S&P Global Ratings

Research

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	+1
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	+1

+

Additional Factors	-1

Issuer Credit Rating
A-/Stable/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: Stable

The stable outlook on Liechtenstein-based VP Bank AG indicates we are likely to remove both the downward transitional notch and our one notch of government support by year-end 2016 and thereby keeping the ratings at their current level if we believe there is a greater likelihood that senior unsecured creditors may incur losses if the bank fails.

We could lower the ratings if we perceived that VP Bank would not maintain a risk-adjusted capital (RAC) ratio above our 15% threshold over the next two years.

We consider a positive rating action remote at this stage, and it would only materialize if the bank were to take steps to mitigate bail-in risk to senior unsecured creditors--such as building a large buffer of subordinated instruments eligible for inclusion in our additional loss-absorbing capacity measure.

Rationale

Our ratings on VP Bank reflect its anchor of 'a-', its weak business position as a niche player in the global private banking business; very strong capital and earnings, mainly based on our expectation of an RAC ratio close to 18% by year-end 2018; adequate risk position, reflecting VP Bank's prudent risk management and sound risk metrics; and average funding and adequate liquidity, mirroring its stable and granular deposit base, as our criteria define these terms. We assess the SACP for the bank at 'a-'.

The ratings also factor in one notch of extraordinary government support to reflect our view of the bank's moderate systemic importance to the Principality of Liechtenstein (AAA/Stable/A-1+) countered by a downward transitional notch to reflect our expectation of Europe-wide bank recovery and resolution directive being implemented in Liechtenstein by year-end 2016. This leads to our 'A-/A-2' ratings on VP Bank.

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.

In our view, Liechtenstein's economy is characterized by 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 Liechtenstein banking 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 to invest in branding and service quality. 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)	**2015**	**2014**	**2013**	**2012**	**2011**
Adjusted assets	12,303.4	11,166.3	11,153.6	10,585.6	10,671.3
Customer loans (gross)	5,067.9	4,308.1	3,968.3	3,764.7	3,903.4
Adjusted common equity	844.5	820.0	823.9	823.2	756.0
Operating revenues	258.3	222.7	239.4	242.4	224.5
Noninterest expenses	193.8	176.1	178.4	186.3	188.7
Core earnings	58.0	42.0	56.3	49.3	33.3

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 operation primarily in the niche segment of private banking and financial intermediaires, and that its organic growth continues to lag behind the private bank 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) 12.4 billion on Dec. 31, 2015 (€11.4 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. This 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's management team, in place since 2013, has taken steps to strengthen VP Bank's stand-alone creditworthniess over the past three years. The strategic decisions by the new management team, including the acquisition of the private banking activities of HSBC Luxembourg as well as the private banking-related fund business in 2013 and Centrum Bank in Liechtenstein in 2015, have in our view strengthened the core operations and will lead to positive synergy effects. We therefore expect that VP Bank will be in 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 in order to achieve a lower cost base (target cost income ratio lower than 70%), and improved group net earnings (CHF80 million)--are challenging but achievable considering potential further acquisitions in the bank's core markets. At year-end 2015, VP Bank managed client assets of CHF34.8 billion, up CHF6 billion from the previous year, mainly driven by the successful integration of Centrum Bank.

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. That said, there is in our view currently only a limited likelihood that VP Bank would merge with another larger Liechtenstein-based private bank.

Table 2

VP Bank AG Business Position

	--Year-ended Dec. 31--				
(%)	**2015**	**2014**	**2013**	**2012**	**2011**
Total revenues from business line (mil. CHF)	308.3	222.7	242.4	265.1	224.5
Commercial & retail banking/total revenues from business line	76.7	91.4	78.4	72.5	89.1
Other revenues/total revenues from business line	23.3	8.6	21.6	27.5	10.9
Investment banking/total revenues from business line	N/A	N/A	N/A	N/A	N/A

Table 2

VP Bank AG Business Position (cont.)					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Return on equity	7.2	2.3	4.3	5.4	0.5

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Capital and earnings: Very strong capital position, but still subdued earnings

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 close to 18% through year-end 2018, compared with 18.1% at year-end 2015.

The higher RAC ratio compared with our previous forecast reflects the increased disclosure on VP Bank's financial collateral, which reduces our assessment of risk-weighted assets. We note that the acquisition of Centrum Bank, which led to increase in both credit and operational risks, had only a moderate impact on the RAC ratio, owing to the simultaneous capital increase by the bank. Our RAC projection factors in limited growth in the bank's total adjusted capital, accompanied by modest growth in its lending business in the next two years. We expect the quality of VP Bank's capital, consisting solely of core capital, will remain high.

VP Bank's revised strategy is expected to translate into significant improvmenet in the bank's earnings capacity, underpinned by a three-year average earnings buffer of 100-110 basis points, reflecting the bank's ability to cover normalized losses with annual earnings. Although the buffer would act as a first line of defense, the bank still underperforms its private bank peers in this respect. In addition, 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 the 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. We understand that VP Bank has initiated more rigid cost management and forecast that it will be able to maintain its target cost-to-income ratio at less than 70% in the next two years (2015: 59.4%).

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 18.1% as of year-end 2015, is significantly below the bank's regulatory capital ratio of 24.4% as of year-end 2015.

Table 3

VP Bank AG Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Tier 1 capital ratio	24.4	20.5	20.4	21.5	18.2
S&P RAC ratio before diversification	18.1	15.8	16.7	17.3	14.1
S&P RAC ratio after diversification	15.7	14.6	15.5	15.7	11.7
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	32.7	29.4	36.3	34.4	29.7

Table 3

VP Bank AG Capital And Earnings (cont.)					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Fee income/operating revenues	48.9	53.2	47.7	47.5	54.3
Market-sensitive income/operating revenues	17.5	17.0	14.9	16.8	15.9
Noninterest expenses/operating revenues	75.0	79.1	74.5	76.9	84.1
Preprovision operating income/average assets	0.5	0.4	0.6	0.5	0.3
Core earnings/average managed assets	0.5	0.4	0.5	0.5	0.3

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 4

VP Bank AG Risk-Adjusted Capital Framework Data					
(CHF 000s)	Exposure*	Basel III RWA	Average Basel III RW (%)	S&PGR RWA	Average S&PGR RW (%)
Credit risk					
Government and central banks	4,164,536	79,443	2	157,471	4
Institutions	2,577,871	555,410	22	516,038	20
Corporate	2,092,447	462,807	22	885,233	42
Retail	4,406,021	1,633,582	37	1,054,583	24
Of which mortgage	3,461,943	1,486,013	43	853,606	25
Securitization§	0	0	0	0	0
Other assets	232,797	166,131	71	236,895	102
Total credit risk	13,473,673	2,897,373	22	2,850,220	21
Market risk					
Equity in the banking book†	74,178	74,178	100	488,496	659
Trading book market risk	--	196,850	--	295,275	--
Total market risk	--	271,028	--	783,771	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	531,286	--	1,040,088	--
(CHF 000s)		**Basel III RWA**		**S&PGR RWA**	**S&PGR RWA**
Diversification adjustments					
RWA before diversification		3,731,138		4,674,079	100
Total Diversification/Concentration Adjustments		--		720,766	15
RWA after diversification		3,731,138		5,394,846	115
(CHF 000s)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&PGR RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		911,204	24.4	844,513	18.1
Capital ratio after adjustments‡		911,204	24.4	844,513	15.7

Table 4

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

*Exposure at default. §Securitization exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Exposure and S&PGR'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.CHF--Swiss Franc. Sources: Company data as of Dec. 31, 2015, 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 BICRA Liechtenstein and our RAC model.

We believe the credit risk from VP Bank's mainly domestic loan portfolio--amounting to CHF5.1 billion on Dec. 31, 2015--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. The share of nonperfoming assets equalled about 0.4% as of Dec. 31, 2015 (against 0.3% in 2014), and we expect VP Bank will maintain prudent underwriting standards that will lead to stable asset quality and a low level of loan losses (22bps in 2015 and 12bps on average over the past five years).

We view positively that the bank has substantially reduced its interbank exposures to CHF2.1 billion as of year-end 2015 (from CHF5.1 billion in 2011), maintaining limits predominantly with highly rated banks. Furthermore, we view that VP Bank is conservatively hedging its market and foreign exchange risks, which in the past 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 threat to this small financial center and its banks, including VP Bank. Furthermore, we think that VP Bank is applying more rigorous procedures and continuously benchmarking internal processes to reduce such risk.

Table 5

VP Bank AG Risk Position					
	--Year-ended Dec. 31--				
(%)	**2015**	**2014**	**2013**	**2012**	**2011**
Growth in customer loans	17.6	8.6	5.4	(3.6)	17.8
Total diversification adjustment / S&P RWA before diversification	15.4	8.6	7.9	10.4	20.3
Total managed assets/adjusted common equity (x)	14.6	13.7	13.6	12.9	14.2
New loan-loss provisions/average customer loans	0.2	0.1	0.1	0.2	0.0
Net charge-offs/average customer loans	0.0	0.1	0.3	0.2	0.0
Gross nonperforming assets/customer loans + other real estate owned	0.4	0.3	0.5	0.9	0.6
Loan-loss reserves/gross nonperforming assets	309.6	357.5	193.7	152.0	209.2

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 94% of its funding base as of Dec. 31, 2015. This large deposit base has translated into a superior stable funding ratio of more than 200% for the past five years (198% as of Dec. 31, 2015), which we expect the bank will maintain over the next 12-24 months. However, 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 despite its comparably high stable funding ratio and, as such, in line with our assessment of systemwide funding in Liechtenstein.

VP Bank invests its excess deposits mainly in short-term interbank lending with counterparts with good creditworthiness, while its securities portfolio of CHF 2.1 billion largely comprises generally highly liquid assets. This is further indicated by the S&P Global Ratings liquidity ratio (broad liquid assets to short-term wholesale funding), which stood at 36.2x at year-end 2015. Although the related 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 neutral factor to the ratings on VP Bank, as its liquidity position depends on clients' investment decision.

Table 6

VP Bank AG Funding And Liquidity

	--Year-ended Dec. 31--				
(%)	**2015**	**2014**	**2013**	**2012**	**2011**
Core deposits/funding base	94.1	93.1	93.4	91.0	90.3
Customer loans (net)/customer deposits	47.5	45.1	41.8	42.7	44.3
Long term funding ratio	98.6	96.7	97.0	95.7	94.6
Stable funding ratio	197.7	208.6	228.0	226.8	221.0
Short-term wholesale funding/funding base	1.5	3.5	3.2	4.7	5.8
Broad liquid assets/short-term wholesale funding (x)	36.2	16.9	20.0	13.7	10.8
Net broad liquid assets/short-term customer deposits	58.3	60.0	65.5	65.6	63.9
Short-term wholesale funding/total wholesale funding	25.9	51.2	48.5	52.2	60.5
Narrow liquid assets/3-month wholesale funding (x)	46.3	13.2	17.0	13.4	N/A

N/A--Not applicable.

External support: One notch of uplift for potential government support

We include one notch of government support, reflecting our view that VP Bank has moderate systemic importance in Liechtenstein, which we still view as supportive of private-sector commercial banks.

Because VP Bank is the third-largest bank in Liechtenstein, we consider there to be a moderately high likelihood that the government would provide extraordinary support to the bank if needed. However, we may remove the one notch of systemic support by year-end 2016, when Liechtenstein is expected to implement the Europe-wide BRRD, including bail-in tools, leading to a greater likelihood that senior unsecured creditors may incur losses if the bank were to fail.

Additional rating factors: One-notch negative adjustment, reflecting less predictable systemic support

Following the improvement in the SACP in July 2016, we apply a one-notch negative adjustment to reflect the likelihood of the eventual removal of government support over our rating horizon. In our view, VP Bank operates in an environment that is transitioning toward less predictable systemic support. If we remove the uplift for support by year-end 2016, we would review the transitional notch at the same time.

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Commercial Paper I: Banks, March 23, 2004
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- VP Bank Outlook Revised To Stable On Expected Improvement In Combined Capital And Risk Position; 'A-/A-2' Rtgs Affirmed, July 25, 2016
- Banking Industry Country Risk Assessment Update July, July 22, 2016
- Principality of Liechtenstein 'AAA/A-1+' Ratings Affirmed; Outlook Stable; Off Watch Neg, Feb. 26, 2016
- Banking Industry Country Risk Assessment: Liechtenstein, Oct. 13, 2015
- VP Bank's Acquisition Of Centrum Bank Has No Immediate Effect On Ratings, Jan. 14, 2015
- Liechtenstein-Based VP Bank Outlook To Negative On Potential Government Support Reduction; 'A-/A-2' Ratings Affirmed, April 30, 2014

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 12, 2016)	
VP Bank AG	
Counterparty Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Counterparty Credit Ratings History	
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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