

Research Update:

Liechtenstein-Based VP Bank Affirmed At 'A/A-1'; Outlook Remains Negative Amid Tightening Economic Environment

July 20, 2022

Overview

- In our view, VP Bank has successfully strengthened its risk-management systems and governance, after a large single-loss event in 2020 amid high market volatility during the pandemic.
- However, we believe VP Bank will face increasing difficulties reaching its ambitious financial targets under its strategy that aims to transform the bank toward an open wealth-management platform. This reflects challenging market conditions on top of structural margin pressures in the private banking industry where VP Bank lacks scale.
- Therefore, we affirmed our 'A/A-1' ratings on VP Bank with a negative outlook.
- The negative outlook is now linked to the uncertainty around the bank's successful transformation and profitability improvement.

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Rating Action

On July 20, 2022, S&P Global Ratings affirmed its 'A/A-1' long-term and short-term issuer credit ratings on VP Bank. The outlook remains negative.

At the same time, we affirmed the issue ratings on VP Bank's senior unsecured note at 'A' and on the senior subordinated note at 'A-1'.

We also affirmed our 'A+/A-1' long- and short-term resolution counterparty ratings on the bank.

Rationale

The rating action reflects that we remain uncertain of VP Bank's ability to deliver on the ambitious targets under its revised strategy in a tightening economic environment. The bank set ambitious goals, including achieving net profits of Swiss franc (CHF) 100 million by end-2026, compared with CHF51 million in 2021. With Strategy 2026, VP Bank targets the transition toward an open wealth-management provider, leveraging its sound market position within intermediaries. This is uncharted territory for VP Bank's management team, and we believe successful execution could become increasingly challenging given the tightening economic environment characterized by inflationary pressures, weaker growth, lower asset prices, worsening customer sentiment, and sanctions. Russia used to be a target market for VP Bank and over the past 10 years about 10% of its net new money came from Eastern Europe, presumably most of it from Russia. We believe that VP Bank might have to unwind some existing business with Russian clients on the back of sanctions. While we do not expect the impact on VP Bank to be material, assets under management as well as fee income could take a moderate hit. We further note that VP Bank holds a niche position in global wealth management, an industry that is facing various structural headwinds, such as continuous pressure on margins and high competition. While the strategic transitioning toward becoming an open wealth-management provider will help VP Bank generate additional fees, it also exposes the bank to disintermediation risk. Net new money inflow amounted to CHF0.3 billion in 2021, materially down from CHF1.4 billion in 2020 due to the announced strategic repositioning of an institutional fund client. In our base case, we assume that VP Bank will continue to attract net new money and increase fee income from its private banking activities, albeit potentially at lower levels than previously.

At the same time, we note that VP Bank has eliminated structural risk management and governance deficits. We believe VP Bank has largely eliminated its deficiencies in risk management and governance that contributed to a CHF20 million single loss within its Lombard book, which we perceived as granular and low risk amid capital market disruptions in 2020. The bank's credit risk management as well as compliance framework are now materially stronger than in the past. Specifically, the bank now has in place an appropriate and regular stress testing of the Lombard portfolio and a clear differentiation between the first and second line of defense in risk management, in line with industry standards, which we consider important. We further note that the loss event triggered severe management and organizational changes. Over the past two years, the new management team has built a successful track record and we believe that the bank's solid management of the recent market turmoil is a testimony to its improved governance and organizational standards. All those elements are crucial, in our view, to prevent future loss events of a similar magnitude.

VP Bank's very strong capitalization remains its main rating strength. Our 'A' long-term issuer credit ratings on VP Bank continues to be materially supported by the bank's very strong capitalization and very solid funding position. That said, the bank's relatively small scale and niche position in the global private banking market remain the main rating constraints.

We maintain a cautious stance toward VP Bank's future buffer of bail-in-able instruments. Currently, we do not assign any rating uplift for additional loss-absorbing capacity that would protect senior unsecured creditors in the event of a resolution. The bank so far has issued only one instrument that will likely count toward its minimum requirement for own funds and eligible liabilities (MREL). We expect the communication of bank-specific requirements in fall 2022.

Outlook

The negative outlook on VP Bank reflects uncertainty around the bank's successful transformation and achievement of ambitious goals under its revised strategy, under currently difficult market conditions. It also considers the challenges around structural problems that persist for VP Bank to deliver sound profitability in private banking, such as from general margin pressure amid high competition.

Downside scenario

We could lower the rating if the bank's growth strategy or search for additional revenue streams were not as successful as planned, leading to a loss of the bank's reasonably successful niche position in private banking and questioning the stability of its business franchise. We could also downgrade the bank if we observe further risk governance deficiencies or loss incidents. A sizable acquisition could also constrain the rating should it materially erode the bank's capital buffer, reflected in our risk-adjusted capital ratio dropping below 15%.

Upside scenario

We could revise the outlook to stable if VP Bank successfully implements its revised strategy, evident from increasing fee income and continuing inflows of net new money that would result in stable to improving profitability despite persistent strong competition and difficult markets.

While we currently think this is rather unlikely, we could also consider revising the outlook to stable if we believed that VP Bank had built a material buffer of bail-inable capital that would protect senior unsecured creditors should the bank become nonviable. However, the regulator will likely only communicate VP Bank's MREL in autumn 2022.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-3

Governance factors are a moderately negative consideration in our credit rating analysis of VP Bank. Due to risk-management and governance deficiencies the bank faced a large single loss in its Lombard book in 2020. We positively note that the reaction to eliminate those was swift and thorough but we believe VP Bank's needs a longer track record to demonstrate its improved resilience and risk governance. The bank is currently in a transformation period, and we remain cautious around potential risk and governance concerns stemming from its transition to an open wealth management platform, which might be less transparent than the bank's current business model.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A/Negative/A-1	A/Negative/A-1
SACP	a	a
Anchor	a-	a-
Business position	Moderate (-1)	Moderate (-1)
Capital and earnings	Very strong (+2)	Very strong (+2)
Risk position	Adequate (0)	Adequate (0)
Funding	Adequate (0)	Adequate (0)
Liquidity	Adequate (0)	Adequate (0)
Comparable ratings analysis	0	0
Support	0	0
ALAC support	0	0
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity.
GRE--Government-related entity.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Banking Industry Country Risk Assessment: Liechtenstein, July 12, 2022
- Banking Industry Country Risk Assessment Update: June 2022, June 28, 2022
- Swiss and Liechtenstein Bank Ratings Affirmed Under Revised FI Criteria, Feb. 8, 2022
- ESG Credit Indicator Report Card: EMEA Banks
- VP Bank AG, Sept. 8, 2021

Ratings List

Ratings Affirmed

VP Bank AG

Issuer Credit Rating	A/Negative/A-1
Resolution Counterparty Rating	A+/-/-A-1
Senior Unsecured	A
Senior Subordinated	A-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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