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Fitch Rates Swiss Raiffeisen Group and Raiffeisen Schweiz 'A+'; Stable Outlook

Fitch Ratings - London - 09 Sep 2021: Fitch Ratings has assigned Swiss Raiffeisen Group (RG) and the members of its mutual-support mechanism, including Raiffeisen Schweiz Genossenschaft (RS) and the 219 local cooperative banks, a Long-Term Issuer Default Rating (IDR) of 'A+' with a Stable Outlook, a Short-Term IDR of 'F1' and a Viability Rating (VR) of 'a+'. A full list of ratings is provided below.

RG is not a legal entity but a cooperative banking network that constitutes Switzerland's third-largest banking group. The network's cohesion is ensured by a mutual-support scheme that ensures that the equity of each bank that is part of the group is available to cover losses of all other banks within the group. RG's IDRs apply to each member bank of the group, in accordance with Fitch's criteria for rating banking groups backed by mutual-support schemes.

RG's ratings are underpinned by the mutual support mechanism, which has proven to be effective as no creditor of any member bank has suffered losses since the establishment of the group. RG is supervised as a group by the Swiss regulator, which does not set individual capital requirements for the local banks, and under its resolution plan the group will be resolved as one.

Key Rating Drivers

IDRS, VR AND DEBT RATINGS

The VR of RG is in line with its implied VR and drives its IDRs. The VR is underpinned by the group's strong franchise in Switzerland, where it has a market share of 18% in domestic mortgage loans and 14% in domestic deposits. It also reflects the group's conservative risk appetite with a loan portfolio dominated by residential mortgage loans, resulting in strong asset quality.

The group's capitalisation is strong, which mitigates its only moderate profitability; the latter has come under pressure from low interest rates given RG's reliance on net interest income. The IDRs of RS and the local banks are group ratings and, as such, in line with RG's IDRs.

RG comprises 219 local banks and RS, the group's central institutions. The local banks exclusively operate in their geographic region focusing on retail and SME clients, and the group's operations are almost exclusively domestic. As the central institution, RS is responsible for the group's strategy and oversight over the local banks' risk profile. RS also acts as the group's central bank, managing the local banks' liquidity and trading needs. RG's mutual-support mechanism includes a solidarity fund to support failing banks and a cross-guarantee between the local banks and RS, to which the local banks are liable for up to the amount of their equity.

RG's asset quality is strong, but the group is highly exposed to the residential real-estate sector as mortgage loans account for about 95% of the group's gross loans. We believe that Switzerland's strong economic fundamentals and RG's conservative underwriting standards mitigate risks arising from this concentrated exposure, and RG's asset quality has a long record of over the past 20 years of low loan impairment charges.

Over half of RG's exposure is composed of owner-occupied homes, but exposure to real-estate investments, including buy-to-let mortgages, is material. The group's asset quality remained resilient in 2020 despite a slowdown of the economy, and although we expect a moderate increase in the inflow of impaired loans, RG's gross impaired loans should remain below 1% of gross loans.

RG's focus on traditional retail and SME banking means that the group is reliant on net interest income, which on average accounts for about three quarters of its revenue. Residential mortgage-lending growth above market rates until 2018 had underpinned revenue in recent years, but under its strategic plan, RG plans to expand its fee-generating businesses, including the sale of investment products to increase non-interest income by 2025.

RG's modest profitability is mitigated by strong capitalisation, and the group's 18% common equity Tier 1 (CET1) ratio at end-1H21 compares well with peers'. Internal capital generation is underpinned by low pay-out ratios to its cooperative members, which averaged 8% over the past four years. At the same time, the group's cooperative structure results in a weaker ability to raise core equity in the capital markets, in case of need, than listed peers'.

RG is subject to consolidated regulatory capital requirements and, as a domestic significantly important bank, it has to maintain a minimum going-concern capital ratio of 13.74% for 2021 (9.44% CET1 ratio, up to 4.3% of the going-concern capital requirement can be met by additional tier 1 capital). RS also has to meet regulatory capital requirements, but the local banks are not subject to them.

RG's 'F1' Short-Term IDR is the lower of the two ratings that maps to an 'A+' Long-Term IDR. This reflects our assessment of the group's funding and liquidity, to which we assign an 'a+' score. The group benefits from a large and stable granular deposit base, which represented close to 80% of funding at end-1H21. The group regularly refinances mortgage loans through the issuance of covered bonds via Pfandbriefbank schweizerischer Hypothekarinstitute AG, and RS has issued unsecured bonds, including bail-in bonds.

The 'F1+' rating of RS's certificates of deposits (CD) issuance programme reflects the protection provided to preferred creditors by an increase of resolution buffers to a minimum 40% of RG's going-concern capital requirement by 2026.

SUPPORT RATINGS AND SUPPORT RATING FLOORS

RG's Support Rating (SR) and Support Rating Floor (SRF) reflect our view that senior creditors of the group cannot rely on receiving full extraordinary support from the sovereign if the group becomes non-viable, largely due to legislation in place in Switzerland to address the 'too big-to-fail' problem for Switzerland's largest banks that includes the ability to bail in senior liabilities.

On 17 August 2021, Fitch published an exposure draft setting out proposed changes to our Bank Rating Criteria. Should final criteria be in line with the exposure draft, RG's SRF would be re-named 'Government Support Rating' and remain at 'No Support' and the SR would be withdrawn.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of RG's VR and Long-Term IDR is unlikely until a material and sustainable improvement in operating profitability materialises with an operating profit/risk weighted asset ratio of above 3% (2020: 1.03%) and the successful execution of the group's strategic plan to increase the proportion of non-interest revenue.

RG's Short-Term IDR would be upgraded if the group's funding and liquidity score is upgraded to 'aa-'.

An upgrade of RG's IDRs would result in an upgrade of RS's and the local banks' IDRs.

We would upgrade RG's SR and revise the group's SRF upward only if we believe in a rising propensity from the sovereign to support systemically important banks, which is highly unlikely in the current regulatory environment.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The most likely trigger for a downgrade of RG's VR and IDRs is a material deterioration of the group's asset quality, which could arise from a prolonged downturn in the Swiss housing market. An increase in the group's gross impaired loan ratio to above 1.5% on a sustained basis would also put ratings under pressure.

The ratings would also come under pressure if the group's Basel leverage ratio declines below 6% without any action taken to restore it to this level within 12-18 months.

A downgrade of RG's IDRs would result in a downgrade of RS's and the local banks' IDRs. A downgrade of RS's Long-Term IDR would trigger a downgrade of its CD issuance programme.

A downgrade of the Long-Term IDR would trigger a downgrade of the group's Short-Term IDR only if our assessment of RG's funding and liquidity profile also weakens. This is because our current assessment of the group's funding and liquidity of 'a+' would still allow the group to achieve a Short-Term IDR of 'F1' under our criteria.

The capitalisation and leverage score of 'a+' has been assigned below the 'aa' category implied score due to the following adjustment reason: Capital flexibility and ordinary support (negative).

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade

scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Applicable Criteria

[Bank Rating Criteria \(pub.28 Feb 2020\) \(including rating assumption sensitivity\)](#)

[Exposure Draft: Bank Rating Criteria \(pub.17 Aug 2021\) \(including rating assumption sensitivity\)](#)

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