

Research Update:

Banque Cantonale Vaudoise Outlook Revised To Positive On Resilient Financials; 'AA-/A-1+' Ratings Affirmed

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Overview

- Switzerland-based Banque Cantonale Vaudoise has improved core earnings while reducing materially its market risk profile.
- We are revising the outlook to positive from stable and affirming our 'AA-/A-1+' ratings on BCV.
- The positive outlook reflects our opinion that the improvement in the bank's underlying financial profile may be sustainable.

Rating Action

On Dec. 6, 2010, Standard & Poor's Ratings Services revised its outlook on Switzerland-based Banque Cantonale Vaudoise (BCV) to positive from stable. At the same time, we affirmed the 'AA-/A-1+' long- and short-term counterparty credit ratings on this entity.

Rationale

Our long-term rating on BCV factors in two notches of support above the bank's current stand-alone credit profile (SACP). This reflects implicit support from its main shareholder, the Swiss Canton of Vaud (AA+/Stable/--), despite the absence of a full statutory guarantee.

The second-largest cantonal bank in the Swiss Confederation (Switzerland; AAA/Stable/A-1+), BCV is a government-related entity (GRE) according to our methodology. In our opinion, it maintains a "very strong" link with the Canton of Vaud and plays a "very important" role in the local economy, which is reflected in its public policy role in the canton's economic development. A law passed in March 2010 stipulates that the canton will keep the absolute majority of the capital in the bank. We believe it is very likely that the canton would provide extraordinary support to the bank in case of need, as it did in the early 2000s.

BCV's strong market position in the canton, satisfactory risk management, and strong capitalization underpin the ratings. The bank's geographic concentration in a mature and highly competitive regional market is balanced by its diversified profile of retail and commercial banking, including trade finance and asset and wealth management.

BCV is less exposed than some peers to potential pressures on offshore banking.

BCV improved its core earnings in 2009 and the first half of 2010. After readjusting for extraordinary items--including the settlement of the litigation with the Swiss Federal Tax Administration for CHF34 million in 2010--core earnings reached CHF154 million in the first semester, compared with CHF294 million for full-year 2009, and CHF213 million for full-year 2008, according to our calculations.

The cost of risk in 2009 and in the first half of 2010 remained very low at about 10 basis points. We believe that BCV's adequate credit risk management should prevent provisioning needs from increasing sharply.

Market risk has decreased significantly following the bank's exit from equity derivatives proprietary trading at the end of 2009, and the division by four of the seed-money portfolio in the asset management business line in the past two years. BCV's trading desks now focus mainly on client-driven business, whether that means trading foreign exchange products for those who require hedging solutions, offering and hedging in-house structured products, or executing trades on bonds and equities for retail and institutional clients.

We view BCV's liquidity position as strong, since it has an ample customer deposit base that covered slightly more than 100% of total customer loans by mid-year 2010. Moreover, the bank demonstrated a cautious approach to liquidity during the crisis by maintaining a large cushion of cash at the Swiss central bank.

Despite the bank's decision to give back CHF267 million to shareholders after its 2009 results, we believe BCV's capitalization remains robust. On Dec. 31, 2009, it had a risk-adjusted capital (RAC) ratio, a Standard & Poor's measurement, of 13.4% after diversification. We expect that the bank's intended reduction of its equity base will only translate into a moderate reduction in the bank's RAC ratio.

Outlook

The positive outlook reflects our opinion that BCV's underlying financial profile has improved, notably on the back of its reduced market risk and resilient earnings. It also factors in our belief that the bank's quality of underwriting will remain satisfactory, despite its planned growth of the residential real estate portfolio. Likewise, we expect capitalization to remain strong according to our RAC ratios. If these expectations materialize, we would revise our assessment of the bank's SACP up by one notch. We would then raise the long-term counterparty credit rating on the bank by one notch, in accordance with our methodology for rating GREs.

On the other hand, we could revise the outlook to stable if we see a material deterioration in capitalization, or if the current dynamic increase in real estate exposures is accompanied by a relaxing of underwriting criteria.

Related Criteria And Research

- Risk-Adjusted Capital Framework For Financial Institutions, March 17, 2010
- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

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

Ratings List

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