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NEW ISSUER REPORT

Rabobank Nederland

Moody's Rates Rabobank Nederland's Senior Contingent Notes issued in 2010 at Baa2(hyb)

Key Ratings

Rabobank Nederland

Deposit Rating	Aa2/Stable
Senior unsecured	Aa2/Stable
Baseline credit assessment (BCA) / adjusted BCA	a2 / a2
Senior Contingent Notes	Baa2(hyb)
Pref stock non-cum	Baa3(hyb)
Counterparty Risk Assessment	Aa1(cr)

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Summary

» We have assigned a Baa2 (hyb) rating to the senior contingent notes (SCN) issued by Rabobank Nederland in 2010 (Rabobank - see left column for ratings).

» The 10-year securities maturing in 2020 rank pari passu with senior debt and therefore senior to Rabobank's subordinated debt, deeply subordinated debt and to Rabobank Certificates qualifying for common equity tier 1 capital (CET1). As for senior debt, the coupons of the SCN may not be cancelled either at the issuer's discretion or mandatorily upon a trigger breach.

» However, the principal of the securities would be permanently written down by 75% if Rabobank Group's Equity Capital Ratio (ECR) fell below 7%, this ratio being defined as the sum of retained earnings and Rabobank Certificates divided by risk-weighted assets. The SCN were issued in March 2010, ahead of Europe's Capital Requirement Regulation and its new definition of common equity tier one (CET1).

» The Baa2(hyb) rating assigned to the SCN reflects Moody's approach to the rating of 'high trigger' contingent capital securities, which takes account of the credit risk of their non-viability component, the credit risk associated with the distance to trigger breach as well as the risk of a 75% principal write-down upon a trigger breach.

» In accordance with its methodology, we use a model to assess the probability of Rabobank Group's ECR reaching the write-down trigger, which suggests a rating of Baa1. The rating of Baa2(hyb) – one notch below the model outcome – reflects the high 75% principal write-down, which is beyond the model's assumption of a normal 55% loss severity.

» We expect that this rating will likely transition upwards over the next few years towards A3(hyb), in line with Rabobank's current Tier 2 debt rating, as Basel 3 transitional provisions for regulatory capital deductions are removed.

» Exhibit 1 summarises the important features of the Senior Contingent Notes.

EXHIBIT 1
Senior Contingent Notes – Instrument Features

Issuer, domicile	Rabobank Nederland, The Netherlands
Rated security (nominal Issuance amount)	EUR 1.25 billion
Rating	Baa2(hyb)
Maturity	19 March 2020
Regulatory treatment	Senior debt. Not eligible as capital under CRR/CRD IV
Ranking	Senior debt, ranking *pari passu* with all other unsecured and unsubordinated debt
Interest	6.875% per annum payable annually in arrears
Coupon skip feature	No
Main form of loss absorption	Mandatory write-down of principal to 25% of original principal; no principal write-up
Principal write-down trigger	If Equity Capital Ratio <7%
Ranking in liquidation	Rank pari-passu with all other unsubordinated and unsecured obligations of the issuer and senior to all subordinated debt, deeply subordinated debt and to the Rabobank Certificates qualifying as CET1.
Subject to statutory resolution / bail-in regime	Yes
Variation/substitution language	No
Is the rating constrained by the non-viability rating cap?	No

Source: Moody's Investors Service, issuer information

Rating rationale

We apply 'high trigger' rating methodology. The Baa2(hyb) rating assigned to the SCN reflects Moody's approach to the rating of 'high trigger' contingent capital securities, which takes account of the credit risk of their non-viability component, the credit risk associated with the distance to trigger breach as well as the risk of a 75% principal write-down upon a trigger breach.

The write-down trigger of the SCN is an Equity Capital Ratio (ECR) of 7%. The ECR was introduced by Rabobank prior to CRD4 and to the definition of common equity tier one (CET1). It was 14.4% at year-end 2014, higher than the bank's phased-in CET1 ratio of 13.6% and significantly higher than its fully-loaded CET1 ratio of 11.8% (fully-loaded refers to the full implementation of regulatory deductions in the calculation of capital ratios). The ECR is exempt from regulatory capital deductions in its numerator and therefore it will be progressively higher than the bank's CET1 ratio as transitional provisions die out.

In accordance with its methodology, we use a model to assess the probability of Rabobank Group's ECR reaching the write-down trigger, which suggests a rating of Baa1. This was based upon Rabobank's CET1 ratio of 13.6% as of year-end 2014. We adjust the CET1 trigger rate input in its model by 82 basis points to 6.2% from 7%, in order to account for the current difference between the ECR and the CET1 ratio. Rabobank's Baseline Credit Assessment (BCA) of a2 is also an input into the model.

The rating for a non-viability contingent capital security with a senior debt host would be positioned at A3(hyb), or one notch below the bank's Adjusted BCA of a2, which in this case is the same as the bank's BCA. This reflects both a Probability of Default (PD) of the security at non-viability in line with the bank's probability of requiring extraordinary support to avoid a default, as well as the high loss severity of the notes. As this is above the Baa1(hyb) model output, the non-viability rating cap does not apply to the SCN.

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The rating of Baa2(hyb) – one notch below the model outcome – reflects the high 75% principal write-down, which is beyond the model's assumption of normal loss severity assumption of 55%.

Security rating should progressively transition towards non-viability security rating. We expect that the rating on the SCN will likely transition upwards over the next few years towards A3(hyb), in line with Rabobank's current Tier 2 debt rating. This is because the ECR will improve more quickly than the CET1 ratio because it benefits from earnings retention without suffering from increasing regulatory deductions as Basel 3 transitional provisions are removed. Eventually, the difference between the ECR and the CET1 ratio will be around 268 bps, based on the current capital structure, which represents the total of the expected deductions. This in turn means that the 7% ECR trigger will be equivalent to a CET1 trigger of 4.3%, which we believe is likely below the point of non-viability, and implying that the security will only default in a resolution, with high severity, similar to non-viability Tier 2 instruments currently rated A3, i.e. one notch below the BCA.

Moody's Related Research

Announcement:

» Moody's assigns Baa2(hyb) rating to Rabobank's senior contingent notes issued in 2010, July 2015

Credit Opinion:

» Rabobank Nederland

Rating Methodology:

» Banks, March 2016 (179038)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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