

Rating Action: Moody's changes outlook on Rabobank to negative from stable; ratings affirmed

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Senior Contingent Notes upgraded to A3(hyb) from Baa2(hyb)

London, 24 November 2016 -- Moody's Investors Service today affirmed Rabobank's long-term deposit and senior unsecured debt ratings of Aa2. In addition, Moody's affirmed Rabobank's baseline credit assessment (BCA) and adjusted BCA of a2. However, Moody's revised the outlook on long-term deposit and senior unsecured debt ratings to negative from stable. At its current level, the bank's BCA largely incorporates the expected improvements resulting from the bank's ongoing restructuring programme while the negative outlook reflects the execution risks inherent to the transformation.

Short-term deposit and senior unsecured debt ratings were affirmed at Prime-1. In addition, Moody's affirmed the bank's subordinated debt rating of A3, non-cumulative tier 1 capital securities rating of Baa2(hyb) and the additional tier 1 (AT1) securities rating of Baa3(hyb). Moody's also affirmed the bank's long-term and short-term counterparty risk assessments (CR assessments) of Aa1(cr) and Prime-1(cr). The ratings of Rabobank's supported entities were also affirmed.

Concurrently, the rating agency upgraded Rabobank's EUR1.25 billion Senior Contingent Notes (SCNs) maturing in 2020 to A3(hyb) from Baa2(hyb).

A list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The affirmation of Rabobank's BCA of a2, which is at the high end of BCAs globally, is driven by the strong financial fundamentals of the bank, in particular its solid asset quality and high level of capitalization. Furthermore, the current BCA incorporates the additional improvements expected from a broad ongoing restructuring which has resulted in a far-reaching overhaul of the bank's governance structure and anticipates significant staff reductions and other cost-cutting and revenue generation initiatives.

Rabobank's asset quality has substantially improved, as reflected by decreasing loan impairment charges, which represented only 7 basis points of gross loans during the first six months of 2016. A period of lacklustre results stemming from losses incurred in several sectors, in particular the Dutch commercial real estate, has come to an end, and indeed during the first half of 2016 Rabobank has been able to reverse some of the provisions linked to these exposures. Moody's now expects asset risks and related provisioning to remain benign over the foreseeable future. The bank's capital levels, with a Common Equity Tier 1 ratio of 13.4% at 30 June 2016, provide a good level of loss-absorption. Underlying profitability has also recovered during the first six months of 2016, thanks to lower loan losses and decreasing operating expenses, despite a number of extraordinary items impacting reported earnings. That being said, Rabobank's recurring profitability remains modest, which has prompted a far-reaching cost-cutting plan currently being implemented.

Rabobank has adopted a new governance structure, merging the 106 local Rabobanks into a single bank in January 2016. This was an important step that will enable the bank to radically streamline its organization and eliminate inefficiencies, which Moody's expects to yield significant improvements over the next three years. The bank targets a head count reduction of 12,000 full-time employees, or 23% of its workforce, by year-end 2018, of which 1,900 was already achieved in the first half of 2016. In the twelve months ending June 2016, operating expenses decreased by 6.2% as a result of these measures, in addition to a reduction of 2,000 employees in 2015. However, the bank's underlying cost-to-income ratio was a relatively high 59% during the first half of 2016, compared to its target of just 50% by 2020. The bank is also seeking a reduction in wholesale funding to below EUR150 billion by 2020, 25% below its current level. This is a positive development given the bank's extensive use of senior bond funding which Moody's believes to be typically more sensitive to changes in market sentiment than customer deposits.

The affirmation of the BCA of a2 incorporates the improvements of the bank's financial fundamentals already achieved, but also to a large extent the expected improvements from the ongoing restructuring.

The affirmation of Rabobank's long-term debt and deposit ratings of Aa2 results from (1) the affirmation of the BCA and adjusted BCA of a2, (2) two notches of uplift under Moody's advanced Loss Given Failure (LGF) analysis and (3) Moody's assumption of a moderate probability of government support for both deposits and senior unsecured debt, resulting in one notch of uplift.

UPGRADE OF SENIOR CONTINGENT NOTES

The upgrade of Rabobank's EUR1.25 billion SCNs to A3(hyb) from Baa2(hyb) reflects the evolution of the notes towards non-viability contingent capital securities with a senior debt host from 'high trigger' contingent capital securities.

The write-down trigger of the SCNs is an Equity Capital Ratio (ECR) of 7%. The ECR was introduced by Rabobank prior to the definition of common equity tier one (CET1) under the current capital requirements directive (CRD IV). The ECR was 14.9% at end-June 2016, higher than the bank's phased-in CET1 ratio of 13.4% and significantly higher than its "fully-loaded" CET1 ratio of 12.5%. The ECR does not take into account new regulatory capital deductions in its numerator and therefore it increases more rapidly than the bank's CET1 ratio as CRD IV provisions are progressively introduced.

The difference between the ECR and the CET1 ratio was 1.5 percentage points at end-June 2016, up from 0.8 percentage points at year-end 2014. This in turn means that the 7% ECR trigger is now equivalent to a CET1 trigger of 5.5% (from 6.2% previously), which in Moody's view means there is little difference between the ECR trigger and standard non-viability instruments. Given a loss-given-default of 75% under the terms of the instrument, Moody's has upgraded the instrument by two notches to A3, one notch below the bank's BCA, and in line with non-viability Tier 2 instruments. This reflects both a probability of default of the security in line with the bank's probability of requiring extraordinary level of support to avoid a default, as well as the high loss severity of the notes.

NEGATIVE OUTLOOK

Moody's BCA of a2 is relatively high and as noted above substantially incorporates both the bank's current fundamentals and the prospects of further improvements under its restructuring. Yet these benefits are subject to some uncertainty and Moody's has therefore assigned a negative outlook to the bank's deposit and senior unsecured debt ratings to reflect the possibility that they are not fully achieved.

WHAT COULD CHANGE THE RATING UP/DOWN

An upgrade of the BCA, and consequently of the deposit and senior unsecured debt ratings, is unlikely in the foreseeable future, as reflected in the negative outlook on the bank's ratings.

The BCA could be downgraded if (1) the bank were unable to improve its profitability as stated in its restructuring plan objectives; (2) asset risks increased due to renewed weakness in the Dutch real estate sector or rising deficiencies in the corporate loan portfolio; and/or (3) the bank were to be unable to reduce wholesale funding as per its stated objectives or if its funding and liquidity profiles deteriorated.

Rabobank's long-term deposit and senior unsecured debt ratings would be downgraded as a consequence of (1) a downgrade of the BCA and/or (2) increased loss-given-failure for senior debt and deposit holders due to lower levels of subordinated debt or a lower level of pari passu debt benefiting these creditors.

LIST OF AFFECTED RATINGS

Issuer: Rabobank

..Upgrades:

....Senior Contingent Notes, upgraded to A3(hyb) from Baa2(hyb)

..Affirmations:

....Long-term Counterparty Risk Assessment, affirmed Aa1(cr)

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Long-term Deposit Ratings, affirmed Aa2, outlook changed to Negative from Stable

....Long-term Deposit Note/CD Program, affirmed (P)Aa2
....Short-term Deposit Ratings, affirmed P-1
..Short-term Deposit Note, affirmed (P)P-1
....Short-term CD Program, affirmed P-1
....Long-Term Issuer Rating, affirmed Aa2, outlook changed to Negative from Stable
....Senior Unsecured Regular Bond/Debenture, affirmed Aa2, outlook changed to Negative from Stable
....Senior Unsecured Medium-Term Note Program, affirmed (P)Aa2
....Backed Senior Unsecured Regular Bond/Debenture, affirmed Aa2, outlook changed to Negative from Stable
....Subordinate Regular Bond/Debenture, affirmed A3
....Backed Subordinate Regular Bond/Debenture, affirmed A3
....Pref. Stock Non-cumulative (AT1), affirmed Baa3 (hyb)
....Pref. Stock Non-cumulative (Tier 1 capital securities), affirmed Baa2 (hyb)
....Commercial Paper, affirmed P-1
....Other Short Term, affirmed (P)P-1
....Other Short Term debt rating, affirmed P-1
....Baseline Credit Assessment, affirmed a2
....Adjusted Baseline Credit Assessment, affirmed a2
..Outlook Action:
....Outlook changed to Negative from Stable

Issuer: Friesland Bank N.V.

..Affirmations:

....Long-term Deposit Ratings, affirmed Aa2, outlook changed to Negative from Stable
....Short-term Deposit Ratings, affirmed P-1
....Backed Senior Unsecured Regular Bond/Debenture, affirmed Aa2, outlook changed to Negative from Stable
....Senior Unsecured Medium-Term Note Program, affirmed (P)Aa2
....Backed Subordinate Regular Bond/Debenture, affirmed A3
....Subordinate Medium-Term Note Program, affirmed (P)A3
....Other Short Term, affirmed (P)P-1
..Outlook Action:
....Outlook changed to Negative from Stable

Issuer: Rabo Capital Securities Limited

....Pref. Stock Non-cumulative, affirmed Baa2 (hyb)

..Outlook Action:

....No Outlook

Issuer: Rabo Financial Products B.V.

..Affirmations:

...Senior Unsecured Regular Bond/Debenture, affirmed Aa2, outlook changed to Negative from Stable

..Outlook Action:

...Outlook changed to Negative from Stable

Issuer: Rabobank Australia Limited

..Affirmations:

...Backed long-term Deposit Rating, affirmed Aa2, outlook changed to Negative from Stable

...Backed short-term Deposit Rating, affirmed P-1

..Outlook Action:

...Outlook changed to Negative from Stable

Issuer: Rabobank Capital Funding Trust IV

..Affirmations:

...Pref. Stock Non-cumulative, affirmed Baa2(hyb)

..Outlook Action:

...No Outlook

Issuer: Rabobank Ireland plc

..Affirmations:

...Backed Commercial Paper, affirmed P-1

..Outlook Action:

...Outlook changed to No Outlook from Stable

Issuer: Rabobank Nederland, Australia Branch

..Affirmations:

...Long-term Counterparty Risk Assessment, affirmed Aa1(cr)

...Short-term Counterparty Risk Assessment, affirmed P-1(cr)

...Senior Unsecured Regular Bond/Debenture, affirmed Aa2, outlook changed to Negative from Stable

...Senior Unsecured Medium-Term Note Program, affirmed (P)Aa2

...Other Short Term, affirmed (P)P-1

...Commercial Paper, affirmed P-1

..Outlook Action:

...Outlook changed to Negative from Stable

Issuer: Rabobank Nederland, Hong Kong Branch

..Affirmations:

...Long-term Counterparty Risk Assessment, affirmed Aa1(cr)

...Short-term Counterparty Risk Assessment, affirmed P-1(cr)

...Long-term Deposit Note/CD Program, affirmed (P)Aa2

...Short-term Deposit Note/CD Program, affirmed (P)P-1

..Outlook Action:

...Outlook changed to No Outlook from Stable

Issuer: Rabobank Nederland, New York Branch

..Affirmations:

...Long-term Counterparty Risk Assessment, affirmed Aa1(cr)

...Short-term Counterparty Risk Assessment, affirmed P-1(cr)

...Long-term Deposit Rating, affirmed Aa2, outlook changed to Negative from Stable

...Long-term Deposit Note/CD Program, affirmed (P)Aa2/Aa2

...Short-term Deposit Note/CD Program, affirmed (P)P-1

...Senior Unsecured Regular Bond/Debenture, affirmed Aa2, outlook changed to Negative from Stable

...Senior Unsecured Medium-Term Note Program, affirmed (P)Aa2

...Commercial Paper, affirmed P-1

...Other short-term, affirmed (P)P-1

..Outlook Action:

...Outlook changed to Negative from Stable

Issuer: Rabobank Nederland, New Zealand Branch

..Affirmations:

...Long-term Counterparty Risk Assessment, affirmed Aa1(cr)

...Short-term Counterparty Risk Assessment, affirmed P-1(cr)

...Short-term Deposit Note/CD Program, affirmed P-1

...Senior Unsecured Regular Bond/Debenture, affirmed Aa2, outlook changed to Negative from Stable

...Commercial Paper, affirmed P-1

..Outlook Action:

...Outlook changed to Negative from Stable

Issuer: Rabobank Nederland, Paris Branch

..Affirmations:

...Long-term Counterparty Risk Assessment, affirmed Aa1(cr)

...Short-term Counterparty Risk Assessment, affirmed P-1(cr)

...Short-term Deposit Note/CD Program, affirmed P-1

..Outlook Action:

....No Outlook

Issuer: Rabobank Nederland, Singapore Branch

..Affirmations:

....Long-term Counterparty Risk Assessment, affirmed Aa1(cr)

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Commercial Paper, affirmed P-1

..Outlook Action:

....No Outlook

Issuer: Rabobank Nederland, The Netherlands Branch

..Affirmations:

....Long-term Counterparty Risk Assessment, affirmed Aa1(cr)

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

..Outlook Action:

....Outlook changed to No Outlook from Stable

Issuer: Rabobank Polska SA

..Affirmations:

....Backed Commercial Paper, affirmed P-1

..Outlook Action:

....No Outlook

Issuer: Rabobank USA Financial Corporation

..Affirmations:

....Backed Commercial Paper, affirmed P-1

..Outlook Action:

....No Outlook

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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