S&P Global Ratings

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Banque Cantonale Vaudoise

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Banque Cantonale Vaudoise

SACP	a
Anchor	a-	
Business Position	Adequate	0
Capital and Earnings	Strong	+1
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Strong	

+

Support	+3
ALAC Support	0
GRE Support	+3
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating

AA/Stable/A-1+

Major Rating Factors

Strengths:	Weaknesses:
• Very high likelihood of support from the Swiss Canton of Vaud in the event of stress. • Good franchise in Vaud's resilient economy. • More diverse business model than those of traditional Swiss cantonal banks. • Strong liquidity.	• Persistent pressure on revenues from the low interest rate environment. • High exposure to the real estate market in the Canton of Vaud. • Presence in the high-risk, low-granularity trade finance business.

Outlook: Stable

Our outlook on Switzerland-based Banque Cantonale Vaudoise (BCV) is stable, reflecting our view of a very high likelihood of support for BCV from the Swiss Canton of Vaud in the event of stress.

Even if BCV's credit quality changed to the extent that we revised the bank's stand-alone credit profile (SACP) downward or upward by one notch, we would not revise our long-term rating on the bank, all else being equal. This is because, according to our criteria, and given our 'AAA' rating on the Canton of Vaud, any one-notch revision of the SACP would be offset by an opposite change in the uplift we attribute for extraordinary government support. All else being equal, a two-notch change in BCV's SACP, upward or downward, would result in a one-notch change (in the same direction) of the issuer credit rating, but we do not consider this likely in the next two years.

Rationale

The rating on BCV reflects the bank's 'a-' anchor, adequate business position, strong capital and earnings, adequate risk position, average funding, and strong liquidity. The SACP is 'a'.

Anchor:'a-' for Swiss banks

Our criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor stand-alone credit profile (SACP), the starting point in assigning an issuer credit rating (ICR). Our anchor for a bank operating mainly in Switzerland is 'a-'. We view the trends for both economic and industry risk as stable.

Our economic risk score of '2' for Switzerland is supported by the country's highly diversified and competitive economy, very high household income levels, and banks' prudent loan underwriting standards. However, it also reflects that risks have increased, owing to the cumulative rise in Swiss house prices and domestic lending over past several years. Although these imbalances are still low in a global context, they have also led the regulator to enact macroprudential measures to rein in robust growth in mortgage indebtedness. We recognize that house price and lending growth have cooled since the beginning of 2014. However, in our view, house prices and household indebtedness remain historically high, in particular when considering the low rate of home ownership in Switzerland. The very high mortgage debt level is mitigated by the large amount of financial assets, including pensions, held by households in Switzerland. Our assessment of the weighted economic risk score for BCV rounds to '2', given its predominant exposure to Switzerland.

Our industry risk score of '2' primarily reflects the banking sector stability and a high share of deposit funding. Banks' net interest margins continue to decline gradually, given the pressure on deposit margins from the negative yield environment. This is partly offset, however, by higher margins on lending products, fee income from investment advisory-related activities, and cost management. As a result, banks are still able to generate returns on core banking products that are adequate to meet their cost of capital. Moreover, in our view, the Swiss regulator's regulatory initiatives are more stringent than those in other European banking industries.

Table 1

Banque Cantonale Vaudoise -- Key Figures					
		--Year-ended Dec. 31--			
(Mil. CHF)	**2016***	**2015**	**2014**	**2013**	**2012**
Adjusted assets	44,662.0	43,328.0	41,973.0	40,344.0	39,680.0
Customer loans (gross)	29,537.0	29,537.0	29,849.0	28,932.0	28,124.0
Adjusted common equity	3,042.0	3,023.0	2,971.0	2,937.0	2,920.0
Operating revenues	493.2	1,024.7	993.2	990.6	1,009.8
Noninterest expenses	295.3	582.9	582.4	592.1	558.0
Core earnings	156.0	357.8	342.6	325.4	364.7

*Data as of June 30. CHF--Swiss franc.

Business position: Good franchise in Vaud and a more diverse business profile than a typical Swiss cantonal bank

We assess BCV's business position as adequate. This is supported notably by our view of BCV's sustained business stability and consistent approach to growth demonstrated by its management and strategy. With total assets of Swiss franc (CHF) 44.7 billion (about €41 billion) on June 30, 2016, BCV is the sixth-largest banking group in Switzerland. It has a market share of about 33% in retail banking and among small and midsize enterprises in Vaud--one of the country's richest and most resilient cantons. Vaud's GDP growth has outperformed Switzerland's GDP growth by an annual average of about 0.5% over the past five years (2.0% for Vaud).

With CHF87.4 billion of assets under management (AuM) on June 30, 2016, BCV has a good franchise in asset and wealth management, although its market share in private banking is much smaller than that in retail banking. For the record, BCV consolidated its wealth management franchise in 2011 with the acquisition of Banque Franck Galland, which had about CHF3 billion in AuM. Banque Franck Galland then merged with Banque Piguet, one of BCV's subsidiaries, to become Piguet Galland & Cie SA.

We believe that control of immigration in Switzerland or a painstaking finalization of the announced reform of the country's corporate tax law could slow demand for bank services, but BCV is confident about the ability of the Swiss government and the Canton of Vaud to implement the changes in a way that will ultimately have a marginal impact on the bank's activities. In addition, the impact on BCV's private banking revenues--due to pressures on Swiss banks from foreign countries with regard to tax conformity--is limited, in our view, as most of BCV's assets are "onshore". Besides, BCV has already revisited its customer portfolios with the objective that its "offshore" assets be deemed tax compliant. In 2015, the bank signed a non-prosecution agreement with the U.S. Department of Justice (U.S. DoJ) and paid US$57.1 million (of which US$15.4 million was paid by BCV's private banking subsidiary Piguet Galland), which marked the end of this process. BCV was participating as a Category 2 bank in a U.S. DoJ program for Swiss banks (a Category 2 Swiss Bank is one requesting a non-prosecution agreement and that is not under criminal investigation but which might be considered by the U.S. DoJ to have committed tax-related or monetary transaction offenses).

In addition to its traditional activities as a Swiss cantonal bank, BCV has a structured product business and is one of the main players in French-speaking Switzerland in transaction-based commodity trade finance, which relates mainly to steel, agro-business, and petroleum derived products. Apart from issuing structured products, 80% of the bank's trading activity is focused on foreign exchange spot and derivatives transactions to serve clients' needs.

Table 2

Banque Cantonale Vaudoise -- Business Position

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Total revenues from business line (mil. CHF)	494.1	1,053.3	995.8	1,001.8	1,013.5
Commercial banking/total revenues from business line	24.1	21.9	27.4	27.6	28.2
Retail banking/total revenues from business line	17.6	17.7	19.4	19.6	20.6
Trading and sales income/total revenues from business line	6.5	6.4	5.0	6.1	5.6
Asset management/total revenues from business line	32.4	31.8	37.1	37.0	36.1
Other revenues/total revenues from business line	19.4	22.1	11.1	9.8	9.4

Table 2

Banque Cantonale Vaudoise -- Business Position (cont.)					
		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Return on equity	9.4	10.0	8.9	8.4	9.4

*Data as of June 30. CHF--Swiss franc.

Capital and earnings: Strong capital position

We view BCV's capital and earnings as strong overall. The quality of the bank's capital is high as it is composed almost entirely of common equity Tier 1 (CET1) capital. The bank's risk-adjusted capital (RAC) ratio was 13.4% as of Dec. 31, 2015, compared with 12.9% as of Dec. 31, 2014. We do not expect the bank's RAC ratio to exceed 15% over the next 18-24 months, given management's stated intention to continue paying high dividends, and despite our expectation of contained growth of exposures. In 2016, BCV distributed CHF284 million to shareholders, out of its CHF336 million post-tax net income for 2015.

BCV had a 16.8% CET1 ratio as of June 30, 2016 (the total capital ratio at the same date was 16.9%). In order to address rising property prices, in 2013, the Swiss regulator (FINMA) implemented a counter-cyclical buffer based on total regulatory risk-weighted assets on mortgage exposures. This buffer was set at 1% in September 2013 then raised to 2% in 2014. In addition, in 2013, FINMA introduced a bank-specific multiplier for regulatory risk-weighted assets on mortgages to reduce the difference in risk weights between banks using an internal rating-based approach and those using the standardized approach. The multiplier for BCV will increase gradually until 2019, and we estimate that it will further cut the bank's CET1 ratio by about 45 basis points (bps). BCV targets a minimum 13% CET1 ratio over time, while FINMA would intervene if the total capital ratio fell below 11%.

Margins on the liability side remain constrained by the negative interest rate environment in Switzerland. We expect BCV's annual post-tax profit to be above CHF300 million over 2016-2018, after the high CHF336 million achieved in 2015 (which included a CHF18 million contribution from the sale of the bank'sstake in Swisscanto). We note that the bank's profitability, adjusted for risk, is strong, with a three-year average earnings buffer of about 1.4% in 2015, indicating adequate capacity for earnings to cover expected losses. We see material upside potential for revenues if interest rates normalize or the yield curve steepens.

Table 3

Banque Cantonale Vaudoise -- Capital And Earnings					
		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Tier 1 capital ratio	16.8	17.6	17.1	17.8	18.4
S&P RAC ratio before diversification	N.A.	13.4	12.9	14.3	14.6
S&P RAC ratio after diversification	N.A.	12.9	12.5	14.0	14.3
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	49.0	47.7	50.7	50.6	51.4
Fee income/operating revenues	32.0	32.4	34.6	34.5	34.4
Market-sensitive income/operating revenues	13.7	14.7	10.7	11.4	11.2
Noninterest expenses/operating revenues	59.9	56.9	58.6	59.8	55.3

Table 3

Banque Cantonale Vaudoise -- Capital And Earnings (cont.)					
		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Preprovision operating income/average assets	0.9	1.0	1.0	1.0	1.2
Core earnings/average managed assets	0.7	0.8	0.8	0.8	0.9

*Data as of June 30. N.A.--Not available. RAC--Risk-adjusted capital.

Table 4

S&P Global Ratings' Risk-Adjusted Capital Framework Detailed Results Publication Table

	EAD (1)	**Basel II RWA (2)**	**Average Basel II RW (%)**	**S&P Global Ratings' RWA**	**Average S&P Global Ratings' RW (%)**
Government and central banks	9,161	10	0	297	3
Institutions	4,483	1,091	24	523	12
Corporate	14,385	8,613	60	10,612	74
Retail	18,090	3,360	19	4,952	27
Of which mortgage	16,308	2,712	17	4,182	26
Securitization (3)	0	0	0	0	0
Other assets	683	660	97	704	103
Total credit risk	46,802	13,734	29	17,087	37
Equity in the banking book (4)	233	532	633	1,880	807
Trading book market risk	--	363	--	545	--
Total market risk	--	895	--	2,425	--
Total insurance risk	--	--	--	0	--
Total operational risk	--	1,789	--	3,018	--
RWA before diversification	--	16,590	--	22,530	100
Total Diversification/Concentration Adjustments	--	--	--	882	4
RWA after diversification	--	16,590	--	23,412	104
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings' RAC ratio (%)**
Capital ratio before adjustments		2,924	17.6	3,023	13.4
Capital ratio after adjustments (5)		2,924	17.6	3,023	12.9

Footnotes: (1) EAD: Exposure at default. (2) RWA: Risk-weighted assets. (3) Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. (4) Equity exposure includes the minority equity holdings in financial institutions. (5) For Tier 1 ratio, adjustments are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons).

Risk position: Concentration of risk in the Canton of Vaud's real estate markets and sizable trade finance exposures

Our assessment of BCV's risk position as adequate reflects the balance between the bank's high exposure to Vaud's property markets, with roughly 80% of BCV's loans being for owner-occupier mortgages or income-producing real estate (we estimate that these loans traditionally account for only one-third of the bank's total income, however) and its good track record of very low cost of risk on real estate exposures over the last five years.

There has been strong cumulative growth in residential real-estate prices and domestic lending in Switzerland over several years, particularly mortgage lending. We consider this to represent an incremental risk for Swiss banks that have mainly domestic operations and large exposure to the Swiss real estate market. Moreover, real estate prices in Vaud have increased by more than the Swiss average over 2004-2012. We acknowledge, though, that house price increases in Vaud partly reflect above-average economic growth in the canton and strong immigration-led demand compared with limited supply. Although house prices have been cooling locally since 2014, more particularly for luxury properties, they remain historically high in our view. Furthermore, given BCV's significant exposure to residential real estate, we consider that an unexpected deterioration in prices could increase the bank's loan losses. However, we consider that the risk of a sharp correction in property prices is low.

We regard BCV's stricter application of underwriting standards since 2011 as positive. Loan-to-value ratios on new mortgage lending are capped at 80% for owner-occupied housing (lower levels are applied to buy-to-let), and borrowers must provide a minimum down payment of 20% in cash. Moreover, the annual cost of borrowing (calculated on a theoretical 7% interest rate) must not exceed one third of a customer's annual net income. We note that BCV limited the annual growth of its mortgage portfolio to 2% in 2015, which came after annual growths of between 2% and 4% over 2012-2014. We expect stable growth in 2016, as illustrated by the 1% achieved over the first six months of the year.

BCV is the only cantonal bank to whom the Swiss regulator has given approval to use the internal ratings-based approach for regulatory purposes. This reflects, in our view, the quality of BCV's credit risk management. Gross nonperforming loans stood at a low 0.9% of total customer loans at end-2015. The bank's riskiest positions include trade finance exposures, which stood at close to CHF1.5 billion at end-2015, compared with CHF1.8 billion at end-2014. Due to low granularity in the portfolio, the cost of risk incurred in this business segment is volatile (it was zero in 2011, 2013, and 2014). We estimate that, through the cycle, it would represent about one third of BCV's total credit risk.

Although BCV hedges market risk arising from its structured products and certificates businesses, some residual risk remains, mainly dividend and correlation risk. Revenues associated with structured products and certificates account for just above 1% of total revenues, according to our estimates.

Table 5

Banque Cantonale Vaudoise -- Risk Position

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Growth in customer loans	N.A.	(1.0)	3.2	2.9	(0.1)
Total diversification adjustment / S&P RWA before diversification	N.A.	3.9	3.1	2.0	2.2
Total managed assets/adjusted common equity (x)	14.7	14.4	14.2	13.8	13.6
New loan loss provisions/average customer loans	N.A.	(0.0)	(0.1)	(0.0)	(0.0)
Net charge-offs/average customer loans	N.A.	(0.0)	0.1	0.1	0.1
Gross nonperforming assets/customer loans + other real estate owned	N.A.	0.9	0.9	1.2	1.6
Loan loss reserves/gross nonperforming assets	N.A.	29.4	30.8	36.3	36.9

*Data as of June 30. N.A.--Not available. RWA--Risk-weighted assets.

Funding and liquidity: Largely funded by deposits, with strong cash liquidity buffers

We assess BCV's funding as average, and its liquidity as strong. Customer deposits were stable, at 75% of the funding base at end-2015, according to our calculations. This is in line with the levels of Swiss cantonal bank peers.

Like other cantonal banks, BCV uses covered bonds issued by the Centrale de lettres de gage (CLG) as a financing source. Through this mutualized source of funding, the bank benefits from the excellent creditworthiness of the CLG, which is backed by Swiss cantonal banks and ultimately by most cantons. BCV's stable funding ratio at end-2015 was 122%, which compares favorably with the ratios of domestic peers.

At end-2015, BCV's liquidity buffer comprised mainly cash held at the Swiss National Bank (SNB). In addition, the bank has a pool of bonds that are eligible as collateral with the SNB. BCV's ratio of broad liquid assets to short-term wholesale funding was a strong 5.1x at end-2015. However, a significant portion of the deposit base contains private banking deposits and uninsured institutional investors' deposits, which are more volatile than traditional retail deposits, in our view. BCV's policy is to exceed by at least 10% the regulatory requirement for the Basel III liquidity coverage ratio, which is set to reach 100% on Jan. 1, 2019 (on Jan. 1, 2016, BCV achieved a level far above the 70% minimum requirement already in force at that date).

Table 6

Banque Cantonale Vaudoise -- Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Core deposits/funding base	70.8	74.5	76.9	77.4	76.0
Customer loans (net)/customer deposits	103.7	102.0	103.7	104.0	104.7
Long-term funding ratio	N.A.	95.2	92.7	93.0	91.3
Stable funding ratio	N.A.	122.3	114.4	113.4	119.3
Short-term wholesale funding/funding base	N.A.	5.2	7.9	7.7	9.5
Broad liquid assets/short-term wholesale funding (x)	N.A.	5.1	3.0	3.0	3.1
Net broad liquid assets/short-term customer deposits	N.A.	29.0	20.2	42.8	56.1
Short-term wholesale funding/total wholesale funding	N.A.	20.4	34.2	33.9	39.5

*Data as of June 30. N.A.--Not available.

External support: Government-related entity status puts the long-term rating three notches above the SACP

We view BCV as a government-related entity (GRE). In accordance with our criteria for GREs, we believe that there is a very high likelihood that the Canton of Vaud would provide timely and sufficient extraordinary support to BCV in the event of financial stress, as it did in 2001-2003. For this reason, the long-term rating on BCV stands three notches above its SACP.

Our view that there is a very high likelihood of extraordinary support is based on our assessment of BCV's:

- Very important role in the local economy, reflecting its public policy role in the canton's economic development and the possibility that a default could damage the canton's reputation; and
- Very strong link with the canton. A law passed in March 2010 stipulates that the canton will keep a majority stake of at least 50% plus one share in the bank. The Canton of Vaud currently owns 66.95% of BCV. Unlike some other

Swiss cantonal banks, however, BCV does not benefit from a cantonal statutory guarantee.

Additional rating factors: None

No additional factors affect the rating.

Related Criteria And Research

Related Criteria

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Group Rating Methodology - Nov. 19, 2013
- Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework - June 22, 2012
- Banks: Rating Methodology and Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology and Assumptions, Nov. 9, 2011
- Bank Capital Methodology and Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related Research

- Banking Industry Country Risk Assessment: Switzerland, Sep. 2, 2016
- Vaud (Canton of), Jun. 27, 2016

Anchor Matrix

Industry Risk	Economic Risk									
	1	**2**	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	**a-**	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of December 15, 2016)	
Banque Cantonale Vaudoise	
Counterparty Credit Rating	AA/Stable/A-1+
Counterparty Credit Ratings History	
18-Jun-2013	AA/Stable/A-1+
03-Jul-2012	AA/Negative/A-1+

Ratings Detail (As Of December 15, 2016) (cont.)	
05-Dec-2011	AA/Stable/A-1+
Sovereign Rating	
Swiss Confederation	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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