FitchRatings

10 MAY 2021

Fitch Affirms UniCredit Bank AG at 'BBB'; Outlook Negative

Fitch Ratings - Milan - 10 May 2021: Fitch Ratings has affirmed UniCredit Bank AG's (HVB) Long-Term Issuer Default Rating (IDR) at 'BBB' with a Negative Outlook. A full list of rating actions is detailed below.

Key Rating Drivers

IDRS; VIABILITY RATING AND SENIOR NON-PREFERRED DEBT RATING

The IDRs and senior non-preferred (SNP) debt ratings of HVB reflect its standalone credit strength as expressed by its 'bbb' Viability Rating (VR). The VR is driven by the bank's strong capitalisation, which is a rating strength compared with HVB's parent UniCredit S.p.A. (BBB-/Stable/F3/bbb-). At the same time, the VR is constrained by contagion risk from its parent.

HVB's mostly wholesale business model - primarily based on a well-established domestic corporate and investment banking (CIB) franchise - is deeply integrated into the UniCredit group. HVB and UniCredit share the same brand and HVB's reputation and franchise could suffer if UniCredit's risk profile deteriorates materially. We therefore limit the uplift of HVB's VR from the parent's Long-Term IDR to one notch.

The Negative Outlook on HVB reflects Fitch's expectation that capital and funding will become more fungible within the UniCredit group entities that operate in the eurozone. In particular, a material capital upstreaming that could constrain HVB's financial flexibility could become likely under the European Single Supervision and Single Resolution Mechanisms as long as UniCredit maintains a single-point-of-entry (SPE) resolution strategy as its preferred option.

HVB's CET1 capital ratio of 18.8% at end-2020 is strong compared with European peers'. According to our understanding, the bank will continue distributing the majority of net profits to UniCredit. This, coupled with regulatory driven risk-weighted-assets (RWAs) inflation, should result in declining capital ratios. However, we expect HVB's capitalisation to remain sound, well above the peer-group average, and to comfortably exceed regulatory requirements.

HVB has considerably reduced its exposure to UniCredit over the past 10 years. Fitch expects an increasing portion of HVB's funding to be down-streamed from its parent to meet regulatory requirements under the group's currently preferred SPE resolution strategy, as UniCredit will be the issuing entity for instruments intended to meet total loss-absorbing capacity (TLAC) requirements and minimum requirement for own funds and eligible liabilities (MREL).

HVB's average profitability is weak compared with European peers', despite benefitting from low loan impairment charges (LICs) from 2017 to 2019. We expect this trend to continue as long as margins remain under pressure from low interest rates and stiff competition in the German corporate business. In 2020, the bank's operating profits declined on higher LICs and valuation losses. We expect LICs to materially decline in 2021 and 2022 from their 2020 levels and have revised the outlook on earnings and profitability to stable from negative.

HVB still has room to reduce its cost base mainly through streamlining and automating its processes, but progress in this area is expected to be slow. The sale of HVB's headquarters sustained net income at EUR668 million in 2020 (EUR810 million in 2019).

We have also revised the outlook on HVB's asset-quality score to stable from negative. The impact of the pandemic on HVB's loan book was largely mitigated by large government support programmes and the suspension until end-April 2021 of the legal obligation for illiquid companies to file for bankruptcy. We expect a rise in impaired loans by end-2021, when support measures expire, but HVB's four-year-average Stage 3 loans ratio (2.6% at end-2020) should remain close to 3% in the medium term.

We have revised the outlook on funding and liquidity to stable from negative because the bank's funding costs proved resilient during 2020 due to the extensive use of central-bank refinancing. Liquidity buffers remained adequate despite strong credit lines drawing by corporates in 1H20. Customer deposits, mostly from corporate clients, account for about half of HVB's total funding. Market-funding reliance is mitigated by the bank's large outstanding stock of covered bonds and by their long average debt maturities. HVB's Short-Term IDR is the higher of two possible ratings that map to a 'BBB' Long-Term IDR on Fitch's rating scale, driven by HVB's funding and liquidity score of 'a-'.

DERIVATIVE COUNTERPARTY RATING (DCR), DEPOSIT RATINGS AND SENIOR PREFERRED DEBT

HVB's DCR, long-term senior preferred debt rating and long-term deposit ratings are rated one notch higher than the bank's IDR to reflect the protection that could accrue to these creditors from the build-up of junior resolution debt and equity buffers. This is because we expect HVB to meet its MREL requirement with SNP and more junior instruments only.

HVB's short-term instrument ratings are the lower of the two ratings that map to a 'BBB+' long-term rating because our assessment of HVB's funding and liquidity score is not sufficient to achieve a higher short-term rating.

SUPPORT RATING

HVB's Support Rating (SR) of '3' indicates a 'BB-' long-term rating floor based on institutional support. It reflects Fitch's opinion that despite UniCredit's strong propensity to support HVB, the parent's constrained ability to do so results in a moderate likelihood of extraordinary support. This is because of the large solvency support that HVB would likely require relative to the capital available in the rest of the group, given that a large share of UniCredit's consolidated equity is in HVB. Our view of UniCredit's strong propensity to support primarily reflects HVB's role as the group's investment-banking hub and sizeable corporate-banking operations in Europe's largest economy.

SUBORDINATED DEBT AND HYBRID SECURITIES

The subordinated Tier 2 debt rating reflects a baseline notching of two notches for loss severity from the bank's VR. The notching reflects our expectation that the bank will not maintain buffers of Tier 2 and AT1 debt exceeding 10% of its respective RWAs.

The bank's hybrid capital notes issued through HVB Funding Trusts I and II are rated four notches below the VR: two notches each for loss severity and for incremental non-performance risk. While the regulator could order a coupon deferral in line with the terms and conditions of these profit-linked instruments, we view such intervention as unlikely in light of HVB's strong capitalisation and distance to the maximum distributable amount (MDA).

RATING SENSITIVITIES

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Factors that could lead to negative rating action/downgrade:

We could downgrade HVB's IDRs, VR, and SNP debt rating, aligning them with UniCredit's, if fungibility of capital within the UniCredit group increases further or following a downgrade of UniCredit's ratings. HVB's ratings could also be downgraded if recurring operating profitability declines durably below 0.5% of RWAs.

We would downgrade HVB's DCR, deposit and senior preferred ratings if HVB's IDR is downgraded or if HVB's SNP and more junior debt buffers are insufficient to restore viability and protect preferred creditors after a failure. This could be the case if HVB forms an own resolution group and includes senior preferred debt in its resolution buffers.

We could downgrade the SR upon a negative change in our view of UniCredit's ability to support HVB, which could be indicated by a downgrade of UniCredit's ratings. The rating is also sensitive to negative changes to Fitch's view of UniCredit's propensity to provide support, which we currently do not expect.

We would downgrade HVB's subordinated debt and hybrid securities' ratings on a downgrade of the bank's VR or upon a widening in the securities' notching, which could arise if we change our assessment unfavourably of the notes' loss severity or relative non-performance risk.

Factors that could lead to positive rating action/upgrade:

An upgrade of HVB's ratings would require an upgrade of UniCredit's ratings. The Outlook on HVB's Long-Term IDR could be revised to Stable if HVB is more effectively ring-fenced and contingency risk is reduced, resulting in a greater de-linkage from UniCredit's credit profile. We would also upgrade HVB's subordinated debt upon a narrowing in the securities' notching, which could arise if we change our assessment favourably of the notes' loss severity or relative non-performance risk.

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
HVB Funding Trust II					
• preferred	LT	BB-	Affirmed		BB-
UniCredit Bank AG	LT IDR	BBB	Affirmed		BBB
	ST IDR	F2	Affirmed		F2
	Viability	bbb	Affirmed		bbb
	Support	3	Affirmed		3
	DCR	BBB+(dcr)	Affirmed		BBB+(dcr)

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• long-term deposits	LT	BBB+	Affirmed		BBB+
• Senior preferred	LT	BBB+	Affirmed		BBB+
• subordinated	LT	BB+	Affirmed		BB+
• Senior non-preferred	LT	BBB	Affirmed		BBB
• short-term deposits	ST	F2	Affirmed		F2
• Senior preferred	ST	F2	Affirmed		F2
HVB Funding Trust I					
• preferred	LT	BB-	Affirmed		BB-

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[Bank Rating Criteria (pub.28 Feb 2020) (including rating assumption sensitivity)]

Additional Disclosures

Solicitation Status

Endorsement Status

HVB Funding Trust I	EU Issued, UK Endorsed
HVB Funding Trust II	EU Issued, UK Endorsed
UniCredit Bank AG	EU Issued, UK Endorsed

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