

Three Swiss Cantonal Bank Ratings Affirmed; Outlooks Stable; Liquidity Revised To Adequate From Strong

October 25, 2024

Overview

- In our view, Swiss cantonal banks Aargauische (AKB), Schwyzer (SZKB), and Zuercher (ZKB) continue to demonstrate remarkable resilience, with sound asset quality and strong profits, benefitting also from very high capitalization.
- At the same time, we believe that a normalization of Switzerland's interest rate environment, the Swiss National Bank (SNB)'s liquidity policy, and revived deposit markets have led to tighter liquidity management.
- As a result, we expect AKB, SZKB, and ZKB will maintain an adequate liquidity buffer, although below levels seen in recent years, supported by a robust deposit base.
- We affirmed our 'AA+/A-1+' long- and short-term ratings on AKB and SZKB as well as our 'AAA/A-1+' long- and short-term ratings on ZKB.
- The stable outlooks on AKB, SZKB and ZKB reflect our expectation of the link to and role for their owners and guarantors, the cantons Aargau, Schwyz and Zurich over the next 24 months.

FRANKFURT (S&P Global Ratings) Oct. 25, 2024--S&P Global Ratings today affirmed its:

- 'AA+/A-1+' long- and short-term issuer credit ratings on Aargauische Kantonalbank and Schwyzer Kantonalbank, and
- 'AAA/A-1+' long- and short-term issuer credit ratings on Zuercher Kantonalbank.

Following normalization of the interest rate environment in Switzerland, we expect AKB, SZKB, and ZKB will manage their funding and liquidity more tightly.

Despite its recent interest rate cut, Switzerland's National Bank (SNB) continues its path toward normalization of its monetary policy. In April 2024, the central bank increased its minimum reserve requirements to 4.0% from 2.5%. It again lowered the threshold factor for the interest rate cap on sight deposits, effective Oct. 1, 2024, to discourage banks from holding large amounts of cash at the central bank. This comes together with a slow, but steady, repricing of customer deposits weighing on banks' funding costs. We therefore expect Swiss banks, including AKB, SZKB, and ZKB, to maintain a lower amount of extraordinary liquidity buffers over time.

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Accordingly, our liquidity ratios on the three cantonal banks no longer exceed those of other banks whose liquidity we regard as strong. We have therefore revised our liquidity assessments for AKB, SZKB and ZKB to adequate from strong. This follows similar rating actions on certain peer banks over recent months. Overall, the revision of our liquidity assessment has no immediate effect on our ratings or on our view of the three banks' stand-alone credit profiles (SACPs). We also continue to factor into our SACP assessment certain intrinsic advantages for the banks from their ownership by the respective cantons and the cantonal guarantees. In our view, these also improve the availability of funding and liquidity and lower the banks' market funding costs.

Aargauische Kantonalbank

We expect AKB will maintain its solid franchise and high business stability, offsetting concentration risks arising from its focus on real estate lending in Aargau. Like most cantonal banks, AKB focuses mainly on its home canton and neighboring regions. It is active primarily in residential mortgage lending (about 93% of the loan book as of June 30, 2023), and in financing local small and midsize enterprises (SMEs). The competitive environment in AKB's core market is tougher than for many cantonal banks we rate, with several other domestic and regional banks competing in the canton. AKB's market share, at about 25%, is lower than that of other cantonal banks.

Our assessment indicates that AKB's liquidity position is adequate, in line with that at most other rated cantonal banks. In line with trends observed in the market, AKB's ratio of net broad liquid assets to short-term customer deposits has steadily reduced, reaching 19.3% as of June 30, 2024, down from 25.2% in 2021. Furthermore, as of that date, its broad liquid assets covered its short-term wholesale funding needs by 1.76x compared with 3.7x at year-end 2021. We expect the bank to maintain its sound stable funding ratio at 115% as of midyear 2024. That said, we do not think the bank would face large withdrawals of customer deposits in times of stress, owing to its close ties with and statutory guarantee from the canton.

The bank's capitalization remains a rating strength and provides a cushion against unexpected losses. We anticipate that AKB will maintain its superior capitalization, with projected risk-adjusted capital (RAC) ratios of 22.5%-23.0% through 2026, compared with 22.2% as of Dec. 31, 2023. Our risk weights for retail exposure in Switzerland are lower than the regulatory risk weights, resulting in an even stronger RAC ratio than regulatory ratios. For 2024, we expect the bank's profit to be lower than in 2023, with its cost-to-income ratio stabilizing at around 45% over 2024-2026, mainly due to higher expenditure in its digital infrastructure. AKB's 1.7% nonperforming loan ratio as of June 30, 2024, is higher than for most Swiss peers and the international average, setting it apart from most other cantonal banks.

Outlook

The stable rating outlook on AKB mirrors that on its owner and guarantor, the canton of Aargau. AKB will continue to benefit from being a government-related entity (GRE) with an extremely high likelihood of receiving support from Aargau over the next two years, if needed. We anticipate that AKB will maintain its sound financial profile, underpinned by its very strong capitalization and sound earnings capacity over that period.

Downside scenario: We could revise our outlook on AKB to negative after a similar rating action on the canton of Aargau.

A downgrade could also be triggered by a significant weakening of AKB's role for, or link with Aargau, due to changes in the statutory guarantee, for example. However, we consider this scenario unlikely and expect AKB's existing obligations would be grandfathered.

A deterioration of AKB's SACP would not immediately affect the overall rating because we expect the canton's support would compensate for the bank's weaker stand-alone creditworthiness.

Upside scenario A positive rating action is very remote. This could only be triggered if we revised upward our assessment of AKB's SACP, which we view as extremely unlikely, since it is already high.

Schwyzer Kantonalbank

SZKB is a small cantonal bank with strong market shares in its home market of Schwyz. SZKB maintains a dense branch and cash-point network in the canton, serving close to 80% of the population. SZKB demonstrates a very stable loan growth trajectory, the majority of which consists of owner-occupied properties and investment properties. We expect the bank to deliver a slightly lower result in 2024, owing to higher interest expenses. However, SZKB continues to rank lower than most of its peers in terms of profitability, even taking into account its larger capital base.

We assess SZKB's liquidity position as adequate, considering its reducing liquidity buffer. Its net broad liquid assets to short-term customer deposits have markedly declined to 8.1% as of June 30, 2024, from 23.8% in 2022. We anticipate the bank will maintain its current ratio of broad liquid assets to short-term wholesale funding of 1.5x at midyear 2024, indicating an adequate capacity to cover maturing wholesale debt. Core customer deposits account for 75% of SZKB's funding base as of June 30, 2024. We expect the funding structure will remain largely as is, with the remainder of funding sources including a wholesale funding mix largely in unsecured and secured long-term funding and only limited use of more volatile interbank markets. Accordingly, we forecast that the bank's stable funding ratio will remain favorable (105% at midyear 2024).

Superior capitalization remains a rating strength. We anticipate that SZKB will maintain its superior capitalization, aided by its sound earnings capacity and moderate shareholder distributions. The bank's RAC ratio was 25.8% as of Dec. 31, 2023, and we project it to strengthen to 28.5%–29.0% by 2026. This puts SZKB's capitalization among the world's strongest, together with that of some cantonal bank peers. We also consider SZKB's sound risk management and solid asset quality, supported by a robust Swiss economy and low risk operating environment for Swiss banks. The bank primarily engages in low-risk collateralized residential mortgage lending with conservative loan-to-value ratios. SZKB's 0.25% nonperforming loan ratio by June 30, 2024, is low by international standards and compared with that of its Swiss peers.

Outlook

The stable outlook on SZKB mainly indicates that we expect the likelihood of support from Schwyz to not change in the next two years. Our rating remains sensitive to our assessment of the cantonal owners' ability and willingness to support the bank.

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We anticipate that SZKB will maintain its sound financial profile, underpinned by its very strong capitalization and low risk profile over that period.

Downside scenario: A weakening of SZKB's role for or link with the canton, or detrimental changes in the statutory guarantee, could lead us to revise down our assessment of the bank's status as a GRE. However, we do not envisage such a scenario in the next two years. Also, if this were to happen, we expect that SZKB's outstanding obligations would be grandfathered.

Upside scenario: It is unlikely we would raise the rating based on an improvement in SZKB's 'a+' SACP, given the bank's comparatively concentrated business profile. A deteriorating SACP would not immediately affect the rating because we expect the owner's support would compensate for the bank's weaker stand-alone credit quality.

Zuercher Kantonalbank

We anticipate ZKB will maintain its strong deposit franchise as one of the largest banks in the country. We view the bank's customer base as stable, with an estimated nationwide market share of about 7%-10% in customer deposits and customer lending. ZKB holds a leading 50% retail banking market share in Zurich, one of Switzerland's strongest regions economically, and also manages about 25% of cross-border client assets. In our view, the bank continues to profit from Credit Suisse's market exit, supporting its asset and wealth management growth over the next two years.

We expect ZKB to operate with adequate liquidity buffers, supported by its nationwide deposit business and regulatory framework. Similar to peers', ZKB's liquidity metrics have decreased from the elevated levels observed in previous years. The bank's ratio of broad liquid assets to short-term wholesale funding has reduced to 1.15x, in line with our adequate assessment. Furthermore, its coverage of net broad liquid assets to short-term customer deposits has dropped to 8.7% as of June 30, 2024, from its historical high of 21.7% in 2022.

ZKB is subject to higher liquidity requirements than other cantonal banks because it is considered a domestic systemically important bank, like its larger, systemic peers. It is therefore subject to liquidity coverage ratio (LCR) requirements, which are to be phased in until year-end 2024. We do not expect ZKB's key liquidity metrics to materially strengthen in the next 12-24 months to a level commensurate with our strong assessment. Larger banks in Switzerland are required to calculate an LCR stress horizon of 90 days to better reflect intraday liquidity risk, and to hold higher buffers for their recovery plan. In our view, ZKB's stressed liquidity has several protection layers not readily available to other cantonal banks, such as SNB's emergency liquidity assistance, a stock of endowment capital, and backing from one of the financially strongest cantons, which we factor in our analysis.

Outlook

Our stable rating outlook on ZKB mirrors that on its owner and guarantor, the canton of Zurich, reflecting our expectation that ZKB will continue to benefit from its status as a GRE with an extremely high likelihood of receiving support from the canton over the next two years, if needed. The stable outlook also reflects our view that the operating environment for Swiss banks such as ZKB will show resilience.

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Downside scenario: If the bank's stand-alone creditworthiness were to weaken significantly and unexpectedly, due for example to higher-than-anticipated cyclical risk and capital depletion--reflected in our RAC ratio falling below 15%--we might consider a downgrade.

A downgrade could also result from competitive pressure on ZKB's business position--such as a margin squeeze in its asset management activities and core lending business due to the entrance of new digital players--particularly if the trend in online banking accelerates.

Upside scenario: An improvement in ZKB's SACP that would support its subordinated debt remains unlikely at this stage, given our already very high assessment of its SACP.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- 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
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Your Three Minutes In Swiss Cantons: Are Hospitals A Major Financial Risk?, Aug. 22, 2024
- Basler Kantonalbank (BKB) And Subsidiary Bank Cler Ratings Affirmed; BKB Liquidity Revised To Adequate From Strong, July 23, 2024
- Basellandschaftliche Kantonalbank 'AA+' Rating Affirmed; Outlook Stable; Liquidity Revised To Adequate From Strong, July 19, 2024
- Switzerland-Based Luzerner Kantonalbank Upgraded To 'AA+' On The Canton's Improved Fiscal Performance; Outlook Stable, June 5, 2024
- Swiss Federal Council Plans To Strengthen The Country's Too-Big-To-Fail Banking Framework, May 29, 2024

Ratings List

Ratings Affirmed

Aargauische Kantonalbank

Issuer Credit Rating AA+/Stable/A-1+

Ratings Affirmed

Schwyzner Kantonalbank

Issuer Credit Rating AA+/Stable/A-1+

Ratings Affirmed

Zuercher Kantonalbank

Issuer Credit Rating AAA/Stable/A-1+

Zuercher Kantonalbank

Senior Unsecured AAA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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