

# MOODY'S

## INVESTORS SERVICE

### CREDIT OPINION

1 December 2016

Update

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#### RATINGS

##### Rabobank

Domicile	Amsterdam, Netherlands
Long Term Debt	Aa2
Type	Senior Unsecured - Fgn Curr
Outlook	Negative
Long Term Deposit	Aa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Rabobank

### Update Following Recent Affirmation of Ratings and Revision of Outlook to Negative

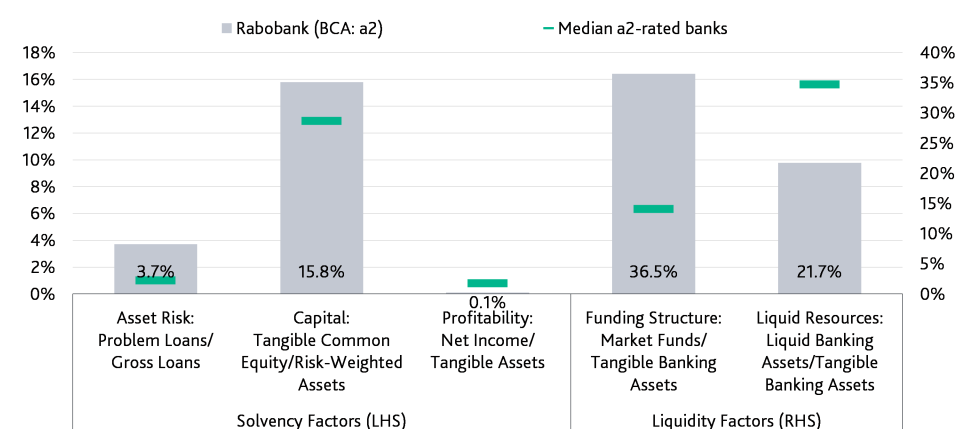
#### Summary Rating Rationale

Rabobank's long-term deposit and senior debt ratings of Aa2, negative outlook, reflect (1) the bank's baseline credit assessment (BCA) of a2; (2) two notches of uplift from our Advanced Loss Given Failure (LGF) analysis; and (3) one notch of uplift stemming from a moderate probability of government support. Rabobank's short-term deposit and senior debt ratings are Prime-1.

Rabobank's BCA of a2 is supported by the bank's conservative business profile, as well as its strong financial fundamentals. The bank's leading position in the Dutch banking sector and strong position in the agribusiness sector worldwide are the primary drivers for a relatively stable, albeit modest earnings generation capacity. Despite a past period of lacklustre results owing to losses in Dutch commercial real estate (CRE) and more recently a number of large extraordinary items, we consider Rabobank's profitability resilient overall.

Exhibit 1

#### Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

The BCA is also underpinned by the bank's capital levels, which provide sound loss-absorption capacity, as well as its good asset quality overall. Rabobank has a high reliance on wholesale funding, but this credit weakness is mitigated by the long duration of its debt issuance and sizeable liquidity buffers.

## Credit Strengths

- » Leading market positions in the Netherlands offer pricing power and stable earnings generation
- » Asset quality is solid overall
- » Capitalisation levels provide sound loss absorption capacity
- » Underlying profitability is improving after period of lacklustre results
- » The bank has ample liquidity reserves and an extended term structure of funding
- » Large volume of subordinated debt and hybrid debt results in very low loss-given-failure for senior unsecured debt and deposits and a two-notch uplift from the BCA
- » Moderate probability of government support results in a one-notch uplift for senior unsecured debt and deposits

## Credit Challenges

- » Net interest margins may suffer from the low interest rate environment
- » Asset quality is inherently vulnerable to a deterioration in the domestic real estate markets
- » Profitability is modest and has recently been impacted by a series of large exceptional items
- » The bank has relatively large and structural wholesale funding needs

## Rating Outlook

The senior unsecured debt and deposit ratings carry a negative outlook. The bank's BCA of a2 is relatively high and substantially incorporates both the bank's current fundamentals and the prospects of further improvements under its recently developed Strategic Framework. These benefits are subject to some uncertainty and we have therefore assigned a negative outlook to the bank's deposit and senior unsecured debt ratings to reflect the possibility that they are not fully achieved.

## Factors that Could Lead to an Upgrade

Rabobank's ratings are at the high end of banks' ratings globally, reflecting our view of the strong credit profile of the institution.

An upgrade of the BCA, and consequently of the deposit and senior unsecured debt ratings, is unlikely in the foreseeable future, as reflected in the negative outlook on the bank's ratings.

## Factors that Could Lead to a Downgrade

The BCA could be downgraded if:

- » the bank were unable to improve its profitability as stated in its restructuring plan objectives
- » asset risks increased due to renewed weakness in the Dutch commercial real estate sector or rising deficiencies in the corporate loan portfolio and/or
- » the bank were to be unable to reduce wholesale funding in accordance with its stated objectives or if its funding and liquidity profiles deteriorated

Rabobank's long-term deposit and senior unsecured debt ratings would be downgraded as a consequence of

- » a downgrade of the BCA and/or

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- » increased loss-given-failure for senior debt and deposit holders due to lower levels of subordinated debt or a lower level of pari passu debt benefiting these creditors.

## Key Indicators

Exhibit 2

### Rabobank (Consolidated Financials) [1]

	6-16 <sup>2</sup>	12-15 <sup>2</sup>	12-14 <sup>2</sup>	12-13 <sup>3</sup>	12-12 <sup>3</sup>	Avg.
Total Assets (EUR million)	643,634.0	634,326.0	637,891.0	638,603.0	699,814.0	-2.1 <sup>4</sup>
Total Assets (USD million)	715,045.6	689,065.4	771,882.0	879,957.8	922,628.9	-6.2 <sup>4</sup>
Tangible Common Equity (EUR million)	33,118.0	34,088.5	32,160.1	30,348.6	32,320.5	0.6 <sup>4</sup>
Tangible Common Equity (USD million)	36,792.5	37,030.2	38,915.5	41,818.6	42,611.1	-3.6 <sup>4</sup>
Problem Loans / Gross Loans (%)	3.7	3.8	3.9	3.5	2.3	3.4 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	15.8	16.0	15.2	14.4	14.5	15.7 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	41.8	42.3	44.7	41.2	30.7	40.2 <sup>5</sup>
Net Interest Margin (%)	1.3	1.4	1.4	1.3	1.2	1.3 <sup>5</sup>
PPI / Average RWA (%)	0.6	1.6	2.0	0.9	1.8	1.4 <sup>6</sup>
Net Income / Tangible Assets (%)	0.1	0.2	0.3	0.2	0.3	0.2 <sup>5</sup>
Cost / Income Ratio (%)	88.4	71.9	66.4	82.8	69.2	75.7 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	36.6	36.5	39.4	39.1	42.8	38.9 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	21.4	21.7	21.0	21.3	23.0	21.7 <sup>5</sup>
Gross loans / Due to customers (%)	137.6	138.3	144.4	142.4	146.3	141.8 <sup>5</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Source: Moody's Financial Metrics

## Detailed Rating Considerations

### Leading market positions in the Netherlands offer pricing power and stable earnings generation

Rabobank holds a leading position in domestic retail banking, which represented 61% of its revenues in June 2016. The bank also has a strong international presence focusing on the food and agribusiness sector. We consider that Rabobank's franchise is one of the most robust amongst Dutch peers, resulting in strong pricing power and steady earnings generation.

In the Netherlands, Rabobank's operations are carried out by a large network of local Rabobanks and are supported by the central wholesale banking capacities. The group's market shares range from 20% to 41%, both in the retail and corporate areas, whilst it reaches 85% in the domestic food and agribusiness (market shares as of June 2016).

International operations support Dutch clients operating internationally via the foreign branch network and allow the bank to capitalise on its knowledge and experience in the food and agribusiness sector with clients outside the Netherlands. This strategy is being pursued through its "wholesale banking and international rural and retail banking" entities in a selected number of countries. These include the United States, Brazil and Chile, accounting altogether for 10.1% of Rabobank's private sector loan book, Europe outside the Netherlands (3.8%) and Australia and New Zealand (4.2%).

### Asset quality is solid, yet vulnerable to deterioration in the domestic commercial real estate markets

We view Rabobank's asset quality as sound due to (1) its relatively conservative underwriting and investment policy and (2) its very limited exposure to countries in riskier parts of the euro area. Nevertheless, with 73% of its private sector lending in the Netherlands, Rabobank is exposed to a deterioration of the Dutch economy and more particularly of its commercial real estate sector. In 2012, 2013 and 2014, the bulk of the deterioration in asset quality came from the CRE portfolio. While the overall quality of Rabobank's CRE portfolio has largely improved and the bank has reduced this exposure by approximately 20% in the last eighteen months, some segments of the Dutch CRE market remain under pressure.

The domestic retail banking segment represented 65% of the bank's private-sector lending and produced very low impairment charges in H1 2016, with greenhouse horticulture and shipping being the only segments recording difficulties. The strong performance of domestic retail banking is an illustration of the recovery of both the Dutch economy and the housing market. The residential mortgage portfolio continued to perform well with a cost of risk of just 4 bps in the first six months of 2016, but its specific features with high loan-to-value (LTV) ratios and a high proportion of bullet rather than amortising loans make it vulnerable to a scenario of severe macroeconomic deterioration. New mortgages now have the statutory obligation to amortise in order to benefit from the tax deductibility of interests. In addition, LTVs are currently following a downward trend due to mortgage repayments and increasing house prices.

The performance of other portfolios was also strong in H1 2016, all reporting significant decreases in cost of risk. Loan loss provisions more than halved to 23 bps in the wholesale and international rural & retail banking portfolio. The real estate segment, which had reported significant losses linked to Dutch CRE exposures in the recent past, reported net write-backs during H1 2016.

Our assigned asset risk score of a2 reflects the bank's good track record and conservative lending policy.

### Capitalisation levels provide sound loss absorption capacity

We consider Rabobank's strong loss absorption capacity to be a key credit strength. At end-June 2016, Rabobank's Basel 3 Common Equity Tier 1 (CET1) ratio and Tier 1 ratio were 13.4% and 16.8% respectively, which provides good resilience under our stress tests and comfortable room above the minimum required CET1 ratio of 9.5% given by the European Central Bank through the Supervisory Review and Evaluation Process (SREP) plus the 0.75% systemic risk buffer imposed by the Dutch central bank for 2016 (progressively increasing to 3% in 2019). Under our calculations, Rabobank's Tangible Common Equity was 15.8% at end-June 2016, benefiting from approximately 2.2 percentage points of high-trigger contingent capital instruments.

The bank's Tier 2 capital was 6.7% of risk-weighted assets at end-June 2016, bringing the group's total capital ratio to 23.5%. Rabobank intends to further increase the level of loss absorption capital and subordinated 'bail-in-able' debt to protect senior unsecured bondholders. In its Strategic Framework 2016-2020, Rabobank targets a CET1 ratio above 14% and a total capital ratio above 25% by 2020.

Rabobank disclosed a buffer of equity, subordinated debt and Senior Contingent Notes, of €56.6 billion which protects senior unsecured debt at end-June 2016, equivalent to 27% of risk-weighted assets. This bail-in buffer, which is Rabobank's own measurement of bail-in-able cushion, appears higher than the Financial Stability Board's (FSB) Total Loss-Absorbing Capital (TLAC) because it is based on gross numbers (i.e. it does not include any regulatory deductions to CET1 and/or grandfathering of old-style Tier 1 and regulatory amortisation of Tier 2 instruments).

Our assigned capital score of aa2 reflects the bank's strong ratios and our belief that the bank's capitalisation is a strength.

### Underlying profitability is improving after period of lacklustre results

After a period of lacklustre results, Rabobank's profitability rebounded along with the improving performance of Dutch CRE exposures. Rabobank's loan loss provisions represented only 7 bps of average gross loans in the first half of 2016 versus 24 bps in 2015 and a long-run historical average of around 36 bps. Despite these improvements, profitability has remained relatively low lately due to a series of large exceptional items.

In the first half of 2016, net profit was notably impacted by restructuring charges (€190 million) and an additional provision for the industry-wide alleged mis-selling of interest rate derivatives to smaller SME customers (€514 million). Adjusting for these elements and other fair value items impacting revenues, the cost-to-income ratio was 59% (74% unadjusted) in H1 2016, notably thanks to a reduction of 6% in staff costs. Rabobank targets an improvement in performance of more than €2.1 billion by 2020 and a cost-to-income ratio of 50% by 2020 in its Strategic Framework 2016-2020.

Going forward, we expect revenue growth to remain modest at best and the low interest rate environment, which had a moderate impact in recent semesters, is likely to progressively erode net interest margins. Nonetheless, we expect profitability to improve overall via continued efforts on operating expenses, as the restructuring progresses and staff reductions take place.

Our ba1 assigned score for profitability reflects the historical stability and quality of earnings of the bank, as well as the expected improvements.

### **Structural reliance on wholesale funding is mitigated by ample liquidity reserves and term structure of funding**

Despite high reliance on wholesale funding, Rabobank's funding structure is robust and high liquidity buffers mitigate this structural feature of the Dutch banking system.

At end-June 2016, the group disclosed a loan-to-deposit ratio of 124%, significantly lower than the 132% level disclosed in H1 2015. The customer funding deficit remains elevated at €84 billion at end-June 2016, despite significant improvements. Rabobank is structurally reliant on wholesale funding (which totals €201 billion as of end-June 2016, as disclosed by the bank) and a portion (36%) of its deposits is derived from (inter)national institutional and corporate investors, which may prove less stable than retail deposits.

Nevertheless, we believe that Rabobank's reliance on wholesale funding, which is a feature of the Dutch banking system, is largely mitigated by its conservative asset and liability management, based on an adequate duration of the bank's funding and a substantial liquidity portfolio. Of the €201 billion gross wholesale funding outstanding at end-June 2016, approximately €118 billion was long-term debt (excluding the portion of long-term debt with residual maturity of less than one year). Out of this, €47 billion had residual maturities of five years or more. As of end-June 2016, the bank's liquidity buffer, consisting of cash, high-quality government bonds and central bank-eligible internal RMBS amounted to €144 billion, representing around 206% of the bank's net interbank borrowings and short-term debt securities (including the portion of long-term debt, the residual maturity of which is less than one year), resulting in a very robust liquidity profile.

The Basel 3 liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) of Rabobank stood at 127% and 116% respectively at end-June 2016, which we view as relatively strong.

The assigned combined liquidity score of baa1 is the result of significant upward adjustments to account for the favourable term structure of market funding, the quality of liquid assets and the low asset encumbrance.

Overall, our assigned BCA is a2, one notch above our assessment of the bank's Financial Profile of a3.

## **Notching Considerations**

### **LOSS GIVEN FAILURE AND ADDITIONAL NOTCHING**

Rabobank is subject to the EU Bank Resolution and Recovery Directive (BRRD), which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits, a proportion of junior deposits of 26% of total customer deposits and assign a 25% probability to deposits being preferred to senior unsecured debt. These assumptions are in keeping with our standard assumptions.

Our LGF analysis indicates very low loss-given-failure for deposits and senior unsecured debt, leading us to position their Preliminary Rating Assessments two notches above the Adjusted BCA.

Our LGF analysis indicates high loss-given-failure for junior debt securities, leading us to position their Preliminary Rating Assessments one notch below the Adjusted BCA. We also incorporate additional notching for junior subordinated and hybrid debt instruments reflecting the coupon features.

### **GOVERNMENT SUPPORT**

We expect a moderate probability of government support for deposits and debt, resulting in one notch of uplift for both the long-term deposits and senior unsecured debt of the bank.

For subordinated and other junior securities, we continue to believe that the probability of government support is low and these ratings do not therefore include any related uplift. Junior securities also include additional downward notching from the BCA reflecting coupon suspension risk ahead of a potential failure.

## COUNTERPARTY RISK ASSESSMENT

The Counterparty Risk (CR) assessment is positioned at Aa1(cr)/Prime-1(cr), four notches above the Adjusted BCA of a2, based on the cushion against default provided to the senior obligations represented by the CR assessment by subordinated instruments and one notch of uplift from our assumption for a moderate probability of government support. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR assessment captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

## ABOUT MOODY'S BANK SCORECARD

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating Methodology and Scorecard Factors

Exhibit 3

Rabobank						
Macro Factors						
Weighted Macro Profile		Strong +				
Financial Profile						
Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	3.7%	a3	↔	a2	Quality of assets	Sector concentration
Capital						
TCE / RWA	15.8%	aa3	↔	aa2	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.1%	b3	↔	ba1	Earnings quality	
Combined Solvency Score		baa1		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	36.5%	ba2	↔	baa2	Term structure	Deposit quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	21.7%	baa1	↔	a3	Quality of liquid assets	Asset encumbrance
Combined Liquidity Score		baa3		baa1		
Financial Profile				a3		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Aaa		
Scorecard Calculated BCA range				a2 - baa1		

Assigned BCA			a2			
Affiliate Support notching			0			
Adjusted BCA			a2			
Failure Balance Sheet						
Balance Sheet	in-scope (EUR)	% In-scope	At-failure (EUR)	% At-failure		
Other liabilities	141,417	22.0%	176,397	27.5%		
Deposits	342,940	53.4%	307,960	47.9%		
Preferred deposits	253,776	39.5%	241,087	37.5%		
Junior Deposits	89,164	13.9%	66,873	10.4%		
Senior unsecured bank debt	118,150	18.4%	118,150	18.4%		
Dated subordinated bank debt	16,753	2.6%	16,753	2.6%		
Preference shares (bank)	3,972	0.6%	3,972	0.6%		
Equity	19,275	3.0%	19,275	3.0%		
Total Tangible Banking Assets	642,507	100.0%	642,507	100.0%		
Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	2	0	aa3	1	Aa2	Aa2
Senior unsecured bank debt	2	0	aa3	1	Aa2	Aa2
Dated subordinated bank debt	-1	0	a3	0	A3	A3
Non-cumulative bank preference shares	-1	-2	baa2	0	Baa2(hyb)	Baa2(hyb)

Source:

## Ratings

Exhibit 4

Category	Moody's Rating
<b>RABOBANK</b>	
Outlook	Negative
Bank Deposits	Aa2/P-1
Baseline Credit Assessment	a2
Adjusted Baseline Credit Assessment	a2
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Issuer Rating	Aa2
Senior Unsecured -Fgn Curr	Aa2
Senior Unsecured -Dom Curr	A3
Subordinate	A3
Pref. Stock Non-cumulative -Fgn Curr	Baa2 (hyb)
Pref. Stock Non-cumulative -Dom Curr	Baa3 (hyb)
Commercial Paper	P-1
Other Short Term -Fgn Curr	P-1
Other Short Term -Dom Curr	(P)P-1
<b>RABOBANK AUSTRALIA LIMITED</b>	
Outlook	Negative
Bkd Bank Deposits -Dom Curr	Aa2/P-1
<b>RABOBANK IRELAND PLC</b>	
Bkd Commercial Paper	P-1
<b>RABOBANK NEDERLAND, SINGAPORE BRANCH</b>	

Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Commercial Paper -Dom Curr	P-1
<b>RABOBANK NEDERLAND, THE NETHERLANDS BRANCH</b>	
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
<b>RABOBANK NEDERLAND, AUSTRALIA BRANCH</b>	
Outlook	Negative
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Senior Unsecured	Aa2
Commercial Paper	P-1
Other Short Term	(P)P-1
<b>RABOBANK NEDERLAND, NEW YORK BRANCH</b>	
Outlook	Negative
Bank Deposits	Aa2/--
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Senior Unsecured	Aa2
Commercial Paper	P-1
Other Short Term	(P)P-1
<b>RABOBANK USA FINANCIAL CORPORATION</b>	
Bkd Commercial Paper	P-1
<b>RABOBANK NEDERLAND, NEW ZEALAND BRANCH</b>	
Outlook	Negative
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Senior Unsecured -Dom Curr	Aa2
Commercial Paper	P-1
<b>FRIESLAND BANK N.V.</b>	
Outlook	Negative
Bank Deposits	Aa2/P-1
Senior Unsecured MTN -Dom Curr	(P)Aa2
Subordinate MTN -Dom Curr	(P)A3
Other Short Term -Dom Curr	(P)P-1
<b>RABOBANK NEDERLAND, HONG KONG BRANCH</b>	
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
<b>RABOBANK NEDERLAND, PARIS BRANCH</b>	
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
<b>RABO BANK CAPITAL FUNDING TRUST IV</b>	
Pref. Stock Non-cumulative	Baa2 (hyb)
<b>RABO CAPITAL SECURITIES LIMITED</b>	
Pref. Stock Non-cumulative -Dom Curr	Baa2 (hyb)
<b>RABO FINANCIAL PRODUCTS B.V.</b>	
Outlook	Negative
Senior Unsecured -Dom Curr	Aa2
<b>RABOBANK POLSKA SA</b>	
Bkd Commercial Paper -Dom Curr	P-1

Source: Moody's Investors Service



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