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CREDIT OPINION
6 December 2016

Update

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RATINGS

Banque Cantonale Vaudoise

Domicile	Switzerland
Long Term Debt	Not Assigned
Type	Not Assigned
Outlook	Not Assigned
Long Term Deposit	Aa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Banque Cantonale Vaudoise

Semiannual Update

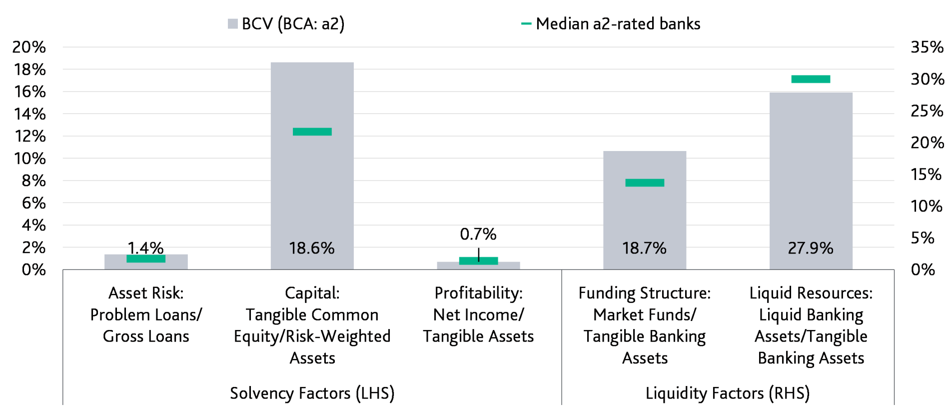
Summary Rating Rationale

We assign Aa2/P-1 deposit ratings with stable outlook to Banque Cantonale Vaudoise (BCV). We also assign a a2 baseline credit assessment (BCA), an a2 Adjusted BCA and A1(cr)/P-1(cr) Counterparty Risk (CR) Assessments.

The Aa2 deposit rating reflects (1) the bank's a2 BCA and Adjusted BCA, (2) the result of our advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by different liability classes in resolution, and which results in two notches of rating uplift for BCV's deposit rating, and (3) the ''High'' probability of BCV receiving (local) government support providing one notch of rating uplift to the bank's long-term ratings. The latest takes into account the majority ownership of the bank by the Canton of Vaud (unrated) and the bank's strong market position in the region.

The a2 BCA reflects (1) the bank's relatively low on-balance-sheet risks, despite displaying a high concentration in the dynamic Canton of Vaud region, including relatively large exposures to the region's real-estate markets; (2) BCV's strong capitalisation, measured by a tangible common equity/risk weighted assets of 18.6% and a CET1 ratio of 16.8% as of end-June 2016 (3) its relatively strong profitability and (4) a sound liquidity profile regarding both its market-funding dependence and the volume of liquid assets available to mitigate existing funding risk.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Credit Strengths

» Strong capital adequacy ratios

» Above-average profitability and efficiency metrics continue despite challenging market environment

» Stable deposit base and low market sensitivity safeguard BCV's sound funding and liquidity profile

» The expected loss severity on depositors is very low given the bank's significant deposit volume

Credit Challenges

» Real estate loan book growth slowed down, but the mortgage loan book remains key asset risk in a real estate market with elevated price levels

» BCV's capital generation capacity is limited by its very high payout ratio on profits

» Interest and market environment for Swiss banks remains challenging

Rating Outlook

The outlook for BCV's ratings is stable, as we do not expect any material change regarding the bank's credit fundamentals, a downturn in the Swiss real-estate market nor a change in the bank's ownership over the next 12-18 months.

Factors that Could Lead to an Upgrade

» BCV's long-term deposit ratings could be upgraded if (1) stronger fundamentals justify an upgrade of the BCA and/or (2) the volume of senior unsecured debt and/or further subordinated instrument increases, which could lead to additional rating uplift, as assessed in our advanced LGF analysis; provided that our government support assumptions remain unchanged. The latest takes into account the Canton of Vaud's long-standing majority ownership, albeit without an explicit statutory guarantee, and the canton's creditworthiness.

» Upward pressure on BCV's BCA could be exerted if BCV (1) sustainably and further reduces its earnings sensitivity to lower interest rates by further diversifying earnings; (2) continues to improve profitability as well as its efficiency metrics; and (3) improves its sound capital adequacy metrics displaying a meaningful buffer over and above the regulatory minimum set by the Swiss Financial Market Authority (FINMA).

Factors that Could Lead to a Downgrade

» BCV's long-term deposit ratings could be downgraded if (1) weaker fundamentals justify a downgrade of the BCA, and/or (2) the volume of deposits decreases, which could lead to lower rating uplift, as assessed in our advanced LGF analysis; provided that our government support assumptions remain unchanged. The latest takes into account the Canton of Vaud's long-standing majority ownership, albeit without an explicit statutory guarantee, and the canton's creditworthiness.

» A substantial deterioration in the credit profile of the Canton of Vaud; and/ or an increased likelihood that the canton's stake in BCV (currently 67%) will fall below the 50.1% legal threshold could also lead to a downgrade of BCV's long-term deposit ratings.

» Negative pressure on BCV's BCA could result from (1) a sustained and/or unexpected weakening of its recurring earnings power and levels of operating efficiency; (2) material asset-quality deterioration, especially if following a marked slowdown in the domestic real-estate market; and (3) impairment to its franchise (i.e., if the bank were to face reputational issues, which would hamper the bank's private wealth management or other businesses).

Key Indicators

Exhibit 2
Banque Cantonale Vaudoise (Consolidated Financials) [1]

	6-16[2]	12-15[2]	12-14[2]	12-13[2]	12-12[3]	Avg.
Total Assets (CHF billion)	44.7	43.4	41.8	40.3	39.6	3.1[4]
Total Assets (EUR billion)	41.3	39.9	34.8	32.9	32.8	5.9[4]
Total Assets (USD billion)	45.9	43.4	42.1	45.3	43.3	1.5[4]
Tangible Common Equity (CHF billion)	3.3	3.4	3.3	3.3	3.3	-0.2[4]
Tangible Common Equity (EUR billion)	3.0	3.1	2.8	2.7	2.7	2.6[4]
Tangible Common Equity (USD billion)	3.3	3.4	3.3	3.7	3.6	-1.7[4]
Problem Loans / Gross Loans (%)	1.4	1.2	1.4	1.5	1.8	1.5[5]
Tangible Common Equity / Risk Weighted Assets (%)	18.6	20.3	19.7	20.1	16.2	19.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	12.4	9.8	12.1	13.0	14.7	12.4[5]
Net Interest Margin (%)	1.1	1.2	1.3	1.3	1.4	1.2[5]
PPI / Average RWA (%)	2.3	2.5	2.4	2.3	1.9	2.4[6]
Net Income / Tangible Assets (%)	0.7	0.7	0.7	0.7	0.8	0.7[5]
Cost / Income Ratio (%)	60.5	58.4	60.3	61.7	60.7	60.3[5]
Market Funds / Tangible Banking Assets (%)	-	18.7	16.7	14.5	15.6	16.4[5]
Liquid Banking Assets / Tangible Banking Assets (%)	30.0	27.9	24.2	25.2	18.9	25.2[5]
Gross loans / Due to customers (%)	103.9	102.1	104.2	101.7	102.3	102.9[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; LOCAL GAAP [3] Basel II; LOCAL GAAP [4] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [5] LOCAL GAAP reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & LOCAL GAAP reporting periods have been used for average calculation
Source: Moody's Financial Metrics

Detailed Rating Considerations

Solid capital adequacy ratios mitigate asset quality risks

BCV's asset quality improved strongly in recent years, reflecting the bank's strong focus on credit risk and its conservative credit risk management. The problem loan ratio of 1.4% (according to Moody's definitions) as of end-June 2016 has declined since 2010. The average loan-to-value of BCV's real-estate loan exposures remained at around 50%, at the lower end compared with those of its closest peers of Swiss cantonal banks and we do not expect that BCV will be immediately affected by moderate negative price movements in the Vaud real-estate market.

BCV's loan book remains concentrated in the dynamic Vaud region, a region supported by strong demographic factors, however, constrained by a still elevated level of house prices. While we take account of the recent slowdown in real-estate prices and lower transaction volumes, the bank remains susceptible to shocks potentially emanating from the domestic real-estate market or during a prolonged period of weaker economic growth in Switzerland. This vulnerability may, in an adverse scenario, weaken the bank's sound capital buffers, despite the modest growth of BCV's mortgage loan book since 2013. We have reflected the geographical concentrations and the tail risks relating to the mortgage book by adjusting our Asset Risk Score to a2.

As a Category 3 institution according to the FINMA definition, BCV must maintain an adequacy target with a (total) capital ratio of at least 12%. Since January 2016, FINMA increased the minimum capital target of BCV to 13% to take into account the bank's interest-rate-risk exposure. As of end-June 2016, BCV reported CET1 and total capital ratios of 16.8% and 16.9% slightly down from 17.6% and 17.7%, respectively, as of year-end 2015. The decrease in capital ratios is due to an increase in risk-weighted assets, as derived from the bank's models. During the same period, BCV's leverage ratio slightly decreased to 6.5% from 6.7%. During 2016 and beyond, we expect that BCV will maintain its strong capital adequacy ratios - including strong leverage - and thus a meaningful buffer over and above its announced 13% long-term minimum CET1 capital ratio target despite high dividend payouts to its majority owner and shareholders that amounted to approximately 90% of net profits in recent years. The low (absolute) capital retention led to an adjustment of its Capital Score to aa3.

Above average profitability and efficiency metrics continue despite challenging market environment

BCV's profitability is strong relative to that of its regional peers in Switzerland. In our view, this profitability provides BCV with a substantial cushion against losses potentially arising from adverse developments. During H1 2016, BCV realised a net-income-to-tangible-assets ratio of 0.70% (0.71% during 2013-15 on average), a level significantly higher than its peers. We have reflected this relative strength in the bank's baa2 Profitability Score, one of the highest among its domestic peers.

BCV's profitability metrics will continue to display sound underlying performance thanks to the bank's comparatively diverse earnings split, thereby better protecting BCV's revenue base against adverse developments resulting from the low interest-rate environment than its Swiss peers. We further anticipate that risk costs will stay at a low level, supported by a continued benign credit environment.

However, for H1 2016, the bank reported a lower - though still solid - net income (Swiss GAAP) of CHF157 million down from CHF179 million one year earlier. The decrease is explained by (1) lower net interest income in a challenging prolonged low interest rate environment; (2) lower trading income comparing with the 2015 exceptionally high level due to high client-trading activities which followed the Swiss National Bank's decision to abandon the Swiss franc's peg to the euro in January 2015; (3) lower fee and commission income and (4) lower extraordinary income since the sale of BCV's stake in Swisscanto (unrated) was booked during H1 2015.

The bank's operating expenses stayed stable at CHF258 million as of end-June 2016. Good cost management further contributed to BCV's efficiency indicators. The bank's cost to income ratio of 60.5% as of end-June 2016 still compares favorably with its peers.

BCV's assets under management stood at CHF87.4 billion as of end-June 2016, down 1% compared with year-end 2015. Net new onshore inflows were slightly more than offset by net offshore outflows. The development reflects the continued focus of BCV's private banking franchise to onshore money and the adherent reduction of offshore money. In 2015, the bank was able to settle with the US authorities regarding its participation in the US Swiss Tax Program, paying CHF41.7 million in fines during H2 2015.

Stable deposit base and strong liquidity safeguard BCV's sound funding and liquidity profile

We expect that BCV will continue to benefit from a strong funding structure, with a loan-to-deposit ratio of around 100% in recent years and sound liquidity management, supported by a liquid balance sheet with CHF7.2 billion of cash at end-June 2016 (up from CHF6.9 billion as of year-end 2015), and CHF5.8 billion of financial investments and interbank assets (up from CHF5.0 billion as of year-end 2015). This is reflected in the bank's Funding Structure and Liquidity Resources scores of a2.

The bank's focused activity in the Swiss Canton of Vaud and its domestic exposures determine its Very Strong - Macro Profile

BCV is predominantly active in its Swiss home canton, aligning its Macro Profile with that of its home country. The very high degree of economic, institutional and government financial strength and very low susceptibility to event risk thus support the bank's BCA. Together with the relatively high and rising private sector debt that is well covered by private sector assets as well as funding conditions benefitting from a strong domestic deposit base and liquid covered bond and interbank markets, BCV's Macro Profile stands at Very Strong -.

Notching Considerations

Loss Given Failure

BCV's is subject to Swiss banking regulation, which we consider an Operational Resolution Regime. We therefore apply our advanced LGF analysis, considering the risks faced by the different debt and deposit classes across the liability structure at failure. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, and assign a 100% probability to deposits being preferred to senior unsecured debt (as reflected in the de facto case in the waterfall below), thereby reflecting depositor preference by law in Switzerland.

Our advanced LGF analysis indicates a very low loss-given-failure for BCV's 'junior' deposits, leading to two notches of rating uplift from the bank's a2 Adjusted BCA.

Government Support

BCV's long-term deposit ratings benefit from one notch of government support uplift taking into account (1) a High probability of regional and local government support from the Canton of Vaud as the majority-owner of the bank; and (2) its strong local market position in retail and commercial (largely small and medium-sized enterprise) banking.

Rating Methodology and Scorecard Factors

Exhibit 3

Banque Cantonale Vaudoise

Macro Factors							
Weighted Macro Profile	**Very Strong -**	**100%**					
Financial Profile							
Factor		**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency							
Asset Risk							
Problem Loans / Gross Loans		1.4%	aa2	←→	a2	Geographical concentration	Expected trend
Capital							
TCE / RWA		18.6%	aa1	↓	aa3	Capital retention	Expected trend
Profitability							
Net Income / Tangible Assets		0.7%	baa2	←→	baa2	Earnings quality	Expected trend
Combined Solvency Score			aa3		a2		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		18.7%	a2	←→	a2	Market funding quality	Expected trend
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		27.9%	a2	←→	a2	Quality of liquid assets	Expected trend
Combined Liquidity Score			a2		a2		
Financial Profile					a2		
Business Diversification					0		
Opacity and Complexity					0		
Corporate Behavior					0		
Total Qualitative Adjustments					0		
Sovereign or Affiliate constraint:					Aaa		
Scorecard Calculated BCA range					a1-a3		
Assigned BCA					a2		
Affiliate Support notching					0		
Adjusted BCA					a2		

Balance Sheet	**in-scope (CHF million)**	**% in-scope**	**at-failure (CHF million)**	**% at-failure**
Other liabilities	--	--	--	--
Deposits	--	--	--	--
Preferred deposits	--	--	--	--
Junior Deposits	--	--	--	--
Senior unsecured bank debt	--	--	--	--
Dated subordinated bank debt	--	--	--	--
Junior subordinated bank debt	--	--	--	--
Preference shares (bank)	--	--	--	--
Senior unsecured holding company debt	--	--	--	--
Dated subordinated holding company debt	--	--	--	--
Junior subordinated holding company debt	--	--	--	--
Preference shares (holding company)	--	--	--	--

Equity	--	--	--	--
Total Tangible Banking Assets	--	--	--	--

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Assessment	--	--	--	--	--	--	--	0	0	a2 (cr)
Deposits	--	--	--	--	--	--	--	2	0	aa3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Counterparty Risk Assessment	0	0	a2 (cr)	--	A1 (cr)	--
Deposits	2	0	aa3	--	Aa2	Aa2

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
BANQUE CANTONALE VAUDOISE	
Outlook	Stable
Bank Deposits	Aa2/P-1
Baseline Credit Assessment	a2
Adjusted Baseline Credit Assessment	a2
Counterparty Risk Assessment	A1(cr)/P-1(cr)

Source: Moody's Investors Service

Profile

BCV was established in 1845 by the Vaud Cantonal Parliament as a corporation organized under public law. The bank is Switzerland's second-largest cantonal bank, with total assets of CHF44.7 billion as of end-June 2016.

BCV has a corporate mandate of contributing to the economic development of its home region, the Canton of Vaud, and also of providing mortgage financing there. Other than operating in its traditional areas of business, including retail banking (deposit-taking and lending) and wealth management, BCV is also engaged in corporate banking and selected trade-financing operations in commodities. Through these activities, BCV is also exposed to other cantons in Switzerland and, to a limited extent, overseas markets.

As of June 2016, the Canton of Vaud held a 67% stake in the bank. In contrast with most Swiss cantonal banks, BCV does not benefit from an explicit guarantee of the canton.

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