29 NOV 2022

Fitch Affirms Unicredit at 'BBB'; Outlook Stable

Fitch Ratings - Milan - 29 Nov 2022: Fitch Ratings has affirmed Unicredit S.p.A.'s Long-Term Issuer Default Rating (IDR) at 'BBB' with a Stable Outlook and Viability Rating (VR) at 'bbb'.

A full list of rating actions is below.

Key Rating Drivers

Geographic Diversification: UniCredit's ratings reflect its international operations, which include large activities in stable and stronger economies (Germany and Austria), which we view as a franchise and business-model strength, counterbalancing exposure to its home country of Italy (BBB/Stable). The ratings also reflect improved asset quality and our expectation that the bank's tightening of credit risks will help mitigate asset-quality pressures from the current uncertain operating environment, and that Unicredit will be able to maintain capital ratios that are commensurate with its ratings.

Pan-European Franchise, Clear Strategy: UniCredit has a strong franchise in the European markets in which it operates, ranking among the leading players by total assets. Despite its geographic diversification, the group's overall credit profile remains influenced by its Italian operations, which accounted for about 40% of group activities at end-September 2022.

We believe that the bank's strategy is commensurate with its business model and franchise and targets are ambitious but achievable, unless the operating environment deteriorates more than we currently expect. This assessment reflects our expectation of resilient revenue, as the likely decline in volumes will be mitigated by rising interest rates, tight risk discipline and good control over the cost base.

Disciplined Risk Approach: Unicredit's risk appetite is commensurate with its business model, reflecting medium-term performance expectations. The risk control framework is robust, underpinned by tight risk discipline for new originations and active balance sheet de-risking over the past five years. Market risk appetite is moderate and in line with other largest domestic peers, including average appetite for Italian sovereign bond holdings, which accounted for close to 0.7x common equity Tier 1 (CET1) capital at end-3Q22.

Asset Quality Close to European Averages: Unicredit's Fitch-calculated impaired loans ratio has halved from end-2019 to about 3% at end-9M22 owing to the execution of legacy rundowns completed in 2021 and the benign economic environment. Fitch expects the group to consistently operate with an impaired loan ratio below 4% but still above the European average, benefiting from strong risk discipline and continued impaired loan disposals.

Stabilising Operating Profitability: We expect Unicredit to generate operating profit on risk-weighted assets (RWAs) of at least 1.5% on a sustained basis in the medium term. Net interest revenue upside from higher interest rates, stable operating costs and tight control of loan impairment charges should contribute to this. Unicredit's operating profitability improved significantly over the past two years but our assessment still reflects slightly lower business diversification and average profitability relative to higher-scored peers.

Adequate Capital, Low Encumbrance: We expect the bank to maintain sound capital buffers above regulatory requirements. We view the 16.04% CET1 ratio at end-September 2022 as a rating strength, after improving on end-2021, due to improved internal capital generation and slight decrease in RWAs.

We expect UniCredit to reduce its CET1 ratio to its target level between 12.5% and 13.0% as the bank plans to distribute EUR16 billion capital by end-2024. Along with the significant asset quality clean-up, capital encumbrance from unreserved impaired loans has significantly reduced to 1.9% of CET1 capital at end-September 2022 (29% at end-2018).

Diversified Funding: Funding benefits from UniCredit's deposit franchise in retail and commercial banking in several countries in Europe. Its loans/customer deposits ratio has been satisfactory, relative to its European peers, at about 90% since end-2020. At end-September 2022, nearly 60% of total funding consisted of customer deposits, which have been resilient, even during periods of market volatility. As a regular issuer in capital markets, wholesale funding is well-diversified by geography and product.

Rating Sensitivities

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

Unicredit's ratings are sensitive to a downgrade of Italy's sovereign rating or to the economic and banking prospects of its core markets.

The ratings could also be downgraded if asset quality deteriorates as a result of weak or negative economic growth causing significant capital erosion, including from higher-than-expected capital encumbrance from unreserved impaired loans.

In this scenario, the ratings could be downgraded if the impaired loans ratio increases and stays above 4% on a sustained basis and operating profitability falls persistently below 1.5%, especially if the CET1 ratio falls below the bank's target of between 12.5%-13.0% without prospects of a recovery in the short term.

The Short-Term IDR would be downgraded by one notch if our assessment of funding and liquidity was lowered from the current 'bbb+'.

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

Rating upside is limited and would require an upgrade of Italy's sovereign rating and sustained improvements in economic conditions in Italy, as evidenced by a higher assessment of the operating environment for Italian banks.

In this scenario, over the longer term, an upgrade would require stronger business and risk profiles, resulting in stronger asset quality and profitability metrics (i.e. an impaired loan ratio kept consistently below 3% and operating profit/RWAs at least above 3%) while preserving its CET1 ratio well-within its current target levels of between 12.5%-13.0% and with sufficient buffers over regulatory requirements.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The long-term deposit rating is one-notch above UniCredit's Long-Term IDR. This is because there is full depositor preference in Italy and 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 its Long-Term IDR. The one-notch uplift also reflects our expectation that the bank will maintain sufficient buffers, especially given its status as a globally systemically important bank and the need to comply with the minimum requirement for total-loss absorbing capacity (TLAC), and the minimum requirement for own funds and eligible liabilities (MREL).

The'F2' short-term deposit rating is the baseline option for a 'BBB+' long-term deposit rating because the funding and liquidity score is not high enough to achieve the higher equivalent short-term rating.

Unicredit's senior preferred (SP) debt is rated in line with its Long-Term IDR because we expect it to use SP debt to meet its MREL.

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

The Tier 2 subordinated debt is rated two notches below the VR to reflect the prospects of poor recoveries in resolution given the notes' subordination.

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 GSR of 'no support' (ns) reflects Fitch's view that although external extraordinary sovereign support is possible, it cannot be relied on. Senior creditors can no longer expect to receive full extraordinary support from the sovereign in the event that the bank becomes nonviable. This is because the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism 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 they 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 of which is currently the case nor do we expect to occur.

An upgrade 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 operating environment score of 'bbb+' is in line with the 'bbb' category implied score but above the 'bbb' score of domestic Italian banks because of the following adjustment reason: international operations (positive).

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

The asset quality score of 'bbb-' has been assigned above the 'bb' category implied score due to the following adjustment reason: 'historical and future metrics' (positive).

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

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
UniCredit S.p.A.	LT IDR	BBB	Affirmed		BBB
	ST IDR	F2	Affirmed		F2
	Viability	bbb	Affirmed		bbb
	DCR	BBB(dcr)	Affirmed		BBB(dcr)
	Government Support	ns	Affirmed		ns
• subordinated	LT	BB+	Affirmed		BB+
• subordinated	LT	BB-	Affirmed		BB-
• Senior preferred	LT	BBB	Affirmed		BBB
• long-term deposits	LT	BBB+	Affirmed		BBB+
• Senior non-preferred	LT	BBB-	Affirmed		BBB-
• Senior	ST	F2	Affirmed		F2

ENTITY/DEBT	RATING			RECOVERY	PRIOR
preferred					
• short-term deposits	ST	F2	Affirmed		F2

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◎	◆
STABLE	▣	

Applicable Criteria

Bank Rating Criteria (pub.07 Sep 2022) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

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