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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	+2
GRE Support	+2
Group Support	0
Sovereign Support	0

\+

Additional Factors	0

Issuer Credit Rating

AA/Negative/A-1+

Major Rating Factors

Strengths:

- Very high likelihood of support from the Canton of Vaud in case of stress.
- Good franchise in resilient Vaud economy.
- More diversified business model than a traditional Swiss cantonal bank.
- Strong liquidity despite management's intention to partly fund growth by drawing on excess liquidity.

Weaknesses:

- High exposure to regional real estate markets.
- Sizable trade finance exposures.

Outlook: Negative

Standard & Poor's Rating Services' negative outlook on Swiss Banque Cantonale Vaudoise (BCV) reflects the likelihood of a downgrade if residential real estate prices in Switzerland and the Canton of Vaud (AA+/Positive/--) keep increasing at the high pace observed over the past three years, potentially harming the quality of BCV's mortgage loan book. We might also lower the long-term rating on BCV if we saw a significant weakening of its risk position. This could occur if the bank's exposures to trade finance increased substantially.

We might revise the outlook on BCV to stable if we believed the trend in house prices would have a limited impact on the quality of BCV's mortgage loan book. Given our methodology for rating government-related entities (GREs), a one-notch upgrade or downgrade of Vaud would have no effect on the counterparty credit ratings on BCV, all other things being equal.

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, as our criteria define these terms. The stand-alone credit profile (SACP) is 'a+'.

Anchor: 'a'

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) methodology and our economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating mostly in Switzerland, like BCV, is 'a' based on an economic risk score of '1' and an industry risk score of '2'.

We view Switzerland as a highly diverse and competitive economy, benefiting from one of the highest levels of GDP per capita in the world, and very robust government finances. We believe Switzerland has a conservative risk and lending structure.

The Swiss banking industry is supported by its sizable and very stable customer deposit base. Swiss banks have not loosened credit standards in recent years, thanks to sound earnings potential from core products. In addition, we consider regulatory standards to be more stringent than for other developed countries.

Table 1

Banque Cantonale Vaudoise Key Figures					
		--Year-ended Dec. 31--			
(Mil. CHF)	**2012***	**2011**	**2010**	**2009**	**2008**
Adjusted assets	39,720.0	37,783.0	35,501.0	35,648.4	35,159.1
Customer loans (gross)	28,043.0	28,165.0	25,723.5	24,576.5	23,191.9
Adjusted common equity	2,930.5	2,906.0	2,911.7	2,870.2	2,839.5
Operating revenues	508.2	1,017.2	995.8	975.9	927.9
Noninterest expenses	310.5	615.4	593.3	583.7	580.5
Core earnings	152.8	294.3	306.5	294.3	213.0

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

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

We assess BCV's business position as "adequate." With total assets of Swiss franc (CHF)39.8 billion on June 30, 2012, the bank is the second-largest Swiss cantonal bank, and the fifth bank by size in Switzerland. It has about a 33% market share in retail banking and small and midsize enterprises in Vaud, which is one of the richest and most resilient cantons in Switzerland. Vaud's GDP growth has outperformed Switzerland's GDP growth by an annual average of about 0.8% over the past five years, with an average annual rate of 2% compared with 1.2% for Switzerland. With CHF80.0 billion of assets under management on June 30, 2012 and CHF372 million of net new money in the first half of the year, the bank also has a good franchise in asset and wealth management, although its market share in private banking is much smaller than for retail banking. The bank further consolidated its wealth management franchise in 2011 with the acquisition of Banque Franck Galland, which had about CHF3 billion in assets under management.

Banque Franck Galland merged with Banque Piguet, one of BCV's subsidiaries, to become Piguet Galland & Cie SA. BCV's main strategy in private banking is twofold--to increase its market share in Vaud and to grow with Piguet Galland & Cie in the French-speaking part of Switzerland. Since the bank has a majority of "on-shore assets," we expect net inflows in Swiss on-shore assets in the next two years to more than offset potential outflows in "off-shore assets" due to threats to Swiss banking secrecy.

On top of the traditional activities of a Swiss cantonal bank, BCV has a structured product business and is one of the main players in French-speaking Switzerland for transaction-based commodities trade finance. The issue of structured products picked up significantly in the first half of 2012 to reach CHF700 million-800 million outstanding. Exposures to trade finance are mainly focused on metals, steel, wheat and corn. They have slightly decreased from highs at the end of 2011 to about CHF2.0 billion.

Apart from issuing structured products, trading operations are focused on foreign exchange spot and derivatives transactions to serve clients' hedging needs. In 2012, the volume of these client-driven transactions has only decreased slightly compared with 2011, despite the introduction of the peg linking the Swiss Franc to the Euro in September 2011.

Table 2

Banque Cantonale Vaudoise Business Position

	--Year-ended Dec. 31--	
(%)	**2012***	**2011**
Commercial banking/total revenues from business line	24.3	27.8
Retail banking/total revenues from business line	20.6	20.7
Trading and sales income/total revenues from business line	5.6	6.0
Asset management/total revenues from business line	36.2	35.6
Other revenues/total revenues from business line	13.2	10.0
Investment banking/total revenues from business line	5.6	6.0
Return on equity	9.7	9.2

Chart 1

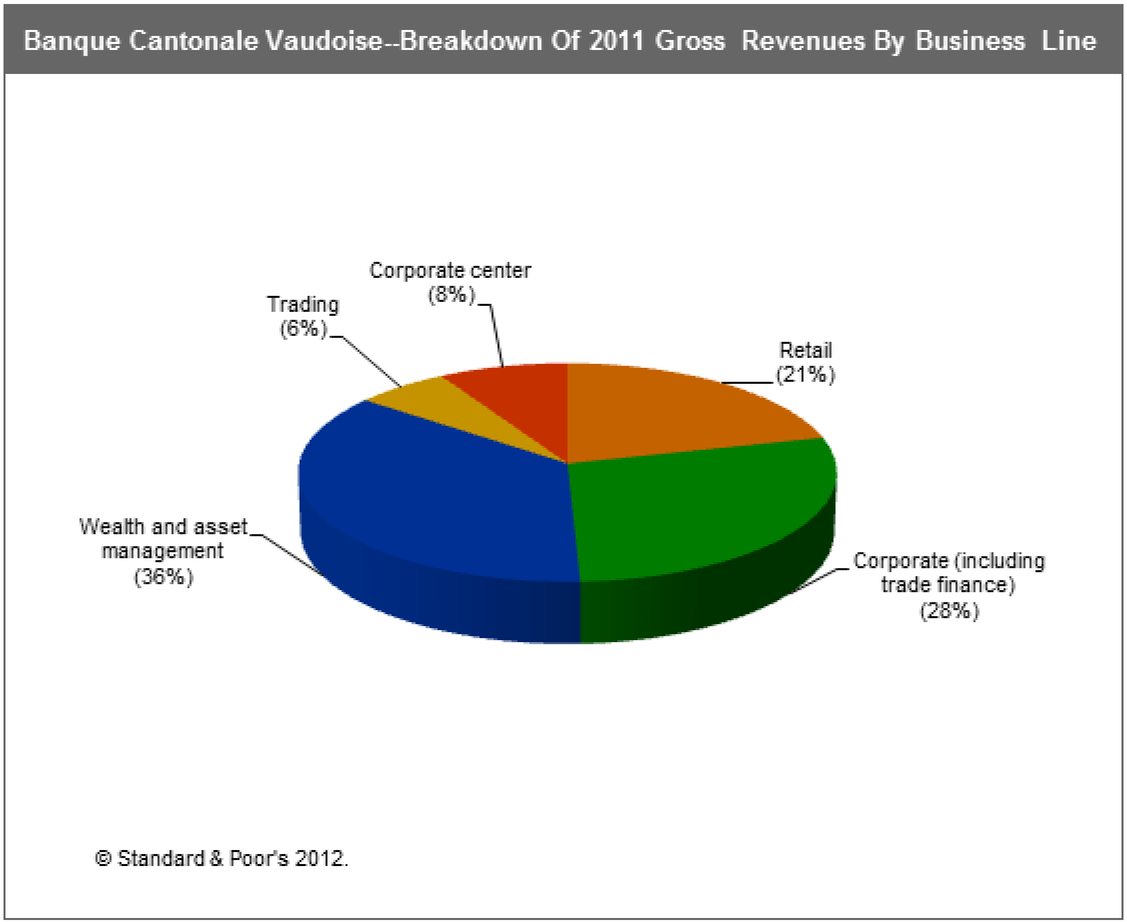
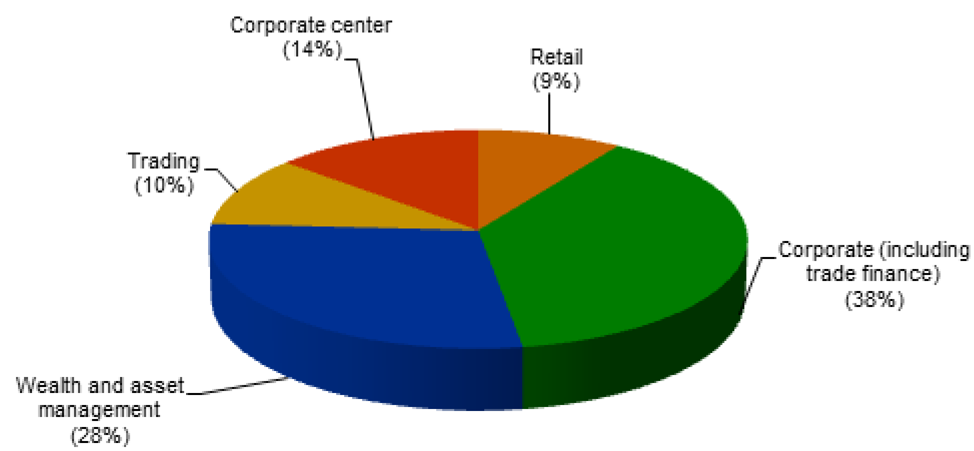

Banque Cantonale Vaudoise--Breakdown Of 2011 Gross Revenues By Business Line
Corporate center (8%)
Trading (6%)
Retail (21%)
Wealth and asset management (36%)
Corporate (including trade finance) (28%)
© Standard & Poor's 2012.

Chart 2

Banque Cantonale Vaudoise--Breakdown Of 2011 Post-Tax Profit By Business Line



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 issues no hybrids. Core earnings have represented about 95% of total revenues since 2009. Net profits before this date were inflated by the reversals on loan-loss provisions recorded at the beginning of the 2000s, and by the sale of subsidiaries. Our risk-adjusted capital (RAC) ratio stood at 14.1 % as of Dec. 31, 2011. We do not expect it to go above the 15% threshold in the next 18 to 24 months given the planned growth of exposures, even at a lower rate than in recent years, and management's intention to keep very high payout ratios over this horizon. A total of CHF275 million was distributed to shareholders in 2011, out of CHF301 million in post-tax net income, and management has announced its intention to continue paying high dividends to shareholders.

Since July 2012 the bank has needed to maintain a minimum 7.8% in core equity tier 1 capital, a minimum 9.6% in tier 1 capital, and 12 % in total capital as part of requirements from the Swiss Banking regulator, FINMA, and according to FINMA computations. This compares with a 13.3% total capital ratio at the end of June 2012 under FINMA standards and 16.8 % under Bank for International Settlements (BIS) standards. However, we do not expect the FINMA thresholds to be particularly binding in the next two years given the expected removal of the specific FINMA multipliers in January 2013 that will allow FINMA and Basel ratios to be more aligned from January 2013. The implementation of Basel III, with notably higher regulatory risk-weighted assets on bank exposures and the introduction of counterparty valuation adjustments, should translate into a limited decrease of BIS capital ratios, with a maximum of 50 basis points (bps).

Margins on residential mortgages have increased significantly since the beginning of the year following the tightening of underwriting criteria. However, margins on the liability side remain constrained by very low short-term interest rates. Profitability for the wealth management business, as measured for example by return on assets, is in line with that for Swiss private banking peers in the on-shore segment. Overall, profitability adjusted for risk is strong, with a three-year average earnings buffer around 160bps, according to our methodology. We expect 2012 post-tax profit to be in line with 2011.

Table 3

Banque Cantonale Vaudoise Capital And Earnings					
		--Year-ended Dec. 31--			
(%)	**2012***	**2011**	**2010**	**2009**	**2008**
Tier 1 capital ratio	16.8	16.8	17.6	17.8	16.4
S&P RAC ratio before diversification	N.M.	14.1	15.5	15.1	N.M.
S&P RAC ratio after diversification	N.M.	13.9	15.0	14.8	N.M.
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	52.1	50.8	51.3	52.0	54.3
Fee income/operating revenues	34.1	35.1	35.3	33.7	36.6
Market-sensitive income/operating revenues	11.0	11.3	9.8	10.1	4.0
Noninterest expenses/operating revenues	61.1	60.5	59.6	59.8	62.6
Preprovision operating income/average assets	1.0	1.1	1.1	1.1	1.0
Core earnings/average managed assets	0.8	0.8	0.9	0.8	0.6

*Data as of June 30. N.M.--Not meaningful.

Risk position: Concentration of risks in regional real estate markets and sizable trade finance exposures

We assess BCV's risk position as "adequate." Our view balances the bank's high exposure to regional real estate markets--close to 60% of its total exposures are in residential mortgages or in income-producing real estate for investors--with its good track record of low new provisions on individuals and real-estate professionals in 2011 and the first half of 2012 of below 1bp. Real estate prices in Vaud have increased by an annual average of 7%-8% since 2002, more than the Swiss average of about 4%.

We acknowledge that price developments in Vaud have been supported to some extent by above-average economic growth and strong immigration-driven demand in a context of limited supply. We also note, however, that a continuation of this real estate price trend could lead to growing economic imbalances and potentially impair the quality of BCV's residential loans book. In the last quarter of 2011, BCV tightened its mortgage underwriting discipline. In anticipation of the guidelines issued by the Swiss Banking Association in June 2012, loan-to-values at origination have been capped at 80%, with a minimum down payment of 10% in cash. Moreover, a minimum of 35% of the initial debt must be amortized after 20 years and the annual cost of borrowing (calculated with a theoretical interest rate of 5%, plus 1% of amortization, plus 1% of maintenance expenses) should not exceed more than one third of a customer's annual net income. In addition, BCV management has decided to limit the growth of the bank's mortgages outstanding to 4% in 2012, with 2% growth in the first half of 2012, compared with 9% growth in full-year 2011.

BCV's most risky positions, in our view, include trade finance exposures of about CHF2.0 billion on June 30, 2012, which have represented close to half of total provisioning needs over the past three years. In a landscape marked by difficulties for some European peers with dollar liquidity issues, BCV was in a position to increase trade finance lending during the second half of 2011 while being more selective in terms of countries and customers. This translated into slightly lower than expected cost of risk on this business line. We view management's decision to formally cap future trade finance exposures--on and off balance sheet--at 10% of the total credit-risk exposures, excluding banks, as positive for the ratings. Exposures to European peripheral countries represent less than 0.2 % of the total balance sheet and are mostly limited to letter of credit in the course of trade finance operations.

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 on credit risk. This reflects the quality of BCV's credit risk management, in our view. Overall, cost of risk has not represented more than 10bps since 2009 and the ratio of gross nonperforming loans to total customer loans stood at a low 1.4% at the end of June 2012.

BCV's market risk fell significantly following its exit from equity derivatives proprietary trading at the end of 2009, and a fourfold decline of the seed-money portfolio in the asset management business line in the past three years. Foreign-exchange positions taken on behalf of customers are pooled and hedged in back-to-back. Market risk positions arising from the trading of structured products and certificates are hedged with some limited residual risks, mainly dividends and correlation risks.

Table 4

Banque Cantonale Vaudoise Risk-Adjusted Capital Framework Data

(Mil. CHF)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	1,659	100	6	51	3
Institutions	3,682	1,063	29	571	16
Corporate	15,180	9,675	64	10,555	70
Retail	16,144	2,650	16	4,184	26
Of which mortgage	14,539	2,038	14	3,155	22
Securitization§	0	0	0	0	0
Other assets	914	869	95	879	96
Total credit risk	37,579	14,357	38	16,240	43
Market risk					
Equity in the banking book†	197	538	493	1,134	575
Trading book market risk	--	300	--	450	--
Total market risk	--	838	--	1,584	--
Insurance risk					
Total insurance risk	--	--	--	0	--

Table 4

Banque Cantonale Vaudoise Risk-Adjusted Capital Framework Data (cont.)					
Operational risk					
Total operational risk	--	1,750	--	2,823	--
(Mil. CHF)		**Basel II RWA**		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		16,944		20,646	100
Total Diversification/Concentration Adjustments		--		224	1
RWA after diversification		16,944		20,870	101
(Mil. CHF)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		2,846	16.8	2,906	14.1
Capital ratio after adjustments‡		2,846	16.8	2,906	13.9

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡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, 2011, Standard & Poor's.

Table 5

Banque Cantonale Vaudoise Risk Position					
		--Year-ended Dec. 31--			
(%)	**2012***	**2011**	**2010**	**2009**	**2008**
Growth in customer loans	(0.9)	9.5	4.7	6.0	0.9
Total diversification adjustment / S&P RWA before diversification	N.M.	1.3	3.2	2.4	N.M.
Total managed assets/adjusted common equity (x)	13.6	13.0	12.2	12.4	12.4
New loan loss provisions/average customer loans	0.0	0.1	0.0	0.1	0.3
Gross nonperforming assets/customer loans + other real estate owned	1.4	1.6	1.9	2.4	2.9
Loan loss reserves/gross nonperforming assets	N/A	44.5	45.5	45.0	54.0

*Data as of June 30. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: Strong liquidity and average funding

We assess BCV's funding as average. The bank has an ample customer deposit base with total deposits representing more than 83% of the funding base on June 30, 2012, according to our calculations, and in line with that of Swiss cantonal bank peers. The bank managed to increase customer deposits by 6% in the first half of the year despite record low interest rates. Covered bonds provide a complementary source of funding for BCV, at about 14% of total funding needs. As is the case for the other cantonal banks, covered bonds are issued directly under the signature of the "Centrale des Lettres de Gages" (CLG). Through this mutualized source of funding, BCV benefits from the excellent creditworthiness of the CLG, which is backed by Swiss cantonal banks and ultimately by the cantons, and gets very attractive funding costs—currently between zero and 5bps above the swap rates for the same maturities.

BCV maintains a high liquidity ratio under the strict norms established by Swiss regulators. Likewise, preliminary data indicate a Basel III liquidity coverage ratio within the range of 100% to 140%. As of June 30, 2012, BCV's liquidity buffer was mainly made up of cash at the Swiss National Bank (SNB). Investing excess liquidity on the repo market is a limited alternative because most banks active on the Swiss Eurex repo platform are cash rich, meaning that repo volumes have come down sharply. A pool of SNB-eligible unencumbered bonds completes the liquidity buffer. 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 a strong liquidity position as, in our view, the bank should be in a position to preserve its capacity to attract deposits.

Table 6

Banque Cantonale Vaudoise Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	**2012***	**2011**	**2010**	**2009**	**2008**
Core deposits/funding base	75.2	76.4	75.8	74.1	70.9
Customer loans (net)/customer deposits	104.4	108.8	107.3	103.9	105.7
Long term funding ratio	89.8	92.5	91.9	90.6	90.6
Broad liquid assets/short-term wholesale funding (x)	1.4	1.8	1.2	2.1	2.6
Net broad liquid assets/short-term customer deposits	8.9	8.8	2.8	15.1	23.7
Narrow liquid assets/3-month wholesale funding (x)	N/A	2.1	1.4	2.7	3.2
Net short-term interbank funding/total wholesale funding	9.2	(12.3)	(17.3)	(44.7)	(63.9)
Short-term wholesale funding/total wholesale funding	48.3	34.6	37.0	39.7	35.6

*Data as of June 30. N/A--Not applicable.

External support: GRE status puts rating two notches above SACP

We view BCV as a GRE, according to our methodology. In accordance with our criteria for GREs, we believe that there is a "very high" likelihood that Vaud would provide timely and sufficient extraordinary support to BCV in the event of financial stress, as it did in the early 2000s. This 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 that 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 at least a 50% plus one share majority in the bank. Unlike some other Swiss cantonal banks, however, BCV does not benefit from the canton's statutory guarantee.

Given its GRE status, BCV's rating is two notches higher than its SACP.

Additional rating factors: None

There are no additional rating factors

Related Criteria And Research

- Banks: Rating Methodology and Assumptions, Nov. 9, 2011
- Bank Capital Methodology and Assumptions, Dec. 6, 2010
- Banking Industry Country Risk Assessment Methodology and Assumptions, Nov. 9, 2011
- Rating Government-Related Entities: Methodology and Assumptions, Dec. 9, 2010

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 November 30, 2012)

Banque Cantonale Vaudoise	
Counterparty Credit Rating	AA/Negative/A-1+
Counterparty Credit Ratings History	
03-Jul-2012	AA/Negative/A-1+
05-Dec-2011	AA/Stable/A-1+
06-Dec-2010	AA-/Positive/A-1+
02-Dec-2008	AA-/Stable/A-1+
Sovereign Rating	
Swiss Confederation (Unsolicited Ratings)	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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