.

UNICREDIT

The stable outlook primarily reflects our view that UniCredit will continue to build up loss-absorbing buffers to protect senior bondholders and reduce its exposures in Italy, thereby improving the chance that it could withstand a sovereign default. In our base-case scenario, we anticipate that the NPE ratio will fall to 7% by 2020, the risk-adjusted capital (RAC) ratio will remain sustainably above 7% over the next two years, and the bank will maintain a balanced funding profile.

Downside scenario

We could downgrade UniCredit over the next 12-24 months if we downgrade Italy and conclude that UniCredit is failing to deliver on its financial measures to reduce risky exposures in Italy and further strengthen its buffers of subordinated bail-inable debt. We could also downgrade UniCredit if we perceive that its performance materially deviates from our current expectations.

Upside scenario

Although very unlikely, we could upgrade UniCredit if we conclude that the bank's stand-alone creditworthiness has improved sufficiently, for example, by materially reducing further nonperforming loans and strengthening capital. An upgrade is also made unlikely by the risks that we see for profitability and funding profiles for Italian banks generally.

Hybrids

We do not assign outlooks to bank issue ratings. However, we will continue to notch the ratings on the hybrids--namely senior nonpreferred, subordinated, and junior subordinated notes--down from the lower of two potential starting points: the bank's SACP and the ICR. Still, in the event of a downgrade of Italy, we might lower our issue ratings on the hybrid instruments by widening the notching, even if we were to affirm the ICR on UniCredit. At this stage, we conclude that our hypothetical sovereign default scenario would trigger the resolution of UniCredit relatively quickly, given the bank's direct sovereign exposures, with a bail-in of the subordinated instruments to recapitalize the bank.

MEDIOBANCA

The negative outlook on Mediobanca and its subsidiary, MB Funding Lux, reflects that we could lower the ratings if we were to lower our ratings on Italy and if we concluded that Mediobanca would be unlikely to withstand a sovereign default without defaulting on its senior debt obligations. We could also take this action if, over the next 12-24 months, operating conditions deteriorate and market pressure rises further for a prolonged period, and we perceived that this could significantly erode Mediobanca's funding profile.

Upside scenario

We could revise the outlook on Mediobanca to stable if we took the same action on Italy. We could also revise the outlook to stable if we considered that Mediobanca were unlikely to default if the sovereign defaulted. This could happen if Mediobanca's loss-absorbing capacity from capital and subordinated instruments further increased, and the bank demonstrated that it could roll over its maturing debt without hampering its profitability.

Hybrids

We do not assign outlooks to bank issue ratings. We currently rate Mediobanca's issues by notching down from the SACP. Therefore, we would expect the issue ratings to move in tandem with the lower of the bank's SACP and the ICR. If we were to lower the rating on Mediobanca, we would also lower the rating on the bank's rated subordinated debt, since we would notch downward the ratings on the hybrids from the lower of the bank's SACP and the ICR.

INTESA SANPAOLO

The negative outlook on Intesa Sanpaolo mirrors that on the sovereign and signifies that we could downgrade Intesa Sanpaolo if we lowered the ratings on Italy in the next 12-24 months and concluded that Intesa Sanpaolo would be unlikely to withstand a hypothetical sovereign default without defaulting on its senior debt obligations.

In our base-case scenario, we anticipate that Intesa Sanpaolo's leading market position in Italy in commercial banking and wealth management, well-diversified revenue sources, strong efficiency, and prudent management will continue to support the bank's outperformance of other domestic banks. We now anticipate that Intesa Sanpaolo will reduce its gross nonperforming asset ratio to around 7% by year-end 2021, while preserving its capitalization over the next couple of years within 5.5%-6.0%, as measured by our RAC ratio.

Upside scenario

We might revise the outlook back to stable if we took a similar action on Italy. Although less likely at this stage, we might also take this action if we concluded that Intesa Sanpaolo were likely to withstand the effects of a hypothetical default scenario of Italy without itself defaulting on its senior unsecured debt. The latter eventuality would stem from the bank's declining direct exposure to the Italian sovereign, and the issuance of loss-absorbing instruments that are sufficient to help the bank absorb the impact of such an adverse scenario on its balance sheets.

Hybrids

We do not assign outlooks to bank issue ratings. However, we will continue to notch down the ratings on Intesa Sanpaolo's hybrids starting from the lower of the bank's SACP and ICR. Therefore, if we were to lower the ratings on Intesa Sanpaolo, we would also lower the rating on the bank's rated additional tier I and tier II instruments.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- 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
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 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
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

*************** **BNP Paribas** ***************		
Upgraded; Ratings Affirmed		
	To	**From**
Banca Nazionale del Lavoro SpA		
Issuer Credit Rating	BBB+/Negative/A-2	BBB/Negative/A-2
Resolution Counterparty Rating	A-/--/A-2	BBB+/--/A-2
************** **Intesa Sanpaolo SpA** **************		
Ratings Affirmed		
Intesa Sanpaolo SpA		
Fideuram - Intesa Sanpaolo Private Banking SpA		
Banca IMI SpA		
Issuer Credit Rating	BBB/Negative/A-2	
Resolution Counterparty Rating	BBB+/--/A-2	
*************** **Mediobanca SpA** ***************		
Ratings Affirmed		
Mediobanca SpA		
MB Funding Lux S.A.		
Issuer Credit Rating	BBB/Negative/A-2	
Resolution Counterparty Rating	BBB+/--/A-2	
*************** **UniCredit SpA** ***************		
Ratings Affirmed; Outlook Action	To	From
UniCredit SpA		
Issuer Credit Rating	BBB/Stable/A-2	BBB/Negative/A-2
Resolution Counterparty Rating	BBB+/--/A-2	