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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 a stable customer deposit base.	• Modest-sized player in a competitive niche private-banking 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. The outlook refers to the timeframe of two years.

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 a 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 takes into account the favorable economic and industry conditions for the Liechtenstein banking system, which benefits from close ties to the EU in terms of trade and regulation.

The bank is the third-largest institution in Liechtenstein and engages in global private banking as a niche player. Outstanding capitalization and prudent risk management support its stability. VP Bank's funding profile reflects its liability-driven balance sheet management and benefits from an excess of private-banking deposits.

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 and concentration, Liechtenstein is a competitive and specialized economy, in our view. 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. At present, however, we see no credit-fueled asset-price bubbles. Furthermore, we expect credit losses in Liechtenstein's retail and corporate banking will remain low in 2019-2020.

In our view, industry risk stems from a business model focused on private banking and wealth management. Although we consider Liechtenstein banks' risk appetite restrained and its risk culture remains conservative, we think that the high confidence sensitivity of the business model exposes the financial industry to reputational risk. Nevertheless, we acknowledge that Liechtenstein has rapidly implemented international best practices on tax compliance and information exchange, which has somewhat reduced reputational risks in recent years. In addition, the financial supervisory authority implements banking regulation and supervision in line with EU standards. Owing to local banks' access to ample customer deposits and focus on private banking, we continue to view funding as a neutral factor for Liechtenstein's banking sector.

Table 1

VP Bank AG Key Figures

	--Year-ended Dec. 31--					
(Mil. CHF)	**2019***	**2018**	**2017**	**2016**	**2015**	**2014**
Adjusted assets	13,044.5	12,376.7	12,723.6	11,742.3	12,303.4	11,166.3
Customer loans (gross)	6,659.1	6,240.4	5,713.1	5,311.0	5,067.9	4,308.1
Adjusted common equity	921.6	913.7	913.7	866.9	844.5	820.0
Operating revenue	162.7	290.8	300.1	273.2	256.6	222.7

Table 1

VP Bank AG Key Figures (cont.)

	--Year-ended Dec. 31--					
(Mil. CHF)	2019*	2018	2017	2016	2015	2014
Noninterest expenses	119.0	229.5	201.2	196.3	193.8	176.1
Core earnings	42.3	70.5	90.0	71.1	56.3	42.0

CHF--Swiss franc. *As of June 30.

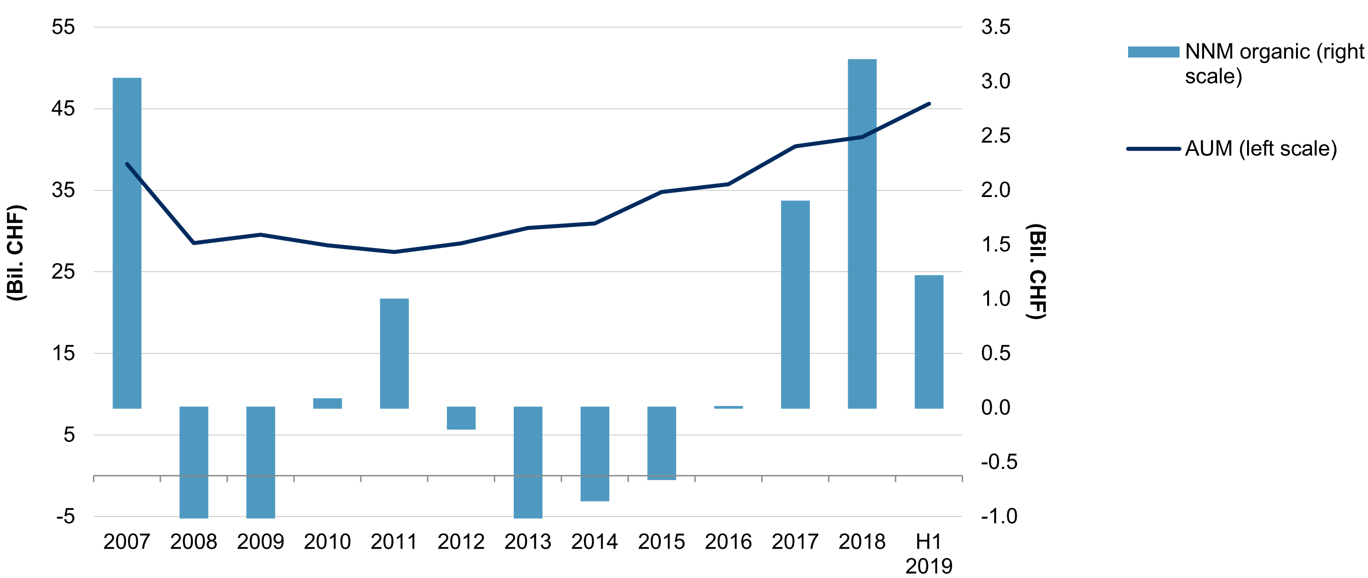
Business position: Niche activity in private banking limits diversity

We consider VP Bank's business position to be weaker than that of larger and more diversified peers, mainly from neighboring Switzerland. This reflects its niche activity in private banking and the financial intermediaries business. At the same time, we also acknowledge its proven business stability and track record.

As of 2018, VP Bank had total AUM of Swiss franc (CHF) 41.5 billion (about €36.8 billion) and recorded net asset inflows of CHF3.2 billion (CHF1.9 billion in 2017), after several years of outflows before 2016. The positive trend of net asset inflows continued over first-half 2019, with organic net new money of CHF1.2 billion and total AUM of CHF45.6 billion. We expect VP Bank will continue to record net new money inflows, while strengthening its position as a niche player in the global private-banking sector. We expect organic net new money growth of CHF2 billion-CHF3 billion annually over 2019 and 2020.

Chart 1

VP Bank AG: Organic NNM Growth After Years Of Outflows



AuM--Assets under management. NNM--New net money. Source: S&P Global Ratings.

At the same time, we expect VP Bank will maintain sound profitability metrics, while continuing to invest in its information technology infrastructure and additional client advisors. This should help the bank reach its 2020 goals of expanding AUM to CHF50 billion, identifying synergies to achieve a lower cost base (target cost income ratio lower than 70%), and improving group net earnings (CHF80 million). That said, we believe these targets can only eventually be achieved with additional acquisitions to gain size and efficiency. VP Bank will appoint a new CEO in October 2019, and we expect that the communication of updated strategic goals will follow.

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 CHF13.1 billion on June 30, 2019, 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 its intermediaries business in its target markets of Liechtenstein, Switzerland, Germany, Luxembourg, Sweden, Denmark, Norway, Russia, Ukraine, and select Asian countries, as well as on retail and commercial banking in Liechtenstein. This will allow the bank to gradually improve efficiency and strengthen 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. 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, the absolute volume of managed assets and net new money generation will continue to lag that of larger private bank peers.

The bank continues to expand through acquisitions to further its medium-term objectives, which recently included the acquisition of Luxembourg private-banking activities of Swedish Catella Bank and Luxembourg-based Carnegie Fund Solutions. Although minor in size, these deals are in line with VP Bank's strategy to achieve growth through acquisitions and play an active role in the consolidation of the private-banking market. We expect VP Bank to be in a position to continue its profitable growth. However, similar to other private banks, VP Bank's business stability will remain sensitive to the overall market environment and client activity.

Table 2

VP Bank AG Business Position

	--Year-ended Dec. 31--					
(%)	**2019***	**2018**	**2017**	**2016**	**2015**	**2014**
Total revenue from business line (mil. CHF)	162.7	290.8	300.1	273.2	306.6	222.7
Commercial & retail banking/total revenue from business line	89.6	95.9	87.6	89.6	77.1	91.4
Other revenue/total revenue from business line	10.4	4.1	12.4	10.4	22.9	8.6
Return on average common equity	7.2	5.6	6.8	6.3	7.2	2.3

CHF--Swiss franc. *As of June 30.

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

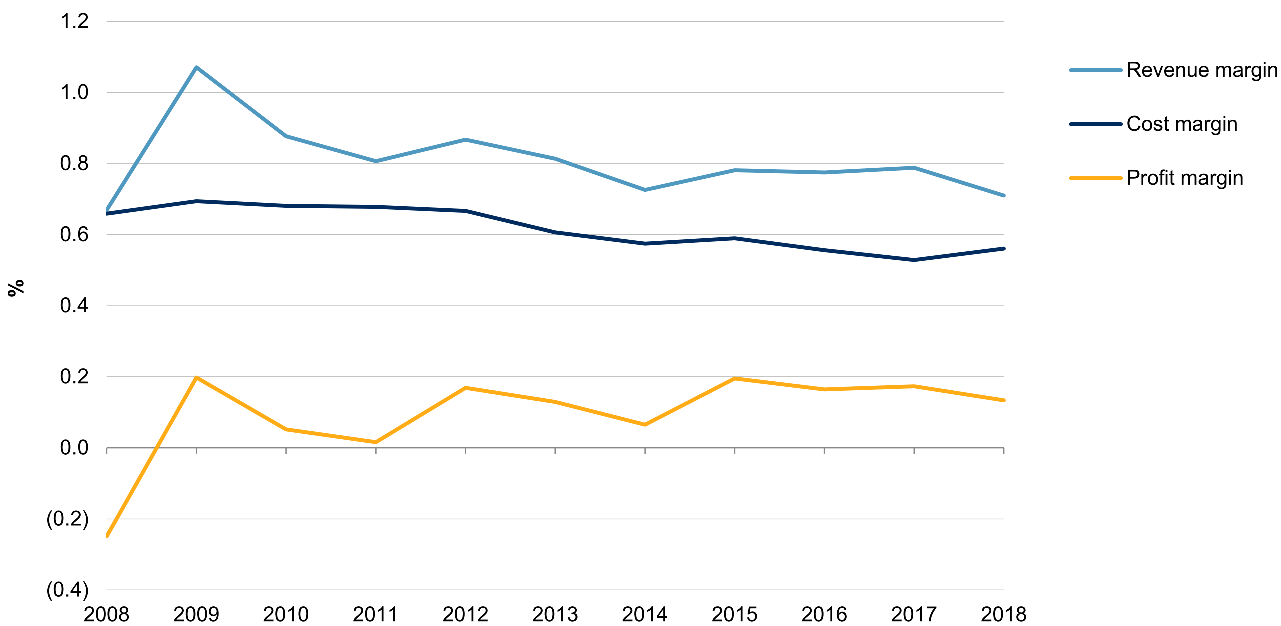
We assess VP Bank's capital and earnings as very strong. The bank's capitalization remains its key rating strength, in our view, underpinned by our projected RAC ratio of 15.5%-16.5% by year-end 2021, compared with 16.8% at year-end 2018. Strong loan growth and the stock-repurchase program over 2018 resulted in a drop from 2017 levels of 21.1%. We note that VP Bank's RAC ratio of 16.8% at year-end 2018 is significantly below the bank's regulatory Tier 1 capital ratio of 20.9% for the same period (19.7% as of June 2019). This reflects our more conservative risk weights compared with the regulatory approach, especially on market and operational risk.

Our forecast does not factor in any potential acquisitions. Although 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 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.

We expect VP Bank's revenue will remain sensitive to market perceptions, development of AUM, 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. Nevertheless, we don't expect the pressure on margins, relative to AUM, to level off in the coming years.

Chart 2

VP Bank AG: Continuing Pressure On Margins Is Unlikely To Reverse



Source: Company financials, S&P Global Ratings. Revenue margin is defined as operating revenue to average assets under management (AUM). Cost margin is defined as noninterest expenses to average AUM. Profit margin preprovision is defined as operating income to average AUM.

Table 3

VP Bank AG Capital And Earnings

		--Year-ended Dec. 31--				
(%)	**2019***	**2018**	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	19.7	20.9	25.7	27.1	24.4	20.5
S&P Global Ratings' RAC ratio before diversification	N/A	16.8	21.1	20.6	18.1	15.8
S&P Global Ratings' RAC ratio after diversification	N/A	14.6	18.3	17.9	15.7	14.6
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenue	34.3	38.9	34.8	37.5	34.4	29.4
Fee income/operating revenue	41.2	42.7	41.3	43.5	49.3	53.2
Market-sensitive income/operating revenue	21.0	15.9	23.1	19.1	16.2	17.0
Noninterest expenses/operating revenue	73.1	78.9	67.0	71.8	75.5	79.1
Preprovision operating income/average assets	0.7	0.5	0.8	0.6	0.5	0.4
Core earnings/average managed assets	0.7	0.6	0.7	0.6	0.5	0.4

RAC--Risk-adjusted capitalization. N/A--Not available. *As of June 30.

Table 4

VP Bank AG Risk-Adjusted Capital Framework Data

(CHF 000s)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global RWA**	**Average S&P Global RW (%)**
Credit risk					
Government & central banks	6,231,111	125,934	2	151,783	2
Of which regional governments and local authorities	127,991	28,851	23	4,713	4
Institutions and CCPs	1,177,456	211,604	18	206,192	18
Corporate	4,309,125	1,447,977	34	1,895,370	44
Retail	5,558,339	1,679,748	30	1,353,747	24
Of which mortgage	3,396,888	1,419,902	42	829,831	24
Securitization§	0	0	0	0	0
Other assets†	228,505	176,018	77	285,883	125
Total credit risk	17,504,535	3,641,281	21	3,892,974	22
Credit valuation adjustment					
Total credit valuation adjustment	--	9,275	--	0	--
Market risk					
Equity in the banking book	92,379	92,378	100	649,265	703
Trading book market risk	--	214,538	--	321,806	--
Total market risk	--	306,915	--	971,071	--
Operational risk					
Total operational risk	--	539,200	--	590,533	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification	--	4,510,319	--	5,454,579	100

Table 4

VP Bank AG Risk-Adjusted Capital Framework Data (cont.)					
Total diversification/ concentration adjustments	--	--	--	817,840	15
RWA after diversification	--	4,510,319	--	6,272,419	115
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		942,783	20.9	913,740	16.8
Capital ratio after adjustments‡		942,783	20.9	913,740	14.6

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' 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 2018', S&P Global Ratings.

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

VP Bank's risk metrics and its loan-loss experience are sound and 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 CHF6.7 billion on June 30, 2019--will remain low. In our view, the loan book 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 is about 0.4% as of June 2019, and we continue to expect limited credit 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---22 basis points (bps) in 2018 and +10 bps on average over the past five years. We expect the cost of risk to remain very low in line with previous years, while the first six months of 2019 again resulted in a reversal of credit loss provisions.

We view positively that the bank has substantially reduced its interbank exposures to CHF771 million as of year-end 2018 (down from CHF893 million in 2017 and 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, following past 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 supportive of the current rating 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 financial crime and related reputational risks.

Table 5

VP Bank AG Risk Position

	--Year-ended Dec. 31--					
(%)	**2019***	**2018**	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	13.4	9.2	7.6	4.8	17.6	8.6
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	15.0	14.8	15.3	15.4	8.6
Total managed assets/adjusted common equity (x)	14.2	13.6	14.0	13.6	14.6	13.7
New loan loss provisions/average customer loans	(0.1)	(0.2)	0.1	0.1	0.2	0.1
Net charge-offs/average customer loans	N.M.	0.1	0.0	0.0	0.0	0.1
Gross nonperforming assets/customer loans + other real estate owned	0.4	0.4	1.0	0.9	0.4	0.3
Loan loss reserves/gross nonperforming assets	N/A	169.3	109.6	137.8	309.6	357.5

RWA--Risk-weighted assets. *As of June 20. N/A--Not available.

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

The balance sheet is largely driven by its private-banking deposit base and the use of Lombard loans by clients, with excess deposits invested in money market and fixed-income instruments. Unlike retail and commercial banks, private banks don't generate their main business on balance sheet. VP Bank benefits from a granular, stable deposit base that accounted for about 93% of its funding base as of June 2019. This large deposit base has historically translated into a superior stable funding ratio of more than 200%, although the ratio decreased somewhat to 150% as of first-half 2019, 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 are generally more confidence-sensitive than those of retail banks, as shown in the past. 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 CHF3.4 billion of its excess deposits in cash and money market instruments and has a securities portfolio of CHF2.7 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 9.1x at first-half 2019. 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.

Table 6

VP Bank AG Funding And Liquidity

	--Year-ended Dec. 31--					
(%)	**2019***	**2018**	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	92.6	92.2	91.3	92.7	94.1	93.1
Customer loans (net)/customer deposits	60.7	60.0	53.5	53.3	47.5	45.1
Long-term funding ratio	95.8	95.7	95.1	96.2	98.6	96.7
Stable funding ratio	150.5	153.0	172.8	175.9	195.2	203.7
Short-term wholesale funding/funding base	4.5	4.7	5.3	4.1	1.5	3.5
Broad liquid assets/short-term wholesale funding (x)	9.1	9.1	9.5	12.4	35.8	16.5
Net broad liquid assets/short-term customer deposits	39.5	41.0	49.5	50.7	57.5	58.7

Table 6

VP Bank AG Funding And Liquidity (cont.)

	--Year-ended Dec. 31--					
(%)	**2019***	**2018**	**2017**	**2016**	**2015**	**2014**
Short-term wholesale funding/total wholesale funding	60.7	59.9	61.2	55.9	25.9	51.2
Narrow liquid assets/3-month wholesale funding (x)	11.9	11.9	10.3	17.1	45.6	12.8

*As of June 30.

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 EU 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.

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.

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

- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- 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

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 27, 2019)*

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
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.

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