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Fitch Affirms UniCredit at 'BBB'; Outlook Stable

Fitch Ratings - Milan - 17 Nov 2023: 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 Rating Outlook on the Long-Term IDR is Stable.

A full list of rating actions is detailed below.

Key Rating Drivers

Geographic Diversification, Adequate Financial Profile: UniCredit's ratings reflect its international footprint, with significant operations in strong economies (Germany and Austria), which Fitch considers a business-model strength, as well as a leading position in its Italian home market. The ratings also reflect improved profitability and our expectation that the group's rigorous risk approach will mitigate asset-quality pressures at times of uncertainty for its operating environments, and that UniCredit will maintain capital ratios commensurate with its ratings.

Pan-European Franchise: UniCredit has a pan-European presence in retail and commercial banking, ranking among the leading banks by total assets in the markets in which it operates. The group's overall credit profile is influenced by its Italian operations, which account for a large part of its activities and revenue, despite its geographic diversification in Germany and central and eastern Europe.

Slowing economic growth will affect business growth and asset quality in 2024, but the impact should be manageable and unlikely to affect its medium-to-long-term strategic and financial targets.

Moderate Risk Profile: UniCredit's risk appetite is moderate overall and is supported by good central oversight, which mitigates the complexity of the group's presence in a large number of jurisdictions. Market risk is well-managed, including average appetite for Italian sovereign bond holdings, which accounted for close to 0.75x common equity Tier 1 (CET1) capital at end-September 2023.

Stable Asset-Quality, Modest Deterioration Expected: The bank's gross impaired loan ratio of 2.7% at end-September 2023 is almost in line with its European peers. The broadly stable trend in the ratio over the past two years benefitted from the economic recovery and government support measures - particularly in Italy. We expect asset quality to weaken in the next 12-24 months due to modest economic growth, but it is unlikely that the ratio will exceed 3.5% given conservative underwriting and continued impaired loans disposals.

Improved Revenue, Lower Diversification: UniCredit's fees and commissions represent a lower portion of operating income than most of its domestic and European peers' but we expect the development of insurance and wealth management under outstanding agreements to result in greater net commission income over the next three years.

We expect UniCredit's operating profit/RWAs to reduce from current levels (9M23: 4.3%), which benefit from potentially-peak interest rates levels and low loan impairment charges (LICs), and stabilise above 2% on a sustained basis, which is well above the average of past four years (1%). Our expectation is underpinned by the improving earnings diversification, ability to contain operating expenses and tight control of LICs.

Adequate Capitalisation: UniCredit's capitalisation is adequate relative to regulatory requirements and the bank's medium-term CET1 ratio target (12.5%-13.0%). Our assessment of UniCredit's capitalisation also factors in improved earnings generation capacity, low capital encumbrance by unreserved impaired loans, well-managed market risks and the adequate capitalisation of international subsidiaries. In 2024, we expect the bank's CET1 ratio to remain well above the end-plan target, thanks to internal capital generation and decreasing RWAs and after the EUR6.5 billion planned capital distribution, unless the bank allocates excess capital to extraordinary shareholder distributions or M&A initiatives within next year.

Diversified Funding, Sound Liquidity: UniCredit has well-established deposit franchises in retail and commercial banking in its European core markets. The loan/deposit ratio is sound and hovers around 90%. It has strong access to a large investor base through funding sources that are well-diversified by geography and product. UniCredit's liquidity is sound with large liquid assets, well above the total wholesale funding maturing within 12 months.

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 unexpected severe setbacks in the economies of the group's key countries, significantly affecting the group's financial metrics. This could be the case if the impaired loan ratio increases and stays well above 4% on a sustained basis, and operating profit falls persistently below 1.5% of RWAs, 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 Issuer Default Rating (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

An upgrade would be contingent on an upgrade of Italy's sovereign rating and a higher assessment of the operating environment for Italian banks, reflecting sustained improvements in economic conditions in Italy. It should be accompanied by an operating profit/RWAs improvement sustainably above 2.5%, without significantly altering the group's risk profile, capitalisation and funding and liquidity positions.

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.

UniCredit's 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 SP 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. For the same reasons, the SP notes are rated in line with the Long-Term IDR.

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.

No Support

UniCredit's Government Support Rating (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 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 debts 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 nor expected in the future.

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 Operating Environment score has been assigned below the implied score due to the following adjustment reasons: International Operations (positive), Sovereign Rating (negative).

The Business Profile score has been assigned below the implied score due to the following adjustment reason: Business Model (negative).

The Asset Quality score has been assigned above the implied score due to the following adjustment reason: Historical and Future Metrics (positive).

The Earning & Profitability score has been assigned above the implied score due to the following adjustment reason: Historical and Future Metrics (positive).

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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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

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

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	○	

Applicable Criteria

Bank Rating Criteria (pub.01 Sep 2023) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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