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Update

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Vontobel Holding AG

Update to credit analysis

Summary

Vontobel Holding AG's (Vontobel Holding or the group) issuer ratings are A3, with a stable outlook.

Vontobel Holding AG (Vontobel Holding) is a listed holding company, with Bank Vontobel AG (Bank Vontobel) being its main operating entity. Bank Vontobel's Aa3 deposit ratings reflect its a2 Baseline Credit Assessment (BCA) and the application of Moody's Advanced Loss Given Failure (LGF) analysis to its liabilities. Moody's does not incorporate rating uplift from government support for Vontobel Holding and Bank Vontobel due to their small domestic market share and low importance to the Swiss banking system.

Bank Vontobel's a2 BCA reflects the bank's strong capital and liquidity profile, with funding predominantly stemming from customer deposits and liquid resources that represent more than half of its assets. The BCA incorporates that Bank Vontobel's credit risks from its asset portfolio are fairly limited but also that the bank's private banking business model exposes it foremost to market and operational risks.

Credit strengths

» Strong capitalisation

» Vontobel's asset management adds to earnings diversification

» Limited on-balance-sheet lending risks, which mainly arise from Lombard loans

Credit challenges

» Moderate dependence on market funds, driven by the issuance of structured products

» Risk management complexities from the issuance of structured products and derivative (investment banking) businesses

» High sensitivity to market risks inherent in the bank's and the group's business models

Outlook

» The stable outlook reflects our expectation of stability in the group's financial factors over the next 12-18 months, despite profit pressures caused by the low interest rates and subdued client activity amid elevated market uncertainty.

Factors that could lead to an upgrade

» The issuer ratings of Vontobel Holding could be upgraded following (1) an upgrade of Bank Vontobel's BCA and Adjusted BCA; or (2) an increase in rating uplift resulting from our Advanced LGF analysis.

» Bank Vontobel's BCA could be upgraded if it achieves a sustainable and significant improvement in its profitability, coupled with meaningfully lower earnings volatility, while not encountering a weakening of key scorecard ratios.

» Bank Vontobel's Adjusted BCA could be upgraded if the group materially reduces its market funding dependency and risk management complexities, which results predominantly from the issuance of structured products.

» Our Advanced LGF analysis could result in higher notches of rating uplift if the volume of bail-in-able senior unsecured debt or subordinated instruments, issued at the bank or the group level, increases.

Factors that could lead to a downgrade

» A downgrade of Vontobel Holding's issuer ratings is likely to follow a downgrade of Bank Vontobel's BCA or Adjusted BCA.

» A downgrade of Bank Vontobel's BCA or Adjusted BCA could follow (1) an unexpected materialisation of operational risks, specifically if caused by litigation charges in connection with typical wealth management lawsuits or IT security issues that are severe enough to threaten the bank's or the group's reputation; (2) substantial capital reductions; (3) any substantial and persistent outflow of client funds, causing sustained and significant profitability pressures; or (4) acquisitions that are unduly aggressive from a commercial, financial or operational risk viewpoint.

Key indicators

Exhibit 1
Vontobel Holding AG (Consolidated Financials) [1]

	06-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (CHF Billion)	27.3	26.0	22.8	19.3	17.5	13.5[4]
Total Assets (USD Billion)	28.0	26.3	23.3	19.0	17.5	14.4[4]
Tangible Common Equity (CHF Billion)	1.6	1.6	1.3	1.2	1.1	11.4[4]
Tangible Common Equity (USD Billion)	1.6	1.6	1.4	1.2	1.1	12.3[4]
Problem Loans / Gross Loans (%)	--	0.8	1.2	1.5	1.6	1.3[5]
Tangible Common Equity / Risk Weighted Assets (%)	21.0	23.4	22.5	23.2	21.7	22.4[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	--	2.3	3.0	3.1	3.6	3.0[5]
Net Interest Margin (%)	0.4	0.4	0.3	0.4	0.4	0.4[5]
PPI / Average RWA (%)	4.3	4.6	4.6	4.6	4.0	4.4[6]
Net Income / Tangible Assets (%)	1.0	0.9	1.1	0.9	0.8	0.9[5]
Cost / Income Ratio (%)	75.7	75.2	75.5	75.6	78.7	76.1[5]
Market Funds / Tangible Banking Assets (%)	44.1	39.5	46.3	42.1	37.6	41.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	54.0	60.7	65.6	70.1	68.1	63.7[5]
Gross Loans / Due to Customers (%)	--	39.0	34.1	28.9	27.1	32.3[5]

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel III - fully-loaded or transitional phase-in; IFRS. [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel III periods presented.
Source: Moody's Investors Service; Company Filings

Profile

Vontobel Holding AG (Vontobel Holding) is the holding company of Switzerland's Bank Vontobel. Vontobel Holding consolidates the group's private banking — mainly performed through its main operating entity Bank Vontobel — asset management and investment banking activities. The latter comprise the issuance of structured products, client-driven capital market activities (such as brokerage, including research and sales), corporate finance (mainly for medium-sized companies in Switzerland) and services for external asset managers, as well as transaction banking.

As of half-year 2019, Vontobel Holding reported advised client assets of CHF213 billion (2018: CHF193 billion), consisting of CHF186 billion of AUM, CHF10 billion of structured products and CHF17 billion of other advised client assets. The acquisition of Notenstein, completed on 2 July 2018, strengthened the group's regional focus on private banking activities in Switzerland, Germany and Italy. Vontobel Holding is listed on the Swiss stock market, with the Vontobel family and associated parties holding 50.7% of all shares as of 30 June 2019.

As of half year 2019, Vontobel Holding reported consolidated assets of CHF27.4 billion, risk-weighted assets of CHF7.5 billion and equity of CHF1.7 billion (Dec 2018: CHF26.0 billion, CHF6.8 billion and CHF1.7 billion, respectively). The group's largest funds included CHF11.3 billion of deposits and CHF10.3 billion of outstanding structured products during the first-half of 2019 (Dec 2018: CHF12.6 billion and CHF7.9 billion, respectively).

In April 2019, Vontobel announced that it completed the acquisition of US-based private clients from Lombard Odier, adding around CHF730 million of AUM. The acquisition strengthens Vontobel's presence in North America, a focus market, and increases total client assets to around CHF4.5 billion for this region. In addition, Vontobel has decided to expand its international business with external asset managers in Asia on a step-by-step basis.

Recent developments

In December 2019, Vontobel announced that it intends to reorganise itself in the first quarter of 2020 and focus on becoming a pure-play active buy-side investment manager. The group plans to exit its sell-side activities and capital markets business in 2020. Vontobel's reorganizsation will increase its focus on customers to foster revenue growth and growth in advised client assets. Vontobel will be offering its products and services through its four client units (1) Asset Management, (2) Wealth Management, (3) Platforms & Services for external asset managers and other intermediaries, and (4) Digital Investing, a segment whose services will be offered to clients across the group. As part of the announcement, Vontobel confirmed its group-wide financial targets for 2020.

Detailed credit considerations

Strong capital but change in composition following the Notenstein acquisition

Vontobel Holding's capitalisation remains strong compared with that of private banking peers and following the Notenstein acquisition in the second half of 2018.

As of half-year 2019, the group's consolidated Tier 1 capital ratio was 18.2%, a decrease from 18.9% ar year-end 2018, but comfortably above the Swiss regulator's minimum Tier 1 capital requirement of 9.6%, which applies to Category 3 banks. The group's regulatory leverage ratio was unchanged unchanged at 4.9% in 2018, compared with December 2018.

Vontobel Holding targets to maintain a total capital ratio of above 16.0% and a minimum CET1 ratio of 12.0% for 2020 after potential acquisitions. Provided that any additional acquisition does not meaningfully erode the level of tangible common equity available to absorb losses before failure and that any potential increase in risk-weighted assets is contained, we would not expect it to hurt Vontobel Holding's credit profile.

Moderate dependence on market funds, reflecting the issuance of structured products and mitigated by sizeable liquidity

Vontobel Holding's ample liquidity is driven by significant volumes of customer deposits that accounted for 44% of consolidated liabilities (excluding equity; 2018: 52%). However, because of its Dubai-based structured product business, Vontobel Holding is exposed to a relatively high share of confidence-sensitive market funding compared with its closest private banking peers. In an adverse scenario, this could leave the group exposed to sudden and pronounced outflows of short-term funding sources.

To limit the group's susceptibility to larger-than-expected customer deposit outflows, Vontobel Holding manages a very liquid balance sheet, with cash and claims to banks accounting for 27% of its total assets as of half-year 2019 (2018: 32%). Moreover, Vontobel Holding's high-quality CHF3.7 billion (2018: CHF4.0 billion) financial securities portfolio, which mainly includes government and other highly rated bonds, further supports our view of very balanced funding and liquidity profiles.

Vontobel Holding's limited on-balance-sheet lending risks are reflected in its small loan book, which accounted for 19% of assets as of half-year 2019 (2018: 19%) and mainly includes Lombard loans. The moderate increase in the first half of 2019 was driven by a rise in both secured Lombard loans and mortgages.

Structured products drive risk management complexities, while asset management activities add diversification to earnings

Vontobel Holding performs non-private banking-related activities. Compared with the credit profile of its main operating entity, Bank Vontobel, we believe that these activities add additional risks, but at the same time provide benefits to the group's earnings diversification.

We believe that the issuance of structured products, amounting to CHF10.3 billion as of June 2019 (2018: CHF7.9 billion), adds to risk management complexities, because it requires constant and sizeable hedging activities to limit market risks for the group.

By contrast, Vontobel's asset management business, which grew its AUM to CHF112 billion as of half-year 2019 from CHF83 billion in 2014, accounted for around 60% of overall AUM in June 2019. We believe that these activities add earnings diversification to the group because the clients serviced are institutional customers, predominantly financial institutions, compared with private individuals in the bank's private banking.

However, our assessment of Vontobel Holding and Bank Vontobel also takes into account the fact that their earnings are highly correlated with, and thus sensitive to, capital market developments, although both entities typically do not act as an underwriter of debt or equity issues, and their non-client-driven trading activities are very limited.

Improved earnings capacity following acquisitions by high correlation to developments of capital markets remains

In the first half of 2019, Vontobel Holding's revenues increased by 7% to CHF626 million from the same period a year earlier, benefitting from an increased balance sheet and client asset base after the Notenstein acquisition and the Lombard Odier portfolio acquisition. The increase as of June 2019 was largely driven by a 8% increase in fees and commissions to CHF410 million and a 23% increase in net interest income to CHF46 million because of higher gross loans, which largely offset margin pressures. Trading income for the first six months was down -2% at CHF162 million resulting from lower client activity and a weaker demand for structured products which were not fully offset by valuation gains on the group's financial securities portfolio.

Vontobel Holding's operating expenses increased by 13% from a year earlier to CHF476 million, largely driven by higher personnel expenses of CHF316 million (+14%) related to the full integration of Notenstein, as well as software amortization.

For the first six months of 2019, Vontobel Holding reported net income of CHF131 million, compared with CHF133 million, down -1% year-over-year.

As of June 2019, Vontobel's cost-to-income ratio was up at 76% (1H2018: 72%), due to the higher cost base following recent acquisitions. We believe that Vontobel's cost-to-income ratio target of below 72% by 2020 continues to be ambitious and assume that the group can achieve its AUM growth target of 4%-6% per year. Specifically, we believe that additional costs for absorbing the research costs for clients in its asset management division, as well as further investments in digitalisation and security, will exert pressure on the group's cost base. At the same time, integration costs have faded, and the recently acquired units are now becoming profitable, thereby balancing the expected negative effects on the group's profitability.

Environmental, social and governance considerations

Bank Vontobel and Vontobel Holding's exposure to environmental risks is low, consistent with our general assessment for the global banking sector.[1] See our Environmental risk heat maps for further information.

Overall, we consider banks and wealth managers to face moderate social risks.[2] See our Social risk heat maps for further information.

Governance is highly relevant for Bank Vontobel and Vontobel Holding, as it is to all players in the banking and wealth management industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit a bank's credit profile. Governance risks are largely internal rather than externally driven, and for Bank Vontobel and Vontobel Holdings we do not have any particular governance concerns and their risk management frameworks are commensurate with its risk appetite. For Swiss private banks, we consider a high degree of reputational, legal (litigation) and operational risks, which is reflected in our Asset Risk score. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Loss Given Failure (LGF) analysis

Bank Vontobel and Vontobel Holding are subject to Swiss banking regulation, which we consider an Operational Resolution Regime. We therefore apply our Advanced LGF analysis, considering the risks faced by the different debt and deposit classes across the liability structure at failure. We assume residual tangible common equity of 3%, post-failure losses of 8% of tangible banking assets, a 25% run-off in junior wholesale deposits and a 5% run-off in preferred deposits, and assign a 100% probability to deposits being preferred to senior unsecured debt, thereby reflecting depositor preference by law in Switzerland.

For Vontobel Holding's long-term issuer ratings, our Advanced LGF analysis indicates a high loss given failure, leading to a positioning one notch below Bank Vontobel's a2 Adjusted BCA, considering the preference of deposits in resolution, as well as the limited volume of bail-in-able debt outstanding.

High-trigger Additional Tier 1 (AT1) securities

The Baa3(hyb) ratings assigned to Vontobel Holding's high-trigger, undated and deeply subordinated AT1 securities reflect our approach to rate these securities to the lower outcome of either (1) a model-based outcome; or (2) the positioning of a non-viability security. Our rating approach captures the credit risk associated with the distance to trigger breach and the credit risk of these securities' non-viability component.

The principal of Vontobel Holding's high-trigger AT1 is subject to a permanent partial or full write-down on a contractual basis if (1) the group's consolidated regulatory CET1 ratio falls below 7%; (2) Vontobel receives public support; or (3) FINMA determines that the conditions for a full write-down of the instrument are fulfilled and orders such a write-down to prevent insolvency as a precautionary measure.

Government support considerations

We do not assign any rating uplift for Bank Vontobel or Vontobel Holding from support by the Government of Switzerland (Aaa stable), reflecting our assumption of a low probability of systemic support in a stress scenario, given the entities' marginal systemic importance to the domestic deposit-taking market and the Swiss payment system.

Methodology and scorecard

The principal methodology we used in rating Vontobel Holding was Banks methodology, published in November 2019.

Ratings

Exhibit 2

Category	Moody's Rating
VONTOBEL HOLDING AG	
Outlook	Stable
Issuer Rating	A3
Pref. Stock Non-cumulative -Dom Curr	Baa3 (hyb)
BANK VONTOBEL AG	
Outlook	Stable
Counterparty Risk Rating	A3/P-2
Bank Deposits	Aa3/P-1
Baseline Credit Assessment	a2
Adjusted Baseline Credit Assessment	a2
Counterparty Risk Assessment	A2(cr)/P-1(cr)

Source: Moody's Investors Service

Endnotes

1 Environmental risks can be defined as environmental hazards encompassing the impacts of air pollution, soil/water pollution, water shortages and natural and man-made hazards (physical risks). Additionally, regulatory or policy risks, like the impact of carbon regulation or other regulatory restrictions, including the related transition risks like policy, legal, technology and market shifts, that could impair the evaluation of assets are an important factor. In our Environmental risk heat map, we scored 84 sectors according to their overall exposure to environmental risks.

2 The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage due to product mis-selling or other types of misconduct is a further social risk. Social trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services increasing information technology cost, aging population concerns in several countries impacting demand for financial services or socially driven policy agendas that may translate into regulation that affects banks' revenue base.

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