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VP Bank Verwaltungs- und Privat-Bank AG

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VP Bank Verwaltungs- und Privat-Bank AG

Major Rating Factors

Strengths:

- Favorable financial profile with very strong capitalization.
- Stable shareholder structure.
- Stable and granular customer deposit base.

Counterparty Credit Rating

A-/Stable/A-2

Weaknesses:

- Operations vastly in the private-banking niche, with limited universal banking operations.
- Weak international private-banking franchise and net new money generation.
- Sizable reputational and operational risks in line with those of private bank peers.

Outlook: Stable

Standard & Poor's Ratings Services' outlook on Liechtenstein-based VP Bank Verwaltungs- und Privat-Bank AG (VP BANK) is stable. This reflects our opinion that the intrinsically high stability of VP BANK's private-banking business model compensates for prevailing franchise weakness and comparatively lower profitability. We believe this is thanks to the long-term nature of the bank's client relationships and significantly lower credit, liquidity, and market risk than is typical for commercial banks.

We would consider lowering the ratings if VP BANK failed to strengthen its business profile by broadening its international onshore customer base and franchise, with the new management team achieving positive new asset generation over the medium term. Any further significant weakening in the bank's operating performance, which might lead to a lower risk-adjusted capital (RAC) ratio, would also threaten the ratings. However, we expect VP BANK's capitalization to remain strong and its profitability to be higher than breakeven. Consequently, the risk of a downgrade is limited.

A positive rating action is remote, in our view. However, an upgrade could result from VP BANK's achieving new asset generation exceeding that of competitors, and a more diverse and less-confidence-sensitive business profile resulting from improvements in its market position.

Rationale

Our ratings on VP BANK reflect its anchor of 'a-', its "weak" business position, "very strong" capital and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. They also factor in our view of the bank's "moderate" systemic importance to the Principality of Liechtenstein (AAA/Stable/A-1+). The stand-alone credit profile (SACP) is 'bbb+'.

Anchor: 'a-'

Our bank criteria use the economic risk and industry risk scores from our Banking Industry Country Risk Assessment (BICRA) to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for a commercial bank operating only in Liechtenstein is 'a-'.

The BICRA score includes our evaluation of economic risk, reflecting Liechtenstein's extremely high wealth, export-oriented industries, and very strong public finances. Owing to the predominance of private banking, lending is of minor importance. Loans are typically highly collateralized, and credit losses have been low.

The industry faces significant changes because of foreign governments' regulations to prevent tax evasion. We therefore expect Liechtenstein's banks to strengthen their positions in international onshore private-banking markets and invest in branding and service quality. Systemwide funding benefits from the banks' sizable deposit bases, but remains vulnerable to the confidence sensitivity of wealth-management activities.

When we assess economic risk for private banks, we use the economic risk factor of the country of origin, which in the case of VP BANK is Liechtenstein.

Table 1

VP Bank Verwaltungs- und Privat-Bank AG Key Figures					
--Year-ended Dec. 31--					
(Mil. CHF)	2011*	2010	2009	2008	2007
Adjusted assets	10,595.7	10,505.9	11,523.7	11,319.6	10,452.8
Customer loans (gross)	3,561.8	3,313.5	3,067.5	3,017.9	3,041.7
Adjusted common equity	831.4	815.1	807.0	781.7	951.7
Operating revenues	125.7	253.2	310.9	223.3	379.2
Noninterest expenses	92.5	196.7	201.5	220.0	200.0
Core earnings	30.8	39.8	84.5	N/A	161.5

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

Business position: Niche business limits business and geographic diversity

VP BANK's "weak" business position reflects our view that the bank operates in private banking, with a lack of business and geographic diversification, although it acts as a universal bank in Liechtenstein and Switzerland. However, despite being the third-largest bank in the domestic market, the bank is small on a global scale. VP BANK's private-banking division focuses predominantly on Liechtenstein-centered offshore business, complemented by smaller onshore operations, mainly in Germany, Asia, and Eastern Europe.

All main international offshore financial centers have accepted the Organization for Economic Cooperation and Development's minimum standards. This creates a level playing field globally, with less room for regulatory arbitrage, so we expect service quality to be the key success factor for private banks in the future. We believe the generally challenging conditions in the international wealth-management business, particularly in offshore private banking, VP BANK's main business, could continue for a prolonged period, however.

In our view, VP BANK's business stability is considerably sensitive to overall market and client activity, as seen in the outflow of assets under management in 2008-2010. On the other hand, we note VP BANK's stable and long-standing customer base. VP BANK has not yet achieved the strong brand awareness of its mainly Switzerland-based peers, which could help compensate for weaker new business in offshore markets through inflows from onshore activities. Furthermore, VP BANK's net new asset generation lags that of domestic peers by more than we previously expected.

VP BANK's CEO, who started in April 2010, is refocusing the group's strategy to address its weak international wealth-management franchise while maintaining its good niche market position with financial intermediaries in

Liechtenstein and Switzerland. We believe VP BANK could be absorbed into another private bank if this new strategy does not show results in the medium term. However, we believe VP BANK's stable shareholder structure allows it sufficient time to implement its refocused strategy.

Table 2

VP Bank Verwaltungs- und Privat-Bank AG Business Position					
	--Year-ended Dec. 31--				
(%)	2011*	2010	2009	2008	2007
Total revenues from business line (mil. CHF)	125.7	256.8	313.8	227.5	N/A
Commercial banking/total revenues from business line	N/A	N/A	N/A	8.9	N.M.
Retail banking/total revenues from business line	56.1	54.1	49.8	N/A	N.M.
Agency services/total revenues from business line	N/A	N/A	N/A	55.4	N.M.
Asset management/total revenues from business line	27.0	28.2	25.3	70.1	N.M.
Other revenues/total revenues from business line	16.9	17.6	24.9	(34.4)	N.M.
Reported return on equity	4.1	1.7	6.6	N/A	N/A

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

Capital and earnings: A key rating strength

We assess VP BANK's capital and earnings as "very strong." The bank's capitalization is its key rating strength, in our view, underpinned by a pro forma RAC ratio of 17.1% and a projected RAC ratio of about 16.5%-17.5% before concentration and diversification effects within our 18-month horizon. VP BANK enjoys a high quality of capital, while its earnings capacity is slightly less than the industry average, underpinned by a three-year average earnings buffer of about 100 basis points.

Lower revenues due to clients' continued risk and cost awareness, together with VP BANK's material investments to expand its international onshore private-banking business in target markets such as Germany and Asia, continue to significantly weigh on its profitability, in our view. Despite comparatively low level of discretionary wealth-management mandates, VP BANK has maintained solid margins on its assets under management. Revenues, specifically from fund and asset management, remained unchanged in the first half of 2011 compared with 2010, and we expect interest income to stay weaker than in previous years. As we understand, the bank has established more rigid cost management to partly offset pressure on revenues. Therefore, we expect the bank to maintain its cost-income-ratio at less than 80% at year-end 2011.

Table 3

VP Bank Verwaltungs- und Privat-Bank AG Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2011*	2010	2009	2008	2007
Tier 1 capital ratio	18.1	19.0	17.1	13.6	16.0
S&P RAC ratio before diversification	N.M.	17.5§	15.4	N.M.	N.M.
S&P RAC ratio after diversification	N.M.	14.4§	14.2	N.M.	N.M.
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	29.8	31.2	38.9	66.5	37.4
Fee income/operating revenues	52.3	49.5	39.7	68.0	46.2
Market-sensitive income/operating revenues	18.0	16.0	17.3	(38.6)	14.2
Noninterest expenses/operating revenues	73.6	77.7	64.8	98.5	52.7

Table 3

VP Bank Verwaltungs- und Privat-Bank AG Capital And Earnings (cont.)					
Preprovision operating income/average assets	0.6	0.5	1.0	0.0	1.8
Core earnings/average managed assets	0.6	0.4	0.7	N/A	1.6

*Data as of June 30. §Ratios based on BICRA scores as of year-end 2010. N/A--Not applicable. N.M.--Not meaningful. CHF--Swiss franc.

Table 4

VP Bank Verwaltungs- und Privat-Bank AG RACF [Risk-Adjusted Capital Framework] Data						
(CHF 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)	
Credit risk						
Government and central banks	1,334,662	14,663	1.1	42,386	3.2	
Institutions	5,472,237	1,593,000	29.1	964,940	17.6	
Corporate	787,167	253,500	32.2	664,151	84.4	
Retail	2,714,431	1,381,200	50.9	854,219	31.5	
Of which mortgage	2,148,349	1,077,913	50.2	469,102	21.8	
Securitization	9,851	123,138	1,250.0	123,138	1,250.0	
Other assets	243,892	230,004	94.3	254,184	104.2	
Total credit risk	10,562,240	3,595,504	34.0	2,903,018	27.5	
Market risk						
Equity in the banking book¶	81,628	86,516	106.0	586,225	718.2	
Trading book market risk	--	173,161	--	259,742	--	
Total market risk	--	259,678	--	845,967	--	
Operational risk						
Total operational risk	--	537,954	--	1,004,273	--	
(CHF 000s)		Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA	
Diversification adjustments						
RWA before diversification		4,393,135		4,753,258	100.0	
Total adjustments to RWA		--		1,163,168	24.5	
RWA after diversification		4,393,135		5,916,426	124.5	
(CHF 000s)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)	
Capital ratio						
Capital ratio before adjustments		809,290	18.4	815,131	17.1	
Capital ratio after adjustments§		809,290	19.0	815,131	13.8	

*Exposure at default. Securitisation exposure includes the securitisation 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. Sources: Company data as of Dec. 31, 2010, Standard & Poor's. CHF--Swiss franc.

Risk position: Credit risk concentrations and high operational and reputation risks

We consider VP BANK's risk position to be "moderate," mainly based on our view of credit risk concentrations, high operational and reputation risks, and a higher losses than that of other market participants. This reflects

significant losses on its securities portfolio and on unhedged foreign exchange risk exposures in 2008. Credit risks from VP BANK's small, mainly domestic lending activities remain low, in our view, since they are mostly highly collateralized and less sensitive to the economic cycle, such as residential mortgages or Lombard loans (i.e. loans backed by securities).

On a positive note, our RAC calculation does not fully reflect the high collateralization of VP BANK's loan book. On the other hand, it does not reflect the sizable reputation risks embedded in VP BANK's private-banking business model. In addition, our RAC calculation indicates higher single-name concentrations than peers' because of limited corporate lending opportunities in Liechtenstein and neighboring Swiss cantons.

VP BANK is very sensitive to operational risks, in our view. Possible accusations of tax evasion assistance, internal fraud, or business with politically exposed individuals might significantly hamper its operations for a long period. We understand that VP BANK is applying more rigorous procedures and continuously benchmarking internal processes to reduce these risks. In our view, VP BANK's substantial investments in the quality of its wealth-management services over the past few years should also help mitigate its sizable operational and reputation risks. However, we do not believe this will offset the weaknesses of its franchise.

Table 5

VP Bank Verwaltungs- und Privat-Bank AG Risk Position					
	--Year-ended Dec. 31--				
(%)	2011*	2010	2009	2008	2007
Growth in customer loans	15.0	8.0	1.6	(0.8)	2.9
Total diversification adjustment/S&P RWA before diversification	N.M.	21.0	8.8	N.M.	N.M.
Total managed assets/adjusted common equity (x)	12.8	13.0	14.4	14.6	11.0
New loan loss provisions/average customer loans	0.0	0.5	0.4	0.4	0.1
Net charge-offs/average customer loans	N.M.	0.2	0.0	0.1	0.2
Gross nonperforming assets/customer loans + other real estate owned	N/A	0.6	0.8	1.0	0.6
Loan loss reserves/gross nonperforming assets	N/A	246.6	174.3	108.8	151.1

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

Funding and liquidity: Benefit from stable and granular deposits

VP BANK's funding is "average" and its liquidity position "adequate," in our opinion.

There is only a minor need for short-term funding because VP BANK benefits from a granular, stable deposit base, which accounts for about 88% of its funding base. Customer deposits have proven to be less confidence sensitive, in our view. Moreover, the Liechtenstein banking association insures most of the deposits for up to Swiss franc (CHF) 100,000 per account holder. VP BANK mainly invests its excess deposits in short-term interbank lending, while its securities portfolio largely comprises generally highly rated and liquid assets. The bank's ratio of liquid assets to short-term liabilities well exceeds regulatory requirements, which benefits its liquidity position. VP BANK's funding is complemented by a limited amount of wholesale funding.

Table 6

VP Bank Verwaltungs- und Privat-Bank AG Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2011*	2010	2009	2008	2007
Core deposits/funding base	87.9	91.4	95.1	92.9	92.2

Table 6

VP Bank Verwaltungs- und Privat-Bank AG Funding And Liquidity (cont.)					
Customer loans (net)/customer deposits	42.4	37.5	30.3	31.1	36.5
Long term funding ratio	95.2	91.9	89.4	98.9	99.1
Broad liquid assets/short-term wholesale funding (x)	7.2	6.9	5.9	21.2	20.2
Net broad liquid assets/short-term customer deposits	66.2	75.6	77.8	90.1	84.4
Narrow liquid assets/3-month wholesale funding (x)	N/A	7.0	6.0	N/A	N/A
Net short-term interbank funding/total wholesale funding	(389.4)	(455.6)	(803.3)	(899.0)	(813.2)
Short-term wholesale funding/total wholesale funding	62.0	102.9	230.9	44.5	41.7

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

External support: "Moderate" systemic importance in a "supportive" country

The counterparty credit rating is one notch higher than the SACP, reflecting our view of VP BANK's "moderate" systemic importance to Liechtenstein and that the government is "supportive" toward its banking sector.

Additional rating factors: None

Ratings Score Snapshot	
Issuer Credit Rating	A-
SACP	bbb+
Anchor	a-
Business Position	Weak (-2)
Capital and Earnings	Very Strong (+2)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	1
GRE Support	0
Group Support	0
Sovereign Support	1
Additional Factors	0

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- 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

Ratings Detail (As Of January 9, 2012)	
VP Bank Verwaltungs- und Privat-Bank AG	
Counterparty Credit Rating	A-/Stable/A-2
Certificate Of Deposit	A-/A-2
Senior Unsecured (2 Issues)	A-
Counterparty Credit Ratings History	
24-Feb-2009	A-/Stable/A-2

Ratings Detail (As Of January 9, 2012) (cont.)	
19-Sep-2008	A/Negative/A-1
30-Aug-2005	A/Stable/A-1
Sovereign Rating	
Liechtenstein (Principality of)	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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