

FITCH AFFIRMS RABOBANK AT 'AA-'; OUTLOOK STABLE

Fitch Ratings-London-13 November 2018: Fitch Ratings has affirmed Cooperatieve Rabobank U.A.'s Long-Term Issuer Default Rating (IDR) at 'AA-' with a Stable Outlook, Viability Rating (VR) at 'a+' and Short-Term IDR at 'F1+'. A full list of rating actions is at the end of this Rating Action Commentary.

The rating actions are part of a portfolio review of major Dutch banking groups rated by Fitch.

KEY RATING DRIVERS

IDRS, DERIVATIVE COUNTERPARTY RATING AND SENIOR DEBT

Rabobank's Long-Term IDR and senior debt ratings are one notch above its VR because Fitch believes the risk of default on senior obligations, as measured by the Long-Term IDR, is lower than the risk of the bank failing, as measured by its VR.

The one-notch uplift reflects the bank's significant qualifying junior debt buffer, which could be made available to protect senior obligations from default in case of failure, either under a resolution process or as part of a private-sector solution (ie, a distressed-debt exchange) to avoid a resolution action.

Without such a private-sector solution, we would expect a resolution action to be taken on Rabobank when it breaches minimum capital requirements. We have assumed that the intervention point would be around the bank's minimum common equity Tier 1 (CET1) requirement of 6.25% (Pillar 1 and Pillar 2, excluding the combined buffer requirements (CBRs)). We further assume Rabobank would need to meet its total minimum capital requirement immediately after a resolution action, which on a fully loaded basis, including the CBR, amounts to 15.25% of total risk-weighted assets (RWAs). Taking into account additional undisclosed Pillar 2 guidance as well as a potential risk-weight increase in a stress scenario, a qualifying junior debt buffer of 10% of RWAs would most likely be sufficient to restore the group's viability without hitting senior credits.

At end-June 2018, the qualifying junior debt buffer was 11.3% of RWAs. Fitch has assumed that the bank will maintain a sufficient buffer, given its stated targets for its CET1 and total capital ratios of at least 14% and at least 25%, respectively, by 2020.

The Derivative Counterparty Rating (DCR) is at the same level as the Long-Term IDR because derivative counterparties have no preferential status over other senior obligations in a resolution scenario under Dutch legislation.

VR

Rabobank's VR is underpinned by its modest risk appetite, which Fitch believes will remain central to the bank's strategy. The rating is also supported by Rabobank's leading market position in Dutch retail banking, complemented by a solid franchise in the global food and agriculture sectors. The rating is based on the expectation that Rabobank's capital ratios will remain sound while the amount of unreserved non-performing loans (NPLs) will decrease and that the bank will maintain prudent liquidity and diversified funding.

We expect Rabobank to maintain a prudent approach to risk, reflected in low-risk underwriting standards, particularly in mortgage lending, and a conservative approach to capital and liquidity management. We also expect the bank to focus on core markets and business segments.

The overall quality of Rabobank's loan book is weaker than peers', with a NPLs/gross loans ratio of 4.4% at end-June 2018. The ratio has been affected over the years by several one-offs, most recently by the tightening of the NPL definition that coincided with the first-time adoption of IFRS 9. We view Rabobank's NPL definition as conservative. On a like-for-like basis, the stock of NPLs decreased by about a quarter between end-2014 and end-June 2018. The ratings factor in our expectation that NPLs will continue to decrease, supported by the favourable economic environment in the Netherlands, and setbacks to this expectation could put ratings under pressure. The NPL coverage by loan-loss allowances of 22% reflects a highly collateralised loan book but is low by international standards and relative to peers. Rabobank's large residential mortgage loan portfolio, which represents just under half of total loans, has been particularly resilient through the cycle.

Rabobank's underlying profitability has been improving in recent years, largely as a result of lower loan impairment charges (LICs) but also since the bank's cost-efficiency measures are starting to pay off. While LICs are at an unsustainably low level (the bank reported releases of provisions in 1H18 and 2017), we expect Rabobank to continue to benefit from the benign operating environment in the Netherlands and the current low interest rates, which reduce borrowers' debt-servicing costs. Cost efficiency is weaker than at domestic peers but is in line with other highly rated European cooperative groups. Fitch expects cost efficiency and structural profitability to improve as Rabobank continues to implement its cost-cutting initiatives although achieving the targeted cost/income ratio of 53%-54% is likely to be difficult in a low-rate environment (1H18: 65%, including results from associates and book gain on the sale of non-core real estate loans).

Rabobank's capital ratios are solid. At end-June 2018, its Fitch Core Capital (FCC)/RWAs ratio was 16.5% and its fully loaded CET1 ratio was 15.8%. However, net NPLs represented slightly over 45% of FCC at the same date, a high level compared with similarly rated peers. This should improve as the stock of impaired loans continues to decrease. The bank's fully loaded leverage ratio of 5.4% at end-June 2018 compared well with peers.

Rabobank remains structurally reliant on wholesale funding, making it sensitive to investor confidence. The group's liquidity management is prudent, and its liquidity buffer is ample with a liquidity coverage ratio of 136% and a total buffer of EUR119 billion (about 20% of assets) at end-June 2018.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign if Rabobank becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of, or ahead of, a bank receiving sovereign support.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and hybrid securities issued by Rabobank are notched off its VR. In accordance with Fitch's criteria, subordinated (lower Tier 2) debt is rated one notch below Rabobank's VR to reflect the higher loss severity of this type of debt compared with average recoveries.

The non-innovative old-style Tier 1 securities are rated four notches below Rabobank's VR to reflect the higher loss severity risk of these securities than average recoveries (two notches from the VR) and the high risk of non-performance (an additional two notches).

The additional Tier 1 capital notes are rated five notches below Rabobank's VR. Two notches represent the potentially high loss severity associated with the deeply subordinated securities. The other three notches represent Fitch's assessment of the incremental non-performance risk of the

securities, taking into account their fully discretionary coupon payments, which Fitch considers the most easily triggered form of loss absorption.

RATING SENSITIVITIES

IDRS, DCR AND SENIOR DEBT

The Long-Term IDR, DCR and senior debt ratings are sensitive to a change in the bank's VR as they are notched up from its VR.

These ratings are also sensitive to a material reduction in the size of the qualifying junior debt buffer, in particular should it fall below 10% of RWAs. The Long-Term IDR would be downgraded if the bank replaces a substantial amount of qualifying junior debt with non-preferred senior notes, but preferred senior debt might in this case receive a one-notch uplift from the Long-Term IDR, provided the combined buffer of qualifying junior debt and non-preferred senior notes exceeded 10% of RWAs.

The notching is also sensitive to changes in assumptions on the resolution intervention point and post-resolution capital needs, and the development of resolution planning more generally.

VR

Rabobank's VR could be downgraded if it fails to reduce NPLs and the ratio of net NPLs to capital. A reduced focus on maintaining a high liquidity buffer would also put pressure on the ratings, due to the group's wholesale funding reliance. Rabobank's ratings are also sensitive to investor sentiment turning against it. An upgrade of the VR is unlikely given its already high level.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the Support Rating or upward revision of the Support Rating Floor would be contingent on a positive change in the Dutch sovereign's propensity to support its banks. This is highly unlikely, in Fitch's view.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid capital are all notched down from the bank's VR in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles, which vary considerably. Their ratings are primarily sensitive to any change in Rabobank's VR.

Additional Tier 1 capital notes are also sensitive to Fitch changing its assessment of the probability of their non-performance relative to the risk captured in Rabobank's VR.

The rating actions are as follows:

Cooperatieve Rabobank U.A.

Long-Term IDR: affirmed at 'AA-'; Outlook Stable

Short-Term IDR: affirmed at 'F1+'

VR: affirmed at 'a+'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'No Floor'

Derivative counterparty rating: affirmed at 'AA-(dcr)'

Long-term senior unsecured debt and programme ratings: affirmed at 'AA-'

Short-term senior unsecured debt and programme ratings: affirmed at 'F1+'

Commercial paper: affirmed at 'F1+'

Subordinated debt and Tier 2 programme: affirmed at 'A'

Hybrid capital (non-innovative Tier 1): affirmed at 'BBB'

Additional Tier 1 capital notes (XS1171914515, XS1400626690, XS1877860533): affirmed at 'BBB-'

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Applicable Criteria
Bank Rating Criteria (pub. 12 Oct 2018)
<https://www.fitchratings.com/site/re/10044408>

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