FitchRatings

Fitch Revises Outlooks on 5 Italian Banks to Negative on Sovereign Outlook Revision

Fitch Ratings-Milan/London-05 September 2018: Fitch Ratings has revised the Outlooks on UniCredit S.p.A.'s, Intesa Sanpaolo's (IntesaSP), Mediobanca S.p.A.'s and Credito Emiliano's (Credem) 'BBB' Long-Term Issuer Default Ratings (IDR) to Negative from Stable. The Outlook on Banca Nazionale del Lavoro's (BNL) 'BBB+' Long-Term IDR has also been revised to Negative from Stable. The five banks' Long- and Short-Term IDRs have been affirmed. A full list of rating actions is at the end of this rating action commentary.

The five banks' Outlook revision to Negative follows the revision of Italy's Outlook to Negative (see: "Fitch Revises Italy's Outlook to Negative; Affirms at 'BBB'" dated 31 August 2018 at www.fitchratings.com) and reflects Fitch's view that the banks would likely be downgraded if Italy's rating is downgraded.

KEY RATING DRIVERS
In our opinion UniCredit's, IntesaSP's, Mediobanca's and Credem's Long-Term IDRs should not be rated above Italy's sovereign rating. BNL's Long-Term IDR, which is driven by institutional support from its owner, BNP Paribas (BNPP; A+/Stable/a+), is capped at one notch above Italy's rating.

IntesaSP's, Mediobanca's and Credem's activities are predominantly domestic and their IDRs and VRs are therefore highly affected by the risk profile of the Italian sovereign and the domestic economy.

UniCredit's geographical diversification, particularly in more stable and highly rated economies such as Germany and Austria, has proved key to supporting the group's overall risk profile. However, Fitch considers that the parent bank's risk profile remains highly correlated with that of the Italian sovereign and with Italy's economy, especially given its substantial domestic non-performing loans. UniCredit's IDRs and VR are therefore also affected by the sovereign rating.

BNL's Outlook revision reflects our view that the propensity and ability of BNPP to support its subsidiary might reduce in case of extreme sovereign stress, as a result of which we cap BNL's IDRs at one notch above those of Italy.

UNICREDIT
VR, LONG-TERM IDR AND LONG-TERM SENIOR DEBT
UniCredit's ratings reflect Fitch's expectation that the bank will continue to reduce its legacy non-performing loans (NPLs) in line with its updated strategic plan and maintain capitalisation with satisfactory buffers over regulatory minimums and generally in line with its peers. Fitch believes that the bank has made good progress in implementing its strategic plan and that it is in a good position to meet its planned targets.

In Fitch's view, UniCredit's asset quality will remain weaker than most of its European peers, even after the reduction envisaged by 2019. Capital, which benefits from the capital strengthening in 2017, remains burdened by an above-average level of unreserved impaired loans compared with banks in other

European countries. Our assessment of UniCredit also considers that the parent bank's asset quality and returns remain weaker than other parts of the group, and we believe that the group's risk profile remains correlated with the operating environment in its Italian home market. The ratings also reflect the group's broad and diversified international franchise, measures that the bank has taken to reduce operating expenses, and a good and diversified funding and liquidity profile.

The rating of senior debt issued by UniCredit's funding vehicles, UniCredit Bank (Ireland) plc, and UniCredit International Bank Luxembourg SA is equalised with that of the parent because it is unconditionally and irrevocably guaranteed by UniCredit, and Fitch expects the parent to honour this guarantee.

The senior non-preferred notes are rated in line with Unicredit's Long-Term IDR and existing senior debt rating.

INTESASP
VR, LONG-TERM IDR AND LONG-TERM SENIOR DEBT
IntesaSP's ratings continue to reflect its leading franchises in several market segments in Italy and its diversified business model, which differentiates the bank domestically and has allowed it to generate better and more stable profitability than domestic peers. This balances the bank's asset quality, which is weak by international standards. The ratings also factor in IntesaSP's good execution track record, which has allowed higher recoveries on outstanding impaired loans. The bank's conservative risk appetite has contributed to lower inflows of new impaired loans since 2007. Capitalisation is satisfactory and maintained with ample buffers over regulatory minimum requirements, although unreserved impaired loans relative to capital as well as its gross impaired loans ratio remain high by global sector averages. The ratings also reflect the group's diversified funding and strong liquidity position.

The ratings of the senior debt issued by IntesaSP's funding vehicles, Intesa Sanpaolo Bank Ireland, Intesa Sanpaolo Bank Luxembourg, S.A. and Intesa Funding LLC are equalised with that of the parent because the debt is unconditionally and irrevocably guaranteed by IntesaSP and Fitch expects the parent to honour this guarantee.

MEDIOBANCA
VR, LONG-TERM IDR AND LONG-TERM SENIOR DEBT
Mediobanca's ratings reflect the group's adequate capitalisation and leverage, which are commensurate with the bank's risk profile and are supported by sound internal capital generation. The ratings also reflect relatively strong asset quality compared with Italian peers, with a gross non-performing exposure ratio of about 5% at end-June 2018.

Mediobanca benefits from a strong franchise in specialised businesses in Italy. This provides it with business and revenue diversification, which has resulted in growing revenue over the past four years. Mediobanca has maintained a strong franchise in Italian corporate and investment banking, and consumer finance over several business cycles. It has also diversified geographically in selected western and south-eastern European countries, where it has a direct branch presence.

The ratings of the senior debt issued by Mediobanca International (Luxemburg) SA are equalised with the parent's Long-Term IDR since the debt is unconditionally and irrevocably guaranteed by Mediobanca, and Fitch expects the parent to honour this guarantee.

The senior non-preferred notes are rated in line with Mediobanca's Long-Term IDR and existing senior debt rating. Fitch views the probability of default on the senior non-preferred notes as the same as the probability of default of the bank.

CREDEM
VR, LONG-TERM IDR AND LONG-TERM SENIOR DEBT
Credem's ratings reflect its diversified and stable business model, which however is concentrated on domestic activities. The business model has resulted in more resilient profitability and healthier asset quality to date than its Italian peers.

Unlike Italian medium-sized peers, Credem's activities include wealth management and insurance. These have contributed fee and commission income and have stabilised the bank's profitability during the years of low interest rates. Strong underwriting standards and a strategy of targeting lower risk, more affluent customers have resulted in low and stable loan impairment charges (LICs), supporting profitability during a time when the domestic banking sector has been affected by the management of large stocks of NPLs.

UNICREDIT, INTESASP, MEDIOBANCA AND CREDEM
SHORT-TERM IDRs, SHORT-TERM SENIOR DEBT AND DCRs
The banks' Short-Term IDRs of 'F2' are the higher of the two possibilities for 'BBB' Long-Term IDRs under our criteria, reflecting our opinion that the banks' short-term liquidity profiles are the strongest domestically and are supported by ready access to central bank facilities.

The banks' DCRs are at the same level as the Long-Term IDRs because in Italy derivative counterparties have no preferential legal status over other senior obligations in a resolution.

UNICREDIT, INTESASP, MEDIOBANCA AND CREDEM
SUPPORT RATINGS (SRs) AND SUPPORT RATING FLOOR (SRFs)
The SRs and SRFs reflect Fitch's view that although external support is possible it cannot be relied upon. Senior creditors can no longer expect to receive full extraordinary support from the sovereign in the event that the bank becomes non-viable.

The EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) for eurozone banks provide a framework for the resolution of banks that requires senior creditors to participate in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

BNL
IDRS, SENIOR DEBT AND SUPPORT RATING
BNL's IDRs and SR reflect institutional support from its parent, BNPP, as Fitch considers BNL core to BNPP's strategy and Italy a home market for the French group. BNL's IDRs are capped at one notch above Italy's sovereign rating. This reflects Fitch's view that in case of extreme sovereign and macroeconomic stress, BNL's financial profile may negatively affect the parent group's financial profile to the extent that this could ultimately reduce BNPP's propensity to support its Italian subsidiary. In such an extreme scenario, the bank, like other banks in Italy, could also be vulnerable to the risk of restrictions being imposed on its ability to service its obligations, therefore potentially constraining its ability to utilise support from BNPP.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
Subordinated debt and other hybrid capital securities issued by the banks are notched down from their respective VRs in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles.

Tier 2 subordinated debt is rated one notch below the VRs for loss severity to reflect below-average recovery prospects. No notching is applied for incremental non-performance risk because write-down of the notes will only occur once the point of non-viability is reached and there is no coupon flexibility before non-viability.

Legacy Tier 1 notes are notched four times from the VRs, two notches for loss severity for deep subordination and another two for non-performance risk as coupon deferral is constrained by look-back clauses.

Additional Tier 1 notes are rated five notches below the VRs, two notches for loss severity relative to senior unsecured creditors and three notches for incremental non-performance risk, the latter notching reflecting the instruments' fully discretionary interest payment.

SENIOR STATE-GUARANTEED SECURITIES

The long-term rating of state-guaranteed debt is based on Italy's direct, unconditional and irrevocable guarantee for the issues, which covers payments of both principal and interest. Italy's guarantee was issued by the Ministry of Economy and Finance under Law Decree 23 December 2016, n. 237, subsequently converted into law 15/2017. The ratings reflect Fitch's expectation that Italy will honour the guarantee provided to the noteholders in a full and timely manner. The state guarantee ranks pari passu with Italy's other unsecured and unguaranteed senior obligations. As a result, the notes' long-term ratings are in line with Italy's 'BBB' Long-Term IDR.

SUBSIDIARY AND AFFILIATED COMPANY

The ratings of IntesaSP's Italian subsidiary, Banca IMI, are based on institutional support from its parent and reflect Fitch's view of its core function and extremely high integration within the group.

Banca IMI's DCR is at the same level as its Long-Term IDR because in Italy derivative counterparties have no preferential legal status over other senior obligations in a resolution.

RATING SENSITIVITIES

UNICREDIT

VR, IDRs, DCR AND SENIOR DEBT

UniCredit's ratings are primarily sensitive to deterioration in the operating environment in Italy and to Italy's sovereign ratings. If Italy's sovereign rating is downgraded, UniCredit's VR, IDRs, DCR and debt ratings would likely be downgraded.

An upgrade of UniCredit's ratings would require a material further improvement in asset quality, a successful record of consistent internal capital generation from the group's operating profit while maintaining its reduced risk appetite and an upgrade of Italy's sovereign rating, which is currently unlikely given the Negative Outlook. Despite the bank's broad and diversified international presence, at this stage Fitch does not believe that the bank should be rated above Italy's sovereign, since it does not believe the bank would retain the capacity to service its obligations following a sovereign default and as it also considers it is possible that the sovereign, following its own default, could impose restrictions on banks' ability to service its obligations.

The ratings could be downgraded if progress in reducing the remaining stock of impaired exposures slows down and if the bank does not meet its targets.

UniCredit's Short-Term IDR would be downgraded if its funding and liquidity weaken.

The ratings of the senior debt issued by UniCredit's funding vehicles, UniCredit Bank (Ireland) plc, and UniCredit International Bank Luxembourg SA, are sensitive to the same considerations as the senior unsecured debt issued by the parent.

INTESASP
VR, IDRs, DCR AND SENIOR DEBT
IntesaSP's ratings are primarily sensitive to deterioration in the operating environment in Italy and to Italy's sovereign ratings. If Italy's sovereign rating is downgraded, IntesaSP's VR, IDRs, DCR and debt ratings would likely be downgraded.

IntesaSP's ratings are sensitive to deterioration in the operating environment in Italy as this could affect asset quality, earnings and capitalisation. IntesaSP's ratings are likely to be downgraded if the bank does not meet its targets to reduce impaired loans or if its capital remains highly exposed to unreserved impaired loans. Similarly, deterioration in the bank's funding and liquidity would put pressure on the ratings. In Fitch's opinion, rating upside is limited and is likely to require an upgrade of Italy's sovereign rating. However, over the longer term IntesaSP's ratings could benefit from sustained improvements in the economic conditions in Italy and evidence of materially stronger asset quality combined with consistent profitability and sound capital levels.

IntesaSP's Short-Term IDR would be downgraded if its funding and liquidity weaken.

The ratings of the senior debt issued by Intesa Sanpaolo Bank Ireland, Intesa Sanpaolo Bank Luxembourg, S.A. and Intesa Funding LLC are sensitive to the same factors that affect the senior unsecured debt issued by the parent.

MEDIOBANCA
VR, IDRs, DCR AND SENIOR DEBT
Mediobanca's ratings are primarily sensitive to deterioration in the operating environment in Italy and to Italy's sovereign ratings. If Italy's sovereign rating is downgraded, Mediobanca's VR, IDRs, DCR and debt ratings would likely be downgraded.

Increased risk appetite, such as expanding higher-risk activities without an equivalent evolution of its risk controls framework, increasing concentration risk, or a less rigorous approach to pricing consumer finance risks or asset-quality deterioration could lead to a downgrade. Deterioration of group liquidity and funding could also result in a downgrade.

Fitch would downgrade the bank's Short-Term IDR if the Long-Term IDR is downgraded or if we perceive a weakening in its funding and liquidity profile.

CREDEM
VR, IDRs, DCR AND SENIOR DEBT
Credem's ratings are primarily sensitive to deterioration in the operating environment in Italy and to Italy's sovereign ratings. If Italy's sovereign rating is downgraded, Credem's VR, IDRs, DCR and debt ratings would likely be downgraded.

The ratings are also sensitive to a material deterioration in asset quality, which could be the result of a worsening operating environment or weaker underwriting standards, the latter of which we do not expect. The ratings could also be downgraded if capitalisation falls as a result of strong loan growth, if funding deteriorates or if the bank increases its risk appetite.

Credem's Short-Term IDR would be downgraded if the bank's liquidity declines or if, for example it is unable to successfully manage the tapering of ECB's bond buying programme and replace central bank funding with market funding.

UNICREDIT, INTESASP, MEDIOBANCA AND CREDEM
SRs AND SRFs
An upgrade of the SRs and upward revision of the SRFs would be contingent on a positive change in the sovereign's propensity to support the banks. In Fitch's view, this is highly unlikely, although not impossible.

BNL
IDRS, SENIOR DEBT AND SR
BNL's IDRs and SR are primarily sensitive to a change in Italy's sovereign rating and would likely be downgraded if Italy is downgraded. The IDRs and SR are also sensitive to a change in Fitch's assessment of BNPP's propensity and ability to provide support to its subsidiary. A downgrade of BNPP's IDRs will only affect BNL's IDRs and SR if the parent's Long-Term IDR is downgraded by more than two notches.

The Short-Term IDR may come under pressure if short-term liquidity support from its parent weakens, which Fitch currently does not expect.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
The subordinated debt and hybrid securities' ratings are primarily sensitive to changes in the respective VRs, from which they are notched. The 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 VRs 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.

SENIOR STATE-GUARANTEED SECURITIES
The notes' ratings are sensitive to changes in Italy's Long-Term IDR. If IntesaSP decides to cancel the guarantees on this senior debt, Fitch will no longer rate the notes based on the guarantee but might rate the notes based on IntesaSP's senior debt rating.

SUBSIDIARY AND AFFILIATED COMPANIES
As Banca IMI's ratings are based on its parent's Long-Term IDR, they are sensitive to changes in IntesaSP's propensity to provide support and to changes in the parent's Long-Term IDR.

The rating actions are as follows:

UniCredit
Long-Term IDR: affirmed at 'BBB' Outlook revised to Negative from Stable
Short-Term IDR: affirmed at 'F2'
VR: affirmed at 'bbb'
DCR: affirmed at 'BBB(dcr)'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Senior unsecured debt (including debt issuance programmes): affirmed at 'BBB', 'F2'
Senior non-preferred debt: affirmed at 'BBB'
Tier 2 notes: affirmed at 'BBB-'
Preferred stock: affirmed at 'BB-'
AT 1 Notes: affirmed at 'B+'

UniCredit Bank (Ireland) p.l.c. (no issuer ratings assigned):
Senior unsecured notes (including debt issuance programmes): affirmed at 'BBB'

UniCredit International Bank (Luxembourg) S.A. (no issuer ratings assigned):
Senior unsecured notes (including debt issuance programmes): affirmed at 'BBB'

Intesa Sanpaolo S.p.A.
Long-Term IDR: affirmed at 'BBB'; Outlook revised to Negative from Stable
Short-Term IDR: affirmed at 'F2'
Viability Rating: affirmed at 'bbb'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Derivative Counterparty Rating: affirmed at 'BBB(dcr)'
Senior debt (including debt issuance programmes): affirmed at 'BBB'/ 'F2'
Commercial paper/certificate of deposit programmes: affirmed at 'F2'
Short-term deposits: affirmed at 'F2'
Subordinated lower Tier II debt: affirmed at 'BBB-'
Tier 1 instruments: affirmed at 'BB-'
AT1 notes: affirmed at 'B+'
State-guaranteed debt: affirmed at 'BBB'

Banca IMI S.p.A.:
Long-Term IDR: affirmed at 'BBB'; Outlook revised to Negative from Stable
Short-Term IDR: affirmed at 'F2'
Support Rating: affirmed at '2'
Derivative Counterparty Rating: affirmed at 'BBB(dcr)'
Senior debt: affirmed at 'BBB'

Intesa Sanpaolo Bank Ireland plc (no issuer ratings assigned):
Commercial paper/short-term debt: affirmed at 'F2'
Senior unsecured debt: affirmed at 'BBB'

Intesa Sanpaolo Bank Luxembourg, S.A. (no issuer ratings assigned):
Commercial paper/short-term debt: affirmed at 'F2'
Senior unsecured debt: affirmed at 'BBB'

Intesa Funding LLC (no issuer ratings assigned):
US commercial paper programme: affirmed at 'F2

Mediobanca
Long-Term IDR: affirmed at 'BBB'; Outlook Stable revised to Negative from Stable
Short-Term IDR: affirmed at 'F2'
Viability Rating: affirmed at 'bbb'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Derivative Counterparty Rating: affirmed at 'BBB(dcr)'
Senior unsecured debt (including debt issuance programmes): affirmed at 'BBB'/'F2'
Senior non-preferred long-term debt (including debt issuance programme): affirmed at 'BBB'
Subordinated debt: affirmed at 'BBB-'

Mediobanca International (Luxemburg) SA (no issuer ratings assigned):
Senior unsecured debt: affirmed at 'BBB'/'F2'

Credem
Long-Term IDR: affirmed at 'BBB'; Outlook revised to Negative From Stable
Short-Term IDR: affirmed at 'F2'
Viability Rating: affirmed at 'bbb'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Derivative Counterparty Rating: affirmed at 'BBB(dcr)'
Senior unsecured EMTN programme: affirmed at 'BBB'
Subordinated notes: affirmed at 'BBB-'

BNL
Long-Term IDR: affirmed at 'BBB+'; Outlook revised to Negative From Stable
Short-Term IDR: affirmed at 'F2'
Viability Rating: 'bb+'; not affected
Support Rating: affirmed at '2'
Senior debt and EMTN programme: affirmed at 'BBB+'

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Applicable Criteria

Bank Rating Criteria (pub. 22 Jun 2018) (https://www.fitchratings.com/site/re/10034713)

Additional Disclosures

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