MOODY'S
INVESTORS SERVICE

CREDIT OPINION

7 December 2018

Update

Rate this Research

RATINGS

Banque Cantonale Vaudoise

Domicile	Switzerland
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	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.

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
alexander.hendricks@moodys.com

Carola Schuler +49.69.70730.766
MD-Banking
carola.schuler@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Banque Cantonale Vaudoise

Update to credit analysis

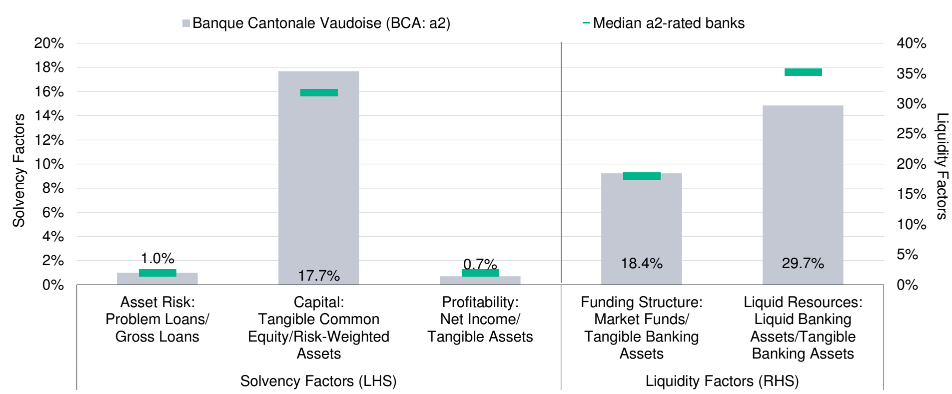
Summary

We assign Aa2 stable/P-1 deposit ratings 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 Rating (CRR).

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, resulting 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 ratings. The (local) government support assumption 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) sound asset quality, despite its high concentration in the dynamic Canton of Vaud region, including the relatively high exposure to the region's real estate markets; (2) strong capitalisation; (3) a profitability that exceeds that of peers; and (4) sound liquidity profile. The BCA further reflects the banks market-funding dependence, with a high volume of liquid assets available, mitigating potential funding risks.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

» BCV has strong capital adequacy ratios, which provide a substantial buffer against downside risks.

» The bank displays sustainable profitability, which exceeds that of peers

» The bank's strong liquid resources and stable deposit base safeguard its sound liquidity profile.

Credit challenges

» BCV's mortgage loan book remains a key asset risk in a real estate market with elevated price levels although its real estate loan book growth has slowed down.

» The bank's high dividend payouts limit its capital generation capacity

Outlook

The outlook on BCV's ratings is stable because we do not expect any significant change in the bank's credit fundamentals, a downturn in the Swiss real estate market or 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 its senior unsecured or further subordinated instruments increases, leading to an additional rating uplift (as assessed in our Advanced LGF analysis, provided our government support assumption remains unchanged).

» Upward pressure on the bank's BCA could result from (1) an improved asset risk profile of the bank; (2) stronger capital adequacy metrics to provide better creditor protection; and (3) sustained higher profitability.

Factors that could lead to a downgrade

» BCV's deposit ratings could be downgraded if (1) weaker fundamentals justify a downgrade of the bank; or (2) the volume of deposits decreases, leading to a lower rating uplift (as assessed in our Advanced LGF analysis, provided our government support assumption remains 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 (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 significant weakening of its power to generate recurring earnings; (2) a significant deterioration in asset quality, especially if it follows a marked slowdown in the domestic real estate market with a significant impact on capitalisation; and (3) a deterioration in the current strong funding situation, illustrated by the bank's liquid resources significantly exceeding confidence-sensitive market funding.

Key indicators

Exhibit 2

Banque Cantonale Vaudoise (Consolidated Financials) [1]

	6-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total Assets (CHF billion)	46	45	44	43	42	2.7[4]
Total Assets (EUR billion)	40	39	41	40	35	3.7[4]
Total Assets (USD billion)	46	47	43	43	42	2.7[4]
Tangible Common Equity (CHF billion)	3.3	3.4	3.4	3.4	3.3	0.3[4]
Tangible Common Equity (EUR billion)	2.9	2.9	3.2	3.1	2.8	1.4[4]
Tangible Common Equity (USD billion)	3.4	3.5	3.3	3.4	3.3	0.3[4]
Problem Loans / Gross Loans (%)	0.9	0.8	1.0	1.2	1.4	1.0[5]
Tangible Common Equity / Risk Weighted Assets (%)	17.7	18.9	19.3	20.3	19.7	19.2[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	8.0	6.5	9.0	9.8	12.1	9.1[5]
Net Interest Margin (%)	1.1	1.1	1.1	1.2	1.3	1.2[5]
PPI / Average RWA (%)	2.1	2.2	2.2	2.5	2.4	2.3[6]
Net Income / Tangible Assets (%)	0.8	0.7	0.7	0.7	0.7	0.7[5]
Cost / Income Ratio (%)	59.7	59.0	60.1	58.4	60.3	59.5[5]
Market Funds / Tangible Banking Assets (%)	-	18.4	18.9	18.7	16.7	18.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	28.3	29.7	28.5	27.9	24.2	27.7[5]
Gross Loans / Due to Customers (%)	100.5	99.4	102.3	102.1	104.2	101.7[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] 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

Banque Cantonale Vaudoise (BCV) is Switzerland's second-largest cantonal bank, with total assets of CHF45.9 billion as of the end of June 2018. The bank was established in 1845 by the Vaud Cantonal Parliament as a corporation organised under public law.

BCV has a corporate mandate to contribute to the economic development of its home region, the Canton of Vaud, and also to provide 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 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 the end of December 2017, the Canton of Vaud held a 67% stake in the bank. Unlike most Swiss cantonal banks, BCV does not benefit from an explicit guarantee of the canton.

Macro Profile

BCV is predominantly active in its Swiss home canton, which aligns its Macro Profile with that of Switzerland at Very Strong-.

Detailed credit considerations

Improving asset quality, although regional concentrations remain

We assign an Asset Risk score of a2 to BCV, three notches below the Macro Adjusted historical score of aa2. The negative adjustment reflects the bank's geographical concentrations and the tail risks associated with its mortgage book.

BCV's asset quality remained at very sound levels over the past years, reflecting the bank's strong focus on credit risk and its conservative credit risk management. The problem loan ratio declined further to a level of 0.8% (according to our definitions) as of year-end 2017, continuing the decline in nonperforming loans that started in 2010. 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 but constrained by still-high house prices. While we take into account the recent slowdown in real estate prices and the 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, despite the modest growth in its mortgage loan book since 2013.

Solid capital adequacy ratios are a strong mitigant

We assign a aa2 Capital score to BCV, in line with the initial score of aa2. The deterioration in the initial score reflected an expected decline in the capital ratios, which was already factored into the assigned Capital score, given the bank's high dividend payouts to its majority owner and shareholders, which amounted to around 90% of its net profit in recent years. Tangible common equity as a percentage of risk-weighted assets stood at 17.7% as of the end of June 2018, down from 18.9% as of year-end 2017.

In 2018 and beyond, we expect BCV to maintain its strong capital adequacy ratios, including strong leverage, and thus a significant buffer over and above its announced 13.7% long-term minimum Common Equity Tier 1 ratio target.

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 12.7%. Since January 2016 and because of the low-yield environment, FINMA has temporarily increased the minimum capital target for BCV to 13.7% to take into account the bank's interest rate risk exposure. As of the end of June 2018, BCV reported Common Equity Tier 1 and total capital ratios of 16.4% and 16.5%, respectively, down from 17.1% and 17.3% as of year-end 2017. The decrease in the capital ratios was primarily based by 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 (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 decreased slightly to a still-solid 6.4% as of the end of June 2018, from 6.5% as of year-end 2017.

Above-average profitability and efficiency metrics persist despite a difficult market environment

BCV's assigned Profitability score of baa2 is in line with the Macro Adjusted historical score, reflecting the bank's stronger profitability than 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 the end of June 2018, BCV recorded net income/tangible assets of 0.82%, up from around 0.7% in the previous years, mainly driven by an asset sale.

BCV's profitability metrics will continue to display sound underlying performance because of the bank's comparatively diverse earnings split, thereby protecting its revenue base better against adverse developments resulting from the low interest rate environment compared with that of its Swiss peers. We also expect risk costs to stay low, supported by a continued benign credit environment.

BCV's net income (Swiss GAAP) for the first half of 2018 increased to CHF188 million from CHF164 million in H1 2017. The increase is mainly explained by a one-off effect, as net interest income declined to CHF247 million from CHF251 million, fee and commission income was stable at CHF159 million and trading income declined to CHF65 million from CHF69 million. Good cost management further contributed to the bank's efficiency indicators. The bank's cost/income of 60% according to Moody's definition as of the end of June 2018 still compares very favourably with that of its peers.

BCV's assets under management increased in H1 2018. The absolute size of assets under management was CHF87.9 billion as of the end of June 2018, up from CHF86.5 billion as of year-end 2017. Net new money remained a positive balance, with strong domestic inflows (CHF2.0 billion) more than offsetting offshore outflows (CHF0.2 billion).

Stable deposit base supports BCV's sound funding profile

We assign an a2 Funding Structure score to BCV, which is in line with the initial score. The assigned score takes into account BCV's stable base of customer deposits, which rose to CHF31.0 billion as of the end of June 2018 (68% of total assets). The bank's loan/deposit has been stable at around 100% in recent years. Further, the bank complemented its deposit funding with CHF5.6 billion in covered bonds and around CHF1.0 billion in senior unsecured bonds and CHF0.8 billion in structured bonds as of year-end 2017.

Strong liquidity safeguards BCV's liquidity profile

The assigned a2 Liquid Resources score (also in line with the initial score) reflects the bank's sound liquidity management and liquid assets, which clearly exceed confidence-sensitive market funding resources. CHF7.4 billion of cash as of the end of June 2018 (down from CHF8.0 billion as of year-end 2017), CHF3.7 billion of mostly repo-eligible financial investments and CHF1.7 billion of interbank assets mitigate potential funding risks.

Support and structural considerations

Loss Given Failure (LGF) analysis

BCV is subject to Swiss banking regulations, 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, 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) the high probability of regional and local government support from the Canton of Vaud, the majority owner of the bank; and (2) its strong local market position in retail and commercial (largely small and medium-sized enterprises) banking.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

BCV's CRRs are positioned at A1/P-1

The CRRs are positioned one notch above the bank's a2 Adjusted BCA, reflecting the high loss given failure from the low volume of instruments that are subordinated to CRR liabilities. Its positioning reflects the depositor preference in Switzerland, the resulting rank ordering of Counterparty Risk exposures below deposits and the volume of instruments ranking below Counterparty Risk exposures, such as senior debt and equity. The CRR further continues to benefit from one notch of government support uplift.

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.

BCV's CR Assessment is positioned at Aa3(cr)/P-1(cr)

The bank's CR Assessment is positioned two notches above the bank's a2 Adjusted BCA. The CR Assessment's positioning reflects the depositor preference in Switzerland, the resulting rank ordering of Counterparty Risk exposures below deposits and the volume of instruments ranking below Counterparty Risk exposures, such as senior debt and equity. The CR Assessment further continues to benefit from one notch of government support uplift.

Methodology and scorecard

Methodology

The principal methodology we used in rating BCV was Banks, published in August 2018.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement 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**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.0%	aa2	←→	a2	Geographical concentration	Quality of assets
Capital						
TCE / RWA	17.7%	aa2	←→	aa2	Risk-weighted capitalisation	Capital retention
Profitability						
Net Income / Tangible Assets	0.7%	baa2	↓	baa2	Return on assets	Expected trend
Combined Solvency Score		aa3		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	18.4%	a2	←→	a2	Extent of market funding reliance	Market funding quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	29.7%	a2	←→	a2	Stock of liquid assets	Quality of liquid assets
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	12,073	26.6%	15,187	33.4%
Deposits	30,527	67.2%	27,413	60.4%
Preferred deposits	22,590	49.8%	21,461	47.3%
Junior Deposits	7,937	17.5%	5,953	13.1%
Senior unsecured bank debt	1,440	3.2%	1,440	3.2%
Equity	1,362	3.0%	1,362	3.0%
Total Tangible Banking Assets	45,402	100%	45,402	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted 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 Rating	6.2%	6.2%	6.2%	6.2%	0	0	0	0	0	a2
Counterparty Risk Assessment	6.2%	6.2%	6.2%	6.2%	1	1	1	1	0	a1 (cr)
Deposits	19.3%	6.2%	19.3%	6.2%	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
Counterparty Risk Rating	0	0	a2	--	A1	A1
Counterparty Risk Assessment	1	0	a1 (cr)	--	Aa3 (cr)	--
Deposits	2	0	aa3	--	Aa2	Aa2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
BANQUE CANTONALE VAUDOISE	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	Aa2/P-1
Baseline Credit Assessment	a2
Adjusted Baseline Credit Assessment	a2
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)

Source: Moody's Investors Service

REPORT NUMBER 1147914