05 Nov 2020 | Affirmation

Correction: Fitch Affirms Unicredit at 'BBB-'; Outlook Stable

Fitch Ratings-Milan-05 November 2020:

This commentary replaces the version published on 3 November 2020 to include the rating action on Unicredit Bank (Ireland) plc's senior preferred debt issues.

Fitch Ratings has affirmed Unicredit S.p.A.'s (Unicredit) Long-Term Issuer Default Rating (IDR) at 'BBB-' and Viability Rating (VR) at 'bbb-'. The Outlook on the Long-Term IDR is Stable.

A full list of rating actions is detailed below.

The affirmation reflects the continuing strength of Unicredit's capitalisation. It also reflects the bank's progress in improving asset quality following the deconsolidation of nearly EUR9 billion of legacy impaired loans over the past 12 months to June 2020.

The Stable Outlook reflects our expectation that, under various possible downside scenarios to our baseline, Unicredit's capitalisation will remain satisfactory relative to the bank's rating and resilient to the expected deterioration of asset quality amid the current economic downturn.

Key Rating Drivers

IDRS, VR, DERIVATIVE COUNTERPARTY RATING (DCR) AND SENIOR DEBT

The ratings of Unicredit reflect the influence of its large operations in Italy and Italian sovereign risk exposure on the group's overall risk profile, despite its well-diversified business profile across a number of countries, including into more stable countries than Italy. In our view, Italy (BBB-/Stable) has a proportionately higher influence due to the group's credit profile being correlated with that of Italian sovereign, as reflected in the sensitivity of the group's overall performance to the operating environment in Italy.

The ratings also factor in Unicredit's progress in reducing impaired loans, in line with the bank's stated objectives, a gradual recovery in operating profitability, satisfactory capital buffers over regulatory minimum requirements and the completion of the bank's TLAC/MREL (total loss-absorbing capacity/minimum required own funds and eligible liabilities) funding plan.

Fitch views the bank's capitalisation (14.5% regulatory CET1 ratio at end-1H20, calculated including 2019 suspended dividend but excluding 1H20 accrued dividend of 30% of underlying profit) as a rating strength, given its satisfactory buffers over regulatory requirements. In 1H20, the strengthening of regulatory capital ratios since end-2019 was driven by lower risk-weighted assets (RWAs), the postponement of an EUR0.5 billion share buyback and the suspension of the 2019 dividend. Our assessment also considers the limited exposure of the bank's CET1 ratio to unreserved impaired loans, which narrowed to nearly 10% at end-1H20, down from 16% at end-2019, and compares well internationally. Its exposure to domestic government bond holdings (which reduced to 87% of CET1 capital at end-1H20 from nearly 100% a year earlier) increases the bank's vulnerability to severe shocks.

During 1H20, Unicredit's impaired loans fell below 6% of total loans following impaired loan disposals, in line with the bank's target to complete the legacy-asset rundown by end-2021. Asset quality remains weaker than at many of its large European peers but this gap should materially reduce once legacy impaired loan disposals are completed. However, we see downside risks to the positive asset-quality trend as we expect inflows of new impaired loans to increase due to the economic downturn. The bank's improved risk discipline, the government's support measures for borrowers and further progress in the impaired loan disposal plan should provide some mitigation.

In 1H20, the bank's operating profitability fell sharply yoy due to EUR1.4 billion of extraordinary loan impairment charges (LIC) for IFRS9 macroeconomic deterioration as the bank front-loaded much of the expected pandemic-related charges to the first half of the year and adopted quite severe macroeconomic assumptions (total LICs for 1H20 were EUR2.1 billion). The weakness was also attributed to lower revenue on shrinking business volumes, which more than offset slightly lower operating costs on cost discipline.

Fitch expects Unicredit's operating profitability to remain under pressure in 2021 as the continuation of the health crisis will likely result in subdued business volumes and high LICs. Over the medium term, we expect Unicredit's operating profit to be above 1% of RWAs on a normalised basis. We also believe that Unicredit's geographic diversification into countries less impacted by the economic downturn than Italy (i.e. Germany and Austria) could support a rebound in 2021 and beyond.

Our assessment of UniCredit's funding profile is underpinned by the bank's pan-European deposit franchise in retail and commercial banking, which provides the group with a sound proportion of customer deposits, and by diversified access to institutional debt market by instrument and geography. In recent years, the bank has been reducing its intragroup exposure to reduce contagion risks among different countries, which led to UniCredit's divisions and subsidiaries being reasonably self-sufficient in funding.

Unicredit's senior preferred notes are rated in line with the Long-Term IDR as we expect these to be part of the bank's resolution buffers and we do not expect more junior buffers to exceed 10% of RWAs on a sustained basis.

UniCredit's senior non-preferred notes (SNP) are rated one notch below the bank's Long-Term IDR to reflect the risk of below-average recoveries arising from the use of senior preferred and SNP debt to meet resolution buffer requirements and the combined buffer of additional Tier 1 (AT1), Tier 2 and SNP debt being unlikely to exceed 10% of RWAs.

The Short-Term IDR and short-term senior debt ratings of 'F3' are in line with our rating correspondence table for a 'BBB-' Long-Term IDR.

Unicredit's DCR is at the same level as the Long-Term IDR because in Italy derivative counterparties have no preferential legal status over other senior obligations in a resolution.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Rating (SR) and Support Rating Floor (SRF) reflect Fitch's view that although external support is possible it cannot be relied upon. Senior creditors can no longer expect to receive full extraordinary support from the sovereign in the event that the bank becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for the resolution of banks that requires senior creditors to participate in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

SUBSIDIARY AND AFFILIATED COMPANY

The ratings of senior preferred debt issued by UniCredit's funding vehicles, UniCredit Bank (Ireland) plc, and UniCredit International Bank Luxembourg SA, are equalised with that of the parent because the debt is unconditionally and irrevocably guaranteed by UniCredit, and Fitch expects the parent to honour this guarantee.

DEPOSIT RATING

The Long-Term Deposit Rating is one notch above UniCredit's Long-Term IDR because we believe the bank has sufficient combined buffers of junior and senior debt that result in a lower probability of default on deposits relative to the Long-Term IDR. The one-notch uplift also reflects our expectation that the bank will maintain sufficient buffers, given its status as a globally systemically important bank (G-SIB) and the need to comply with TLAC and MREL requirements.

The 'F3' Short-Term Deposit Rating of Unicredit is the baseline option for a 'BBB' Long-Term Deposit Rating because the funding and liquidity scores are not high enough to achieve the higher equivalent short-term rating option possible at a 'BBB' level.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid capital securities issued by Unicredit are notched down from the VR in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles.

Unicredit's Tier 2 subordinated debt is rated two notches below the VR for loss severity to reflect poor recovery prospects. No notching is applied for incremental non-performance risk because write-down of the notes will only occur once the point of non-viability is reached and there is no coupon flexibility before non-viability.

Unicredit's AT1 notes are rated four notches below the VR, comprising two notches for loss severity relative to senior unsecured creditors and two notches for incremental non-performance risk. The latter reflects the instruments' fully discretionary interest payment.

Unicredit's legacy Tier 1 notes are notched down four times from the VR, comprising two notches for loss severity for deep subordination and another two for non-performance risk as coupon deferral is constrained by look-back clauses.

RATING SENSITIVITIES

IDRS, VR, SENIOR-PREFERRED AND SNP

Factors that could, individually or collectively, lead to negative rating action/downgrade:

UniCredit's ratings are likely to be downgraded if Italy's sovereign rating is downgraded. The ratings are also sensitive to the depth and duration of the economic crisis caused by the pandemic and its impact on the bank's financial profile and could be downgraded if UniCredit's CET1 ratio falls below 13% without the prospect of recovery in the short term. This weakening of capitalisation could be caused by a delay to the recovery of Italy's economy, which could result in prolonged damage to the bank's asset quality, earnings and, ultimately, capital.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

For Unicredit's ratings to be upgraded, Italy would need to be upgraded and the operating environment would have to stabilise and pressures on earnings, asset quality and risk appetite that have arisen from the economic downturn would need to ease.

Unicredit's senior preferred and SNP debt ratings could also be upgraded if Unicredit is expected to meet the resolution buffer requirements of the consolidated entity with SNP and more junior instruments, or if resolution buffers represented by SNP and more junior instruments are expected to be at least 10% of RWAs on a sustained basis, neither of which is currently the case.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the SR and upward revision of the SRF would be contingent on a positive change in the sovereign's propensity to support the bank. In Fitch's view, this is highly unlikely, although not impossible.

SUBSIDIARY AND AFFILIATED COMPANIES

The ratings of the senior debt issued by UniCredit's funding vehicles, UniCredit Bank (Ireland) plc, and UniCredit International Bank Luxembourg SA, are sensitive to the same considerations as the senior unsecured debt issued by the parent.

DEPOSIT RATING

The Deposit Ratings are primarily sensitive to changes in the bank's IDRs, from which they are notched. The Long-Term Deposit Rating Is also sensitive to a reduction in the size of the senior and junior debt buffers, although we view this unlikely in light of the bank's current and future TLAC/MREL requirements. The Short-Term Deposit Rating could be upgraded if we upgrade Unicredit's funding and liquidity scores.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The subordinated debt's and hybrid securities' ratings are primarily sensitive to changes in the VR, from which they are notched. The ratings are also sensitive to a change in the notes' notching, which could arise if Fitch changes its assessment of their non-performance relative to the risk captured in the VR or their expected loss severity. For AT1 issues, this could reflect a change in capital management or flexibility, or an unexpected shift in regulatory buffers and requirements, for example.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond 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 four 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, visit [https://www.fitchratings.com/site/re/10111579]

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.

ESG Considerations
Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

UniCredit International Bank Luxembourg SA
----Senior preferred; Long Term Rating; Affirmed; BBB-
UniCredit S.p.A.; Long Term Issuer Default Rating; Affirmed; BBB-; Rating Outlook Stable
; Short Term Issuer Default Rating; Affirmed; F3
; Viability Rating; Affirmed; bbb-
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
; Derivative Counterparty Rating; Affirmed; BBB-(dcr)
----subordinated; Long Term Rating; Affirmed; BB
----subordinated; Long Term Rating; Affirmed; B+
----long-term deposits; Long Term Rating; Affirmed; BBB
----Senior preferred; Long Term Rating; Affirmed; BBB-
----Senior non-preferred; Long Term Rating; Affirmed; BB+
----short-term deposits; Short Term Rating; Affirmed; F3
----Senior preferred; Short Term Rating; Affirmed; F3
Unicredit Bank (Ireland) p.l.c
----Senior preferred; Long Term Rating; Affirmed; BBB-

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Applicable Criteria
Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status
Endorsement Policy

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