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Ratings

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VP Bank AG

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VP Bank AG

SACP	a-		
Anchor	a-		
Business Position	Weak	-2	
Capital and Earnings	Very Strong	+2	
Risk Position	Adequate	0	
Funding	Average	0	
Liquidity	Adequate		

\+

Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

\+

Additional Factors	0

Issuer Credit Rating
A-/Positive/A-2

Major Rating Factors

Strengths:	Weaknesses:
• Very strong capitalization. • Stable shareholder structure. • Sound funding and liquidity position underpinned by stable customer deposit base.	• Modest-sized player in a competitive private-banking niche segment. • High fixed-cost base. • Inherent legal and reputational risk due to private banking model.

Outlook: Positive

S&P Global Ratings' positive outlook on Liechtenstein-based VP Bank AG reflects two factors: our view that the bank could potentially benefit from one notch of additional loss-absorbing capacity (ALAC) uplift, but also the possibility of improvement in its business position over the next 2 years.

The potential ramp-up of capital that can be bailed in, following the future introduction of local minimum requirement for own funds and eligible liabilities (MREL) requirements, could result in a sufficiently high ALAC buffer for VP Bank to protect senior creditors should the bank become nonviable. We expect to have more clarity on the local MREL framework within the next 24 months.

The positive outlook also reflects VP Bank's improving business position since its strategic initiatives over the past years. We could consider an upgrade if we saw sustainable organic growth in VP Bank's assets under management, reversing the negative trend of recent years. This could enhance VP Bank's performance compared with that of peers and justify a moderate business position, despite its niche activity in the global private banking market.

We could revise the outlook to stable if the national implementation of an MREL framework and VP Bank's entity-specific buffers are not likely to result in a sufficient sustainable ALAC buffer to protect senior unsecured creditors.

We could also revise the outlook to stable if we saw fewer prospects for an improving business position, reflected, for example, in a lack of organic growth in assets under management.

Rationale

The 'A-' long-term rating on VP Bank is based on our 'a-' anchor for private banks in Liechtenstein and the bank's weak business position as a niche player in the global private banking business. The rating also takes into account our very strong capital and earnings assessment, which is based on our forecast of a risk-adjusted capital (RAC) ratio of around 21.0% by year-end 2018. In addition we assess the risk position as adequate, due to VP Bank's prudent risk management and sound risk metrics.

Furthermore, we also take into account the average funding and adequate liquidity assessment, mirroring its stable and granular deposit base. Based on these factors, we assess VP Bank's stand-alone credit profile (SACP) at 'a-'. Absent any extraordinary support this equates to the 'A-' long-term rating.

Anchor:'a-' for banks operating only in Liechtenstein

Under our bank criteria, we use the economic risk and industry risk scores from our Banking Industry Country Risk Assessment to determine a bank's anchor, the starting point in assigning an issuer credit rating to a bank. The anchor for a commercial bank operating only in Liechtenstein is 'a-', based on an economic risk score of '2' and an industry risk score of '3'.

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.

Economic risk for Liechtenstein's banks remains relatively low in a global comparison. Despite its small size, we view Liechtenstein as a very competitive and specialized economy. It has export-oriented industries holding niche positions worldwide and a specialized financial industry focused on wealth management. Liechtenstein's wealth levels are among the highest of any rated sovereign, and household debt remains average by European standards. Mirroring trends in neighboring countries such as Switzerland and Germany, house prices in Liechtenstein have risen moderately in recent years, but at present we see no credit-fueled asset-price bubbles. Owing to the predominance of private banking, lending is of minor importance. Furthermore, we expect credit losses in Liechtenstein's retail and corporate markets to remain low.

In our view, industry risk in Liechtenstein stems from business models focused on private banking and wealth management. While we consider that Liechtenstein banks' risk appetite are restrained and risk culture remains conservative, we think that the high confidence sensitivity of this business model exposes the financial industry to reputation risk. In our view, Liechtenstein's financial market has rapidly implemented international best practices and is at the forefront of international development in employing legitimate strategies. A strict regulatory framework supports Liechtenstein's overall aim of repositioning as a tax-compliant financial center. Systemwide funding benefits from sizable deposit bases, but remains vulnerable to the confidence sensitivity of wealth management activities.

Table 1

VP Bank AG Key Figures

	--Year ended Dec. 31--				
(Mil. CHF)	**2016**	**2015**	**2014**	**2013**	**2012**
Adjusted assets	11,742	12,303	11,166	11,154	10,586
Customer loans (gross)	5,311	5,068	4,308	3,968	3,765
Adjusted common equity	867	845	820	824	823
Operating revenues	273	257	223	239	242
Noninterest expenses	196	194	176	178	186
Core earnings	71	56	42	56	49

CHF--Swiss Franc.

Business position: Niche activity in private banking business limits business diversity

We consider VP Bank's business position to be weak, reflecting the bank's operations primarily in the niche segment of private banking and financial intermediaries, and that its organic growth continues to lag behind the private banking peers. Although it acts as a universal bank with retail and commercial lending activities in Liechtenstein and adjacent parts of Switzerland, it lacks business diversification, in our view.

With total assets of Swiss franc (CHF) 11.8 billion on Dec. 31, 2016 (€12.6 billion), VP Bank is the third-largest bank in Liechtenstein. We expect VP Bank will continue to focus on its core competencies in onshore private banking and intermediaries business in its target markets in Liechtenstein, Switzerland, Germany, Luxembourg, Russia, Ukraine, and Asia, as well as on commercial banking in Liechtenstein. In addition, we expect VP Bank to further grow and attract new money in its international funds business. This strategic focus will allow the bank to gradually raise efficiency and to improve its business stability, in our view. We expect that the bank will be able to attract new client assets in its core markets, but that it will remain a niche player in a global context, which limits our assessment of its business position.

VP Bank has taken several steps to strengthen its business profile and franchise over the past five years, including a new management team and strategic acquisitions. The acquisition of the private banking activities of HSBC Luxembourg and its private banking-related fund business in 2013, as well as Centrum Bank in Liechtenstein in 2015, have in our view strengthened the core operations and will continue to have positive synergy effects.

We expect VP Bank will be in a position to reach sustainable and profitable growth in terms of client assets, leading to improved business stability over the medium term. Positively, VP Bank is well supported by a stable and longstanding customer base. However, similar to other private banks, VP Bank's business stability will remain sensitive to overall market and client activity.

We believe VP Bank's medium-term targets--expanding its client assets under management to CHF50 billion, identifying synergies to achieve a lower cost base (target cost income ratio lower than 70%), and improved group net earnings (CHF80 million)--are challenging but achievable given potential further acquisitions in the bank's core markets. At year-end 2016, VP Bank managed client assets of CHF35.8 billion. In 2016 VP Bank achieved small but positive organic net new money inflow, after some years of mainly regulatory outflows.

We anticipate that it will be difficult for VP Bank to achieve a strong brand awareness similar to its mainly Liechtenstein- and Switzerland-based peers. Consequently, net new asset generation will continue to lag that of the larger private bank peers. In general, we believe the currently challenging conditions in the international wealth-management industry could stretch over a protracted period.

Table 2

VP Bank AG Business Position

	--Year ended Dec. 31--				
(%)	**2016**	**2015**	**2014**	**2013**	**2012**
Total revenues from business line (mil. CHF)	273	307	223	242	265
Commercial & retail banking/total revenues from business line	89.6	77.1	91.4	78.4	72.5
Other revenues/total revenues from business line	10.4	22.9	8.6	21.6	27.5
Return on equity	6.3	7.2	2.3	4.3	5.4

CHF--Swiss Franc.

Capital and earnings: Very strong capital position in an international comparison

We assess VP Bank's capital and earnings as very strong. The bank's capitalization remains its key rating strength, in our view, underpinned by S&P Global Ratings' projected RAC ratio of around 21.0% by year-end 2018, compared with 20.9% at year-end 2016.

Our forecast does not factor in any potential acquisitions. While we believe VP Bank could undertake an acquisition, we expect that it would not jeopardize its outstanding capitalization. In addition, we note that VP Bank would be able to use its treasury shares or to issue additional capital instruments to buffer any material capital effects from a larger acquisition. We nevertheless expect the quality of VP Bank's capital, currently consisting solely of core capital, to remain high.

VP Bank's revised strategy resulted in significant improvements in the bank's earnings capacity, underpinned by an expected three-year average earnings buffer of around 130 basis points (bps) in 2017, compared with 74 bps in 2014. The earnings buffer acts as a first line of defense and reflects the bank's ability to cover normalized (annual average through the cycle) losses, with annual preprovision earnings. Nevertheless, we expect VP Bank's revenues will remain sensitive to market perceptions, development of assets under management, client activity, and persisting low interest rates, similar to private bank peers. Despite a comparatively low number of discretionary wealth-management mandates, we expect VP Bank will maintain solid margins on its assets under management.

VP Bank's RAC ratio incorporates high market and operational risk-weighted assets (RWAs), a multiple of the regulatory RWAs, which reflects the bank's exposure to legal, operational, and reputational risks inherent to private banking. Consequently, VP Bank's RAC ratio of 20.9% as of year-end 2016 is significantly below the bank's regulatory Tier 1 capital ratio of 27.1% as of year-end 2016.

Table 3

VP Bank AG Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2016**	**2015**	**2014**	**2013**	**2012**
Tier 1 capital ratio	27.1	24.4	20.5	20.4	21.5
S&P RAC ratio before diversification	20.6	18.1	15.8	16.7	17.3
S&P RAC ratio after diversification	17.9	15.7	14.6	15.5	15.7
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	37.5	34.4	29.4	36.3	34.4
Fee income/operating revenues	43.5	49.3	53.2	47.7	47.5
Market-sensitive income/operating revenues	19.1	16.2	17.0	14.9	16.8
Noninterest expenses/operating revenues	71.8	75.5	79.1	74.5	76.9
Preprovision operating income/average assets	0.6	0.5	0.4	0.6	0.5
Core earnings/average managed assets	0.6	0.5	0.4	0.5	0.5

Table 4

VP Bank AG Risk-Adjusted Capital Framework Data

(CHF 000s)	**Exposure***	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global Ratings' RWA**	**Average S&P Global Ratings' RW (%)**
Credit risk					
Government and central banks	4,757,302	88,241	2	65,558	1
Institutions and CCPs	1,175,154	183,752	16	213,346	18
Corporate	2,511,484	582,018	23	880,807	35
Retail	4,498,573	1,550,637	34	958,868	21
Of which mortgage	3,384,748	1,450,310	43	803,616	24
Securitization§	0	0	0	0	0
Other assets†	234,634	181,839	77	243,322	104
Total credit risk	13,177,147	2,586,486	20	2,361,900	18
Credit valuation adjustment					
Total credit valuation adjustment	--	8,700	--	0	--
Market risk					
Equity in the banking book	67,384	67,384	100	506,602	751.8
Trading book market risk	--	218,042	--	327,063	--
Total market risk	--	285,426	--	833,665	--

Table 4

VP Bank AG Risk-Adjusted Capital Framework Data (cont.)

Operational risk					
Total operational risk	--	560,608	--	958,487	--
(CHF 000s)		**Basel III RWA**		**S&P Global Ratings' RWA**	**% of S&P Global Ratings' RWA**
Diversification adjustments					
RWA before diversification		3,441,220		4,154,053	100.0
Total Diversification/Concentration Adjustments		--		1,125,283	27.1
RWA after diversification		3,441,220		5,279,336	127.1
(CHF 000s)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings' RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		938,537	27.1	868,423	20.9
Capital ratio after adjustments‡		938,537	27.1	868,423	16.4

*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, 2016, S&P Global Ratings.

Risk position: Risk metrics and loan-loss experience in line with private bank peers

We consider VP Bank's risk position to be adequate, reflecting our view of its sound risk metrics and low loan-loss experience, which are in line with peers. We also believe that the operational and reputational risks inherent in VP Bank's business model are largely captured by our assessment of Liechtenstein's banking industry and our RAC model.

We believe the credit risk from VP Bank's mainly domestic loan portfolio--amounting to CHF5.3 billion on Dec. 31, 2016--will remain low. In our view, the loan book--in which we expect only limited growth--is highly collateralized and less sensitive to the economic cycle because the bank's Lombard loans are backed by securities and its real estate lending is conservatively managed and also well collateralized. The share of nonperforming assets roughly doubled to 0.85% as of Dec. 31, 2016, due to a single exposure, compared with 0.4% in 2015, but we expect an improved ratio next year. We also expect VP Bank will maintain prudent underwriting standards that will lead to stable asset quality and a low level of loan losses (5bps in 2016 and 12bps on average over the past five years).

We view positively that the bank has substantially reduced its interbank exposures to CHF660 million as of year-end 2016 (from CHF5.1 billion in 2011), maintaining limits predominantly with highly rated banks. Furthermore, we think that VP Bank is conservatively hedging its market and foreign exchange risks, which in the past has raised some concerns about the bank's ability to address such risks in its operations. On a combined basis, we expect our assessment for all capital, earnings, and risks will remain rating positive over the next 24 months.

As a private bank, VP Bank remains sensitive to operational and reputational risks. With regard to reputational risks, we already make a negative adjustment in our BICRA on Liechtenstein to reflect the potential threat to this small financial center and its banks, including VP Bank. Furthermore, we think that VP Bank is applying rigorous procedures and is continuously benchmarking internal processes to reduce such risk.

Table 5

VP Bank AG Risk Position

	--Year ended Dec. 31--				
(%)	**2016**	**2015**	**2014**	**2013**	**2012**
Growth in customer loans	4.8	17.6	8.6	5.4	(3.6)
Total diversification adjustment / S&P RWA before diversification	15.3	15.4	8.6	7.9	10.4
Total managed assets/adjusted common equity (x)	13.6	14.6	13.7	13.6	12.9
New loan loss provisions/average customer loans	0.1	0.2	0.1	0.1	0.2
Net charge-offs/average customer loans	0.0	0.0	0.1	0.3	0.2
Gross nonperforming assets/customer loans + other real estate owned	0.9	0.4	0.3	0.5	0.9
Loan loss reserves/gross nonperforming assets	137.8	309.6	357.5	193.7	152.0

Funding and liquidity: Funding profile benefits from stable and granular deposits

VP Bank's funding is average and its liquidity adequate, in our opinion.

VP Bank benefits from a granular, stable deposit base that accounted for about 93% of its funding base as of Dec. 31, 2016. This large deposit base has historically translated into a superior stable funding ratio of more than 200%, although the ratio decreased somewhat to 178% as of year-end 2016, partly due to reduced long-term capital market funding and increased short-term liabilities to banks. Despite this comparably high ratio, it is our view that private banks' customer deposits were more confidence-sensitive than those of retail banks in the past. In general, we envisage higher volatility of private banks' client deposits if capital market conditions improve and clients switch to other investments. Accordingly, we assess VP Bank's funding as average and, as such, in line with our assessment of systemwide funding in Liechtenstein.

VP Bank holds CHF3.5 billion of its excess deposits at the central bank and has a securities portfolio of CHF2.1 billion, largely comprising generally highly liquid assets. This is further indicated by our liquidity ratio (broad liquid assets to short-term wholesale funding), which stood at 12.6x at year-end 2016. Although VP Bank's liquidity ratios are outstanding in a global comparison, we consider liquidity to be generally neutral to the ratings on private banks. In our view, private banks' liquidity depends strongly on clients' investment decisions, since a sudden shrinkage in client deposits could prompt a drop in liquid assets. Unlike retail and commercial banks, private banks don't generate their main business on balance sheet. Therefore, we consider liquidity to be a neutral factor to the ratings on VP Bank.

Table 6

VP Bank AG Funding And Liquidity

	--Year ended Dec. 31--				
(%)	**2016**	**2015**	**2014**	**2013**	**2012**
Core deposits/funding base	92.7	94.1	93.1	93.4	91.0
Customer loans (net)/customer deposits	53.3	47.5	45.1	41.8	42.7
Long term funding ratio	96.2	98.6	96.7	97.0	95.7
Stable funding ratio	178.4	197.7	208.6	228.0	226.8
Short-term wholesale funding/funding base	4.1	1.5	3.5	3.2	4.7
Broad liquid assets/short-term wholesale funding (x)	12.6	36.2	16.9	20.0	13.7
Net broad liquid assets/short-term customer deposits	51.6	58.3	60.0	65.5	65.6

Table 6

VP Bank AG Funding And Liquidity (cont.)					
	--Year ended Dec. 31--				
(%)	**2016**	**2015**	**2014**	**2013**	**2012**
Short-term wholesale funding/total wholesale funding	55.9	25.9	51.2	48.5	52.2
Narrow liquid assets/3-month wholesale funding (x)	17.4	46.3	13.2	17.0	13.4

Support:No notches of uplift for ALAC

VP Bank is the third-largest bank in Liechtenstein, and we assess its systemic importance as moderate.

However, we consider the likelihood of extraordinary government support for banks in Liechtenstein to be uncertain, and we therefore no longer include uplift for such support in our ratings on systemic banks. This is because the Principality of Liechtenstein implemented the recovery and resolution act (Sanierungs- und Abwicklungsgesetz) into national law effective on Jan. 1, 2017. It provides the authorities with bail-in powers over domestic banks and leads us to believe that prospects for extraordinary government support, before any burden-sharing by senior unsecured creditors, now appears uncertain, even for systemically important banks.

We also consider the country's bank resolution framework to be effective, which generally allows us to include uplift for additional loss-absorbing capacity (ALAC) in our ratings on individual systemically important banks. However there is no communication by the regulator yet on eligible bail-in capital instruments and minimum buffers.

We note that VP Bank already has total adjusted capital of 5.7% beyond the minimum threshold for our very strong capital and earnings score, and could thus qualify for a one-notch uplift for ALAC. However, we currently don't think this level of excess capital is sustainable, as VP Bank could use it for further acquisitions or increased shareholder distributions.

Additional rating factors: None

No other factors affect this rating.

Related Criteria

- 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: 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: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- The Resolution Story For Europe's Banks: A Job Not Yet Half Done, So Plenty More Work To Come; April 5, 2017
- Liechtenstein-Based LGT Bank And VP Bank Ratings Affirmed After Review Of Government Support; LGT Off Watch; March 2, 2017
- Banking Industry Country Risk Assessment: Liechtenstein, Dec. 6, 2016
- VP Bank; Aug. 12, 2016
- Research Update: Ratings On The Principality of Liechtenstein Affirmed At 'AAA/A-1+'; Outlook Stable; July 28, 2016
- VP Bank Outlook Revised To Stable On Expected Improvement In Combined Capital And Risk Position; 'A-/A-2' Rtgs Affirmed, July 25, 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 August 21, 2017)	
VP Bank AG	
Counterparty Credit Rating	A-/Positive/A-2
Senior Unsecured	A-
Counterparty Credit Ratings History	
02-Mar-2017	A-/Positive/A-2
25-Jul-2016	A-/Stable/A-2
29-Apr-2014	A-/Negative/A-2
03-Sep-2013	A-/Stable/A-2
22-Aug-2012	A-/Negative/A-2
Sovereign Rating	
Liechtenstein (Principality of)	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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