Rating Action: Moody's downgrades Raiffeisen Schweiz's long-term deposit ratings to Aa3 and senior unsecured rating to A3

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Outlook remains negative

Frankfurt am Main, June 19, 2018 -- Moody's Investors Service has today downgraded Raiffeisen Schweiz's long-term deposit ratings to Aa3 from Aa2 and the senior unsecured debt ratings to A3 from A2. The outlook on these ratings remains negative. Furthermore, Moody's downgraded the Counterparty Risk Assessment (CR Assessment) to A2(cr), from A1(cr), as well as the Baseline Credit Assessment (BCA) and the Adjusted BCA to a3, from a2.

At the same time, Moody's affirmed Raiffeisen Schweiz's high-trigger Additional Tier 1 instrument rating at Baa3(hyb), as well as its short-term deposit ratings at P-1 and its short-term CR Assessment at P-1(cr). Moody's further assigned new A3/P-2 Counterparty Risk Ratings as part of the rating action.

Today's action follows Moody's evaluation of the credit implications of significant corporate governance shortfalls by Raiffeisen Schweiz, Raiffeisen Group Switzerland's (Raiffeisen Group) central institution, as identified by the Swiss Financial Market Supervisory Authority (FINMA). While immediate financial sanctions or fines are immaterial, the rating agency has taken into account broader medium to longer-term implications such as potentially crystallizing higher asset risks from previous underwritings at Raiffeisen Schweiz, given the significant corporate governance shortcomings revealed. The negative outlook reflects Moody's assessment of remaining tail-risks related to potential further investigations, and also reflects the rating agency's view around the bank's lending standards and general risk management shortfalls at the Raiffeisen Schweiz level, given the significance of the regulator's findings.

RATINGS RATIONALE

DOWNGRADE OF BASELINE CREDIT ASSESSMENT

The downgrade of Raiffeisen Schweiz's BCA and Adjusted BCA to a3 from a2 reflects Moody's evaluation of the revealed governance shortfalls, but also broader implications around the risk culture and supervisory practices at Raiffeisen Schweiz, the central institution of Raiffeisen Group, a co-operative banking group operating under a statutory mutualist support framework with strong cohesion.

As a result of its investigation, FINMA identified various control issues and problems, including significant shortfalls in the group's overall corporate governance practices related to the management of shareholdings and related persons. Raiffeisen Schweiz failed to effectively oversee and control its own management and mitigate potential conflicts of interest arising from the management's and the supervisory board's involvement in day-to-day decision making. This lead to breaches of several supervisory laws and best practices, mainly during the 2012-15 period. Further shortfalls included inadequate risk management around lending standards related to individuals closely associated with the bank and/or involving significant shareholdings and participation, which in one case led to a miscalculation of regulatory capital.

In its assessment of the various supervisory findings, Moody's acknowledges that weaknesses around corporate governance are at least partially balanced by the bank's and the group's solid fundamentals, as reflected in generally sound asset quality, adequate capital levels and a good liquidity profile. Further, Moody's understands that financial sanctions for Raiffeisen Schweiz as a result of the investigations were immaterial.

However, Moody's revised assessment of asset risk now incorporates the potential that applied lending standards and risk appetite prove to have been more aggressive and on a broader set of risk categories than previously anticipated. Therefore, the rating agency believes that the combination of the aforementioned challenges and mitigating factors is more commensurate with a BCA of a3, compared to a2 previously.

On a more positive note, the rating agency acknowledges the responsiveness of the bank's management and supervisory board in implementing revised stricter policies and procedures that aim to eliminate any future corporate governance shortfalls. Moody's expects FINMA's findings to be addressed in 2018, supported by an
enhanced and refocused supervisory board.

RATIONALE FOR ACTIONS ON DEPOSIT, SENIOR UNSECURED AND HYBRID INSTRUMENT RATINGS

The downgrade of Raiffeisen Schweiz's deposit and senior unsecured debt ratings reflects the downgrade of its BCA and unchanged results from Moody's Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of losses faced by different liability classes in resolution. For deposits, the analysis results in a very low loss-given-failure and two notches of rating uplift and takes into account a flexible resolution framework in Switzerland, which only excludes privileged deposits and covered bonds explicitly from bail-in, a cash-rich corporate sector and the bank's deposit structure. For Raiffeisen Schweiz's senior unsecured liabilities, the LGF analysis results in a high loss-given-failure and a positioning one notch below the BCA, prior to government support.

Raiffeisen Schweiz's long-term senior debt and deposit ratings benefit from one notch of government support uplift, taking into account Raiffeisen Group's status as a domestic systemically important financial institution.

The affirmation of Raiffeisen Schweiz's High-Trigger AT1 instrument at Baa3(hyb) reflects the identified potential pressures on the BCA, balanced by the banking group's increased capitalization, measured by its Common Equity Tier 1 (CET1) ratio. The rating agency views the increased cushion for investors as reflected in buffers versus the trigger levels to balance the downside pressure on the BCA.

RATIONALE FOR THE NEGATIVE OUTLOOK

The outlook on Raiffeisen Schweiz's Aa3 deposit ratings and the A3 senior unsecured rating remains negative. While Moody's expects that the identified corporate governance issues have been or will be addressed in 2018 with limited financial impact, tail risks regarding further proceedings and questions about adequate risk procedures remain, given the revealed substantial shortfalls.

However, still solid asset risk indicators as reflected in extremely low non-performing loan ratios and improving capital buffers provide investors with a cushion for downside risks. While profitability is expected to remain low, the market funding structure should remain defensive, with adequate liquid reserves retained. The negative outlook is based on unchanged government support assumptions and a largely stable funding structure, which results in unchanged rating uplift from Moody's LGF analysis.

ASSIGNMENT OF COUNTERPARTY RISK RATING

Moody's Counterparty Risk Ratings (CRR) are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

In assigning A3/P-2 CRRs to Raiffeisen Schweiz, Moody's starts with the bank's Adjusted Baseline Credit Assessment (Adjusted BCA) and uses the agency's existing Advanced Loss Given Failure (LGF) approach that takes into account the level of subordination to CRR liabilities in the bank's balance sheet and assumes a nominal volume of such liabilities. For Raiffeisen Schweiz, the level of subordination is limited, leading to a one-notch reduction from the bank's a3 Adjusted BCA as a result of the LGF analysis.

The CRRs assigned are positioned between senior unsecured debt and junior deposits. In Switzerland, we expect CRR obligations will receive preference relative to other senior creditors given the desire of government authorities to ensure the continuity of a failing bank's operations, but will remain junior to depositors given national depositor preference by law. We also expect that CRR obligations will occupy a unique place in the waterfall without any other pari-passu obligations.

For Raiffeisen Schweiz, Moody's further considers the likelihood of government support for CRR liabilities to be moderate, resulting in one additional notch of uplift, reflecting Raiffeisen Schweiz's high degree of interconnectedness and systemic importance to the Swiss banking system.

WHAT COULD CHANGE THE RATING UP/DOWN
Raiffeisen Schweiz’s ratings could be upgraded if stronger credit fundamentals justify an upgrade of the BCA, and/or the volume of senior unsecured debt or further subordinated instruments increases, which could lead to additional rating uplift (as assessed in Moody’s Advanced LGF analysis), provided that Moody’s government support assumptions remain unchanged.

While very unlikely at present, upward pressure on the bank’s a3 BCA could develop following a significant strengthening of its corporate governance, including the full implementation of FINMA measures and higher comfort with regards to potential tail risks. Furthermore, a combination of a slowdown in the group’s mortgage-loan book growth to below the market average over the coming years in line with re-assurance of cautious risk management, a sustainable improvement in its risk-adjusted levels of recurring profitability and efficiency, significantly stronger capitalisation levels at the consolidated group level, and increased liquid-asset volumes could result in upward pressure.

A downgrade of Raiffeisen Schweiz's ratings could be triggered following a downgrade of the bank's BCA, or a decline in the group's cohesion, which, however, is considered highly unlikely. The bank's deposit ratings could be strained further in case the deposit volume declines substantially, resulting in fewer notches of rating uplift.

Challenges for the bank's BCA could arise from a meaningful deterioration in its asset quality, especially if linked to risk management shortfalls; a higher risk appetite, in particular if accompanied by a reduction in the bank's capital ratios; a sustained weakening of the group's liquid resources; or a substantial increase in the bank's or the group's market funding ratio.

Raiffeisen Schweiz's hybrid ratings for the high-trigger AT1 instruments may be downgraded in case the CET1 ratio falls below 13.23% on a sustainable basis.

LIST OF AFFECTED RATINGS
Issuer: Raiffeisen Schweiz

.Downgrades:
   ....Long-term Bank Deposits, downgraded to Aa3 Negative from Aa2 Negative
   ....Long-term Counterparty Risk Assessment, downgraded to A2(cr) from A1(cr)
   ....Adjusted Baseline Credit Assessment, downgraded to a3 from a2
   ....Baseline Credit Assessment, downgraded to a3 from a2
   ....Senior Unsecured Regular Bond/Debenture, downgraded to A3 Negative from A2 Negative
   ....Subordinate Regular Bond/Debenture, downgraded to Baa1 from A3

.Assignments:
   ....Long-term Counterparty Risk Rating (Local Currency), assigned A3
   ....Short-term Counterparty Risk Rating (Local Currency), assigned P-2
   ....Long-term Counterparty Risk Rating (Foreign Currency), assigned A3
   ....Short-term Counterparty Risk Rating (Foreign Currency), assigned P-2

.Affirmations:
   ....Short-term Bank Deposits, affirmed P-1
   ....Short-term Counterparty Risk Assessment, affirmed P-1(cr)
   ....Preferred Stock Non-cumulative, affirmed Baa3(hyb)

.Outlook Action:
   ....Outlook remains Negative
PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in June 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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