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CREDIT OPINION
24 May 2016

Update

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RATINGS

Banque Cantonale Vaudoise

Domicile	Switzerland
Long Term Rating	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

Semi-annual update

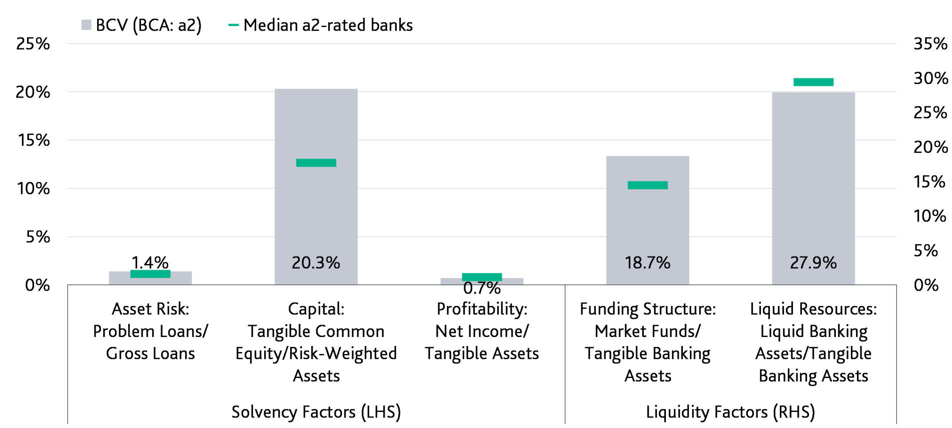
Summary Rating Rationale

We assign Aa2/P-1 long- and short-term deposit ratings to Banque Cantonale Vaudoise (BCV). Further, we assign a baseline credit assessment (BCA) of a2, an adjusted BCA of a2, and an A1(cr)/P-1(cr) Counterparty Risk Assessment.

The Aa2 long-term deposit ratings reflect (1) the bank's a2 BCA and adjusted BCA, (2) the result of our 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 ratings, and (3) our "high" government support assumption, which results in one additional notch of rating uplift and considers the majority ownership of the bank by the Canton de Vaud (unrated) and the bank's strong market position in the region.

BCV's 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/tangible assets of 20.3% as of year-end 2015 and a CET1 ratio of 17.6%; (3) its reasonable level of 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 still unseasoned 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

BCV's long-term deposit ratings carry a stable outlook.

Factors that Could Lead to an Upgrade

An upgrade of BCV's deposit ratings would be likely in the event of (1) an upgrade of the BCA and/or (2) an increase in uplift resulting from our LGF analysis.

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).

Any upgrade of BCV's BCA would most likely exert upwards pressure on the bank's deposit ratings, provided that our current support assumptions remain unchanged. This takes into account the Canton of Vaud's (unrated) long-standing majority ownership, albeit without an explicit statutory guarantee.

In addition, BCV's deposit ratings could further improve if the volume of senior unsecured and/or subordinated debt rises substantially so that is results a higher rating uplift under our LGF framework.

Factors that Could Lead to a Downgrade

A downgrade of BCV's deposit ratings would be likely in the event of (1) a downgrade of the BCA, and/or (2) a substantial deterioration in the credit profile of the Canton of Vaud; and/ or (3) if there is a growing likelihood that the canton's stake in BCV (currently 67%) will fall below the 50.1% legal threshold. Additionally, a decrease in uplift resulting from our LGF analysis may exert downward rating pressure.

Challenges for the bank's BCA may arise 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).

In addition, BCV's deposit ratings could be downgraded if the volume of this debt class or its subordinated instruments decreases significantly relative to the bank's tangible banking assets. This could result in fewer notches of uplift resulting from our LGF analysis.

Key Indicators

Exhibit 2

Banque Cantonale Vaudoise (Consolidated Financials) [1]

	12-15[2]	12-14[2]	12-13[2]	12-12[3]	12-11[3]	Avg.
Total Assets (CHF billion)	43.4	41.8	40.3	39.6	37.7	3.6[4]
Total Assets (EUR billion)	39.9	34.8	32.9	32.8	31.1	6.5[4]
Total Assets (USD billion)	43.4	42.1	45.3	43.3	40.3	1.8[4]
Tangible Common Equity (CHF billion)	3.4	3.3	3.3	3.3	3.2	1.0[4]
Tangible Common Equity (EUR billion)	3.1	2.8	2.7	2.7	2.7	3.8[4]
Tangible Common Equity (USD billion)	3.4	3.3	3.7	3.6	3.5	-0.7[4]
Problem Loans / Gross Loans (%)	1.2	1.4	1.5	1.8	2.1	1.6[5]
Tangible Common Equity / Risk Weighted Assets (%)	20.3	19.7	20.1	16.2	15.0	20.1[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	9.8	12.1	13.0	14.7	16.9	13.3[5]
Net Interest Margin (%)	1.2	1.3	1.3	1.4	1.5	1.3[5]
PPI / Average RWA (%)	2.5	2.4	2.3	1.9	1.9	2.4[6]
Net Income / Tangible Assets (%)	0.7	0.7	0.7	0.8	0.8	0.7[5]
Cost / Income Ratio (%)	58.4	60.3	61.7	60.7	60.8	60.4[5]
Market Funds / Tangible Banking Assets (%)	18.7	16.7	14.5	15.6	21.7	17.4[5]
Liquid Banking Assets / Tangible Banking Assets (%)	27.9	24.2	25.2	18.9	14.7	22.2[5]
Gross loans / Due to customers (%)	102.1	104.2	101.7	102.3	107.9	103.7[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 loan book remains concentrated in the dynamic Vaud region, supported by strong demographic factors, however, negatively impacted by the experienced real-estate price inflation until 2014, resulting in an 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 slowdown in mortgage-loan growth from high levels witnessed during the 2009-11 period. We have reflected these tail risks by adjusting our Asset Risk score to a2.

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 bank reported a problem loan ratio of 1.2% in 2015, declining 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 do not expect that BCV will be immediately affected by negative price movements in the Vaud real-estate market.

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%. As of year 2015, BCV reported CET1 and total capital ratios of 17.6% and 17.7%, respectively (under the foundation internal ratings-based approach). During 2015 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% target 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. Over the past three years, BCV realised a net-income-to-tangible-assets ratio of 0.73% on average, reflecting BCV's successful measures to improve its commercial performance and reduce its risk profile. We have reflected this relative strength in the bank's baa2 Profitability score, one of the highest among its domestic peers.

The bank's 2015 operating result was driven by strong trading income, reflecting the Swiss National Bank's abolition of the peg to the euro in January 2015 and the bank's pro-active management of interest-rate risks. Net interest income only declined slightly, driven by persistently low interest rates and reduced trade finance activities. Good cost management further contributed to BCV's efficiency indicators improving slightly from prior year levels.

During 2015, BCV recorded an extraordinary gain on the sale of its stake in Swisscanto (unrated) to Zuercher Kantonalbank (Aaa stable/Aaa stable, a2)[1] . This gain mitigated the negative P&L effect of the bank's participation in the US Swiss Tax Program as a Category 2 institution, where the bank was able to reach a settlement with the US authorities in 2015, paying CHF41.7 million in fines.

BCV's profitability metrics will continue to display sound underlying performance thanks to the bank's earnings split being less dependent on net interest income, thereby protecting BCV's revenue base against adverse developments resulting from the low interest-rate environment. We further anticipate that risk costs will stay at a low level, supported by a continued benign credit environment.

BCV's assets under management stood at CHF88.0 billion as of year-end 2015, up 2% (CHF1.6 billion) compared to year-end 2014. This was supported by net new inflows of CHF2.5 billion during 201. The development reflects the continued focus of BCV's private banking franchises to onshore money and the adherent reduction of offshore money.

STABLE DEPOSIT BASE AND LOW MARKET SENSITIVITY 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 CHF6.9 billion of cash at year-end 2015, and approximately CHF5.0 billion of financial investments and interbank assets. 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 FAILLURE (LGF) ANALYSIS

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, thereby reflecting depositor preference by law in Switzerland.

The high volume of deposits that share losses in the unlikely event of failure indicates a very low loss-given-failure for BCV's 'junior' deposits, leading to two notches uplift above the bank's a2 Adjusted BCA.

GOVERNMENT SUPPORT

BCV's long-term senior debt and deposit ratings benefit from one additional notch of government support uplift taking into account our assessment of a high probability of regional and local government support from the Canton of Vaud as the majority owner of the bank.

The bank continues to remain an important financial institution within the regional economy of the canton, reflected by its strong local market position in retail and commercial (largely small and medium-sized enterprise) banking. Its corporate mission - as expressed by Article 4 of the 'Cantonal Act Governing the Organisation of Banque Cantonale Vaudoise' (referred to locally as LBCV) - is to contribute to the development of all areas of the private-sector economy, financing of cantonal public-sector entities and mortgage lending within the canton.

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	Unseasoned risk
Capital						
TCE / RWA	20.3%	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		

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)	1	A1 (cr)	--
Deposits	2	0	aa3	1	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 CHF43.4 billion as of 31 December 2015.

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 31 December 2015, 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.

Output of the Baseline Credit Assessment 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.

Endnotes

1 The bank ratings shown in this report are the banks' deposit rating and outlook/its senior unsecured rating and outlook, and its baseline credit assessment

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