FITCH RATES LEONTEQ AG AND LEONTEQ SECURITIES AG AT 'BBB-'/POSITIVE

Fitch Ratings-London-14 January 2019: Fitch Ratings has assigned Leonteq AG (Leonteq) and Leonteq Securities AG (Leonteq Securities) Long-Term Issuer Default Ratings (IDR) of 'BBB-'. The Outlook on both Long-Term IDRs is Positive. A full list of rating actions is at the end of this rating action commentary.

Zurich-domiciled Leonteq is a SIX Swiss Exchange-listed provider of structured products that are distributed via a range of private banks, asset managers, and other institutional counterparties, both in Switzerland and increasingly abroad. Leonteq Securities is the group's Finma-regulated securities dealer and principal notes issuer.

KEY RATING DRIVERS
IDRS
Leonteq's and Leonteq Securities' Long- and Short-Term IDRs reflects the sound financial metrics of Leonteq including adequate and improving capitalisation, moderate credit risk exposure and comprehensive liquidity management as well as its sophisticated structured products issuance platform and sound risk management systems. This has allowed the company to establish a solid track record in generating fairly stable revenue and adequate underlying profitability.

However, the IDRs also reflect Leonteq's only moderate, albeit improving, franchise and exposure to concentration risk, in particular with regard to fairly small number of structured product issuance partners, including Raiffeisen Schweiz (Raiffeisen) and EFG International AG (EFGI, A/Negative).

The Positive Outlook on Leonteq and Leonteq Securities reflects Fitch's view that improved issuance partner diversification, enhanced scale (reflected in increasing transaction volumes), more efficient balance sheet utilisation as a result of implementing its Smart Hedging and Issuance Platform (SHIP) and consistent growth in Leonteq's capital base could - over the next 12 to 18 months - lead to a one-notch upgrade of the Long-Term IDRs.

Leonteq's IDRs are constrained by Fitch's assessment of the company's franchise and business model. While Fitch views Leonteq's franchise in the Swiss and increasingly international structured products issuance market as adequate, Leonteq operates in a narrow and highly competitive segment of the wealth and asset management sector. Moreover, Leonteq relies on a small number of issuance partners, notably EFGI and Raiffeisen. Similarly, revenue has to date been predictable but is, in Fitch's view, potentially more volatile than the earnings profile of investment managers and private banks due to Leonteq's larger proportion of volume-based revenue. Consequently, a sizeable proportion of Leonteq's revenue relies on continued client appetite for structured products being offered on the company's established and sophisticated issuance platform.

However, while client appetite is partly correlated to volatility in financial markets, Leonteq's broad product offering within structured products means that the company should be in a position to generate adequate returns under most market conditions. Leonteq's small but growing insurance & wealth planning solutions division, which largely generates annuity-based revenue, partially offsets potential revenue volatility.

While Leonteq's franchise is fairly narrow (it has a market share of around 10% in the CHF82 billion Swiss structured products market and smaller market shares in Europe and Asia), both Fitch's assessment of its franchise and business model stability reflects the sound growth potential

for structured product markets (in particular outside Switzerland) and Leonteq's well-established and highly-automated issuance platform, which allows for quick turnaround times even for more complex products. Leonteq does not offer warrants (due to corresponding capital/liquidity consumption), which constrains its franchise but benefits its overall risk profile.

Fitch views Leonteq's risk controls favourably compared with other securities firms' and regulated banks'. Risk management benefits from having to comply with Finma requirements for securities firms, which are broadly identical to those for regulated banks. Given its business model, Leonteq is primarily exposed to residual market risk (including corresponding liquidity risks) and, to a lesser extent, credit risk largely relating to investing proceeds from structured product issuance. Leonteq's market risk management is underpinned by a granular limit framework (by option risk type and historical scenarios) and extensive and frequent stress testing, in particular with regard to solvency and short-term liquidity risks.

Leonteq has shown some weaknesses in corporate governance in the past, leading to financial underperformance in 2016 and 2017. Governance and management changes in 2018, including a restructured board of directors with a larger proportion of independent board members, has brought Leonteq's corporate governance in line with similarly- and higher-rated peers'.

Profitability suffered in 2016 and 2017 from restructuring-related one-off costs but is generally sound with an adjusted operating profit/average equity ratio of above 10%. While net fee revenue has been broadly stable, new revenue and the net hedging result are sensitive to market-induced volatility, which in turn affects its overall profitability. Costs have been predictable and managed in a sufficiently flexible manner to cover revenue variability. Leonteq's internal capital generation is supported by management's decision not to propose dividend distribution in the 2018 financial year and the foreseeable future.

While Leonteq's balance sheet is sizeable in an asset management context (total assets of CHF8.5 billion at end-1H18), the vast majority of its liabilities relate to outstanding structured products (CHF3.5 billion), hedging-related derivative negative replacement values (CHF2.4 billion; for both own and partner bank issuance) and short-term settlement balances with brokers and partner banks (CHF1.8 billion). Consequently, Leonteq currently has no outstanding corporate debt. Liquidity requirements from OTC margin calls and other hedging-related activities are potentially sizeable but adequately stress-tested and mitigated by a sizeable unencumbered liquidity buffer (around CHF1 billion at end-1H18).

Leonteq's balance sheet leverage is adequate and in line with the company's Long-Term IDR. Its common equity Tier 1 ratio is strong (23.3% at end-1H18 pro forma for the August 2018 CHF118 million capital increase) and will likely increase further given management's ambition to increase CET1 capital in absolute terms. Fitch views Leonteq's capitalisation as adequate and generally resilient to meaningful market-related shocks.

RATING SENSITIVITIES

IDRS

In Fitch's view, Leonteq's Long-Term IDR is currently constrained by a fairly concentrated franchise (notably regarding issuance partners) and the company's modest, albeit increasing, size (in terms of turnover, revenue and equity) compared with higher-rated peers'. However, management has identified these constraints and intends to improve issuance partner diversification and transaction volumes, improve balance sheet efficiency by gradually rolling out SHIP and increase Leonteq's capital base. Fitch views these ambitions as achievable, which is reflected in the Positive Outlook on Leonteq's Long-Term IDR.

Increased scale (including internationally), and reduced reliance on Leonteq's main issuance partners EFGI and Raiffeisen, which leads to improved business diversification and a more

resilient business model, could result in positive rating action, in particular, if in combination with improved capitalisation (especially in absolute terms).

Significant progress in expanding Leonteq's capital base in absolute terms over the next 12 to 18 months could lead to positive rating action, in particular if achieved along with improved business diversification and a successful roll-out of SHIP.

Evidence that Leonteq's profitability, which improved considerably in 1H18 following restructuring-related charges in 2016 and 2017, can be broadly maintained at current levels (in particular in changing market conditions) could also support an upgrade.

A loosening of the risk management standards, for instance driven by an increased board-approved risk appetite, weakened counterparties and hedging strategies, or a less granular stress-testing framework could be rating-negative.

Failure to improve capitalisation in line with management's projections or inability to decrease the capital intensity of its business model through its new hedging approach could be rating-negative.

A material operational loss, for instance caused by ineffective hedging, a cyber-attack or internal/ external fraud, negatively affecting Leonteq's profitability and ultimately the company's capital base could lead to a negative rating action. Similarly, an event that adversely impacts the reputation of the organisation could be negative for Leonteq's ratings.

The rating actions are as follows:

Leonteq AG
Long-Term IDR assigned at 'BBB-'; Outlook Positive
Short-Term IDR assigned at 'F3'

Leonteq Securities AG
Long-Term IDR assigned at 'BBB-'; Outlook Positive
Short-Term IDR assigned at 'F3'

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Applicable Criteria
Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018)
https://www.fitchratings.com/site/re/10044407

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