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Research Update:

# UniCredit Bank And UniCredit Austria Affirmed At 'BBB+/A-2' On Changes To The Group's Structure; Outlooks Still Negative

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## Overview

- On Dec. 3, 2019, UniCredit revealed its new multi-year plan, reiterating its commitment to implement a single point of entry resolution strategy based on a slightly adjusted group structure.
- We believe that, once implemented, the strategy could lead us to synchronize the creditworthiness of UniCredit Bank and UniCredit Bank Austria with the Italian parent UniCredit SpA.
- Until then, we are affirming our 'BBB+/A-2' ratings on both entities.
- The negative outlooks indicate that we could lower our ratings once full details of the resolution strategy for UniCredit group are available, and the group takes action to implement it effectively.

## Rating Action

On Dec. 12, 2019, S&P Global Ratings affirmed its 'BBB+/A-2' long- and short-term issuer ratings on UniCredit Bank AG and UniCredit Bank Austria AG (Bank Austria) including its funding vehicles BA-CA Finance (Cayman) Ltd. and BA-CA Finance (Cayman) (2) Ltd. The outlooks on all these entities remain negative.

At the same time, we affirmed our 'A-/A-2' resolution counterparty ratings on UniCredit Bank and Bank Austria.

We also affirmed our issue ratings on all of the entities' outstanding instruments.

## Rationale

Since the implementation of the EU Bank Recovery and Resolution Directive (BRRD) across Europe in 2015, we have rated UniCredit Bank and Bank Austria above their Italian parent, UniCredit SpA (BBB/Stable/A-2). This is due to the subsidiaries' greater intrinsic strength than the parent, and uncertainty about whether the group's resolution strategy would allow these entities to remain operationally and financially self-reliant, and separable in resolution, similar to a multiple point of entry approach.

On Dec. 3, 2019, UniCredit confirmed in its multi-year plan that it prefers a single point of entry (SPE) approach, under which it will gradually become the group's sole resolution entity and eventually the issuer of bailinable debt. We see this development as potentially negative for the two subsidiaries' credit profiles over the medium term, because it implies the subsidiaries' and parent's prospects in a resolution would not be markedly different. We have affirmed our ratings pending further clarifications on the strategy, its timing, and the steps to implement it.

UniCredit's new multi-year strategy (Team 2023) includes a plan to enhance the group's resolvability by creating an Italian-based intermediate nonoperating holding company that will own UniCredit's foreign subsidiaries, excluding Turkey-based Yapi ve Kredi Bankasi. By doing this, UniCredit intends to lower its consolidated minimum requirements for own funds and eligible liabilities (MREL) in the medium term, with the first step being to minimize intragroup exposures. This implies UniCredit SpA would become the only entity issuing instruments to investors to meet the group's MREL requirements. It also means that loss-absorbing capacity will eventually be available to material subsidiaries to fulfil their individual requirements through internal instruments subscribed by the parent.

Although key details of the resolution strategy are yet to be disclosed, we see the creation of the intermediate holding company as having no immediate impact on the subsidiaries' stand-alone creditworthiness. Moreover, the existence of such an entity does not alter our view that the group's resolution strategy is moving toward the SPE approach. If fully implemented, this strategy would be similar to that at the HSBC group, in our view, where regional subgroups are operationally separable but the ultimate holding company remains the sole issuer of bail-inable debt.

While we may do so in future, we have not immediately aligned our ratings on the subsidiaries with those on UniCredit, for two reasons:

- First, the two subsidiaries remain financially and operationally self-reliant. Both still benefit from a material buffer of externally issued bail-in instruments, which will eventually be replaced with intragroup issuance. Until then, the Single Resolution Board (SRB) could employ separate resolution processes for UniCredit and its large German and Austrian subsidiaries. This supports higher ratings on the subsidiaries than on the parent. We assess UniCredit Bank and Bank Austria's stand-alone credit profiles at 'bbb+', which is higher than the 'bbb' group credit profile (GCP).
- Second, we await further clarifications beyond the outline that UniCredit has announced. The strategic plan clarifies UniCredit's timeline to meet its external total loss-absorbing capacity and MREL requirements. However, we have no information on how the SPE strategy will operate, including the timeframe for replacing maturing external bail-in instruments with intragroup instruments. We expect to receive more information on this over the next 12-18 months.

Once we are satisfied that UniCredit, UniCredit Bank, and Bank Austria would be subject to a single unified resolution process, we would no longer rate these subsidiaries above the parent. This is because they would depend on UniCredit's issuance for their bail-in buffers, thereby linking their prospects to the effectiveness of a resolution process at the parent level.

Other constraints to the ratings stem from idiosyncratic factors: For UniCredit Bank, we mainly consider the negative effects of the worsening operating environment in Germany. For Bank Austria, we consider residual earnings pressures after it completed its material restructuring in 2018.

## Outlook

The negative outlook indicates that we could lower our ratings on UniCredit Bank and Bank Austria over the next 12-18 months after receiving and reviewing further pertinent details of the UniCredit group's resolution strategy and whether the strategy's implementation is sufficiently advanced.

### Downside scenario

If we conclude that the resolution approach for the UniCredit group means a unified, single process involving all entities, this would alter our current view that the prospects of stronger subsidiaries would be markedly different from those of the weaker parent. As a result, we would no longer rate UniCredit Bank and Bank Austria above the parent, and therefore lower our ratings to the GCP level, all other factors remaining equal.

We could also lower the ratings if the group's parent, UniCredit, were downgraded, which we consider unlikely given the stable outlook on UniCredit. We cap our ratings on both subsidiaries at one notch above GCP, since we believe their creditworthiness would feel the weight of the parent's weaker credit quality and still see uncertainties in the implementation of the group's resolution strategy.

In addition, if economic or industry risk increases for German banks, we would likely revise down our anchor for UniCredit Bank to 'bbb+' from 'a-'. That could lead us to lower the rating because higher risks in Germany could materially affect UniCredit Bank's asset quality, bringing our risk-adjusted capital (RAC) ratio for the bank below the 10% threshold commensurate with strong capital and earnings. Further extraordinary capital transfers to other group entities, or stronger credit expansion in a worsening economic cycle, could also weaken the RAC ratio and lead to a downgrade. A downgrade of UniCredit Bank would result in the downgrade of the bank's senior preferred debt, senior subordinated debt, and junior subordinated instruments.

Moreover, we could also lower the ratings on Bank Austria by one notch if its earnings capacity and efficiency were weaker than anticipated following the restructuring of its domestic franchise. This action would lead us to lower our ratings on the 'BBB+' senior unsecured and 'BBB-' subordinated debt, as well as the junior subordinated instruments.

### Upside scenario

We would revise the outlooks to stable if it was clear that the SRB would employ separate resolution processes for both subsidiaries and the parent.

For UniCredit Bank, a stable outlook would depend on the bank's ability to neutralize the effect of negative trends we currently observe in Germany, thereby maintaining favorable asset quality and a RAC ratio sustainably above 10% through the economic cycle.

## Ratings Score Snapshot

| UniCredit Bank AG | |
|---|---|
| Issuer credit rating | BBB+/Negative/A-2 |
| SACP | bbb+ |
| Anchor | a- |
| Business position | Adequate (0) |
| Capital and earnings | Strong (+1) |
| Risk position | Weak (-2) |
| Funding and liquidity | Average and adequate (0) |
| Support | (0) |
| **UniCredit Bank Austria** | |
| Issuer credit rating | BBB+/Negative/A-2 |
| SACP | bbb+ |
| Anchor | a- |
| Business Position | Adequate (0) |
| Capital and Earnings | Adequate (0) |
| Risk Position | Moderate (-1) |
| Funding and liquidity | Average and adequate (0) |
| Support | (0) |

SACP--Stand-alone credit profile.

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9,

2011

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

| **Ratings Affirmed** | |
|---|---|
| **UniCredit Bank AG** | |
| **BA-CA Finance (Cayman) Ltd.** | |
| **BA-CA Finance (Cayman) (2) Ltd.** | |
| **UniCredit Bank Austria AG** | |
| Issuer Credit Rating | BBB+/Negative/A-2 |
| **UniCredit Bank AG** | |
| **UniCredit Bank Austria AG** | |
| Resolution Counterparty Rating | A-/--/A-2 |
| **UniCredit Bank AG** | |
| Senior Unsecured | BBB+ |
| Senior Subordinated | BBB |
| Short-Term Debt | A-2 |
| **UniCredit Bank Austria AG** | |
| Senior Unsecured | BBB+ |
| Subordinated | BBB- |
| **BA-CA Finance (Cayman) (2) Ltd.** | |
| **BA-CA Finance (Cayman) Ltd.** | |
| **HVB Capital LLC I** | |
| **HVB Capital LLC II** | |
| **HVB Capital LLC III** | |
| **HVB Funding Trust I** | |
| **HVB Funding Trust II** | |
| **HVB Funding Trust III** | |
| Junior Subordinated | BB |