FITCH AFFIRMS RABOBANK AT 'AA-'; OUTLOOK STABLE

Fitch Ratings-Paris/London-14 April 2016: Fitch Ratings has affirmed Cooperatieve Rabobank U.A.'s (Rabobank) 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 ratings actions are part of a periodic portfolio review of major Benelux banking groups rated by Fitch.

KEY RATING DRIVERS
IDRs and Senior Debt Ratings
Rabobank's Long-term IDR and senior debt ratings are one notch above the group's VR because we believe 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 one-notch uplift reflects the bank's significant 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 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. The ECB's capital requirement for Rabobank's following the 2015 SREP is a common equity Tier 1 ratio to risk-weighted assets of 9.5% for 2015. The Dutch DNB also requires the systemic risk buffer to reach 3% in 2019.

We have assumed that the intervention point would be 6%-7% of the risk exposure amount (REA). Fitch believes Rabobank would need to meet its minimum capital requirements immediately after a resolution action. Rabobank's systemic importance means Fitch believes minimum capital requirements will include most, if not all, the bank's combined buffer requirements.

Therefore, on a risk-weighted basis Fitch has estimated that after resolution action a common equity Tier 1 capital requirement at the upper end of the 12%-15% range is plausible under a bail-in scenario;

At end-2015, the qualifying junior debt buffer was around 11% of REA. Fitch's view of the regulatory intervention point and post-resolution capital needs suggests that this this should be sufficient to restore the group's viability without hitting senior creditors.

We have also assumed that the group will further strengthen this junior debt buffer, in line with its minimum stated target of a total capital ratio of 25% over the next few years to increase protection for its senior creditors and meet potential additional capital requirements through capital and subordinated instruments.

Viability Rating
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 the group's leading market position in retail banking in the Netherlands, which is complemented by a solid franchise in the global food and agriculture sectors. Fitch factors into the rating its expectation that Rabobank will continue to improve its capitalisation, and maintain its diversified funding and conservative liquidity management.

Rabobank is increasingly centralising its risk controls, helped by its merger into one bank, and further strengthened its focus on a prudent approach to risk. The group has tightened its risk appetite in its core markets have been tightened, and Fitch believes the loan impairment charges taken to date while exiting some non-core areas will not need to be repeated. The merger into one bank, with an aim of simplifying the organisation, was accompanied by a decision to reduce staff by an additional 9,000 (around 20% of the workforce).

The high cost base, partly arising from the group's cooperative model, has affected profitability, which is fairly weak compared to peers. However, Fitch expects the improving trend to continue for structural and cyclical reasons, and for the group to reduce the profitability gap to similarly rated peers.

Asset quality is in line with its domestic peers and Fitch expects it to improve as the Dutch economy continues to recover. Rabobank's large residential mortgage loan portfolio has proved particularly resilient compared with peers during the tough economic conditions in the Netherlands in recent years.

In Fitch's view this reflects conservative underwriting standards. The de-risking in commercial real estate lending is reducing downside tail risks. Fitch does not expect the group to deviate from its focus on its core banking activities, and this supports the Stable Outlook.

Rabobank's Fitch Core Capital to weighted risks ratio was 14% at end-2015 and has consistently improved from 12% at end-2012. The group aims for a minimum common equity Tier 1 ratio of 14% 2020, and Fitch's expectation that the group will meet this target is factored into the rating. Rabobank is considering reducing its assets significantly, for example through sales of assets in non-core businesses and true sales of loan portfolios, to meet higher capital requirements, including revisions to Basel 3 the introduction of minimum requirement for own funds and eligible liabilities (MREL), and strengthen its balance-sheet flexibility.

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 the cautious approach to risk.

Support Rating and Support Rating Floor
The '5' Support Rating and 'No Floor' Support Rating 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 Rabobank's VR. In accordance with Fitch's criteria, subordinated (lower Tier 2) debt is rated one notch below Rabobank's VR to reflect the above-average loss severity of this type of debt compared with average recoveries.

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

The perpetual non-cumulative capital securities (XS0583302996 and XS0703303262) and the additional Tier 1 capital notes (XS1171914515) 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 and Senior Debt Ratings
The Long-term IDR and senior debt ratings are sensitive to a change in the bank's VR as they are notched up from the bank'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.

Viability Rating
Rabobank's VR is sensitive to any material setbacks in the improving trend in the bank's structural profitability or delays in strengthening capitalisation. A reduced focus on maintaining a high liquidity buffer would also put negative 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 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, although not impossible.

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.

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.

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'

Long-term senior unsecured debt (EMTN and GMTN): affirmed at 'AA-'
Short-term senior unsecured debt (EMTN and GMTN): affirmed at 'F1+'
Commercial Paper: affirmed at 'F1+'
Senior Long-term market-linked notes: affirmed at 'AA-emr'
Subordinated debt: affirmed at 'A'

Hybrid capital (non innovative Tier 1 and preferred stock): affirmed at 'BBB'
Perpetual non-cumulative capital securities (XS0583302996 and XS0703303262): affirmed at 'BBB-'
Additional Tier 1 capital notes (XS1171914515): affirmed at '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