FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades UniCredit to 'BBB+'; Outlook Positive

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Fitch Ratings - Paris - 31 Oct 2024: Fitch Ratings has upgraded UniCredit S.p.A.'s (UniCredit) Long-Term Issuer Default Rating (IDR) to 'BBB+' from 'BBB' and Viability Rating (VR) to 'bbb+' from 'bbb'. The Outlook on the IDR is Positive. Fitch has also upgraded UniCredit's debt instruments by one notch, mirroring the upgrades of the VR and Long-Term IDR. A full list of rating actions is below.

The upgrades reflect Fitch's views that following a multi-year long restructuring, balance sheet de-risking and materially improved loss absorption capacity, UniCredit can achieve - and be capped at - a rating one notch above the Italian sovereign Long-Term IDR of 'BBB'/'Positive'. This is thanks to its exceptional position of strength relative to its domestic peers supported by a successful geographic diversification in well-performing or growing economies, which we believe would mitigate pressures on UniCredit against a severe Italian sovereign stress.

The upgrades also reflect Fitch's forecasts that UniCredit will maintain profitability above large European banks' average, supporting strong internal capital generation, and an asset quality now fairly close to European average.

The Positive Outlook on the Long-Term IDR mirrors the recent revision of the Outlook on Italy's Long-Term IDR (see Fitch Revises Italy's Outlook to Positive; Affirms at 'BBB'), as UniCredit's Long-term IDR is capped at one notch above that of Italy. The Positive Outlook also follows the revision of the outlook on the 'bbb' Italian operating environment score to 'positive' from 'stable', which in turn reflects the Positive Outlook on the sovereign and our assessment of improving business prospects for Italian banks over the longer term as a result of a better medium-term economic growth outlook. This will benefit UniCredit's credit profile due to its leading domestic franchise, risk profile, strong profitability and adequate asset quality.

KEY RATING DRIVERS

Geographic Diversification, Resilient Financial Profile: The ratings reflect UniCredit's international footprint, with large operations in strong economies (Germany and Austria), which Fitch considers a business model strength, and a leading position in its Italian home market. The ratings also reflect that profitability has improved to strong levels and our expectation that the bank's disciplined risk appetite will mitigate asset quality pressures in an economic downturn, and that it will maintain capital ratios commensurate with its risk profile.

Ratings One Notch above Italy: UniCredit's ratings are capped at one notch above Italy. This is underpinned by the group's geographic diversification and strength relative to domestic peers, which should help it navigate risks of a potential default of its home sovereign, albeit the probability of the latter is low, given Italy's 'BBB' Long-Term IDR.

The ratings reflect our expectations that the bank would likely continue servicing its obligations in case of a sovereign default, and that the Italian sovereign is unlikely to impose material restrictions on the bank's debt service capacity, given strong institutional constraints as a key member of the eurozone and integration into the global economy.

Improving Operating Environment: UniCredit's operating environment score is one notch above that of other Italian banks, reflecting the benefits of diversification into higher-rated and well-performing economies. We believe this provides UniCredit with additional growth opportunities and positively influences the bank's credit profile compared with that of purely domestic peers. UniCredit will also benefit from improving operating conditions in light of the Positive Outlook on Italy.

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 credit profile remains influenced by its Italian operations to an extent, but its geographic diversification supports through-the-cycle performance. UniCredit has consistently met its strategic goals over the last three years and we expect continued strong execution on 2025-2026 targets, as further diversification rolls out.

Disciplined, Diversified Risk Profile: UniCredit's risk appetite is controlled and supported by good central oversight. The risk profile benefits from diversification outside of Italy, where we expect the improving operating environment will contribute to lower risk levels. Market risk and interest rate risks are well-managed, including adequate appetite for Italian sovereign bond holdings, which accounted for close to 0.9x common equity Tier 1 (CET1) capital at end-June 2024. We believe the bank's remaining presence in Russia, although rapidly reducing, is a source of potential operational risk losses.

Asset Quality Close to Average: The impaired loans ratio of 2.8% at end-June 2024 is close to the European average. The broadly stable ratio over the past three years benefited from resilient economies and government support measures, particularly in Italy. We expect asset quality to only modestly deteriorate in the next 12-24 months, given conservative underwriting and active impaired loan management. The loan loss allowance coverage ratio remains well above peers due to conservative overlays that could be repurposed.

Robust Earnings Generation: UniCredit has restored its profitability metrics thanks to extensive restructuring and the benefits of higher rates, and now has strong earnings generation and loss absorption capacity. This benefits from geographic diversification and a growing share of non-interest income through the roll-out of insurance, asset management and corporate and investment banking services. We forecast its operating profit/risk-weighted assets (RWAs) to remain at the high-end of large European banks, within 3.5%-4.0% by 2026 (1H24: 5.3%), well above the bank's 10-year average of 0.8%.

Capital Ratios Well Above Target: UniCredit's capitalisation is materially above regulatory requirements and the bank's medium-term CET1 ratio target (12.5%-13.0%). We expect the CET1 ratio to gradually decline towards the strategic target, as the bank looks into deploying its excess capital either through organic or external growth or by pursuing elevated shareholder distributions. However, we expect these lower capital ratios will be balanced by consistent internal capital generation.

Diversified Funding, Sound Liquidity: UniCredit has well-established deposit franchises in retail and commercial banking in its European core markets. The loans/deposits 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. 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

Fitch could affirm UniCredit's ratings and revise the Outlook to Stable if it sees risks that UniCredit will not maintain performance levels broadly consistent with higher-rated large European banks or geographical diversification benefits weaken, or if Italy's sovereign rating is affirmed and the Outlook revised to Stable.

UniCredit's ratings are sensitive to a downgrade of Italy's sovereign rating, as its ratings are capped at one notch above its home country, or to material weakening of the operating environment of its key markets.

The ratings are also sensitive to a material and prolonged weakening of UniCredit's performance, which would make it no longer exceptional relative to domestic peers, and a reduction of its loss absorption capacity, which would undermine the bank's resilience to a potential stress on the Italian sovereign.

We believe this could result from a material asset quality deterioration following severe economic setbacks in key countries, or by a durable fall in its earnings generation. This could be the case if the impaired loans ratio increases and stays well above 3% on a sustained basis, and operating profit fails to be within 2.5%-3.0% of RWAs, especially if the CET1 ratio falls materially below 13% without prospects of a recovery in the short term.

Materially higher exposure to the Italian sovereign, if it was durably larger than the CET1 capital, would also lead to negative rating action, as this would greatly increase UniCredit's sensitivity to Italian risk in distressed scenarios. Reduced flexibility and capacity to access the wholesale funding markets, if it materially impacts liquidity, could also lead to negative rating action.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of Italy's sovereign rating and a higher assessment of the operating environment for Italian banks, both of which currently have Positive Outlooks, are prerequisites for an upgrade of UniCredit's ratings, all else equal. In addition, an upgrade would also be contingent on UniCredit maintaining its currently strong performance through the cycle, in particular operating profit/RWAs comfortably above 3%, without significantly altering the group's risk profile, while maintaining significant capital buffers above requirements (a CET1 ratio that remains comfortably above the bank's target).

UniCredit's acquisition of a 21% stake in Commerzbank AG had no immediate effect on UniCredit's ratings (see Full UniCredit Takeover of Commerzbank Could Strengthen Combined Group). If a full takeover becomes likely, Fitch will assess its rating impact with reference to the terms of the deal and the likely implications for UniCredit's credit profile.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The Short-Term IDR of 'F2' is the lower of the two options that map to a 'BBB+' Long-Term IDR as UniCredit's funding and liquidity score is below the threshold for a higher

Short-Term IDR.

The long-term deposit rating, which has been upgraded to 'A-' following the IDR upgrade, 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 given the need to comply with the minimum requirement for own funds and eligible liabilities (MREL).

The 'F2' short-term deposit rating is the lower of the two options for a 'A-' 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 debt and Derivative Counterparty Rating (DCR), which have been upgraded to 'BBB+' following the IDR upgrade, are rated in line with its Long-Term IDR because we expect UniCredit to use senior preferred debt to meet its MREL and the buffer of senior non-preferred and more junior instruments is forecasted to remain slightly below 10% of RWAs (end-June 2024: 8.1%). For the same reasons, UniCredit's senior non-preferred notes, which have been upgraded to 'BBB' following the IDR upgrade, are rated one notch below the bank's Long-Term IDR.

The Tier 2 subordinated debt, which has been upgraded to 'BBB-' following the upgrade of the VR, is rated two notches below the VR which is the baseline notching for these instruments. This is because of loss severity, as we expect recoveries to be poor for this type of debt in case of failure of the bank.

Additional Tier 1 notes, which have been upgraded to 'BB' following the upgrade of the VR, are rated four notches below the VR, reflecting Fitch's baseline notching for loss severity (two notches) and incremental non-performance risk (two notches) relative to the anchor. The notching reflects the instruments' fully discretionary interest payment and the bank's comfortable distance to mandatory coupon omission points.

No Government 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

The Short-Term IDR would be downgraded by one notch if both the bank's Long-Term IDR was downgraded and we lowered our assessment of funding and liquidity from the current 'bbb+'. The Short-Term IDR would be upgraded if both the long-Term IDR was upgraded and we raised our assessment of funding and liquidity to at least 'a'.

UniCredit's senior debt, DCR, deposit ratings and subordinated and hybrid debt are primarily sensitive to changes in the Long-Term IDR and VR.

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 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 MREL.

UniCredit's senior debt ratings and DCR could also be upgraded if the bank is expected to meet its resolution buffer requirements exclusively with senior non-preferred debt and more junior instruments, or if we expect resolution buffers represented by senior non-preferred debt and more junior instruments to be at least 10% of RWAs on a sustained basis, neither which is currently the case nor expected.

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.

An upgrade of the GSR would be contingent on a positive change in the Italian 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+' has been assigned below the 'a' implied category score due to the following adjustment reasons: international operations (positive), sovereign rating (negative).

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

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.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
UniCredit S.p.A.	LT IDR	BBB+ Rating Outlook Positive	Upgrade	BBB Rating Outlook Stable
	ST IDR	F2	Affirmed	F2
	Viability	bbb+	Upgrade	bbb
	DCR	BBB+(dcr)	Upgrade	BBB(dcr)
	Government Support	ns	Affirmed	ns
subordinated	LT	BBB-	Upgrade	BB+
Senior preferred	LT	BBB+	Upgrade	BBB

long-term deposits	LT	A-	Upgrade	BBB+
Senior non-preferred	LT	BBB	Upgrade	BBB-
junior subordinated	LT	BB	Upgrade	BB-

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Rafael Quina
Senior Director
Primary Rating Analyst
+33 1 44 29 91 81
rafael.quina@fitchratings.com
Fitch Ratings Ireland Ltd
28 avenue Victor Hugo Paris 75116

Paolo Comensoli
Director
Secondary Rating Analyst
+39 02 9475 6550
paolo.comensoli@fitchratings.com

Olivia Perney
Managing Director
Committee Chairperson
+33 1 44 29 91 74
olivia.perney@fitchratings.com

MEDIA CONTACTS

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 15 Mar 2024) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

UniCredit S.p.A.	EU Issued, UK Endorsed

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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. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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