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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	Moderate	-1
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/Stable/A-1

Resolution Counterparty Rating
A+/--/A-1

Major Rating Factors

Strengths:	Weaknesses:
• Favorable financial profile with 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. • Net new money generation lags that of larger peers. • Inherent legal and reputational risk due to private banking model.

Outlook: Stable

The stable outlook on VP Bank AG reflects S&P Global Ratings' view that the bank will further invest in its current franchise, supporting net new money growth and sound financial performance.

We consider a positive rating action as remote currently. We could consider a positive rating action if we believed that VP Bank had built a buffer of bail-in-able capital that protects senior unsecured creditors should the bank become nonviable. The size and sustainability of the future additional loss-absorbing capital (ALAC) buffer will depend on the introduction of local minimum requirement for own funds and eligible liabilities (MREL). We expect to have more clarity on the local MREL framework within the next 24 months.

A downgrade could occur if we concluded that the bank's business position was weakening, reflected, for example, in a lack of organic growth in assets under management (AUM) or in deteriorating profitability. Although remote, a sizable acquisition could constrain the rating should it result in the material consumption of the capital buffer, as reflected by our risk-adjusted capital (RAC) ratio dropping below 15%.

Rationale

The 'A-' long-term rating on VP Bank is based on our 'a-' anchor for private banks in Liechtenstein and the bank's moderate 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 RAC ratio of around 21% by end-2020. 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-'. Since we do not factor in any extraordinary support, the long-term rating is 'A-'.

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

We 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 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 is 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)	**2017**	**2016**	**2015**	**2014**	**2013**
Adjusted assets	12,723.6	11,742.3	12,303.4	11,166.3	11,153.6
Customer loans (gross)	5,713.1	5,311.0	5,067.9	4,308.1	3,968.3

Table 1

VP Bank AG Key Figures (cont.)

	--Year-ended Dec. 31--				
(Mil. CHF)	**2017**	**2016**	**2015**	**2014**	**2013**
Adjusted common equity	917.7	866.9	844.5	820.0	823.9
Operating revenues	300.1	273.2	256.6	222.7	239.4
Noninterest expenses	201.2	196.3	193.8	176.1	178.4
Core earnings	90.0	71.1	56.3	42.0	56.3

CHF--Swiss franc.

Business position: Niche activity in private banking business limits diversity

We consider VP Bank's business position to be moderate, reflecting its niche activity in private banking and financial intermediaries business, while also acknowledging its proven business stability.

Over 2017, VP Bank recorded net assets inflows of Swiss franc (CHF) 1.9 billion (approximately €1.6 billion), thus reversing the trend of net assets outflows over the previous five years. We assume most of these outflows stemmed from the increasing global tax transparency and Liechtenstein's commitment to international cooperation. We expect VP Bank will grow its AUM both organically and through acquisitions, while strengthening its position as a specialized player in the global private banking sector. We expect sustainable organic net new money growth of CHF1 billion-CHF2 billion annually in 2018-2019.

At the same time, we expect VP Bank to maintain sound profitability metrics while continuing to invest in its IT infrastructure and additional client advisors. Despite net asset outflows and margin pressure, VP Bank has consistently grown its operating revenues over the past five years, mainly on the back of the higher AUM base thanks to mergers and acquisitions and the favorable market environment. Furthermore, interest income increased markedly through the expansion in Lombard lending and domestic retail lending. Successful efforts to contain operational costs improved its cost-to-income ratio to 67% in 2017 from a high of 79% in 2014, which is now more in line with its peers.

Although VP Bank acts as a universal bank with retail and commercial lending activities in Liechtenstein and adjacent parts of Switzerland, it lacks business diversification and scale compared with its commercial and private banking peers, in our view.

With total assets of CHF12.8 billion on Dec. 31, 2017, VP Bank is the third-largest bank in Liechtenstein. We expect VP Bank will continue to focus on its core competencies in private banking and intermediaries business in its target markets in Liechtenstein, Switzerland, Germany, Luxembourg, Russia, Ukraine, and select Asian countries, as well as on retail and commercial banking in Liechtenstein. This will facilitate gradual improvements in efficiency and its business stability, in our view. Although we expect the bank will attract new clients in its core markets, it will remain a niche player in a global context. This somewhat weighs on our assessment of its business position despite the recent improvements.

In our view, VP Bank successfully executed its strategic decisions, including the acquisitions of HSBC Luxembourg's private banking activities and related fund business in 2013 and Centrum Bank in Liechtenstein in 2015. This enhanced the bank's core operations and contributed positive synergy effects. Also, the focus on its defined client segments and its intermediary business, as well as specifying target markets, contributed to an improved operational performance.

We expect VP Bank to be in a position to continue its profitable growth, supported by new customer generation. However, similar to other private banks, VP Bank's business stability will remain sensitive to overall market environment and client activity.

We believe VP Bank's medium-term targets--expanding its client AUM 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. 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, we think that the absolute volume of managed assets and net new money generation will continue to lag that of larger private bank peers.

Table 2

VP Bank AG Business Position

	--Year-ended Dec. 31--				
(%)	**2017**	**2016**	**2015**	**2014**	**2013**
Total revenues from business line (mil. CHF)	300.1	273.2	306.6	222.7	242.4
Commercial & retail banking/total revenues from business line	87.6	89.6	77.1	91.4	78.4
Other revenues/total revenues from business line	12.4	10.4	22.9	8.6	21.6
Return on average equity	6.8	6.3	7.2	2.3	4.3

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 21.5%-22.0% by year-end 2020, versus 21.2% at year-end 2017.

Our RAC forecast does not factor in any potential acquisitions. We believe VP Bank could undertake an acquisition of AUMs between CHF10 billion and CHF20 billion, without jeopardizing 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.

VP Bank's revised strategy resulted in meaningful improvements in the bank's earnings capacity, underpinned by an expected three-year average earnings buffer of around 185 basis points (bps) in 2019, compared with 74 bps in 2014.

The earnings buffer acts as a first line of defense and reflects our view on 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 AUM.

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 21.2% is significantly below the bank's regulatory Tier 1 capital ratio of 25.7% as of year-end 2017.

Table 3

VP Bank AG Capital And Earnings

	--Year-ended Dec. 31--				
(%)	**2017**	**2016**	**2015**	**2014**	**2013**
Tier 1 capital ratio	25.7	27.1	24.4	20.5	20.4
S&P RAC ratio before diversification	21.2	20.6	18.1	15.8	16.7
S&P RAC ratio after diversification	18.4	17.9	15.7	14.6	15.5
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	34.8	37.5	34.4	29.4	36.3
Fee income/operating revenues	41.3	43.5	49.3	53.2	47.7
Market-sensitive income/operating revenues	23.1	19.1	16.2	17.0	14.9
Noninterest expenses/operating revenues	67.0	71.8	75.5	79.1	74.5
Preprovision operating income/average assets	0.8	0.6	0.5	0.4	0.6
Core earnings/average managed assets	0.7	0.6	0.5	0.4	0.5

RAC--Risk-adjusted capital.

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	4,824,332	118,090	2	69,303	1
Of which regional governments and local authorities	125,508	25,973	21	4,576	4
Institutions and CCPs	1,284,652	191,527	15	233,845	18
Corporate	3,241,098	842,419	26	1,234,597	38
Retail	4,706,050	1,575,416	33	1,067,654	23
Of which mortgage	3,341,675	1,432,883	43	796,253	24
Securitization§	0	0	0	0	0
Other assets†	274,078	185,561	68	331,209	121
Total credit risk	14,455,718	2,913,013	20	2,936,609	20
Credit valuation adjustment					
Total credit valuation adjustment	--	6,241	--	0	--
Market risk					
Equity in the banking book	59,978	59,978	100	439,309	732
Trading book market risk	--	199,708	--	299,562	--
Total market risk	--	259,686	--	738,871	--
Operational risk					
Total operational risk	--	608,905	--	661,410	--

Table 4

VP Bank AG Risk-Adjusted Capital Framework Data (cont.)					
(CHF 000s)		**Basel III RWA**		**S&P Global Ratings' RWA**	**% of S&P Global Ratings' RWA**
Diversification adjustments					
RWA before diversification	--	3,799,412	--	4,336,890	100
Total Diversification/Concentration Adjustments	--	--	--	643,638	15
RWA after diversification	--	3,799,412	--	4,980,528	115
(CHF 000s)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings' RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments	--	976,553	25.7	917,740	21.2
Capital ratio after adjustments‡	--	976,553	25.7	917,740	18.4

*Exposure at default. §Securitization exposure includes the securitization 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 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 CHF5.7 billion on Dec. 31, 2017) 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 well collateralized.

The share of nonperforming assets is around 1% as of Dec. 31, 2017, but we expect limited losses due to strong collateralization. We also expect VP Bank will maintain prudent underwriting standards that will lead to stable asset quality and a low level of loan losses (8bps in 2017 and 10bps on average over the past five years).

We view positively that the bank has substantially reduced its interbank exposures to CHF893 million as of year-end 2017 (from CHF5.1 billion in 2011), maintaining limits predominantly with highly rated banks. Furthermore, we understand that VP Bank is conservatively hedging its market and foreign exchange risks, which in the past raised concerns about the bank's ability to address such risks in its operations. On a combined basis, we expect our assessment for 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--				
(%)	**2017**	**2016**	**2015**	**2014**	**2013**
Growth in customer loans	7.6	4.8	17.6	8.6	5.4
Total diversification adjustment / S&P RWA before diversification	14.8	15.3	15.4	8.6	7.9
Total managed assets/adjusted common equity (x)	13.9	13.6	14.6	13.7	13.6
New loan loss provisions/average customer loans	0.1	0.1	0.2	0.1	0.1
Net charge-offs/average customer loans	0.0	0.0	0.0	0.1	0.3
Gross nonperforming assets/customer loans + other real estate owned	1.0	0.9	0.4	0.3	0.5
Loan loss reserves/gross nonperforming assets	109.6	137.8	309.6	357.5	193.7

RWA--Risk-weighted assets.

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 91% of its funding base as of Dec. 31, 2017. This large deposit base has historically translated into a superior stable funding ratio of more than 200%, although the ratio decreased somewhat to 173% as of year-end 2017, partly due to reduced long-term capital market funding and increased short-term liabilities to banks. We believe that private banks' customer deposits are more confidence-sensitive than those of retail banks. We envisage higher volatility in customer deposits of private banks, since we observe less granularity, volumes often in excess of deposits insurance limits, and that large parts are cash positions within the customers' asset allocations. Accordingly, we assess VP Bank's funding as average and in line with private bank peers that generally exhibit high funding and liquidity ratios.

VP Bank holds CHF3.6 billion of its excess deposits at the central bank and has a securities portfolio of CHF2.4 billion, largely comprising generally highly liquid assets. This is further indicated by the ratio of broad liquid assets to short-term wholesale funding, which stood at 9.5x at year-end 2017. 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 the balance sheet, which is largely liability driven. Therefore, we think that a need for a higher liquidity buffer is a requisite of the business model and 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--				
(%)	**2017**	**2016**	**2015**	**2014**	**2013**
Core deposits/funding base	91.3	92.7	94.1	93.1	93.4
Customer loans (net)/customer deposits	53.5	53.3	47.5	45.1	41.8
Long term funding ratio	95.1	96.2	98.6	96.7	97.0
Stable funding ratio	172.9	175.9	195.2	203.7	223.6

Table 6

VP Bank AG Funding And Liquidity (cont.)

	--Year-ended Dec. 31--				
(%)	**2017**	**2016**	**2015**	**2014**	**2013**
Short-term wholesale funding/funding base	5.3	4.1	1.5	3.5	3.2
Broad liquid assets/short-term wholesale funding (x)	9.5	12.4	35.8	16.5	19.8
Net broad liquid assets/short-term customer deposits	49.5	50.7	57.5	58.7	64.5
Short-term wholesale funding/total wholesale funding	61.2	55.9	25.9	51.2	48.5
Narrow liquid assets/3-month wholesale funding (x)	10.3	17.1	45.6	12.8	16.5

Support: No external support

VP Bank is the third-largest bank in Liechtenstein, and we assess its systemic importance as moderate, based on its scale and interconnectedness with the domestic economy.

However, since the beginning of 2017, 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 Liechtenstein implemented the European Union Bank Recovery and Resolution Directive (BRRD) into national law effective on Jan. 1, 2017. The recovery and resolution act (Sanierungs- und Abwicklungsgesetz) 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 appear uncertain, even for systemically important banks, such as VP Bank.

We do not rule out the possibility that systemically important banks in Liechtenstein might receive extraordinary government support, but we now see the predictability of such support as materially reduced. That said, if such a bank experienced financial difficulties and we saw clear evidence that government support would be forthcoming, we could still reflect this "additional short-term support" in our ratings on individual banks.

We also consider the country's bank resolution framework to be effective, which generally allows us to include uplift for ALAC in our ratings on individual systemically important banks. We expect to have more clarity on the local framework and bank-specific buffers for MREL within the next two years.

We note that VP Bank already has TAC of 6.2% 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.

Resolution Counterparty Ratings (RCR)

We have assigned a Resolution Counterparty Rating (RCR) to VP Bank since we assess the resolution regime in Liechtenstein to be effective and the bank as likely to be subject to a bail-in led resolution if it reaches nonviability. The RCR is a forward-looking opinion of the relative default risk of certain senior liabilities that may be protected from default through an effective bail-in resolution process for the issuing financial institution. We position the long-term

RCR up to one notch above the long-term issuer credit rating (ICR) when the ICR ranges from 'BBB-' to 'A+'.

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: 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

- Resolution Counterparty Ratings Jurisdiction Assessment For Liechtenstein Completed, June 29, 2018
- 24 European Banking Groups Assigned Resolution Counterparty Ratings, June 29, 2018
- Research Update: Liechtenstein 'AAA/A-1+' Ratings Affirmed; Outlook Stable, June 1, 2018
- Rating Actions Taken On Liechtenstein-Based LGT Bank And VP Bank On Stronger Business Positions, May 17, 2018
- Ask No Secrets: Europe's Private Banks Learn How To Live A New Normal, May 18, 2018
- Banking Industry Country Risk Assessment: Liechtenstein, Feb. 8, 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 August 9, 2018)

VP Bank AG	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Senior Unsecured	A
Issuer Credit Ratings History	
17-May-2018	A/Stable/A-1
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
Sovereign Rating	
Liechtenstein	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.