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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 / 0

\+

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, although the customer deposit base would likely not be immune to a higher interest-rate environment.	• 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

S&P Global Ratings' 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 (AAA/Stable/--), in the event of financial 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, given our 'AAA' rating on the Canton of Vaud, any one-notch revision of the SACP would be off-set 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

We define BCV as a government-related entity (GRE). The rating on BCV reflects the bank's 'a-' anchor and our view of its adequate business position, strong capital and earnings, adequate risk position, average funding, and strong liquidity. We assess BCV's SACP at 'a', a level that compares well with that of peers, in particular other Swiss cantonal banks

We add three notches of uplift for GRE support to the SACP to reflect our view that BCV has a very high likelihood of receiving extraordinary support from the canton of Vaud if needed. We believe that the links between Vaud and BCV are very strong and durable, and that the role the bank plays within the canton is very important, as shown by its market-leading position locally.

Anchor: 'a-' for Swiss banks operating mainly in Switzerland

Our criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor 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 remain, owing to the cumulative rise in Swiss house prices over the past several years. Although imbalances remain moderate in a global context, they have led the regulator to enact macroprudential measures to rein growth in mortgage indebtedness. We recognize that house price growth has cooled since the beginning of 2014, while lending has recently picked up again after several years with moderate growth. In our view, house prices and household indebtedness remain historically high. The very high mortgage debt level is mitigated by the large amount of financial assets, including pensions, held by households in Switzerland.

Our industry risk score of '2' primarily reflects the banking sector stability and a relatively 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)	**2018***	**2017**	**2016**	**2015**	**2014**	**2013**
Adjusted assets	45,776.0	45,330.0	44,002.0	43,328.0	41,973.0	40,344.0
Customer loans (gross)	31,213.0	30,335.0	29,933.0	29,537.0	29,849.0	28,932.0
Adjusted common equity	2,903.0	2,856.4	2,822.0	3,023.0	2,971.0	2,937.0
Operating revenues	496.0	986.8	971.9	1,024.7	993.2	990.6
Noninterest expenses	290.0	538.8	541.5	582.9	582.4	592.1

Table 1

Banque Cantonale Vaudoise Key Figures (cont.)						
		--Year ended Dec. 31--				
(Mil. CHF)	**2018***	**2017**	**2016**	**2015**	**2014**	**2013**
Core earnings	160.0	348.2	343.6	357.8	342.6	325.4

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

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

Our assessment 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) 45.4 billion at year-end 2017 and about €46 billion on June 30, 2018, 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 slightly underperformed Switzerland's GDP growth in 2017 and was close to 0.8% in 2017. For the next two years, we expect Vaud's GDP growth to slightly outperformed Switzerland's GDP growth.

With CHF86.5 billion of assets under management (AuM) on Dec. 31, 2017, 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.

We note that a definition of a unique corporate tax rate (13.79%) approved by the Vaud's electorate in 2016 will come into force no later than 2019, regardless of the stage of adoption of the announced federal reform of corporate tax law. The reform is set to support the local economy by protecting the attractiveness of the canton. In our view, it will ultimately have a limited impact on BCV's activities, while the bank's net income will benefit automatically from the lower tax charge (we estimate that this should affect the net profit by CHF28 million-CHF29 million). That said, as a result of lower taxes, we expect that BCV will increase its dividend by share from CHF33 to CHF34-CHF38.

We also believe that the impact on BCV's private banking revenues from pressure on Swiss banks, owing to tax conformity, is limited because most of BCV's assets are "onshore". BCV has already revisited its customer portfolios with the objective that its "offshore" assets be deemed tax compliant. For the record, in 2015, BCV signed a non-prosecution agreement with the U.S. Department of Justice and paid a total of $57.1 million ($41.7 million by BCV and $15.4 million by BCV's private banking subsidiary, Piguet Galland SA), which marked the end of this process.

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, about 75% 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--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**	**2013**
Total revenues from business line (mil. CHF)	530.0	1,003.6	978.6	1,053.3	995.8	1,001.8
Commercial banking/total revenues from business line	25.1	28.7	27.1	24.6	27.4	27.6

Table 2

Banque Cantonale Vaudoise Business Position (cont.)

		--Year ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014	2013
Retail banking/total revenues from business line	15.9	17.3	17.8	18.0	19.4	19.6
Commercial & retail banking/total revenues from business line	40.9	46.0	44.9	42.6	46.8	47.1
Trading and sales income/total revenues from business line	4.5	5.3	6.2	6.4	5.0	6.1
Asset management/total revenues from business line	34.0	35.6	33.1	32.1	37.1	37.0
Other revenues/total revenues from business line	20.6	13.1	15.8	18.9	11.1	9.8
Investment banking/total revenues from business line	4.5	5.3	6.2	6.4	5.0	6.1
Return on average common equity	11.0	9.3	9.1	10.0	8.9	8.4

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

Capital and earnings: Solid capital position

We view BCV's capital and earnings as solid overall. The bank's risk-adjusted capital (RAC) ratio was 13.3% as of Dec. 31, 2017, and June 2018. This ratio was slightly below the 13.5% achieved one year before, which reflected the close to 3% growth in risk exposures as measured under S&P Global Ratings' risk-weighted assets (RWAs) combined with limited retained earnings. We expect the bank's RAC ratio to remain at about 13.0%-13.3% 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 the next couple of years. For the record, BCV distributed CHF284 million to shareholders, out of its CHF320 million post-tax net income for 2017.

The quality of the bank's capital is high as it is composed almost entirely of common equity tier 1 (CET1) capital. BCV had a 16.4% CET1 ratio as of June 30, 2018 (the total capital ratio at the same date was 16.5%). BCV targets a minimum 13.7% CET1 ratio over time, while the Swiss regulator, FINMA, would intervene if the total capital ratio fell below 12%.

In order to address rising property prices, in 2013, FINMA implemented a counter-cyclical buffer based on total regulatory RWAs 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 RWAs 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 will be phased in by Jan. 1, 2019, and we estimate that it will further cut BCV's CET1 ratio by about 20 basis points from its mid-2018 level.

Margins on the liability side remain constrained by the negative interest rate environment in Switzerland. After the CHF320 million achieved in 2017, we expect BCV's annual post-tax profit to remain above CHF300 million and gradually increasing over 2018-2020 to reach nearly CHF350 million. We note that the bank's profitability, adjusted for risk, is strong, with a three-year average earnings buffer of about 1.6% in 2017, 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--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**	**2013**
Criteria reflected in RAC ratios	2017 RAC Criteria	2017 RAC Criteria	2017 RAC Criteria	2010 RAC Criteria	2010 RAC Criteria	2010 RAC Criteria
Tier 1 capital ratio	16.4	17.1	16.8	17.6	17.1	17.8
S&P Global Ratings' RAC ratio before diversification	13.3	13.3	13.5	13.4	12.9	14.3
S&P Global Ratings' RAC ratio after diversification	11.8	11.8	12.1	12.9	12.5	14.0
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	49.7	50.4	49.7	47.7	50.7	50.6
Fee income/operating revenues	32.1	32.1	31.7	32.4	34.6	34.5
Market-sensitive income/operating revenues	13.1	13.6	14.3	14.7	10.7	11.4
Noninterest expenses/operating revenues	58.5	54.6	55.7	56.9	58.6	59.8
Preprovision operating income/average assets	0.9	1.0	1.0	1.0	1.0	1.0
Core earnings/average managed assets	0.7	0.8	0.8	0.8	0.8	0.8

*Data as of June 30. RAC--Risk-adjusted capital.

Table 4

Banque Cantonale Vaudoise Risk-Adjusted Capital Framework Data

(Mil. CHF)	**Exposure***	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global RWA**	**Average S&P Global RW (%)**
Credit risk					
Government and central banks	10,241	373	4	70	1
Of which regional governments and local authorities	0	0	0	0	0
Institutions and CCPs	2,493	971	39	455	18
Corporate	14,888	9,040	61	10,315	69
Retail	18,789	4,101	22	5,477	29
Of which mortgage	17,000	3,472	20	4,248	25
Securitization§	0	0	0	0	0
Other assets†	680	680	100	701	103
Total credit risk	47,091	15,165	32	17,018	36
Credit valuation adjustment					
Total credit valuation adjustment	--	139	--	0	--
Market risk					
Equity in the banking book	103	203	196	331	320
Trading book market risk	--	324	--	486	--
Total market risk	--	527	--	817	--

Table 4

Banque Cantonale Vaudoise Risk-Adjusted Capital Framework Data (cont.)

Operational risk					
Total operational risk	--	1,789	--	3,673	--
(Mil. CHF)		**Basel III RWA**		**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification		18,199		21,508	100
Total Diversification/Concentration Adjustments		--		2,700	13
RWA after diversification		18,199		24,208	113
(Mil. CHF)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		3,118	17.1	2,856	13.3
Capital ratio after adjustments‡		3,118	17.1	2,856	11.8

*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. CHF--Swiss Franc. Sources: Company data as of Dec. 31, 2017, S&P Global.

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.

There has been strong cumulative growth in residential real-estate prices and domestic lending in Switzerland over the past several years, particularly mortgage lending. We consider this represents an incremental risk for Swiss banks that have mainly domestic operations and large exposure to the Swiss real estate market. However, we think this risk has reduced due to recent prudential measures to rein in growth in mortgage indebtedness. We acknowledge that house price increases in Vaud partly reflect above-average economic growth in the canton and strong immigration-led demand compared with limited supply. House prices have been cooling locally since 2014, more particularly for luxury properties, but 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.

BCV's underwriting standards support our assessment of its risk position. 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 1.5% in 2017, which came after annual growth of between 2% and 4% over 2012-2016. We expect further stable loan growth over our rating horizon, with an annual increase of below 2%

between 2018 and 2020.

BCV was the very first cantonal bank to file its regulatory reporting using the internal ratings-based approach. This reflects, in our view, the quality of BCV's credit risk management. Gross nonperforming loans stood at a low 1% of total customer loans at end-2017, broadly unchanged since end-2014. The bank's riskiest positions include trade finance exposures, which stood at just above CHF2 billion at June 2018, compared with CHF1.8 billion at end-2016. Due to low granularity in the portfolio, the cost of risk incurred in this business segment is volatile (for instance, it was zero in 2011, 2013, and 2014), while we estimate that, through the cycle, it would represent about one-third of BCV's total cost of 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--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**	**2013**
Growth in customer loans	5.8	1.3	1.3	(1.0)	3.2	2.9
Total diversification adjustment/S&P Global Ratings' RWA before diversification	12.6	12.6	11.6	3.9	3.1	2.0
Total managed assets/adjusted common equity (x)	15.8	15.9	15.6	14.4	14.2	13.8
New loan loss provisions/average customer loans	0.0	0.1	0.0	(0.0)	(0.1)	(0.0)
Gross nonperforming assets/customer loans + other real estate owned	1.0	1.0	0.9	0.9	0.9	1.2
Loan loss reserves/gross nonperforming assets	32.8	32.8	30.1	29.4	30.8	36.3

*Data as of June 30. RWA--Risk-weighted assets.

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

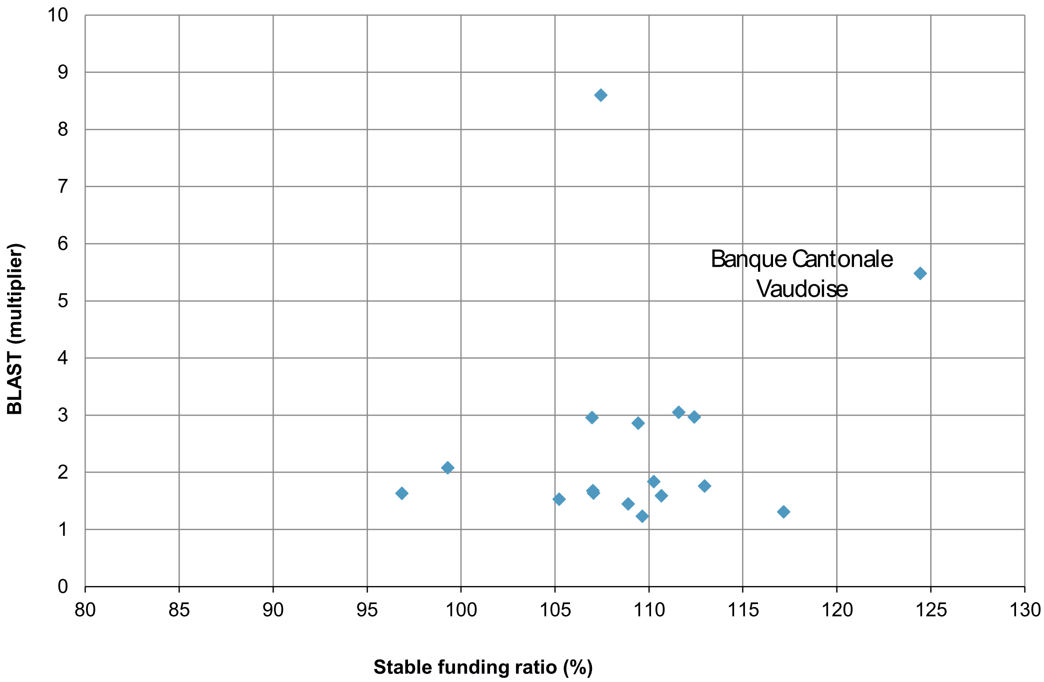
Core customer deposits were stable, at 75% of the funding base at end-2017 and at June 2018, according to our calculations. This is in the upper band compared with the levels of Swiss cantonal bank peers.

Like other cantonal banks, BCV uses covered bonds issued by the Centrale de Lettres de Gage (CLG; the Swiss Cantonal Bank Mortgage Bond Centre) 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-2017 was 124%, which is quite comparable with the levels achieved by domestic cantonal peers, which we also see as having adequate funding. We expect BCV to maintain a broadly similar stable funding ratio.

At end-2017, 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 5.5x. 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 (LCR), which is set to reach 100% on Jan. 1, 2019. We note that on June 30, 2018, BCV achieved a level of LCR of

117%, already far above the 2019 minimum requirement.

Banque Cantonale Vaudoise And Peers Funding And Liquidity Ratios



BLAST--Broad liquid assets/short-term wholesale funding.

Table 6

Banque Cantonale Vaudoise Funding And Liquidity

		--Year ended Dec. 31--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**	**2013**
Core deposits/funding base	75.4	75.0	74.2	74.5	76.9	77.4
Customer loans (net)/customer deposits	100.3	99.1	102.1	102.0	103.7	104.0
Long-term funding ratio	95.1	95.2	94.9	95.2	92.7	93.0
Stable funding ratio	122.4	124.4	122.6	122.5	114.4	113.2
Short-term wholesale funding/funding base	5.3	5.2	5.5	5.2	7.9	7.7
Broad liquid assets/short-term wholesale funding (x)	5.1	5.5	5.0	5.2	3.0	3.0
Net broad liquid assets/short-term customer deposits	29.0	30.9	29.6	29.2	20.2	42.4
Short-term wholesale funding/total wholesale funding	21.4	20.7	21.4	20.4	34.2	33.9
Narrow liquid assets/3-month wholesale funding (x)	6.5	3.9	3.3	3.4	3.8	3.9

*Data as of June 30.

External support: GRE status puts the long-term rating three notches above the SACP

We view BCV as a 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 this rating.

Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment: Switzerland, Nov. 30, 2018
- Vaud (Canton of), June 27, 2018

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 January 7, 2019)

Banque Cantonale Vaudoise	
Issuer Credit Rating	AA/Stable/A-1+
Issuer Credit Ratings History	
18-Jun-2013	AA/Stable/A-1+
03-Jul-2012	AA/Negative/A-1+
05-Dec-2011	AA/Stable/A-1+
Sovereign Rating	
Switzerland	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.