FITCH REVISES RABOBANK'S OUTLOOK TO STABLE; DOWNGRADES VR TO 'A+'

Fitch Ratings-Paris/London-09 June 2015: Fitch Ratings has revised Rabobank Group's (Rabobank) Cooperatieve Centrale Raiffeisen-Boerenleenbank BA's (Rabobank Nederland) Outlook to Stable from Negative.

It has also affirmed Rabobank's Long-term Issuer Default Rating (IDR) at 'AA-' and downgraded the Viability Rating (VR) to 'a+' from 'aa-'. Fitch has further affirmed Rabobank's central organisation, Rabobank Nederland's Long-term IDR at 'AA-'.

A full list of rating actions is available at the end of this rating action commentary.

The downgrade of the group's VR reflects Fitch's assessment of the group's capitalisation, which the agency now views as solid rather than outstanding, and modest, although showing signs of improvement, structural profitability. The revised Outlook on the Long-term IDR to Stable reflects reduced pressure on the VR following the downgrade, and Fitch's expectation that Rabobank will maintain sufficient junior debt buffers to continue supporting the one-notch uplift of the Long-term IDR and senior debt above the VR. The uplift reflects the substantial protection offered to senior creditors by the group's qualifying junior debt.

KEY RATING DRIVERS

VR
Rabobank's VR is supported by the group's modest risk appetite, which Fitch views as a factor of high importance in deriving its rating. The rating also factors in the group's leading market position in retail banking in the Netherlands, solid and improving capitalisation, robust funding profile, and conservative liquidity management. The group's balance sheet profile is strong, and management has taken steps to further strengthen it, in particular through a focus on core activities.

Asset quality is in line with domestic peers and is expected to improve as the Dutch economy continues to recover. During the tough economic conditions in the Netherlands over the past few years, Rabobank's large residential mortgage loan portfolio proved to be particularly resilient compared with peers, a reflection, in Fitch's view, of conservative underwriting standards.

The high loan impairment charges suffered in its commercial real estate lending in the past two years have led management to take steps to reduce risks in this sector, in line with the group's modest risk appetite. In Fitch's view, these will reduce tail risks. Fitch does not expect that the high loan impairment charges will be repeated. The agency does not expect the group to deviate from its focus on its core banking activities, and this supports the Stable Outlook.

Underlying profitability improved significantly in 2014, and Fitch expects further improvements to feed through in 2015 and 2016, in particular from the cost-cutting measures and strengthened focus on core activities. Overall profitability will also benefit from lower loan impairment charges. However, in Fitch's view, Rabobank's profitability levels will remain somewhat below that of similarly rated peers, reflecting its cooperative nature. Fitch expects the group to build up a track record of resilient profitability, supporting the rating and the Stable Outlook.

Rabobank's fully loaded common equity Tier 1 ratio was 11.8% at end-2014. While this does not compare favourably with similarly rated peers, Fitch expects that the group will take measures to strengthen it. Capitalisation was historically a rating strength for Rabobank but while highly rated banks have generally strengthened capitalisation, the pace of capital building has not kept up for Rabobank, in Fitch's view.

Rabobank is structurally reliant on wholesale funding, making it sensitive to investor confidence. However, the group's liquidity buffer is ample and liquidity management is prudent, a further reflection of Rabobank's cautious approach to risk.

IDRS AND SENIOR DEBT RATINGS

The Long-term IDR and senior debt ratings of Rabobank are one notch above the group's VR because we believe that the risk of default on senior obligations, as measured by the Long-term IDR, is lower than the risk of the group failing, as measured by its VR.

The group has built up a significant junior debt buffer, recently issuing Tier 2 and additional Tier 1 instruments, 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, distressed debt exchange) to avoid a resolution action.

Absent such a private sector solution, we would expect a resolution action being taken on Rabobank when it breaches minimum capital requirements. Pillar 2 requirements are not disclosed for Rabobank, but we have assumed that the intervention point would be around 6%-7% of risk exposure amount. Fitch believes that Rabobank would need to meet its minimum capital requirements immediately after a resolution action. Given Rabobank's systemic importance, Fitch believes, minimum capital requirements will include most, if not all, of its combined buffer requirements. On a risk weighted basis, therefore, Fitch has estimated that post resolution action a common equity Tier 1 capital requirement in the 12%-15% range is plausible under a bail-in scenario.

At the time of this release, taking into account 2015 issuance so far, the qualifying junior debt buffer amounted to around 9.9% of end-2014 risk exposure amount, which means that taking Fitch's view of the regulatory intervention point and post-resolution capital needs, this should be sufficient to restore the group's viability without hitting senior creditors.

We have further assumed that the group will continue to strengthen this junior debt buffer, in line with its stated target of a total capital ratio in the 25-30% range over the next few years. This will provide additional protection for its senior creditors and meet potential capital requirements such as TLAC through capital and subordinated instruments.

SUPPORT RATING AND SUPPORT RATING FLOOR

The group's Support Rating and Support Rating Floor reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign in the event that Rabobank becomes non-viable. In Fitch's view, the EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) for eurozone banks are now sufficiently progressed to 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.

In the EU, BRRD has been effective in member states since 1 January 2015, including minimum loss absorption requirements before resolution financing or alternative financing (eg, government stabilisation funds) can be used. Full application of BRRD, including the bail-in tool, is required from 1 January 2016.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and hybrid securities issued by Rabobank Nederland are notched off Rabobank's VR. Therefore, their respective ratings have been downgraded by one notch in line with the downgrade of Rabobank's VR.

In accordance with Fitch's criteria, subordinated (lower Tier 2) debt are rated one notch below Rabobank's VR to reflect below-average loss severity of this type of debt.

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

The perpetual non-cumulative capital securities (XS0583302996 and XS0703303262) as well as the additional Tier 1 capital notes (XS1171914515) are rated five notches below Rabobank's VR: two of the 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 high triggers.

SUBSIDIARY AND AFFILIATED COMPANY
Rabobank Nederland is the group's central bank and it is part of the cross-support scheme, hence its IDRs are aligned with those of Rabobank.

RATING SENSITIVITIES

VR
Rabobank's VR is sensitive to a setback in the improving trend in the group's structural profitability or delays in strengthening capitalisation. A reduced focus on maintaining high liquidity buffer, given the group's wholesale funding reliance, would also put negative pressure on the ratings. Rabobank's ratings are also sensitive to an adverse turn in investor sentiment. A rating upgrade is unlikely in the near future given its already high level.

IDRS AND SENIOR DEBT RATINGS
As the Long-term IDR and senior debt ratings are notched up from the group's VR, they are sensitive to a downgrade of the group's VR.

The Long-term IDR and senior debt ratings are also sensitive to a material reduction in the size of the qualifying junior debt buffer. Our base case is that the ratio will increase and would need to be at a minimum of 10% to be able to afford protection to senior creditors. The notching is sensitive to changes in assumptions on resolution intervention point and post-resolution capital needs, and the development of resolution planning more generally.

SUPPORT RATING AND SUPPORT RATING FLOOR
Any upgrade to the Support Rating or upward revision to the Support Rating Floor would be contingent on a positive change in the Dutch sovereign's propensity to support its banks. While not impossible, this is highly unlikely in Fitch's view.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
Subordinated debt and other hybrid capital issued by Rabobank Nederland are all notched down from the VR of the group 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 a change in Rabobank's VR.

Perpetual non-cumulative capital securities and 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.

SUBSIDIARY AND AFFILIATED COMPANIES
Rabobank Nederland's IDRs are sensitive to a change in Rabobank's IDRs.

The rating actions are as follows:

Rabobank
Long-term IDR: affirmed at 'AA-'; Outlook revised to Stable from Negative
Short-term IDR: affirmed at 'F1+'
VR: downgraded to 'a+' from 'aa-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No floor'

Rabobank Nederland
Long-term IDR: affirmed at 'AA-'; Outlook revised to Stable from Negative
Short-term IDR: affirmed at 'F1+'
Long-term senior unsecured debt (EMTN and GMTN): affirmed at 'AA-'
Short-term senior unsecured debt (EMTN and GMTN): affirmed at 'F1+'
Senior Long-term market-linked notes: affirmed at 'AA-emr'
Subordinated debt: downgraded to 'A' from 'A+'
Hybrid capital (non innovative Tier 1 and preferred stock): downgraded to 'BBB' from 'BBB+'
Perpetual non-cumulative capital securities (XS0583302996 and XS0703303262): downgraded to 'BBB-' from 'BBB'
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Applicable Criteria
Global Bank Rating Criteria (pub. 20 Mar 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501