MOODY'S
INVESTORS SERVICE

CREDIT OPINION
23 December 2019

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.

Contacts

Goetz Thurm, CFA +49.69.70730.773
VP-Senior Analyst
goetz.thurm@moodys.com

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

Banque Cantonale Vaudoise

Update to credit analysis

Summary

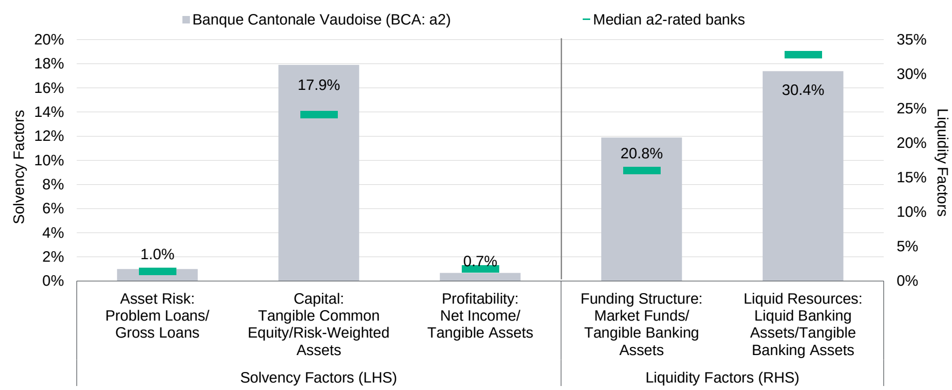
We assign Aa2(stable)/P-1 deposit ratings to Banque Cantonale Vaudoise (BCV). We also assign an a2 Baseline Credit Assessment (BCA), an a2 Adjusted BCA and A1(cr)/P-1(cr) Counterparty Risk Ratings (CRRs).

Banque Cantonale Vaudoise's (BCV) Aa2 deposit ratings reflect its a2 Baseline Credit Assessment (BCA), the application of our Advanced Loss Given Failure (LGF) analysis to its liabilities, resulting in two notches of rating uplift for deposits, and one notch rating uplift from (local) government support for BCV, because of the majority ownership by the Canton of Vaud and the bank's important role in the region.

BCV's a2 BCA reflects its strong financial profile, in particular relatively low balance sheet risks, despite displaying a high concentration in the Canton of Vaud's real estate market and its strong capitalization, which, - despite high pay-out of profits -- provide a sound buffer for adverse developments. The BCA further reflects BCV's above-average profitability levels among Swiss banking peers and its strong deposit funding base as well as its sizeable liquid resources.

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 its 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.

» BCV has increased its market funding to support its profit generation capacity via its repo business.

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 a combination of sustainably improved solvency and liquidity profiles.

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 latter 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 a (1) a deterioration in the current strong funding situation, illustrated by the bank's liquid resources significantly exceeding confidence-sensitive market funding; and (2) a sustained and significant weakening of its solvency profile, affecting asset quality, capital and the bank's earnings generation capacity.

Key indicators

Exhibit 2

Banque Cantonale Vaudoise (Consolidated Financials) [1]

	06-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (CHF Billion)	47.1	47.9	45.4	44.1	43.4	2.4[4]
Total Assets (USD Billion)	48.3	48.6	46.6	43.4	43.4	3.1[4]
Tangible Common Equity (CHF Billion)	3.4	3.5	3.4	3.4	3.4	0.2[4]
Tangible Common Equity (USD Billion)	3.5	3.6	3.5	3.3	3.4	0.9[4]
Problem Loans / Gross Loans (%)	1.0	0.7	0.8	1.0	1.2	0.9[5]
Tangible Common Equity / Risk Weighted Assets (%)	17.9	19.1	18.9	19.3	20.3	19.1[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	9.0	6.5	6.5	9.0	9.8	8.2[5]
Net Interest Margin (%)	1.1	1.1	1.1	1.1	1.2	1.1[5]
PPI / Average RWA (%)	2.1	2.2	2.2	2.2	2.5	2.3[6]
Net Income / Tangible Assets (%)	0.8	0.7	0.7	0.7	0.7	0.7[5]
Cost / Income Ratio (%)	59.5	58.6	59.0	60.1	58.4	59.1[5]
Market Funds / Tangible Banking Assets (%)	26.0	20.8	18.4	18.9	18.7	20.6[5]
Liquid Banking Assets / Tangible Banking Assets (%)	27.5	30.4	29.7	28.5	27.9	28.8[5]
Gross Loans / Due to Customers (%)	104.0	101.5	99.4	102.3	102.1	101.9[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]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 Investors Service; Company Filings

Profile

Banque Cantonale Vaudoise (BCV) is Switzerland's second-largest cantonal bank, with total assets of CHF47.1 billion as of half-year 2019. 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 half-year 2019, 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.

Detailed credit considerations

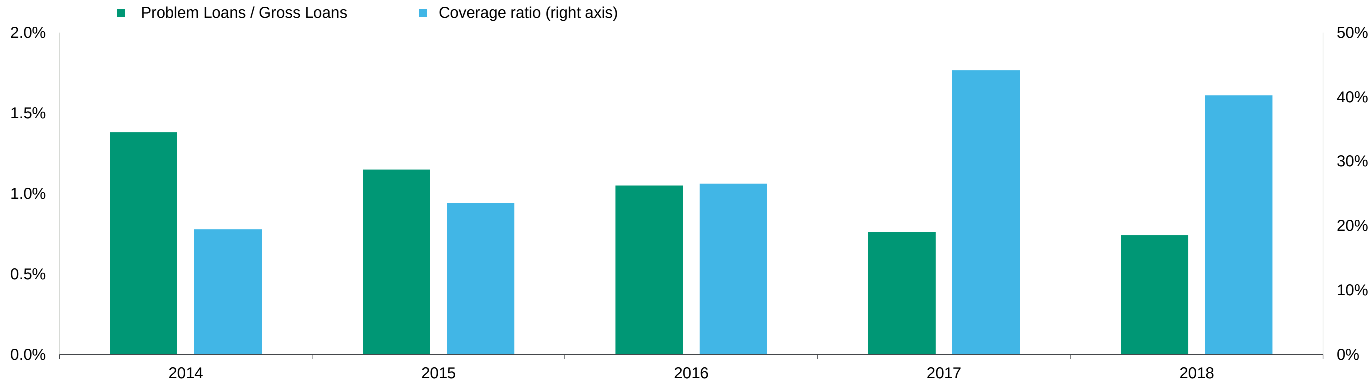
Improving asset quality, although regional concentrations remain

We assign an Asset Risk score of a2 to BCV, three notches below the initial score[1] 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 remained stable at 0.7% (according to our definitions) as of year-end 2018, reaching a bottom after a continuous decline in nonperforming loans since 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 demographical 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.

Exhibit 3
BCV's problem loan ratio is gradually decreasing



Problem loan ratio in accordance with our definitions; since 2018, according to IFRS 9 reporting standards.
Sources: Company reports, Moody's Investors Service

Solid capital adequacy ratios are a strong mitigant

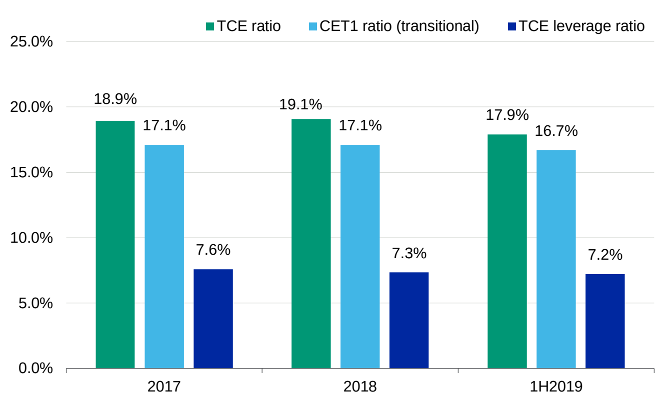
We assign a aa2 Capital score to BCV, in line with the initial score. The assigned score reflects some volatility and the expectation of a limited decline in the capital ratios, given the bank's high dividend payouts to its majority owner and shareholders, which amounted to around 90% of its net profit in recent years. Tangible common equity as a percentage of risk-weighted assets stood at 17.9% as of half-year 2019, down from 19.1% as of the year-end 2018.

For 2019 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 13.8% long-term minimum Common Equity Tier 1 capital 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 12.8%. Since January 2016 and because of the low-yield environment, FINMA has temporarily increased the minimum capital target for BCV to 13.8% to take into account the bank's interest rate risk exposure. As of half-year 2019, BCV reported stable Common Equity Tier 1 capital and total capital ratios of 16.7% and 16.8%, respectively.

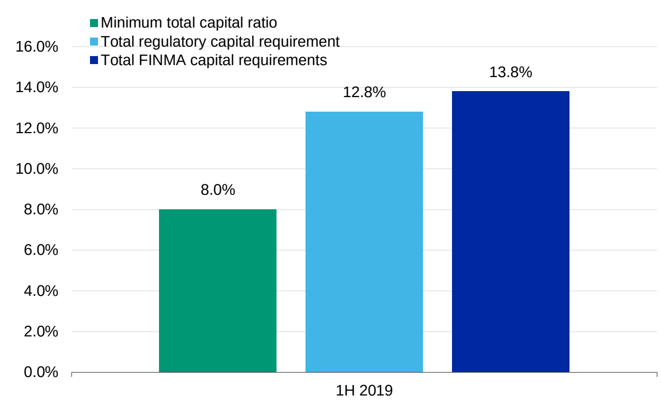
Although the bank uses an internal ratings-based approach, in contrast to its peers (the regional and cantonal banks in Switzerland), the leverage ratio indicates that the chosen model approach is conservative, not pushing risk weights to an excessively low level. BCV's leverage ratio declined to 6.7% as of half-year 2019, after an increase to a solid 7.3% as of year-end 2018 from 6.5% as of year-end 2017.

Exhibit 4
BCV comfortably exceeds its capital requirements



TCE = Tangible common equity (our calculation); CET1 = Common Equity Tier 1 capital.
Sources: Company reports, Moody's Investors Service

Exhibit 5
BCV's capital requirements



Source: Company reports

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

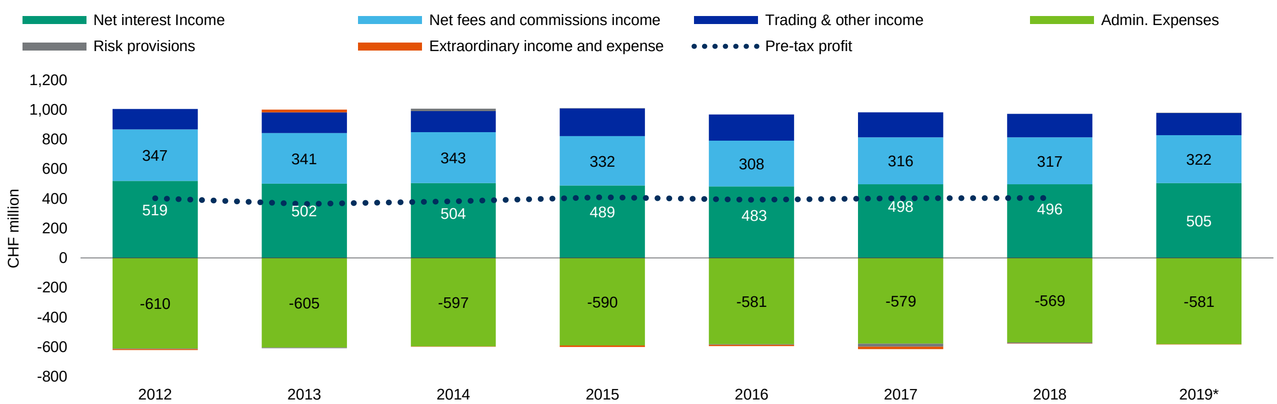
BCV's assigned Profitability score of baa2 is in line with the initial score, reflecting the bank's stronger profitability than that of its regional peers in Switzerland. In our view, this profitability provides BCV with a substantial buffer against losses potentially arising from adverse developments. As of year-end 2018, BCV recorded net income/tangible assets of 0.7%, stable versus that in the previous years.

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 remain low, supported by a continued benign credit environment.

BCV's net income (Swiss GAAP) for the half-year 2019 decreased to CHF182.4 million from CHF187.6 million the year before. While net interest income increased further by 4% to CHF252.5 million and fee and commission income remained stable at 161.2 million, a 9% lower trading and fair value adjustment income pressured earnings. However, key driver for the lower result was a positive one-off effect in 2018. Good cost management further contributed to the bank's efficiency indicators. The bank's cost-to-income ratio of 59.5%, according to our definition, as of half-year 2019 still compares very favourably with that of its peers.

BCV's assets under management increased within the first half-year 2019. The absolute size of assets under management was CHF92.8 billion, up from 87.6 billion as of year-end 2018. Net new money remained a positive balance of CHF0.8billion, the remainder of the increase is attributable to a positive marekt performance.

Exhibit 6
BCV displays a relatively diverse earnings split



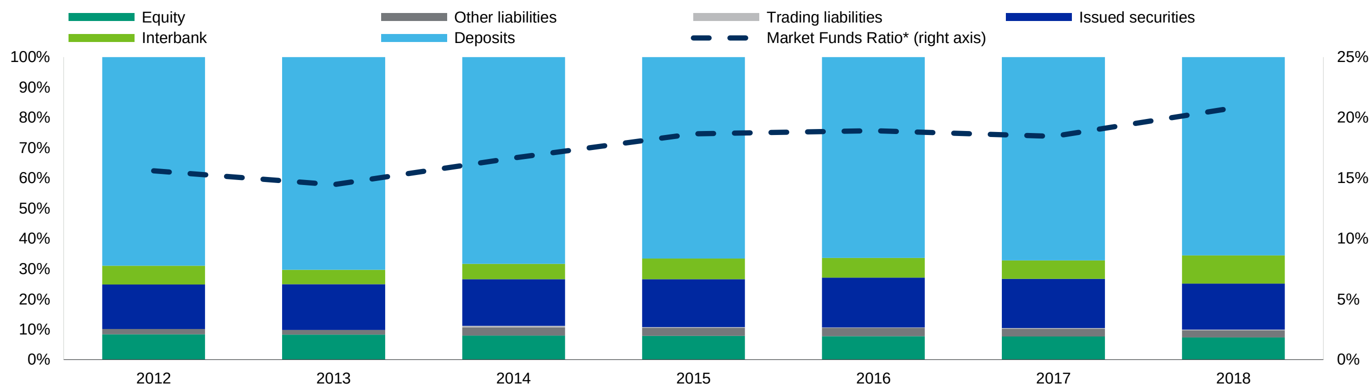
*Annualized 1H2019 financials
Sources: Company reports, Moody's Financial Metrics, Moody's Investors Service estimates

Stable deposit base supports BCV's sound funding profile

We assign an a3 Funding Structure score to BCV, which is one notch above the initial score. The assigned score takes into account BCV's stable base of customer deposits, which remained stable at CHF31.3 billion as of half-year 2019 (67% of total assets). The bank's loan-to-deposit ratio has been stable at around 100% in recent years.

Further, the bank complemented its deposit funding with a stable CHF5.5 billion in covered bonds and around CHF1.0 billion in senior unsecured bonds and CHF0.8 billion in structured bonds as of year-end 2018. Due to financial institutions, however, almost doubled to CHF2.7 billion in 2018, reflecting higher repo activities, helping to stabilise the bank's profitability.

Exhibit 7
BCV has a strong deposit franchise
Extent of market funding gradually increased over recent periods



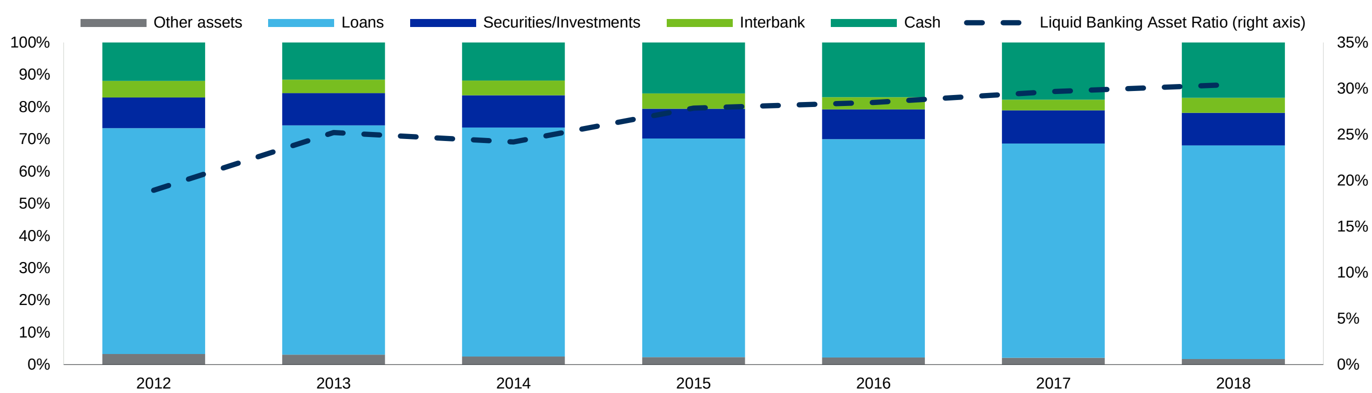
*Market funds ratio = Market funds/tangible banking assets.
Sources: Company reports, Moody's Investors Service

Strong liquidity safeguards BCV's liquidity profile

The assigned a2 Liquid Resources score (one notch below the initial score) reflects the bank's sound liquidity management and liquid assets, which clearly exceed confidence-sensitive market funding resources.

CHF8.2 billion of cash as of year-end 2018 (up from CHF8.0 billion as of year-end 2017), CHF3.7 billion of mostly repo-eligible financial investments and CHF1.9 billion of interbank assets mitigate potential funding risks. The bank's liquid assets of 30% of tangible banking assets still significantly exceed its market funding dependence of 21% of tangible banking assets.

Exhibit 8
BCV's balance-sheet liquidity is slightly increasing



Liquid banking assets ratio = Liquid assets/tangible banking assets.
Sources: Company reports, Moody's Investors Service

Environmental, social and governance (ESG) considerations

In line with our general view on the banking sector, BCV has a low exposure to environmental risks (see our environmental risk heatmap[2] for further information).

For social risks, we also place BCV in line with our general view for the banking sector, which indicates a moderate exposure (see our social risk heatmap[3]).

Governance is highly relevant for BCV, as it is to all players in the banking industry. Governance risks are largely internal rather than externally driven, and for BCV we do not have any particular governance concern[4].

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 November 2019.

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 9
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						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	17.9%	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	20.8%	baa1	←→	a3	Extent of market funding reliance	Market funding quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	30.4%	a1	←→	a2	Stock of liquid assets	Quality of liquid assets
Combined Liquidity Score		a3		a3		
Financial Profile				a2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - 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	14,452	30.7%	16,277	34.5%
Deposits	31,262	66.3%	28,073	59.6%
Preferred deposits	23,134	49.1%	21,977	46.6%
Junior deposits	8,128	17.2%	6,096	12.9%
Senior unsecured bank debt			1,364	2.9%
Equity	1,414	3.0%	1,414	3.0%
Total Tangible Banking Assets	47,128	100.0%	47,128	100.0%

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	5.9%	5.9%	5.9%	5.9%	-1	-1	-1	0	0	a2
Counterparty Risk Assessment	5.9%	5.9%	5.9%	5.9%	0	0	0	1	0	a1 (cr)
Deposits	18.8%	5.9%	18.8%	5.9%	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 Investors Service

Ratings

Exhibit 10

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

Endnotes

1 This is referred to as the Macro-Adjusted score in our Bank Scorecard

2 Environmental risks can be defined as environmental hazards encompassing the impacts of air pollution, soil/water pollution, water shortages and natural and man-made hazards (physical risks). Additionally, regulatory or policy risks, like the impact of carbon regulation or other regulatory restrictions, including the related transition risks like policy, legal, technology and market shifts, that could impair the evaluation of assets are an important factor. Certain banks could face a higher risk from concentrated lending to individual sectors or operations exposed to the aforementioned risks.

3 Social risk considerations represent a broad spectrum, including customer relations, human capital, demographic and societal trends, health and safety and responsible production. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct is a further social risk. Societal trends are also relevant in a number of areas, such as shifting customer preferences toward digital banking services increasing information technology costs, ageing population concerns in several countries affecting demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue bases.

4 Corporate governance is a well-established key driver for banks and related risks are typically included in our evaluation of the banks' financial profile. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Further factors like specific corporate behaviour, key person risk, insider and related-party risk, strategy and management risk factors and dividend policy may be captured in individual adjustments to the BCA. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

REPORT NUMBER 1206176

Contacts

Simon Boemer +49.69.70730.892
Associate Analyst
simon.boemer@moodys.com

MOODY'S
INVESTORS SERVICE