17 DEC 2021

Fitch Upgrades Unicredit to 'BBB' on Sovereign Upgrade; Outlook Stable

Fitch Ratings - Milan - 17 Dec 2021: Fitch Ratings has upgraded Unicredit S.p.A.'s Long-Term Issuer Default Rating (IDR) to 'BBB' from 'BBB-' with a Stable Outlook and Viability Rating (VR) to 'bbb' from 'bbb-'. Unicredit's Short-Term IDR has also been upgraded to 'F2' from 'F3'. A full list of rating actions is below.

The rating action follows the upgrade of Italy's sovereign rating to 'BBB' from 'BBB-' (see "Fitch Upgrades Italy to 'BBB'; Outlook Stable " dated 3 December 2021 at www.fitchratings.com).

Italy's sovereign upgrade also supported the revision of Unicredit's operating environment score 'bbb+' from 'bbb', given the influence the Italian operations have on the overall blended assessment of the bank's operating environment.

Fitch has withdrawn Unicredit's Support Rating of '5' and Support Rating Floor of 'No Floor' as they are no longer relevant to the agency's coverage following the publication of its updated Bank Rating Criteria on 12 November 2021. In line with the updated criteria, we have assigned a Government Support Rating (GSR) of 'No Support' (ns).

Key Rating Drivers

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

The upgrade primarily reflects the benefits to Unicredit's risk and business profile from operating in a stronger and more stable operating environment, which should result in reduced risks and greater potential for the bank to generate stronger and more sustainable profits. As a result of the sovereign upgrade, Unicredit's direct Italian sovereign risk exposure (equal to 83% of its common equity Tier 1 (CET1) capital at end-September 2021), has also become comparatively less risky. Unicredit's VR is one notch above the 'bbb-' implied rating, driven by a risk profile adjustment assessed by Fitch at 'bbb'.

The upgrade also reflects the benefits to the bank's funding profile and market access as these are influenced by perceptions of Italian sovereign risk, which has now improved.

Unicredit's ratings continue to reflect its well-established retail and commercial banking franchise in several countries in Europe, including in more stable and higher-growth countries (Germany and Austria) than Italy, which is counterbalanced by its large operations in and exposure to Italy. We continue to believe that Italy has a proportionately high influence on Unicredit's overall credit profile, as reflected in the sensitivity of the group's overall performance to the operating environment in Italy.

Unicredit's ratings also factor in the full rundown of non-core assets by end-2021 and the expectation that credit risks will moderately reduce thereafter during the current strategic cycle; a gradual recovery in operating profitability and greater internal capital generation as per its newly presented strategy, resulting in satisfactory capital buffers over regulatory minimum requirements (capital guidance of maintaining a common equity Tier 1 ratio between 12.5% and 13.0%); and a stable and well-diversified funding profile.

The main financial targets under the new 2022-2024 strategic plan encompass a EUR0.5 billion cost reduction (representing nearly 5% of total operating costs in 2021), about 150bp of organic capital generation per year and an impaired loan ratio below 3.5% by end-2024. The achievement of these financial goals will allow the bank to distribute at least EUR16 billion dividends between 2021 and 2024 through a combination of dividends and buyback.

We believe that the new strategic plan is ambitious as it envisages a complex re-design of the digital architecture and a challenging change in the business model that should be more driven by fee-intensive activities. However, we also acknowledge that the strategy and targets are clear and the management team has been significantly strengthened since the appointment of the new CEO in April 2021.

Senior preferred (SP) notes are rated in line with the bank's Long-Term IDR as we expect these to be part of the bank's resolution buffers and we do not expect more junior debt buffers to exceed 10% of risk-weighted assets (RWA) on a sustained basis. For the same reasons, the senior non-preferred debt (SNP) is rated one notch below the bank's Long-Term IDR to reflect the risk of below-average recoveries arising from the use of more senior debt to meet resolution buffer requirements. The SP and SNP debt has been upgraded by one notch in line with upgrade of the bank's Long-Term IDR.

Unicredit's Short-Term IDR and short-term senior debt ratings have been upgraded to 'F2' from 'F3', the higher of two options corresponding to the group's Long-Term IDR and long-term SP debt ratings of 'BBB', based on our improved assessment of the group's funding and liquidity at 'bbb+'.

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.

Rating Sensitivities

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

IDRS, VR AND DCR

UniCredit's ratings are likely to be downgraded if Italy's sovereign rating is downgraded. The ratings are also sensitive to an unexpected severe setback in the economic recovery in the group's core markets. A downgrade could be triggered if the CET1 ratio decreases below 12.5% with no discernible plans to restore this, if the four-year average impaired loans ratio increases above 6% without a clear path to reduction, or if there is prolonged earnings weakness with operating profit persistently below 1% of

RWAs.

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

Rating upside is limited and will require an upgrade of Italy's sovereign rating and sustained improvements in economic conditions in the bank's core markets, especially in Italy. Positive rating action would also require a stronger risk profile and business profile operating at its full potential, resulting in materially stronger asset quality and profitability metrics (i.e. an impaired loan ratio kept consistently below 3% and operating profit/RWAs at least above 3%) and sound capital levels.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

DEPOSIT RATINGS

The long-term deposit rating has been upgraded to 'BBB+' from 'BBB' and is one notch above the Long-Term IDR to reflect the likely protection provided by more junior bank resolution debt and equity buffers. The rating also reflects our expectation that the bank will maintain sufficient buffers, given its status as a globally systemically important bank and the need to comply with total-loss absorbing capacity (TLAC) and minimum requirement for own funds and eligible liabilities (MREL).

The short-term deposit rating has been upgraded to 'F2' from 'F3', the baseline option for a 'BBB+' long-term deposit rating.

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. All subordinated and hybrid securities have been upgraded by one notch in line with the equivalent VR upgrade.

Unicredit's Tier 2 subordinated debt is rated two notches below the VR for loss severity to reflect below-average 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 Additional Tier 1 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.

GSR

The GSR of 'ns' reflects our view that although external extraordinary sovereign 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 (BRRD) and the Single Resolution Mechanism (SRM) for eurozone banks provide a framework for resolving banks that requires senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

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

Unicredit's Long- and Short-Term senior debt, deposit ratings and subordinated and hybrid debt would be downgraded if the Long-Term IDR and VR were downgraded.

The deposit ratings could be downgraded by one notch, and be aligned with the IDRs, in the event of a reduction in the size of the senior and junior debt buffers that would result in a lower protection to deposits so that these would no longer have a lower probability of default relative to the IDRs; we view this unlikely in light of current and future TLAC/MREL requirements.

Unicredit's subordinated debt's and hybrid securities' 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 additional Tier 1 issues, this could reflect a change in capital management or flexibility, or an unexpected shift in regulatory buffers and requirements, for example.

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

Unicredit's Long- and Short-Term senior debt, deposit ratings and subordinated and hybrid debt would be upgraded if the Long-Term IDR and VR were upgraded.

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

GSR

An upward revision of the GSR 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.

VR ADJUSTMENTS

The Business Profile score of 'bbb+' has been assigned below the 'a' category implied score due to the following adjustment reason: Business Model (negative).

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

Fitch Ratings Analysts

Gianluca Romeo
Director
Primary Rating Analyst
+39 02 879087 201
Fitch Ratings Ireland Limited Sede Secondaria Italiana Via Morigi, 6 Ingresso Via Privata Maria Teresa, 8
Milan 20123

Francesca Vasciminno
Senior Director
Secondary Rating Analyst
+39 02 879087 225

Cristina Torrella Fajas
Senior Director
Committee Chairperson
+34 93 323 8405

Media Contacts

Louisa Williams
London
+44 20 3530 2452
louisa.williams@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
UniCredit S.p.A.	LT IDR	BBB	Upgrade		BBB-
	ST IDR	F2	Upgrade		F3
	Viability	bbb	Upgrade		bbb-
	Support	WD	Withdrawn		5
	Support Floor	WD	Withdrawn		NF
	DCR	BBB(dcr)	Upgrade		BBB-(dcr)
	Government Support	ns	New Rating		
• subordinated	LT	BB+	Upgrade		BB
• subordinated	LT	BB-	Upgrade		B+
• long-term deposits	LT	BBB+	Upgrade		BBB
• Senior preferred	LT	BBB	Upgrade		BBB-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• Senior non-preferred	LT	BBB-	Upgrade		BB+
• short-term deposits	ST	F2	Upgrade		F3
• Senior preferred	ST	F2	Upgrade		F3

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.12 Nov 2021) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Disclaimer

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

Copyright

Endorsement policy

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.