FitchRatings

Banks
Universal Commercial Banks
Germany

UniCredit Bank AG

Key Rating Drivers

Standalone Credit Profile Drives IDRs: UniCredit Bank AG's (HVB) Issuer Default Ratings (IDRs) are driven by its standalone credit strength, as expressed by its Viability Rating (VR), which is highly influenced by HVB's strong capitalisation. However, the deep integration of HVB's mostly wholesale business model (which rests on a well-established domestic corporate and investment banking (CIB) franchise) into the UniCredit group limits the difference between HVB's VR and that of its weaker parent UniCredit S.p.A. (UniCredit; bbb-) to one notch.

Capitalisation Is a Key Strength: HVB's common equity Tier 1 (CET1) capital ratio of 18.8% at end-2020 is strong compared with European peers'. We understand that the bank will continue to distribute the majority of its net profits to UniCredit. This, coupled with the regulatory-driven inflation of risk weighted assets (RWAs), should result in declining capital ratios. However, we expect HVB's capitalisation to remain sound, well above the peer group's average, and to comfortably exceed regulatory requirements.

Fungibility Expectations Drive Outlook: The Negative Outlook on HVB's Long-Term IDR reflects Fitch Ratings' expectation that capital and funding will become more fungible within the UniCredit group entities that operate in the eurozone. In particular, the probability of material capital upstreaming could increase under the European Single Supervision and Single Resolution Mechanisms as long as UniCredit maintains a single-point-of-entry resolution strategy as its preferred option. This could constrain HVB's financial flexibility.

Pandemic Downside Subsiding: We revised the outlook on HVB's asset quality and profitability to stable from negative in May 2021 because the risk of a material deterioration of underlying metrics has subsided since our previous review. Government support programmes have largely cushioned the impact of the pandemic on HVB's loan book, similar to peers. We expect impaired loans to rise by end-2021, when the 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.

Profitability Below European Peers': HVB's average profitability has been modest, even from 2017 to 2019, when loan impairment charges (LICs) were particularly low. We expect the pressure to remain as long as low interest rates and stiff competition weigh on interest margins in German corporate banking. In 2020, the bank's operating profit declined on higher LICs and valuation losses. We expect LICs to materially decline in 2021 and 2022 from their 2020 levels.

Resilient Funding and Liquidity: We revised the outlook on funding & liquidity to stable from negative in May 2021 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. The bank's reliance on market funding is mitigated by its large outstanding stock of covered bonds and by its long average debt maturities.

Rating Sensitivities

Linkage to UniCredit: We could downgrade HVB's IDRs and VR, 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 its recurring operating profit declines durably below 0.5% of RWAs.

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 the bank is more effectively ring-fenced from its parent and intragroup contingency risk is reduced, resulting in a greater de-linkage from UniCredit's credit profile.

Ratings

Foreign Currency	
Long-Term IDR	BBB
Short-Term IDR	F2
Derivative Counterparty Rating	BBB+(dcr)
Viability Rating	bbb
Support Rating	3
Sovereign Risk	
Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA
Outlooks	
Long-Term Foreign-Currency IDR	Negative
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Fitch Affirms UniCredit Bank AG at 'BBB'; Outlook Negative (May 2021)

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Debt Rating Classes

Rating level	Rating
Long-term deposits	BBB+
Short-term deposits	F2
Long-term senior preferred debt	BBB+
Short-term senior preferred debt	F2
Senior non-preferred debt	BBB
Tier 2 subordinated debt	BB+
HVB Funding Trust I and II hybrid notes	BB-

Source: Fitch Ratings

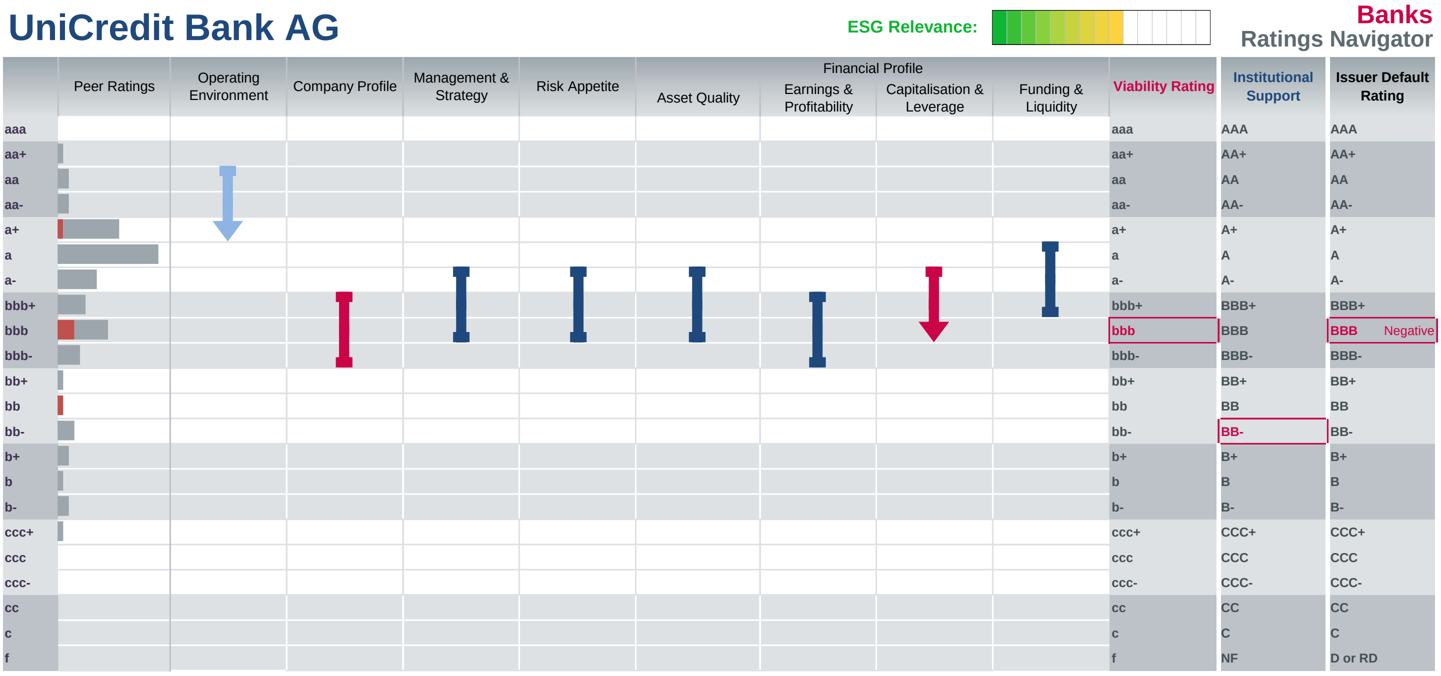
HVB's long-term senior preferred debt and deposit ratings are rated one notch above the bank's Long-Term IDR to reflect the protection that accrues to these creditors from the build-up of junior resolution debt and equity buffers. This is because we expect HVB to meet its MREL requirement with senior non-preferred and more junior debt only.

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

The subordinated Tier 2 debt rating reflects Fitch's 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 additional Tier 1 (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. The regulator could order a coupon deferral in line with the terms and conditions of these profit-linked instruments, but we view such intervention as unlikely in light of HVB's strong capitalisation and distance to its maximum distributable amount (MDA) trigger.

Ratings Navigator



Significant Changes

Downside Risk from the Pandemic Has Subsided

We revised the outlooks on asset quality, earnings & profitability and funding & liquidity to stable from negative in May 2021 because the risk of a significant deterioration of the underlying metrics has subsided since our previous review in May 2020.

The German government put in place at the beginning of the pandemic large emergency programmes to support companies and households affected by the crisis. A strong export-driven rebound in the manufacturing sector in 2H20, persisting high demand for housing and a relatively low proportion of the economy affected by the lockdowns has also sustained economic performance in Germany, which was better than expected and better than most European peers in 2020. The legal obligation for companies that qualify for state support to file for bankruptcy was suspended until end-April 2021. The combination of these elements has kept the number of corporate insolvencies and HVB's incurred credit losses very low in 2020.

Fitch's latest *Global Economic Outlook* forecasts the German GDP to recover close to its pre-pandemic level by end-2021. We expect insolvencies in Germany to peak between 2H21 and 1H22 because we expect a large portion of government support programmes to remain in place until the end of the lockdown. However, we expect only a moderate deterioration of asset quality at HVB. This is because HVB focuses on larger corporates, which benefited more from government support, and has a lower exposure to micro and small SMEs, which we expect to be hit harder once support measures are lifted.

HVB's funding costs also 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.

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧ Positive	⇩ Negative
⇳ Evolving	▫ Stable

Brief Company Summary

Contagion Risk from UniCredit Constrains VR

Contagion risk from UniCredit constrains HVB's VR, along with the inherently higher risk of the CIB's business model. As HVB and UniCredit share the same brand, HVB's reputation and franchise could suffer if UniCredit's risk profile deteriorates materially. We, therefore, limit the uplift of HVB's VR from UniCredit's Long-Term IDR to one notch. UniCredit's Long-Term IDR is capped by Italy's 'BBB-'/Stable sovereign rating because of the bank's large Italian operations and sovereign risk exposure.

Since 2012, HVB has considerably reduced its unsecured funding exposure to UniCredit. We understand that HVB caps its upstream exposure well below the limit imposed by the German regulator (100% of a bank's total regulatory capital) to contain contagion risk. The exposure to UniCredit accounted for a significant proportion of HVB's EUR10 billion Italian exposure at end-2020. The remaining Italian exposure relates mostly to well-known Italian companies that have significant global revenue diversification, which mitigates credit risk.

The Negative Outlook on HVB's Long-Term IDR reflects Fitch's expectation that capital and funding will become more fungible within the UniCredit group entities that operate under the European Single Supervision and Single Resolution Mechanisms as long as UniCredit maintains a single-point-of-entry resolution strategy as its preferred option. Fitch also believes that UniCredit could increasingly replace some of HVB's excess CET1 with junior debt that qualifies as MREL.

Main Focus on Wholesale Commercial Banking

HVB is one of Germany's largest banks, with an established nationwide CIB franchise. It is a leading arranger of covered bonds as well as leveraged and acquisition loans and Schuldscheine for large German corporates, and it offers lending and trade financing to SMEs. As UniCredit's CIB hub, it also benefits from the group's leading market positions in central and eastern Europe.

The Private Client Bank's (PCB) retail deposits reduce HVB's reliance on wholesale funding. However, the modest performance of PCB's retail and private banking offers little profit diversification beyond CIB and corporate banking and reflects HVB's modest nationwide retail market share concentrated in Bavaria and northern Germany. To revive the segments' revenues, HVB targets growth in the mass-affluent and private banking segments by focusing on advisory services. At the same time, it aims to reduce costs by increasingly shifting its mass-retail clients from branches to its digital product offering. However, we believe this is unlikely to materially increase profitability as long as interest rates remain low and HVB lacks critical mass and earnings power in the highly competitive German retail and private banking market.

Deeply Integrated in UniCredit Strategy

HVB's management team has a high degree of depth and experience and a solid execution record. The regular rotation of senior executives across UniCredit entities fosters the transfer of competences and experience and consistent implementation of the group's strategy. Senior management roles are regularly filled with internal candidates, thus strengthening the corporate culture.

HVB aims to use its leading position with large German corporates to develop its SME franchise beyond its core regions of Bavaria and northern Germany. This includes using UniCredit's international presence to support clients abroad, increasing cross-selling between the corporate banking, CIB and PCB divisions and extending the CIB division's trade and working capital finance products to SMEs.

UniCredit's new CEO will communicate the group's updated strategy in 2H21. We expect HVB to continue focusing on strengthening domestic commercial banking, further plugging in CIB into CB's business, and improving cost efficiency by optimising its processes, IT infrastructure, headcounts and branch network.

Summary Financials and Key Ratios

	31 Dec 20		31 Dec 19	31 Dec 18	31 Dec 17
	(USDm)	(EURm)	(EURm)	(EURm)	(EURm)
Summary income statement					
Net interest and dividend income	2,981	2,450	2,412	2,509	2,552
Net fees and commissions	1,225	1,007	973	1,014	1,103
Other operating income	774	636	766	836	1,439
Total operating income	4,980	4,093	4,151	4,359	5,094
Operating costs	3,406	2,800	2,844	3,079	3,295
Pre-impairment operating profit	1,573	1,293	1,307	1,280	1,799
Loan and other impairment charges	894	735	115	16	195
Operating profit	679	558	1,192	1,264	1,604
Other non-operating items (net)	625	514	169	-872	-7
Tax	492	404	551	154	261
Net income	813	668	810	238	1,336
Other comprehensive income	-146	-120	423	-67	118
Fitch comprehensive income	667	548	1,233	171	1,454
Summary balance sheet					
Assets					
Gross loans	148,273	121,875	124,556	120,562	113,780
- Of which impaired	4,044	3,324	2,669	2,984	3,614
Loan loss allowances	2,324	1,910	1,830	1,946	2,149
Net loans	145,949	119,965	122,726	118,616	111,631
Interbank	15,639	12,855	15,649	15,045	16,005
Derivatives	69,096	56,794	47,191	42,575	43,873
Other securities and earning assets	116,831	96,031	86,575	84,719	85,091
Total earning assets	347,516	285,645	272,141	260,955	256,600
Cash and due from banks	57,826	47,531	26,215	19,990	36,414
Other assets	6,020	4,948	5,242	5,743	6,046
Total assets	411,362	338,124	303,598	286,688	299,060
Liabilities					
Customer deposits	162,423	133,506	121,171	113,204	112,316
Interbank and other short-term funding	100,026	82,218	73,162	69,139	75,961
Other long-term funding	40,487	33,279	29,584	25,946	28,862
Trading liabilities and derivatives	79,519	65,362	55,050	55,065	57,901
Total funding	382,456	314,365	278,967	263,354	275,040
Other liabilities	7,098	5,834	5,662	5,531	5,095
Preference shares and hybrid capital	2,129	1,750	54	52	51
Total equity	19,679	16,175	18,915	17,751	18,874
Total liabilities and equity	411,362	338,124	303,598	286,688	299,060
Exchange rate		USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057	USD1 = EUR0.83382

Source: Fitch Ratings, Fitch Solutions, HVB

Summary Financials and Key Ratios

	31 Dec 20	31 Dec 19	31 Dec 18	31 Dec 17
Profitability				
Operating profit/risk-weighted assets	0.7	1.4	1.5	2.0
Net interest income/average earning assets	0.9	0.9	1.0	1.0
Non-interest expense/gross revenue	68.4	68.1	71.1	64.5
Net income/average equity	3.9	4.5	1.3	7.0
Asset quality				
Impaired loans ratio	2.7	2.1	2.5	3.2
Growth in gross loans	-2.2	3.3	6.0	-7.0
Loan loss allowances/impaired loans	57.5	68.6	65.2	59.5
Loan impairment charges/average gross loans	0.6	0.1	0.0	0.2
Capitalisation				
Common equity Tier 1 ratio	18.8	17.5	19.9	21.1
Tangible common equity/tangible assets	4.8	6.2	6.1	6.1
Basel leverage ratio	4.9	4.3	4.9	5.1
Net impaired loans/common equity Tier 1	9.4	5.6	6.3	8.8
Funding and liquidity				
Loans/customer deposits	91.3	102.8	106.5	101.3
Customer deposits/funding	50.2	51.5	50.5	48.1

Source: Fitch Ratings, Fitch Solutions, HVB

Key Financial Metrics – Latest Developments

CIB Drives Risk

Risk at HVB is concentrated in CIB, which accounted for almost three quarters of the bank's economic capital at end-2020. The international CIB business also entails conduct risk, which resulted in large settlement payments to the US authorities in the past. Risk limits are derived from UniCredit's risk appetite framework.

HVB's Stage 3 loans ratio was already higher than German peers' before the crisis. This is because of HVB's shipping exposure, its international CIB business and the practice of working out bad loans internally. Stage 3 loans further increased in 2020 mainly due to the impairment of few large loans. However, we view the bank's provisioning as adequate. Stage 2 customer loans, more than 80% of which are rated sub-investment-grade, also doubled to 19% of gross customer loans yoy at end-2020. The volume of loans under moratoria was negligible, in line with domestic peers.

HVB's two largest non-public sector exposures at end-2020 were to real estate (EUR27 billion) and to special products (EUR15 billion), which include mostly highly-rated European ABS/CDO investments, client-related and own securitisations and structured credit products. HVB's real-estate exposure focuses on residential property and offices with adequate collateralisation. We believe this mitigates the bank's exposure to structural changes in the market. We also understand that management's approach to commercial real-estate lending had already become more cautious before the crisis due to very high and rising margin pressure.

We believe that market risk, which essentially arises from the CIB activities, is manageable in light of HVB's large capital buffer and focus on non-proprietary, client-driven transactions. Interest-rate risk compares favourably with domestic peers.

Capitalisation Is of High Importance for the VR

HVB's CET1 capital ratio of 18.8% at end-2020 is strong compared with European peers'. We understand that the bank will continue to distribute the majority of its net profits to UniCredit. This, coupled with coupon payments on the EUR1.7 billion AT1 instruments issued to UniCredit in 2020 and regulatory-driven RWAs inflation, should result in declining capital ratios. However, we expect HVB's capitalisation to remain sound, well above the peer group's average, and to comfortably exceed regulatory requirements.

We also believe that strong capitalisation is essential for clients' confidence to remain unquestioned in CIB and for HVB to retain its ability to commit capital for large transactions and mitigate the fairly high single-name concentrations inherent in its loan book.

Profitability Under Pressure from Low Margins in Germany

HVB's average operating profitability is modest compared with European peers. Its net interest margins are under pressure from the sectors' strong price competition and low interest rates in the eurozone, similar to other large domestic peers. HVB already passes on negative rates to business and wealth management clients and we believe it will also increasingly charge its mass-retail clients. This will mitigate the margin decline, though we do not expect price competition to ease. Compared with domestic peers, HVB's revenue benefits from net trading and investment income in CIB, which typically accounts for a fifth of the bank's operating revenue.

HVB's profitability was supported by low LICs from 2017 to 2019. In 2020, its operating profits declined on higher LICs and valuation losses. We expect LICs to materially decline in 2021 and 2022 from their 2020 levels and average operating profits/RWAs to remain above 1%.

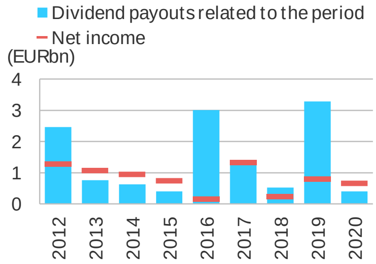
HVB still has room to reduce its cost base, mainly by streamlining and automating its processes, but progress in this area is likely to be slow. The sale of HVB's headquarters helped maintain an acceptable net income of EUR668 million in 2020 (EUR810 million in 2019).

Institutional Support Assessment

HVB's Support Rating of '3' indicates a 'BB-' long-term rating floor based on support from UniCredit. This 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.

Dividend Payments to Unicredit

EUR12.8bn in total since 2013



Source: Fitch Ratings, HVB

Institutional Support			Value
Parent IDR			BBB-
Total Adjustments (notches)			-3
Institutional Support:			**BB-**
Support Factors (negative)	Equalised	1 Notch	2+ Notches
Parent ability to support and subsidiary ability to use support			
Parent/group regulation	✓		
Relative size			✓
Country risks	✓		
Parent Propensity to Support			
Role in group	✓		
Potential for disposal	✓		
Implication of subsidiary default	✓		
Integration	✓		
Size of ownership stake	✓		
Support track record		✓	
Subsidiary performance and prospects	✓		
Branding	✓		
Legal commitments			✓
Cross-default clauses			✓

Environmental, Social and Governance Considerations

FitchRatings **UniCredit Bank AG**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

UniCredit Bank AG has 5 ESG potential rating drivers

- UniCredit Bank AG has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE
How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

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

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.