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Research Update:

Banque Cantonale Vaudoise Long-Term Rating Raised To 'AA' From 'AA-' On Bank Criteria Change; Outlook Stable

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Overview

- Following a review under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we have raised our long-term rating on Banque Cantonale Vaudoise (BCV) to 'AA' from 'AA-'.
- We have affirmed the short-term rating at 'A-1+'.
- Our ratings on BCV reflect its 'a' anchor as well as its adequate business position, strong capital and earnings, adequate risk position, average funding, and adequate liquidity.
- We continue to regard BCV as a government-related entity and we believe there is a "very high" likelihood of support from the Canton of Vaud in case the bank experiences stress, and for that reason the ratings incorporate two notches of uplift.
- The outlook is stable, reflecting our expectation that the bank's planned growth of its loan book will not jeopardize its strong capital and the adequate liquidity position.

Rating Action

As previously announced on Dec. 5, 2011, Standard & Poor's Ratings Services raised its long-term counterparty credit rating on Banque Cantonale Vaudoise (BCV) to 'AA' from 'AA-', and affirmed the short-term rating at 'A-1+'. The outlook is stable.

Rationale

Standard & Poor's bases its issuer credit rating (ICR) on BCV on the 'a' anchor and the company's "adequate" business position, "strong" capital and earnings, "adequate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. The stand-alone credit profile (SACP) is 'a+'.

The 'a' anchor draws on our Banking Industry Country Risk Assessment (BICRA) methodology and our view of the weighted average economic risk in the countries in which BCV operates, based on the geographic distribution of its exposures at default: Switzerland (85%), the European Union (10%), and others (5%). The weighted average economic risk score for these territories is close to '1' on a scale of 1-10 (1 is the lowest risk and 10 the highest), reflecting the weight of Switzerland in BCV's operations. The industry risk assessment for BCV is based solely on its home market Switzerland. We view

Switzerland as a highly diversified and competitive economy, benefiting from among the highest GDP per capita in the world and very robust government finances. We believe Switzerland demonstrates a conservative risk and lending culture, which has accompanied recent moderate growth of house prices and loan portfolios. The Swiss banking industry is supported by its sizable and very stable customer deposit base. Pure domestic Swiss banks have not loosened credit standards in recent years, thanks to sound earnings potential from core products. We consider regulatory standards to be more stringent than in other developed countries.

We regard BCVs' business position as "adequate." With total assets of Swiss franc (CHF) 37.6 billion as of end-June 2011, the bank is the second-largest Swiss cantonal bank. It has about a 33% market share (for retail banking and small and midsize enterprises) in the canton of Vaud, which is one of the richest and fastest-growing cantons in Switzerland. With CHF75.3 billion of assets under management at end-September 2011 and CHF600 million of net new money in the first three quarters of 2011, the bank also has a good franchise in asset management. On top of the traditional activities of a Swiss cantonal bank, the bank has a structured products business and is one of the main players in French-speaking Switzerland for transaction-based commodities trade finance. We view BCV's management team as very skilled but probably more "aggressive," notably in its willingness to create shareholder's value, than for a traditional Swiss cantonal bank.

We view BCV's capital and earnings as "strong" overall. Quality of capital is high, as the bank has issued no hybrids. Core earnings have represented about 95% of total revenues since 2009. Revenues before this date were inflated by reversals on loan-loss provisions recorded at the beginning of the 2000s. Profitability adjusted for risk is strong with, a three-year average earnings buffer around 160 basis points, according to our methodology. We expect the risk-adjusted capital (RAC) ratio before diversification adjustments to decrease slightly in the next 18 months to in the 13%-14% range, given the planned growth of exposures (notably in residential mortgages) and management's intention to gradually reduce the equity base through very high payout ratios.

Our risk position assessment for BCV is "adequate." Our view balances the bank's high exposure to regional real estate markets--with mortgage loans up 7% at end-September 2011 since the beginning of the year--with its good track record of low credit risk losses (less than 10 basis points since 2009). BCV is the only cantonal bank to have been approved by the Swiss regulator for Basel II's internal ratings-based approach (for regulatory purposes). This reflects the quality of BCV's credit risk management, in our view. Market risk has decreased significantly following the exit of equity derivatives proprietary trading at the end of 2009 and a fourfold decline of the seed-money portfolio in the asset management business in the past two years. In our opinion, BCV's most risky positions include trade finance exposures (about CHF1.7 billion at end-June 2011), which have represented close to half of total provisioning needs over the past three years.

We regard both BCV's funding as "average" and its liquidity as "adequate." BCV benefits from an ample customer deposit base with a loan-to-deposit ratio of 109% at end-June 2011 according to our calculations and in line with that of Swiss cantonal bank peers. Covered bonds provide a complementary source of funding for BCV, at about 13% of total funding needs. The bank maintains a high liquidity ratio under the strict norms established by Swiss regulators. We understand that management intends to partly fund the expected growth in the loan book by drawing on its excess liquidity. However, we believe that BCV will still maintain an "adequate" liquidity position.

We continue to view BCV as a government-related entity (GRE) according to Standard & Poor's methodology. In accordance with our criteria for GREs, we believe that there is a "very high" likelihood that the Swiss Canton of Vaud (AA+/Positive/--) would provide timely and sufficient extraordinary support to BCV in the event of financial distress, as it did in the early 2000s. This is based on our assessment of BCV's:

- "Very important" role in the local economy, reflecting the public policy role in the canton's economic development and because a default could damage the canton's reputation.
- "Very strong" link with the canton. A law passed in March 2010 stipulates that the canton will keep the majority of the capital in the bank. Contrary to some other Swiss cantonal banks, though, BCV does not benefit from the canton's statutory guarantee.

Given the GRE status, the ICR is two notches higher than the SACP.

Outlook

The stable outlook reflects our belief that BCV will continue to benefit from the implicit support of the canton of Vaud, despite the absence of a full guarantee. We expect the bank's 2011 results to be slightly lower than in 2010, partly because a strong Swiss franc has been putting pressure on fees and commissions, and also because of flat net interest income despite the growth in the loan book. (This is because the net interest margin is constrained on the liability side by the near-zero interest rate environment in Switzerland). The stable outlook also factors in our expectation that the planned growth of the loan book will not jeopardize the bank's "strong" capital and "adequate" liquidity position. It also reflects our belief that risk management at the subsidiary Piguet Galland & Cie will be aligned to strict standards for the parent.

Given our GRE methodology, a one-notch upgrade or downgrade of the canton would have no effect on the ICR of BCV, all other things being equal.

We will lower the ICR if we see a significant weakening in the risk profile. This could occur because of a dynamic increase in real estate exposure, accompanied by a relaxation of underwriting criteria, or because of substantial growth in the bank's exposure to trade finance. This could also occur should real estate prices in the canton grow at an unsustainable pace. An upgrade is unlikely at this stage, in our view.

Ratings Score Snapshot

Issuer Credit Rating	AA
SACP	a+
Anchor	a
Business Position	Adequate (0)
Capital and Earnings	Strong (+1)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	2
GRE Support	2
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings List

Upgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Banque Cantonale Vaudoise		
Counterparty Credit Rating	AA/Stable/A-1+	AA-/Positive/A-1+
Certificate Of Deposit	AA/A-1+	AA-/A-1+

Additional Contact:
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