FITCH DOWNGRADES 5 ITALIAN BANKS' FOLLOWING SOVEREIGN DOWNGRADE

Link to Fitch Ratings' Report: Fitch Downgrades 5 Italian Banks' Following Sovereign Downgrade
https://www.fitchratings.com/site/re/897599

Fitch Ratings-Milan/London-27 April 2017: Fitch Ratings has downgraded the Long-Term Issuer Default Ratings (IDRs) of UniCredit S.p.A., Intesa Sanpaolo S.p.A. (IntesaSP), Credito Emiliano (Credem) and Mediobanca S.p.A. to 'BBB' from 'BBB+'. It affirmed the banks' Short-Term IDRs at 'F2'. Fitch has also downgraded Banca Nazionale del Lavoro's (BNL) Long-Term IDR to 'BBB+' from 'A-', Short-Term IDR to 'F2' from 'F1' and Support Rating (SR) to '2' from '1'.

Fitch revised the Outlooks on all the banks to Stable from Negative, in line with Italy's rating Outlook. A full list of rating actions is given in the related Rating Action Report.

The downgrade of the five banks follows the downgrade of Italy's Long-Term Foreign-Currency IDR to 'BBB' from 'BBB+' (see: "Fitch Downgrades Italy's LTFC IDR to 'BBB'; Outlook Stable '" dated 21 April 2017 at www.fitchratings.com).

Fitch has also assigned a 'BBB(dcr)' Derivative Counterparty Rating (DCR) to UniCredit as part of its roll-out of DCRs to significant derivative counterparties in western Europe and the US. DCRs are issuer ratings and express Fitch's view of banks' relative vulnerability to default under derivative contracts with third-party, non-government counterparties.

KEY RATING DRIVERS
UniCredit, IntesaSP, Credem and Mediobanca's IDRs are based on their standalone credit profiles as reflected in their Viability Ratings (VRs). IntesaSP, Credem and Mediobanca's activities are predominantly domestic and therefore highly correlated with the risk profile of the Italian sovereign and exposed to the domestic economy. Fitch has therefore downgraded the VRs of the three banks to the same level as the sovereign Long-Term IDR.

For UniCredit, 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.

BNL's downgrade reflects our view that the downgrade of Italy has reduced BNL's attractiveness to its parent BNP Paribas (BNPP, A+/Stable) by increasing the risk of BNL negatively affecting the parent group's financial profile and ultimately reducing the parent's propensity to support its Italian subsidiary.

UniCredit
VR, IDRS, SENIOR DEBT AND DCR
UniCredit's ratings reflect the benefits from the EUR13 billion capital increase the bank completed in February 2017 and the planned reduction in legacy NPL stock, but also remaining problems with asset quality and earnings for the parent bank after the restructuring. The ratings also reflect the group's broad and diversified international franchise, measures being taken on costs, and a good, diversified funding and liquidity profile.

Fitch affirmed UniCredit's Short-Term IDR at 'F2', the higher of the two possibilities for a 'BBB' Long-Term IDR under our criteria, to reflect its well-diversified funding and liquid assets, which in our opinion benefit from the group's direct presence in and market access to investors in strong European countries.

The rating of the 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.

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

IntesaSP
VR, IDRs AND SENIOR DEBT
IntesaSP's ratings reflect the bank's diversified and stable business model, combined with its leading domestic franchise in various market segments. IntesaSP's company profile has helped the group generate profitability that has remained above domestic peers' in a challenging operating environment. The bank's good execution track record has enabled it to generate consistent profitability through the economic cycle, which differentiates the bank domestically.

The ratings also reflect Fitch's view of the group's resilient capitalisation and robust funding structure, but also its asset quality, which remains weak compared with international peers, and the high level of unreserved impaired loans, which weighs on capitalisation.

Fitch affirmed IntesaSP's Short-Term IDR at 'F2', the higher of the two possibilities for a 'BBB' Long-Term IDR under our criteria, to reflect that the bank's short-term liquidity profile is supported by good access to central bank facilities given the ECB's accommodative policy.

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.

SUBSIDIARY AND AFFILIATED COMPANY
The ratings of IntesaSP's Italian subsidiary Banca IMI reflect Fitch's view of its core function and extremely high integration within the group.

DCRs
IntesaSP and Banca IMI's DCRs are at the same level as their Long-Term IDRs because in Italy derivative counterparties have no preferential legal status over other senior obligations in a resolution scenario.

Credem
VR, IDRs AND SENIOR DEBT
Credem's ratings benefit from more healthy asset quality than at other Italian banks, helped by active targeting of more creditworthy customers. The ratings also reflect sound capitalisation and resilient profitability, due to a more diverse business model than that of many other medium-sized Italian commercial banks.

Fitch affirmed Credem's Short-Term IDR at 'F2', the higher of the two possibilities for a 'BBB' Long-Term IDR under our criteria, to reflect that the bank's short-term liquidity profile is supported by good access to central bank facilities given the ECB's accommodative policy.

Mediobanca

VR, IDRS, SENIOR DEBT AND DCR

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 by Italian bank standards, which compares adequately with international peers, and the group's ample liquidity.

Mediobanca's Short-Term IDR was affirmed at 'F2', the higher of the two possibilities for a 'BBB' Long-Term IDR under our criteria, to reflect that the bank's short-term liquidity profile is supported by good access to central bank facilities given the ECB's accommodative policy.

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

Mediobanca'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 scenario.

SUPPORT RATINGS AND SUPPORT RATING FLOORS

UniCredit, IntesaSP, Credem and Mediobanca

UniCredit IntesaSP, Credem and Mediobanca's SR and Support Rating Floor reflect Fitch's view that senior creditors cannot rely on receiving full extraordinary support from the sovereign if a bank becomes non-viable. 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 to participate in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

BNL

IDRS, SENIOR DEBT AND SUPPORT RATING

The IDRs and SR reflect institutional support from BNL's parent, BNPP, as Fitch considers BNL core to BNPP's strategy and Italy a home market for the French group. Nonetheless, BNL's Long-Term IDR is capped at one notch above Italy's sovereign rating because in Fitch's view BNPP's propensity to support BNL is linked to Italy's operating environment. The operating environment in Italy affects the attractiveness of BNL to the group and the Italian subsidiary's impact on the French group's financial profile.

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.

The legacy Upper Tier 2 debt rating reflects its higher loss severity given its subordination to senior unsecured and subordinated Tier 2 obligations (two notches) and incremental non-performance risk (one notch) for its cumulative coupon deferral subject to constraints.

Legacy Tier 1 notes are notched four times from the VR, 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.

RATING SENSITIVITIES
UniCredit
VR, IDRS, SENIOR DEBT AND DCR
UniCredit's ratings could be downgraded if the bank fails to demonstrate notable, sustained progress in selling down and reducing the remaining stock of impaired exposures. The bank intends to dispose of around EUR18 billion impaired loans remaining following the disposal of EUR1 billion in 4Q16 and the portion of the EUR17.7 billion securitised NPLs (in the FINO transaction) that it has not yet sold to third-party investors by 2018. The ratings could also be downgraded if there is material slippage in its cost reduction plan.
Unicredit's rating remains sensitive to the operating environment in Italy, particularly as this affects asset quality and earnings. A notable economic improvement could be beneficial for the ratings, if accompanied by a substantial reduction of impaired loans, while further deterioration could be negative.

It is possible that Fitch will at some point assign common VRs to UniCredit S.p.A. and its German banking subsidiary to reflect the increasingly close integration between the two entities. Capital and funding are progressively becoming more fungible across the group, and the German subsidiary UniCredit Bank AG is large in relation to the group, highly integrated into the parent and supervised by the same regulator, the ECB.

UniCredit Bank Austria AG's relative size fell and its business model has become domestically focused following the transfer of CEE subsidiaries to the parent. If and when we conclude that capital has become essentially fungible within the group, we would equalise the Austrian subsidiary's ratings with those of its Italian parent because Bank Austria is highly integrated into the parent and supervised by the same regulator.

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, SENIOR DEBT AND DCR
IntesaSP's ratings could be downgraded if the bank does not meet its impaired loan reduction targets and its capital remains highly exposed to unreserved impaired loans. Similarly, deterioration in the bank's funding and liquidity would put pressure on the ratings, as would prioritising dividend distribution over capital retention in case of need. IntesaSP's ratings remain sensitive to deterioration in the operating environment in Italy and to Italy's sovereign ratings.

Its Short-Term IDR would be downgraded if the bank is unable to successfully manage the ECB tapering and replace central bank funding with market funding.

An upgrade of the ratings would require a significant improvement of the bank's asset quality and, given its overwhelmingly domestic operations, an upgrade of Italy's sovereign rating.

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 considerations that affect the senior unsecured debt issued by the parent.

SUBSIDIARY AND AFFILIATED COMPANIES
IDRS, SENIOR DEBT AND DCR
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.

Credem
VR, IDRS AND SENIOR DEBT
Credem's ratings are primarily sensitive to a material deterioration in asset quality, which could be the result of weaker underwriting standards, which we do not expect, or exposure to the domestic economy. Ratings could also be downgraded if capitalisation deteriorates as a result of strong loan growth or if the bank increases its risk appetite.

Credem's Short-Term IDR would be downgraded if the bank is unable to successfully manage the ECB tapering and replace central bank funding with market funding.

Credem's ratings remain sensitive to a deterioration in the operating environment in Italy and to Italy's sovereign rating. Any upgrade of the ratings would first require an upgrade of Italy's sovereign rating.

Mediobanca
VR, IDRS, SENIOR DEBT AND DCR
Mediobanca's ratings are primarily sensitive to a deterioration in the operating environment in Italy and to Italy's sovereign rating. Any upgrade of the ratings would first require an upgrade of Italy's sovereign rating.

Increased risk appetite, such as expanding higher-risk activities in non-Italian operations, increasing concentration risk, or a less rigorous approach to pricing consumer finance risks or asset-quality deterioration could lead to a downgrade. Similarly, significantly increased volumes of foreign-originated activities without an equivalent evolution of its risk controls framework could put pressure on the bank's ratings. Deterioration of group liquidity and funding could also result in a downgrade.

Fitch would downgrade the bank's Short-Term IDR it is unable to successfully manage the ECB tapering and replace central bank funding with market funding.

SUPPORT RATING AND SUPPORT RATING FLOOR
UniCredit, IntesaSP, Credem and Mediobanca
An upgrade of the SRs and upward revision of the Support Rating Floors 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.

A change in the sovereign's propensity to provide support to the banking sector in general would not necessarily mean that the propensity to provide support to Mediobanca increases to the same extent, because of its limited retail deposit and lending market shares.

BNL
IDRS, SENIOR DEBT AND SR
BNL's 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 three notches.

The Short-Term IDR may come under pressure if short-term liquidity support from its parent weakens, which Fitch does not expect. The IDRs and SR remain sensitive to a change in Italy's sovereign rating and would probably be downgraded further if Italy was downgraded.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
The subordinated debt and hybrid securities' ratings are primarily sensitive to changes in the 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.

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Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051