MOODY'S
INVESTORS SERVICE

CREDIT OPINION
12 December 2017

Update

Rate this Research

RATINGS

Banque Cantonale Vaudoise

Domicile	Switzerland
Long Term Rating	Not Available
Type	Not Available
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.

Analyst Contacts

Andrea Wehmeier 49-69-70730-782
VP-Senior Analyst
andrea.wehmeier@moodys.com

Alexander Hendricks, CFA 49-69-70730-779
Associate Managing Director - Banking
alexander.hendricks@moodys.com

Carola Schuler 49-69-70730-766
Managing Director - Banking
carola.schuler@moodys.com

Banque Cantonale Vaudoise

Update to credit analysis

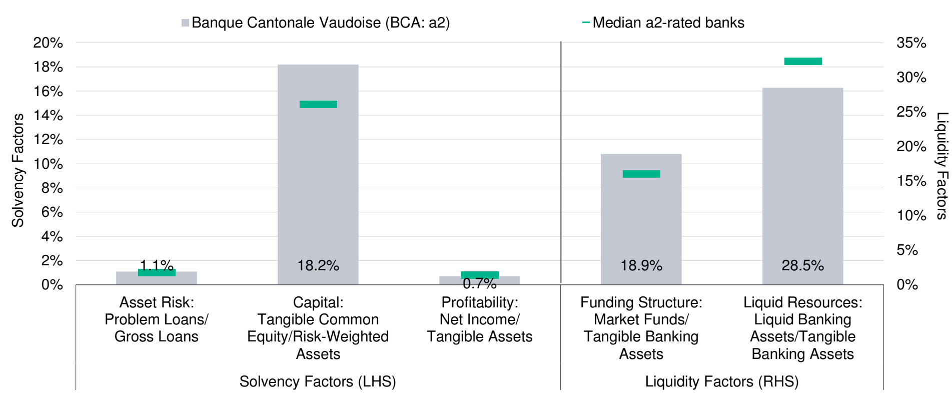
Summary

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

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 results in two notches of rating uplift for BCV's deposit rating; and (3) the high probability of BCV receiving (local) government support, which provides one notch of rating uplift to the bank's long-term ratings. The third point above takes into account the majority ownership of the bank by the Canton of Vaud and the bank's strong market position in the region.

The a2 BCA reflects BCV's (1) relatively low on-balance-sheet risks, despite its high concentration in the dynamic Canton of Vaud region, including relatively large exposures to the region's real estate markets; (2) strong capitalisation, measured by tangible common equity/risk-weighted assets of 18.2% and a Common Equity Tier 1 (CET1) capital ratio of 16.4% as of the end of June 2017; (3) strong profitability; and (4) sound liquidity profile. The BCA reflects a slight upward trend in its market-funding dependence, though the high volume of liquid assets available mitigates potential funding risks.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

» BCV has strong capital adequacy ratios, providing a substantial buffer for downside risks.

» The bank displays sustainable above-average profitability and efficiency metrics despite a challenging market environment.

» A stable deposit base and low market sensitivity safeguard BCV's sound funding and liquidity profiles.

Credit challenges

» The bank's real estate loan book growth has slowed down, however, the mortgage loan book remains a key asset risk in a real estate market with elevated price levels.

» BCV's capital generation capacity is limited by its close to complete payout of profits.

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

» Upward pressure on the bank's BCA could result from a combination of the bank (1) further continuing to improve its profitability, as well as its efficiency metrics; (2) improving its sound capital adequacy metrics to provide better creditor protection; and (3) providing stronger liquidity and funding profiles.

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 bank; or (2) the volume of deposits decreases, which could lead to a lower rating uplift, as assessed in our Advanced LGF analysis, provided our government support assumptions remain unchanged. The latest takes into account the Canton of Vaud's long-standing majority ownership, although without an explicit statutory guarantee, and the canton's creditworthiness.

» A substantial deterioration in the credit profile of the Canton of Vaud 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 or an unexpected weakening of its recurring earnings-generation power and levels of operating efficiency; (2) a material deterioration in asset quality, especially if following a marked slowdown in the domestic real estate market; and (3) a deterioration in the current strong funding situation that is illustrated by liquid resources significantly exceeding confidence-sensitive market funding.

Key indicators

Exhibit 2

Banque Cantonale Vaudoise (Consolidated Financials) [1]

	6-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (CHF billion)	45	44	43	42	40	3.2[4]
Total Assets (EUR billion)	41	41	40	35	33	6.7[4]
Total Assets (USD billion)	47	43	43	42	45	1.1[4]
Tangible Common Equity (CHF billion)	3.3	3.4	3.4	3.3	3.3	-0.0[4]
Tangible Common Equity (EUR billion)	3	3.2	3.1	2.8	2.7	3.3[4]
Tangible Common Equity (USD billion)	3.4	3.3	3.4	3.3	3.7	-2.1[4]
Problem Loans / Gross Loans (%)	1.0	1.0	1.2	1.4	1.5	1.2[5]
Tangible Common Equity / Risk Weighted Assets (%)	18.2	19.3	20.3	19.7	20.1	19.5[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	9.1	9.0	9.8	12.1	13.0	10.6[5]
Net Interest Margin (%)	1.1	1.1	1.2	1.3	1.3	1.2[5]
PPI / Average RWA (%)	2.3	2.2	2.5	2.4	2.3	2.3[6]
Net Income / Tangible Assets (%)	0.7	0.7	0.7	0.7	0.7	0.7[5]
Cost / Income Ratio (%)	59.2	60.1	58.4	60.3	61.7	59.9[5]
Market Funds / Tangible Banking Assets (%)	-	18.9	18.7	16.7	14.5	17.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	29.0	28.5	27.9	24.2	25.2	27.0[5]
Gross Loans / Due to Customers (%)	102.9	102.3	102.1	104.2	101.7	102.6[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] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

Profile

BCV is Switzerland's second-largest cantonal bank, with total assets of CHF45.1 billion as of the end of June 2017. The bank was established in 1845 by the Vaud Cantonal Parliament as a corporation organised under public law.

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, the bank is also engaged in corporate banking and select trade-financing operations in commodities. Through these activities, the bank is also exposed to other cantons in Switzerland and, to a limited extent, overseas markets.

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

Detailed credit considerations

Improving asset quality, though regional concentrations remain

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 stabilised at a level of 1.1% (according to Moody's definitions) as of the end of June 2017, after declining during 2010-16. The average loan/value of BCV's real estate loan exposures remained at around 50%, at the lower end compared with those of its closest peers among Swiss cantonal banks. We do not expect BCV to be immediately affected by the 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 volume, 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 in 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.

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 the 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-.

Solid capital adequacy ratios a strong mitigant

As a Category 3 institution according to the Swiss Financial Market Supervisory Authority (FINMA) definition, BCV must maintain an adequacy target with a (total) capital ratio of at least 12%. Since January 2016 and owing to the low-yield environment, FINMA has temporarily increased the minimum capital target of BCV to 13% to take into account the bank's interest rate risk exposure. As of the end of June 2017, BCV reported CET1 and total capital ratios of 16.4% and 16.5%, slightly down from 16.8% and 16.9%, respectively, as of year-end 2016. The decrease in capital ratios is due to an increase in risk-weighted assets, as derived from the bank's models.

Although the bank uses an internal ratings-based approach, in contrast to its peers among the regional and cantonal banks in Switzerland, the leverage ratio indicates that the chosen model approach is conservative, not pushing risk weights to an excessively low level. BCV's leverage ratio slightly decreased to a still solid 6.5% as of the end of June 2017 from 6.6% as of year-end 2016.

During 2017 and beyond, we expect BCV to maintain its strong capital adequacy ratios, including strong leverage, and thus a meaningful buffer over and above its announced 13% long-term minimum CET1 ratio target, despite high dividend payouts to its majority owner and shareholders that amounted to around 90% of net profits in recent years. The low (absolute) capital retention led to an adjustment of its Capital score to aa2.

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

BCV's profitability is strong compared with that of its regional peers in Switzerland. In our view, this profitability provides BCV with a substantial buffer against losses potentially arising from adverse developments. As of end-June 2017, BCV realised net income/tangible assets of 0.73% (0.71% during 2014-16 on average), a level significantly higher than that of 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 compared with that of its Swiss peers. We further expect risk costs to stay low, supported by a continued benign credit environment.

BCV's net income (Swiss GAAP) for the first half of 2017 increased by 4.5% to CHF164 million from CHF157 million in H1 2016. The increase is mainly explained by a higher net interest result of CHF251 million (up from CHF242 million), as interest expenses declined to CHF59 million as of the end of June 2017 from CHF82 million as of the end of June 2016. Good cost management further contributed to the bank's efficiency indicators. The bank's cost/income of 59.2% as of the end of June 2017 still compares very favourably with that of its peers.

BCV's assets under management continued to experience a moderate reduction, primarily because of the effect of the Swisscanto sale. The absolute size of assets under management was CHF82 billion as of the end of June 2017, down from CHF85 billion as of year-end 2016. Net new money remained a positive balance, with the inflow of SME and retail banking clients more than balancing outflows from institutional investors and large corporates. 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 in H2 2015.

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

We expect BCV to continue to benefit from its strong funding structure, though market funding is trending slightly upwards.

Our a2 Funding Structure score takes into account BCV's stable base of customer deposits, which rose to CHF29.5 billion as of the end of June 2017 (65% of total assets). The bank's loan/deposit of around 100% in recent years and sound liquidity management, supported by a liquid balance sheet with CHF7.6 billion of cash as of the end of June 2017 (up from CHF7.5 billion as of year-end 2016) and CHF5.1 billion of financial investments and interbank assets (CHF4.6 billion as of year-end 2016), mitigate potential funding risks. This is reflected in the bank's Liquidity Resources score of a2.

Support and structural considerations

Loss Given Failure (LGF) analysis

BCV 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 and 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 considerations

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.

Counterparty Risk (CR) Assessment

A CR Assessment is an opinion of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

BCVs' CR Assessment is positioned at A1(cr)/P-1(cr).

The bank's CR Assessment is positioned one notch above the bank's a2 Adjusted BCA. This positioning reflects the depositor preference in Switzerland, and the resulting rank ordering of Counterparty Risk exposures below deposits, and the moderate volume of instruments ranking below Counterparty Risk exposures, such as senior debt and equity, which is insufficient to reduce the expected loss to a level that would warrant uplift from the Adjusted BCA. The CR Assessment, however, benefits from one notch of government support uplift.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 3

Banque Cantonale Vaudoise

Macro Factors						
Weighted Macro Profile	**Very Strong -**	**100%**				

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.1%	aa2	← →	a2	Geographical concentration	Expected trend
Capital						
TCE / RWA	18.2%	aa1	↓	aa2	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	18.9%	a2	← →	a3	Market funding quality	Expected trend
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	28.5%	a2	← →	a2	Quality of liquid assets	Expected trend
Combined Liquidity Score		a2		a3		
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	11,852	26.9%	14,924	33.9%
Deposits	30,113	68.3%	27,042	61.4%
Preferred deposits	22,284	50.6%	21,169	48.0%
Junior Deposits	7,829	17.8%	5,872	13.3%
Senior unsecured bank debt	781	1.8%	781	1.8%
Equity	1,322	3.0%	1,322	3.0%
Total Tangible Banking Assets	44,068	100%	44,068	100%

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				
Deposits	18.1%	4.8%	18.1%	4.8%	2	2	2	2	0	aa3

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Deposits	2	0	aa3	--	Aa2	Aa2

Source: Moody's Financial Metrics

Ratings

Exhibit 5

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

REPORT NUMBER 1100314

Analyst Contacts

Andrea Wehmeier
VP-Senior Analyst

Anatolii Dzeman
Associate Analyst