FitchRatings

FITCH AFFIRMS RABOBANK AT 'AA-'; OUTLOOK STABLE

Fitch Ratings-London-24 February 2017: 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.

In addition, Fitch has assigned a 'AA-(dcr)' Derivative Counterparty Rating (DCR) to Rabobank as part of its roll-out of DCRs to significant derivative counterparties in western Europe and the US. DCRs are issuer ratings and express Fitch's view of banks' relative vulnerability to default under derivative contracts with third-party, non-government counterparties.

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 the bank's 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 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, and we have assumed that the intervention point would be around the bank's current minimum common equity tier 1 (CET1) requirement of 6.25% (Pillar 1 and Pillar 2 - excluding the capital conservation (CCB) and the domestic systemic importance (DSIFI) buffers). We further assume Rabobank would need to meet its total minimum capital requirements immediately after a resolution action, which on a fully loaded basis, including the CCB and DSIFI buffers, currently amounts to 15.25% of total risk exposure amount (REA). Taking also 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 REA would most likely be sufficient to restore the group's viability without hitting senior credits.

At end-June 2016, the qualifying junior debt buffer was 11.5% of REA. Fitch has also assumed that the bank will maintain a sufficient buffer, given its stated targets of CET1 and total capital ratios of at least 14% and at least 25% by 2020.

A DCR has been assigned to Rabobank due to its significant derivatives activity. The DCR is at the same level as the Long-Term IDR because under Dutch legislation, derivative counterparties have no preferential status over other senior obligations in a resolution scenario.

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 the bank's leading market position in Dutch retail banking, complemented by a solid franchise in the global food and agriculture sectors. The rating factors in the expectation that Rabobank's capitalisation will continue to improve, and that the bank will maintain prudent liquidity and diversified funding.

Rabobank's underlying profitability has improved in recent years, largely as a result of lower LICs, but it remains weaker than similarly rated peers' due to weaker cost efficiency. Fitch expects the gap to narrow and structural profitability to improve through significant cost-cutting initiatives, including reducing staff by an additional 7000 by 2018 (around 15% of the current workforce. Rabobank reported again much lower loan impairment charges (LICs) in 2016, and while they are currently at an unsustainably low level (7bp of private sector gross loans reported), we expect the bank will continue to benefit from the benign operating environment and the current low interest-rate environment. We also expect Rabobank to maintain a prudent approach to risk and to focus on core markets, where the bank has tightened its risk appetite.

Asset quality is in line with domestic peers, and the ratio of impaired to gross loans, as reported by the bank, improved to 4.3% at end-2016 (end-2015: 4.5%). Fitch expects this trend to continue in 2017, but the bank still has notable exposure to commercial real estate, which is of weaker quality. The bank's reserve coverage of just over 40% is relatively low but acceptable in light of a high share of well-collateralised loans. Rabobank's large residential mortgage loan portfolio, which represents just below half of total loans, has proved particularly resilient through the cycle compared with domestic peers'.

Rabobank's capitalisation is solid and continues to improve. At end-2016, the pro forma fully loaded CET1 ratio was 14.3% (including Rabobank Certificates issued in January 2017). Fitch estimates that net impaired loans represented about 35% of Fitch-adjusted equity at end-2016 (including the newly issued Rabobank Certificates), a high level compared to similarly rated peers. This should improve as the stock of impaired loans continues to decrease. The fully loaded leverage ratio of 4.6% at the same date compared well with peers.

To further strengthen its balance-sheet flexibility and to meet potential future capital requirements, Rabobank is also considering reducing its balance sheet significantly. In 2016 the bank sold some mortgage portfolios as well as a car leasing subsidiary, and some further portfolio sales are possible in 2017.

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 total buffer of High Quality Liquid Assets (HQLA) of EUR103bn (16% of assets) at end-2016 compared to the bank's total wholesale funding of EUR191bn.

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 and 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 the bank's 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 REA. 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 is sensitive to material setbacks in the improving trend in the bank's structural profitability or a failure to reduce the ratio of net impaired loans 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 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'
Derivative counterparty rating: assigned at 'AA-(dcr)'
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 (XS1400626690 and XS0703303262): affirmed at 'BBB-'
Additional Tier 1 capital notes (XS1171914515): affirmed at 'BBB-'

Contact:

Primary Analyst
Bjorn Norrman
Senior Director
+44 20 3530 1330
Fitch Ratings Limited
30 North Colonnade
London E14 5GN

Secondary Analyst
Konstantin Yakimovich
Director
+44 20 3530 1789

Committee Chairperson
Olivia Perney Guillot
Senior Director
+33 144 299 174

Media Relations: Elaine Bailey, London, Tel: +44 203 530 1153, Email: elaine.bailey@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051