S&P Global Ratings

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Research Update:

Liechtenstein-Based VP Bank Downgraded To 'A-/A-2' On Weaker Expected Financial Performance; Outlook Stable

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Overview

- In our view, VP Bank is facing headwinds in implementing its strategy to become an open wealth-management platform, which will weigh on profitability over the coming years.
- These headwinds partially stem from the unfavorable geopolitical environment, which could lead to some further outflows in managed assets, but also high management turnover and strong competition, which could result in delays in achieving financial targets.
- We consequently lowered the long- and short-term issuer credit ratings on VP Bank to 'A-/A-2' from 'A/A-1'.
- The stable outlook reflects our view that the bank's very strong capitalization will support its multi-year strategy implementation, even if profitability only gradually improves.

Rating Action

On July 19, 2023, S&P Global Ratings lowered its long- and short-term issuer credit ratings on VP Bank to 'A-/A-2' from 'A/A-1'. The outlook is stable.

At the same time, we lowered the issue rating on VP Bank's senior unsecured notes to 'A-' from 'A' and issue rating on the senior subordinated notes to 'BBB+' from 'A-'.

We also lowered our long- and short-term resolution counterparty ratings on the bank to 'A/A-1' from 'A+/A-1'.

Rationale

The rating action reflects our view that the financial benefits of VP Bank's current strategy implementation will be very gradual and could take longer than planned. With Strategy 2026, VP Bank targets the transition toward an open wealth-management provider, leveraging its sound market position within the intermediaries business. The strategy measures include material investments into its IT platform--to enable more efficient processes and digital self-services--including digital onboarding for intermediaries. To foster revenue growth, the strategy plan also aims to improve the bank's digital value proposition--that rests on integrating additional modular services from external partners to its platform and services for digital assets and sustainable investments. Through these steps, VP Bank aims to meet its somewhat softened 2026 financial targets of net new money growth above 4% annually (2% in 2022), income growth of 4%-6% (2% in 2022), and a cost-to-income ratio of below 75% (86.6% reported in 2022). The bank revised its cost-to-income ratio target upward from below 70%, which--in our view--acknowledges the challenges around significantly growing the revenue base. We also forecast the cost base will likely remain elevated, but will not materially grow from next year onward.

VP Bank's financial performance will remain only moderate over the next 12-24 months. Whether the ongoing investments result in the intended benefits will likely only become visible over several years, in our view. Until then, we expect VP Bank's financial performance will continue to be muted, with weak efficiency and relatively low profitability compared with many other private banks. We think that larger peers especially can absorb investment needs better than VP Bank, thanks to larger economies of scale, and therefore will continue to post stronger results. We forecast VP Bank's return on equity to be a low 3.0%-3.5% between 2023 and 2025 (less than 3.7% in 2022 and 4.8% in 2021). Similarly, we project its cost-to-income ratio will likely stay elevated above 80% between 2023 and 2025, versus 80% in 2022 and 72%-78% over previous years.

Frequent management changes could also weigh on strategy execution. VP Bank's management board has had an almost complete overhaul over the past three years. This was partially driven by the risk-management and governance overhaul, which identified deficiencies in 2020, and also its new strategic orientation. Although the bank is fully committed to implementing its formulated strategy measures, we think recent management changes, especially over the past 12 months, could cause some delays to their implementation as the new team gets settled in.

The uncertain geopolitical environment increases risks of further sanction driven outflows. Russia was a target market for VP Bank, and the bank reported net new money outflows from Russia-connected clients of Swiss franc (CHF) 500 million in 2022. With the ongoing extension of sanctions related to the war in Ukraine, we think there is potential for the bank to experience further outflows reducing its asset base and related fee income. Together with strong competition and continuing margin pressure, this weighs on VP Bank's profitability.

VP Bank's very strong capitalization remains its main rating strength. Our 'A-' long-term issuer credit rating on VP Bank is materially supported by its very strong capitalization and solid funding and liquidity position. We project VP Bank's risk-adjusted capital ratio, our main capital indicator, will modestly decline to a still very strong 17% by 2025, from 18% at end-2022, depending on Lombard lending demand. We view VP Bank's communicated target of a common equity tier 1 ratio of above 20% as supporting its conservative capital management. That said, the bank's relatively small scale and niche position in the global private banking market remain the main rating constraints. We think this makes it more difficult to generate return levels that allow it to easily absorb the ongoing material investments in digitalization.

VP Bank has received its minimum requirement for own funds and eligible liabilities requirement by the Financial Markets Authority, but it does not provide additional material protection to senior creditors. We understand VP Bank has to meet the full minimum requirement for own funds and eligible liabilities (MREL) by 2026, but it is already above the regulatory requirement. While there is no subordination requirement, VP Bank's existing CHF155 million senior subordinated bond is also MREL eligible. However, this subordinated bond results in an additional loss-absorbing capacity (ALAC) buffer of only 278 basis points (bps) as of year-end 2022 and we do not incorporate additional issuances in the future. As such, the ALAC buffer will stay below our adjusted threshold of 400 bps. We include a 100 bp upward adjustment to our standard 300 bp threshold to reflect VP Bank's maturity concentration with only one instrument.

Outlook

The stable outlook on VP Bank reflects our view that over the next 12-24 months the bank's very strong capitalization will support its multi-year strategy implementation, even if profitability only gradually improves.

Downside scenario

We could lower the ratings if the bank's strategy implementation experiences material setbacks, leading to a loss of clients and net outflows in assets under management, as this would question the stability of its business franchise. We could also downgrade the bank if there are indications of an increasing risk appetite. A sizable acquisition could also constrain the rating should it materially erode the bank's capital buffer, reflected in our risk-adjusted capital ratio dropping below 15%.

Upside scenario

We could consider raising the ratings if we think VP Bank has built a material buffer of bail#inable subordinated capital, above our adjusted threshold, that would be used by the Financial Markets Authority to protect senior unsecured creditors should the bank become nonviable.

While much less likely at this stage, we could also consider an upgrade if Strategy 2026 successfully results in sustainable new asset inflows and results in increasing fee income. A higher rating would then be supported by improving cost efficiency and profitability also compared to peers.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-3

Governance factors are a moderately negative consideration in our credit rating analysis of VP Bank. The bank is currently in a transformation period and experienced material management turnover over the past years that might delay its strategy implementation. At the same time, we consider past weaknesses in risk-management and governance, that led to a large single loss in its Lombard book in 2020, to be remediated.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	**A-/Stable/A-2**	**A/Negative/A-1**
SACP	a-	a
Anchor	a-	a-
Business position	Constrained (-2)	Moderate (-1)
Capital and earnings	Very strong (+2)	Very strong (+2)
Risk position	Adequate (0)	Adequate (0)
Funding	Adequate (0)	Adequate (0)
Liquidity	Adequate (0)	Adequate (0)
Comparable ratings analysis	0	0
Support	0	0
ALAC support	0	0
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions , March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions , Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology , Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- General Criteria: Group Rating Methodology , July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology , July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

Related Research

- Bulletin: VP Bank AG Maintains Its Strategy, But 2026 Financial Targets Need Review Amid A Tightening Economic Environment, Aug. 18, 2022
- Research Update: Liechtenstein-Based VP Bank Affirmed At 'A/A-1'; Outlook Remains Negative Amid Tightening Economic Environment, July 20, 2022
- Banking Industry Country Risk Assessment: Liechtenstein, July 12, 2022

Ratings List

Downgraded

	To	From
VP Bank AG		
Issuer Credit Rating	A-/Stable/A-2	A/Negative/A-1
Senior Unsecured	A-	A
Senior Subordinated	BBB+	A-

Downgraded; Ratings Affirmed

	To	From
VP Bank AG		
Resolution Counterparty Rating	A/--/A-1	A+/--/A-1