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Update

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Vontobel Holding AG

Update to credit analysis

Summary

We assign A3 issuer ratings to Vontobel Holding AG's (Vontobel Holding or "the group") with a stable outlook.

Vontobel Holding's issuer ratings reflected (1) Bank Vontobel AG's (Bank Vontobel, Aa3 stable, a2[1]) Baseline Credit Assessment (BCA) and its Adjusted BCA of a2; (2) the results of our Advanced Loss Given Failure (LGF) analysis taking into account the severity of loss faced by the different debt classes in resolution, which results in the positioning of the group's issuer ratings at A3, one notch below the bank's Adjusted BCA.

Bank Vontobel's a2 BCA reflects the bank's (1) limited on-balance-sheet business risks, (2) strong capitalisation, and (3) sound liquidity profile. The BCA also takes account of the group's (1) well-established franchise in Swiss and international cross-border private banking and asset management markets, and (2) prominent position in Swiss capital markets, including those of structured investment products and security custody. The bank's BCA also reflects a degree of earnings dependence on capital market developments, as well as typical risks that apply to private banks, such as a high sensitivity to reputational and operational risks.

Credit strengths

» High-quality and strong capital adequacy metrics

» Highly liquid balance sheet mitigates dependence on market funding sources

» Limited on-balance-sheet lending risks

Credit challenges

» Strong asset management has to continue withstanding strains from market developments and key personnel changes

» Risk management complexities in the group's structured product and derivative (investment banking) businesses

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

Outlook

» Vontobel Holding stable outlook reflects our expectation that the group's franchise and operating performance strains will be mitigated by organic growth and growing earnings levels in its other banking activities.

Factors that could lead to an upgrade

» Ratings of Vontobel Holding could be upgraded following an upgrade of Bank Vontobel's BCA or Adjusted BCA, or higher rating uplift resulting from our LGF analysis. The bank's BCA could be upgraded if it achieves a sustainable and significant improvement in its profitability, coupled with meaningfully lower earnings volatility while not otherwise encountering a weakening of key scorecard ratios. The bank's Adjusted BCA could be upgraded if the group materially reduces its market funding dependency, which results predominantly from its structured product business.

» LGF analysis-related upward pressure on the group's ratings could result from higher notches of rating uplift, driven by continued and sustainable growth in the volume of bail-inable senior unsecured debt or subordinated instruments.

Factors that could lead to a downgrade

» A downgrade of Vontobel Holding's ratings is likely to follow a downgrade of Bank Vontobel's BCA or Adjusted BCA, which might be caused by a sustained and substantial outflow of client funds, causing persistent profitability pressures; unexpected emergence of operational risks, specifically if caused by litigation charges in connection with typical private banking and wealth management lawsuits; IT security issues that are severe enough to threaten the bank's or the group's currently solid reputation; sizeable acquisitions that result in a material adverse development of key scorecard ratios; or a weakening in the Very Strong- Macro Profile for Switzerland.

Key indicators

Exhibit 1

Vontobel Holding AG (Consolidated Financials) [1]

	12-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (CHF billion)	23	19	18	18	20	3.9[4]
Total Assets (EUR billion)	19	18	16	15	16	5.1[4]
Total Assets (USD billion)	23	19	17	18	22	1.5[4]
Tangible Common Equity (CHF billion)	1.3	1.2	1.1	1.2	1.4	-1.9[4]
Tangible Common Equity (EUR billion)	1.1	1.2	1.0	1.0	1.2	-0.7[4]
Tangible Common Equity (USD billion)	1.4	1.2	1.1	1.2	1.6	-4.1[4]
Problem Loans / Gross Loans (%)	1.2	1.5	1.6	1.3	1.6	1.5[5]
Tangible Common Equity / Risk Weighted Assets (%)	22.4	23.0	21.7	23.2	27.2	23.5[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	3.0	3.1	3.6	2.3	2.0	2.8[5]
Net Interest Margin (%)	0.3	0.4	0.4	0.3	0.2	0.3[5]
PPI / Average RWA (%)	4.6	4.6	4.0	3.4	3.2	3.9[6]
Net Income / Tangible Assets (%)	1.1	0.9	0.8	0.9	0.7	0.9[5]
Cost / Income Ratio (%)	75.5	75.6	78.7	80.0	80.6	78.1[5]
Market Funds / Tangible Banking Assets (%)	46.3	42.1	37.6	40.2	41.9	41.6[5]
Liquid Banking Assets / Tangible Banking Assets (%)	65.6	70.1	68.1	50.6	53.5	61.6[5]
Gross Loans / Due to Customers (%)	34.1	28.9	27.1	23.7	19.8	26.7[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 Financial Metrics

Profile

Vontobel Holding AG is the parent company of the Swiss wealth management group Vontobel. Vontobel Holding's business model integrates private banking, wealth management, asset management and investment banking. Investment banking comprises the group's structured product and client-driven capital market activities such as brokerage (including research and sales), corporate finance (mainly for medium-sized companies in Switzerland), services for external asset managers and transaction banking.

The group's regional focus is mainly on Switzerland, Germany, Italy, the UK, the US and emerging markets. The non-bank holding company is listed on the Swiss stock market, with the Vontobel family and associated parties holding 50.7% of all shares as of 31 March 2018.

Bank Vontobel AG is the group's main operating entity, accounting for around half of total client assets and a significant portion of the group's balance sheet. In addition, the majority of the group's private banking/wealth management is performed out of the Zurich-based Bank Vontobel.

On a consolidated basis, and pursuant to IFRS, Vontobel Holding reported total assets of CHF22.9 billion, risk-weighted assets of CHF6.0 billion and shareholders' equity of CHF1.6 billion as of year-end 2017. In addition to sizeable volumes of client deposits, the group's balance sheet largely reflects outstanding structured products of CHF8.5 billion. Vontobel Holding reported total client assets of CHF246.5 billion as of 31 December 2017.

Detailed credit considerations

High-quality and strong capital adequacy metrics provide meaningful loss-absorption capacity and leave room for growth

Vontobel Holding's capitalisation is strong, also compared with other private-banking peers. At year-end 2017, the group's fully phased-in common equity tier 1 (CET1) capital of CHF1.1 billion translated into a CET1 and total capital ratio of 18.4% (2016: 19.0%), comfortably above the Swiss regulator's total capital ratio requirement of 12.0%. At the same time, the group's regulatory leverage ratio stood at 4.7% as of 31 December 2017. The change in the CET1 ratio of minus 60 basis points was largely attributable to business growth as well as the acquisition of the Eastern European client portfolio of Notenstein La Roche.

Vontobel Holding has set itself a total capital ratio target of above 16.0% and a minimum CET1 ratio of 12.0% for 2020, even including potential acquisitions.

As presented on its Investor Day in August 2017, such an acquisition could include a Swiss private bank with assets under management (AuM) of approximately CHF10-15 billion. Vontobel Holding said that the target bank must have a strong strategic fit and be present in Vontobel Holding's core operating markets. In addition, Vontobel Holding said it would have to be able to extract meaningful cost synergies from integrating the bank by using Vontobel Holding's domestic IT and booking platforms. Under the scenario presented, Vontobel Holding might pay a consideration of 1.5% of the target's AuM and would aim to finance the acquisition by issuing Basel-III-eligible hybrid debt such as Additional Tier 1 (AT1) capital. Provided that such an acquisition (1) would not meaningfully erode the level of tangible common equity (TCE) available to absorb losses prior to failure; and (2) keeps contained any potential increase in risk-weighted assets, we would not expect it to negatively affect Vontobel Holding's credit profile.

Highly liquid balance sheet mitigates dependence on market funding sources

Vontobel Holding's primary liquidity source comprises significant volumes of client deposits that accounted for 46% of total liabilities (excluding equity) with a gross loan to deposit ratio of 34%, as of 31 December 2017.

At the same time, and owing to its Dubai-based structured product business, Vontobel Holding remains exposed to a relatively high share of confidence-sensitive market funding sources if compared to 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.

In order to effectively limit its susceptibility to risks potentially emanating from larger-than-anticipated outflows in its private banking/ wealth management or institutional deposit/structured notes franchise, Vontobel Holding manages a very liquid balance sheet, with cash and due from banks accounting for 35% of its total assets as of year-end 2017. Morover, Vontobel Holding's high-quality interbank and financial investment portfolios (CHF3.4 billion, essentially consisting of government and other highly-rated bonds) further support our view of a very balanced funding and liquidity profile.

At year-end 2017, Vontobel Holding's CHF3.3 billion (2016: CHF2.6 billion) gross loan book mainly included Lombard loans, while the proportion of its mortgage-lending business grew it still remained low at 7.1% of total loans.

Structured products and investment banking activities drive risk-management complexities while the asset management unit withstood pressure from key personnel changes

While the majority of the group's private banking/wealth management is performed out of the Zurich-based Bank Vontobel, asset management and investment banking activities, including the group's Dubai-based structured product business, are consolidated under the holding company, thereby providing additional profits and some degree of earnings diversification. At the same time, Vontobel Holding's financial products and investment banking activities add an additional layer of credit risk, compared with other private banking peers, which mainly arises because of Vontobel Holding's sizeable structured product activities, amounting to CHF8.5 billion as of the end of December 2017 (2016: CHF6.4 billion). This business mix renders Vontobel Holding's earnings more correlated with, and thus sensitive to capital market developments, although it typically does not act as an underwriter of debt or equity issues, and its trading activities remain fairly limited.

During 2017, Vontobel Holding's AuM grew by 19% to CHF165 billion, above the newly communicated AuM growth target range of 4%-6%. However, the increase was largely owing to market performance and total net new money of CHF5.9 billion. Net new money inflows of CHF6.3 billion in the last three quarters of 2017 were able to reverse a CHF2.7 billion outflow in the Quality Growth boutique during the first quarter.

AuM's in the group's Quality Growth boutique increased to CHF37.4 billion in 2017. This stabilised performance follows the 31% drop to CHF33 billion as of year-end 2016 from CHF48 billion as of year-end 2015, largely triggered by the departure of Mr. Rajiv Jain (announced in March 2016), former leader of the group's Quality Growth investment process. Meanwhile, net outflows in the boutique have reversed and have additionally been compensated by net new money inflows in other business areas. The retention of key investment professionals and sustaining a solid product performance will be key to any further stabilisation in net new money inflows across the firm. We therefore expect effects on the group's profitability to remain manageable and longer-term repercussions on the bank's private banking and other wealth management operations to remain limited.

During 2017, Vontobel Holding's revenue increased by 9%[2] to CHF1,060 million from the same period a year earlier, largely driven by a 16% increase in its trading income to CHF289 million and a 7% year-over-year increase in net fee and commission income to CHF693 million. Net interest income remained stable at CHF68.7 million as increased loan book volumes were offset by margin pressures. The group's operating expenses increased by 5% year-over-year to CHF801 million, largely driven by higher personnel expenses of CHF533 million (up 10% year-over-year) related to the full integration of Vescore AG's employees and Notenstein La Roche's Eastern European business. Overall, the group reported net income of CHF209 million for 2017, up 12% from CHF195 billion, when adjusting for M&A related costs, changes in US tax system and excluding the Helvetia dividend in 2016.

Vontobel's cost-to-income ratio target of below 75% by 2020 (2017: 75.5%) is ambitious considering the bank's aforementioned 4%-6% per year growth target. Specifically, additional costs for absorbing the research costs for clients in its asset management division, as well as further investments into digitalisation and security, will exert pressure on the group's cost base. At the same time, integration costs will fade, and the recently acquired units will start becoming profitable from 2018 onwards, thereby balancing anticipated negative effects on the group's profitability.

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 issuer ratings, or its hypothetical senior unsecured debt, our Advanced LGF analysis indicates a high loss given failure, leading to a positioning one notch below the bank's a2 Adjusted BCA, considering the preference of deposits in resolution, as well as the limited volume of bail-inable debt outstanding.

Government support considerations

We do not assign any rating uplift for Bank Vontobel or Vontobel Holding from government support, reflecting our assumption of a low probability of systemic support in the event of a stress scenario, given Bank Vontobel's and Vontobel Holding's marginal importance to the domestic deposit-taking market and the Swiss payment system.

Ratings

Exhibit 2

Category	Moody's Rating
VONTOBEL HOLDING AG	
Outlook	Stable
Issuer Rating	A3
BANK VONTOBEL AG	
Outlook	Stable
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 The ratings shown are the bank's deposit rating and outlook, and its Baseline Credit Assessment.

2 Excluding a gain of CHF102 million from the sale of participation in Helvetia Holding AG in November 2016

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