S&P Global
Ratings

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Basler Kantonalbank

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Basler Kantonalbank

SACP	a
Anchor	a-	
Business Position	Adequate	0
Capital and Earnings	Very Strong	+2
Risk Position	Moderate	-1
Funding	Average	0
Liquidity	Strong	

+

Support	+4
ALAC Support	0
GRE Support	+4
Group Support	0
Sovereign Support	0

+

Additional Factors	0

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

Major Rating Factors

Strengths:	Weaknesses:
• Extremely high likelihood of support from the Swiss Canton of Basel-City. • Very strong capitalization supported by stable earnings generation. • Very strong customer franchise in home region.	• Limited growth prospects in the saturated Basel-City banking market. • Earnings pressure from lower for longer interest-rate cycle. • Mediocre but improving profitability of Bank Cler subsidiary.

Outlook: Stable

S&P Global Ratings' stable outlook on Switzerland-based Basler Kantonalbank (BKB) reflects that on its owner and guarantor, the Swiss Canton of Basel-City (AAA/Stable/A-1+). We expect BKB will for the foreseeable future continue to benefit from an extremely high likelihood of timely and sufficient extraordinary support from the Canton of Basel-City in the event of financial distress. In addition, we expect that BKB will maintain its sound market position and financial profile, underpinned by its very strong capitalization over our two-year horizon.

Downside scenario

In our view, a downside scenario is currently remote. It could be triggered if we lowered our ratings on the Canton of Basel-City by one or more notches, which is a very unlikely scenario considering the canton's stable outlook. Alternatively, we could consider a negative rating action if there is a change in BKB's role for or link with the Canton of Basel-City, or changes in the statutory guarantee, potentially leading to a weaker assessment of BKB's status as a government-related entity (GRE). However, we currently consider this scenario as very unlikely and would expect BKB's existing obligations to be grandfathered. In our view, unchanged potential extraordinary support from the canton would cushion a material multi-notch deterioration of BKB's stand-alone creditworthiness, with the ratings on the senior unsecured debt remaining unchanged. Ratings on the subordinated instruments could, however, be directly affected if the bank's stand-alone credit profile (SACP) deteriorated.

Upside scenario

A positive rating action is currently very remote. This could only be triggered if BKB's stand-alone creditworthiness improved by two or more notches, which we regard as unlikely given our expectation that the bank will not materially change its concentrated business model, or be able to materially improve its funding position in addition to improving its risk to be on par with cantonal peers. Ratings on the subordinated instruments could be directly affected if the bank's SACP improved.

Rationale

Our rating on BKB reflects its strong and sustainable but regionally concentrated cantonal franchise, supported by its operations in the favorable conditions of low banking and industry risk for Swiss banks.

We view the bank's superior capitalization levels (by global comparison) as a key rating strength. The bank has demonstrated significant progress in improving its group risk-management systems in recent years, yet it believes that BKB's risk position is a small but relative weakness compared with many Swiss cantonal peers. This is mainly due to BKB's lower earnings buffer owing to weaker efficiency, comparably higher single-name concentrations, and a higher share of more cyclical commercial real estate lending.

We also take into account an untested track record of managing its subsidiary Bank Cler through the cycle, and its related above-market growth in nationwide residential mortgage lending and small and midsize enterprise (SME) lending. We expect BKB's combined funding and liquidity management to remain sound, but a neutral rating factor, in line with that of most of its Swiss cantonal bank peers, because of its solid base of granular customer deposits and the cantonal guarantee.

Anchor:'a-' as a commercial bank operating in Switzerland

Our criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor stand-alone credit profile (SACP), the starting point in assigning an issuer credit rating (ICR). Our anchor for a bank, such as BKB, operating mainly in Switzerland is 'a-'. We view the trends for both economic and industry risk as stable.

Our economic risk score of '2' for Switzerland is supported by the country's highly diversified and competitive economy, very high household income levels, and banks' prudent loan underwriting standards. However, we also consider housing market risks. In our view, house prices and household indebtedness both remain historically high. The investment property segment (30% of the market) is a particular risk, in our view, where we have observed the first signs of a price correction. We expect imbalances to remain moderate in a global context, partly because of the regulator's macro prudential measures to rein in the growth in mortgage indebtedness, and also because of further strengthening of self-regulatory measures to prevent excessive risk taking in mortgage financing. We recognize that house-price growth has cooled materially since 2014, with lending growth remaining at moderate levels. In addition, very high mortgage debt level is mitigated by the large amount of financial assets, including pensions, held by households in Switzerland.

Our industry risk score of '2' primarily reflects the banking sector stability and a relatively high share of deposit funding. In our view, the Swiss regulator's initiatives are more stringent than those in other European banking industries. Banks' net interest margins continue to decline gradually, given the pressure on deposit margins from the negative yield environment. However, this is partly offset by higher margins on lending products, fee income from investment advisory-related activities, and cost management. As a result, banks are able to generate returns on core banking products that are adequate to meet their cost of capital. We consider the risk for Swiss banks from tech disruption as limited at present, given the population's preference for cash payments, the small size of the market with few foreign banks, Switzerland's own regulatory framework, and technologically well-equipped banks.

Table 1

Basler Kantonalbank--Key Figures

	--Year ended Dec. 31--				
(Mil. CHF)	**2019***	**2018**	**2017**	**2016**	**2015**
Adjusted assets	44,989.3	44,031.1	40,770.3	38,512.3	38,513.6
Customer loans (gross)	31,130.2	30,324.7	28,719.2	27,791.2	27,187.0
Adjusted common equity	3,734.7	3,616.3	3,687.5	3,605.5	3,556.1
Operating revenues	278.8	557.4	597.0	564.7	575.5
Noninterest expenses	195.5	366.0	411.7	351.6	350.0
Core earnings	73.9	228.6	187.7	204.1	180.6

*Data as of June 30. CHF--Swiss franc.

Business position: Strong but regionally focused market franchise

We expect BKB will continue to benefit from its strong and sustainable franchise, supported by its developed modern digital-banking platform. This is balanced by BKB's geographic concentration from its mostly regionally focused market position, like many other cantonal Swiss banks. We expect BKB to remain the eighth-largest bank in

Switzerland, with total assets of CHF45 billion as of June 30, 2019 (CHF44 billion as of December 2018), consolidating its subsidiary Bank Cler, which had total assets of CHF18 billion at the same date.

While BKB benefits from its strong franchise on its retail and corporate lending business in the wealthy Basel region, we believe it will increasingly also benefit from growth in diversified and lower-risk countrywide residential mortgage lending and lending to SMEs through its subsidiary Bank Cler. BKB increased its stake to better manage the subsidiary's comparatively low profitability, improve cost income ratios, and allow for a prudent but higher growth strategy. We believe this is in line with the bank's well-managed strategic refocus on its core competencies and products, moderate growth, and digitalization in recent years. Ancillary private banking and trading business lines provide diversity, but we expect these will continue to contribute a modest proportion of up to one-third of operating revenues. Trading revenues--which we expect will continue to represent between 10%-15% of operating revenues in the next two years--are mainly client-initiated foreign exchange and precious metals trading operations. Against an ultra-low-interest-rate environment, we expect noninterest income to gradually improve from prudent growth strategies and remain between 35%-40% of operating revenues in the next two years.

We anticipate that Bank Cler will experience higher loan growth than BKB's wider group over the medium term due to propelled Swiss-wide growth initiatives, which is an additional business opportunity that most other cantonal banks with a traditional sole regional focus do not have. As such, we expect Bank Cler's profitability (representing roughly one-third of the group's half-year 2019 operating revenues) will narrow, becoming more in line with the wider group in the medium term due to a prudent leverage and growth. For structural reasons, like most other regionally focused Swiss cantonal banks, BKB parent's lending growth potential is constrained by the saturated banking market in Basel-City.

"Zak", the digital bank offering of Bank Cler, is targeting new digital affine customers and is competing with other fintechs and digital banks entering the Swiss market. Nevertheless, we do not expect any material revenue contributions soon.

Table 2

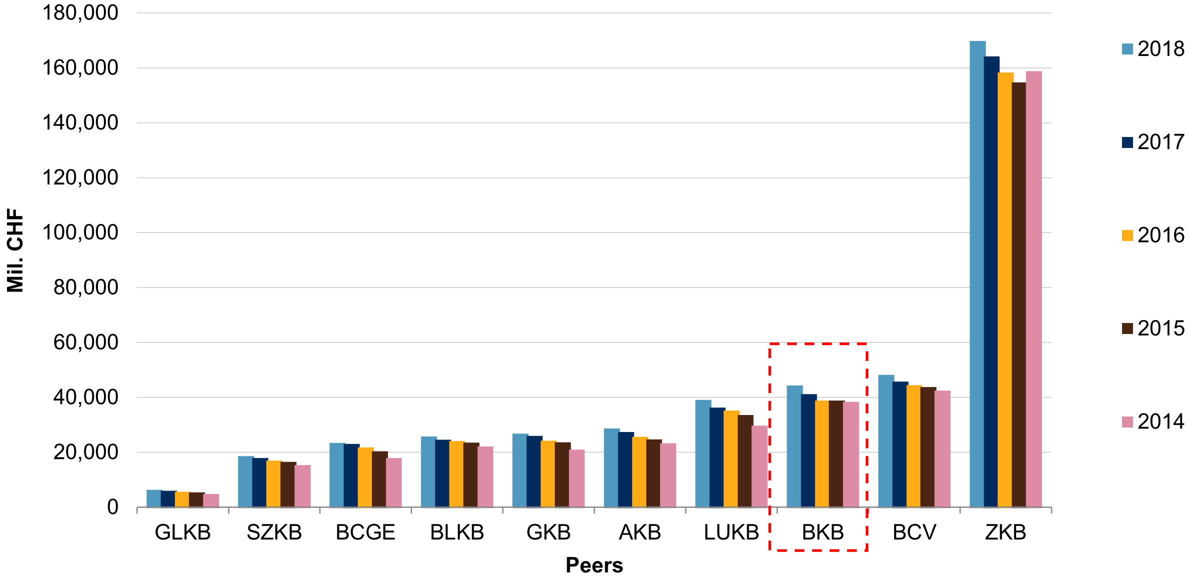
Basler Kantonalbank--Business Position

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Total revenues from business line (currency in millions)	281.9	636.4	680.7	601.8	642.6
Commercial & retail banking/total revenues from business line	82.5	85.1	85.4	84.5	82.9
Asset management/total revenues from business line	17.5	14.9	14.6	15.5	17.1
Return on average common equity	2.9	5.2	5.2	3.7	3.5

*Data as of June 30.

Chart 1

Asset Size Of Swiss Cantonal Banks
BKB's asset size versus other cantonal banks



CHF--Swiss franc. Source: S&P Global Ratings.

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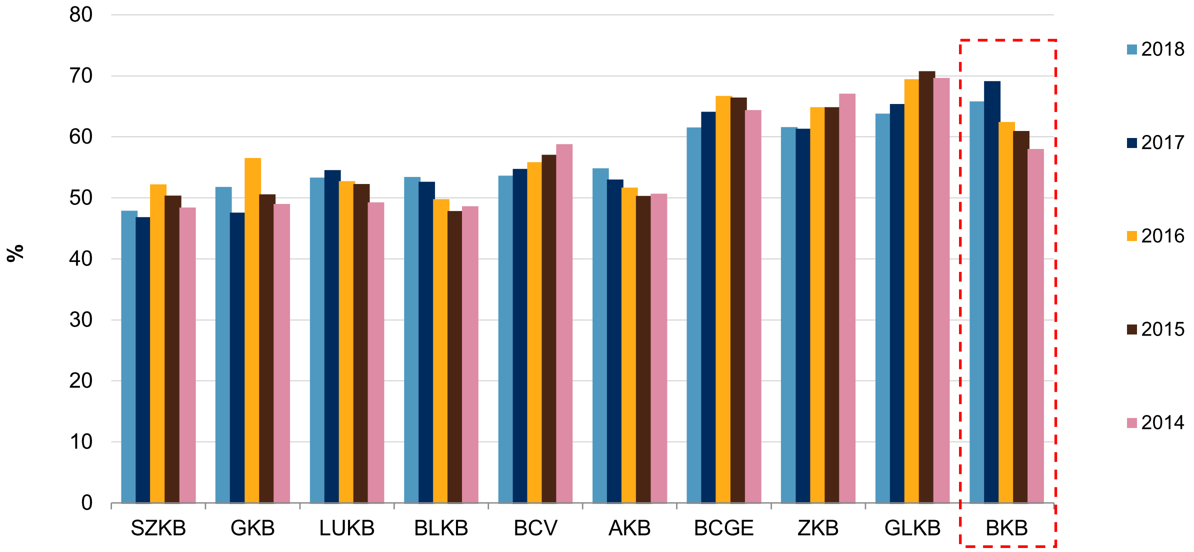
Chart 2

Noninterest Expenses/Operating Revenues

BKB's operating efficiency is comparatively on the higher side



Source: S&P Global Ratings.

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Capital and earnings: Maintaining main strength from very strong capitalization

We expect BKB's capital position and earnings to remain a particular rating strength that compares well in a domestic and global context. This mainly reflects our projection that the bank will maintain its very strong RAC ratio at around 20% in the medium term, along with its moderate growth strategies. BKB's RAC ratio was 20.8% at year-end 2018, which is at the upper end of our very strong range in line with the superior capitalization of many Swiss cantonal banks, and well above the levels of most other banks we rate globally. Our projected RAC incorporates our forecast of growth in the bank's risk-weighted assets (RWAs) of around 3%, which is only slightly higher than our expectation Swiss GDP growth, reflecting limited growth opportunities in the saturated Basel-City region, but Bank Cler's growth initiatives. Furthermore, we regard the bank's owner as supportive of BKB's superior capital position, and would expect timely additional support in times in a stress scenario.

In our view, BKB's earnings became very predictable and stable in recent years, and we do not expect any changes to the bank's dividend policy of distributing 40%-50% of earnings to the home canton. Pressured by low interest rates, we estimate that BKB will be able to cover 40-50 basis points (bps) of RWA losses in a credit stress, with its annual earnings (measured by our three-year-average earnings buffer). BKB's capacity to cover normalized losses is below that of many Swiss cantonal peers, yet BKB's average annual real credit losses in the past five years were only a fraction (7%) of our normalized loss assumptions.

Table 3

Basler Kantonalbank--Capital And Earnings

	--Year ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Tier 1 capital ratio	N/A	17.4	18.4	18.2	17.6
S&P Global Ratings' RAC ratio before diversification	N/A	20.8	22.0	16.8	16.7
S&P Global Ratings' RAC ratio after diversification	N/A	15.0	15.9	12.9	14.1
Adjusted common equity/total adjusted capital	97.4	97.3	97.4	97.3	97.3
Net interest income/operating revenues	62.6	64.9	60.4	63.1	60.1
Fee income/operating revenues	22.5	22.1	20.9	22.0	23.6
Market-sensitive income/operating revenues	12.7	10.9	17.2	13.4	13.2
Noninterest expenses/operating revenues	70.1	65.7	69.0	62.3	60.8
Preprovision operating income/average assets	0.4	0.5	0.5	0.6	0.6
Core earnings/average managed assets	0.3	0.5	0.5	0.5	0.5

*Data as of June 30. N/A--Not applicable.

Table 4

Basler Kantonalbank--Risk-Adjusted Capital Framework Data

(CHF 000s)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings' RWA	Average S&P Global Ratings' RW (%)
Credit risk					
Government & central banks	8,639,142.0	574,250.0	6.6	53,036.6	0.6
Of which regional governments and local authorities	1,356,478.0	574,250.0	42.3	48,833.2	3.6
Institutions and CCPs	5,250,124.0	828,762.5	15.8	656,604.7	12.5
Corporate	7,202,825.0	5,579,275.0	77.5	4,521,456.8	62.8
Retail	24,455,863.0	11,161,662.5	45.6	7,293,488.1	29.8
Of which mortgage	20,221,307.0	7,414,587.5	36.7	4,684,825.4	23.2
Other assets§	65,591.0	49,512.5	75.5	75,847.6	115.6
Total credit risk	45,613,545.0	18,193,462.5	39.9	12,600,433.8	27.6
Credit valuation adjustment					
Total credit valuation adjustment	--	802,825.0	--	--	--
Market risk					
Equity in the banking book	76,923.0	105,662.5	137.4	576,922.5	750.0
Trading book market risk	--	1,864,050.0	--	3,545,166.3	--
Total market risk	--	1,969,712.5	--	4,122,088.8	--
Operational risk					
Total operational risk	--	1,068,975.0	--	1,119,399.4	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification	--	22,237,066.3	--	17,841,921.9	100.0
Total diversification/ concentration adjustments	--	--	--	6,898,430.5	38.7

Table 4

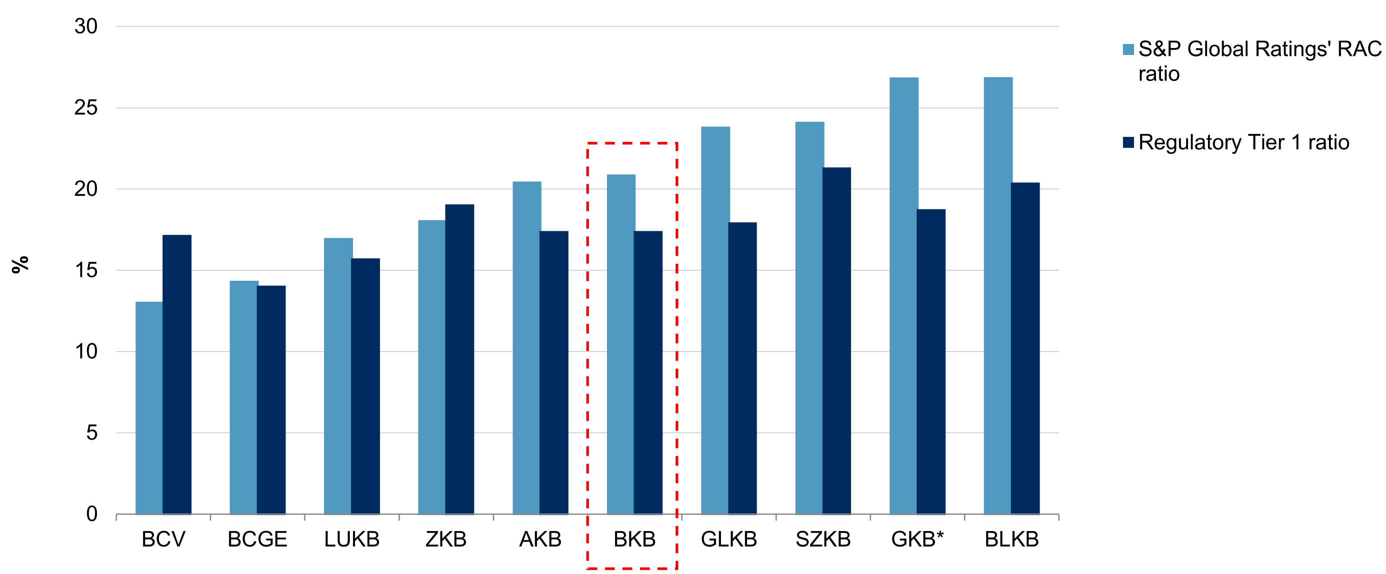
Basler Kantonalbank--Risk-Adjusted Capital Framework Data (cont.)					
RWA after diversification	--	22,237,066.3	--	24,740,352.4	138.7

	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global RAC ratio (%)
Capital ratio				
Capital ratio before adjustments	3,859,615.0	17.4	3,716,305.0	20.8
Capital ratio after adjustments†	3,859,615.0	17.4	3,716,305.0	15.0

*Exposure at default. §Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. †Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. CHF--Swiss franc. Sources: Company data as of Dec. 31 2018, S&P Global Ratings.

Chart 3

BKB's Capital Ratios Are In Line With The Peer Average
As of year-end 2018



RAC--Risk-adjusted capital. Source: S&P Global Ratings.

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Risk position: Very sound asset quality, despite some concentrations

We expect BKB's risk position will remain a relative weakness compared with many Swiss Cantonal peers, reflecting its comparably higher single-name concentrations, and a higher share of more cyclical commercial real estate lending. We also take into account an untested track record of managing Bank Cler through the cycle, and its related above-market growth in nationwide residential mortgage lending and SME lending.

We view as supportive of the rating BKB's sound asset quality with prudent underwriting; low-risk collateralized residential mortgage lending and lending to SMEs; and its pronounced progress in improving risk-management systems in recent years. We also acknowledge positively BKB's settlement of, and conservative over-provisioning in, its legal prosecution by the U.S. tax authorities.

We expect BKB's loan growth will remain about 3%, which is roughly in line with the average of the Swiss banking industry and reflects the bank's cautious approach to mortgage lending and prudent risk management. We believe that limited growth perspectives in its saturated home market are balanced in the medium term by increasing diversification in lower-risk countrywide residential mortgage lending and SME lending through its subsidiary, Bank Cler. However, BKB's share in commercial lending--which we generally view as riskier than residential real estate lending--represents about one-third of BKB's loan portfolio. In addition, single-name concentration in BKB's corporate portfolio is higher than in peers'. We estimate that its top 10 corporate loans account for about 10% of its total commercial loan portfolio. Nevertheless, risk arising from BKB's corporate loan portfolio partly reflects the narrowness of Basel-City's economic structure. In addition, we understand that BKB focuses only on high-quality names, and therefore we expect tail-risk will be relatively remote. At the same time, we regard the asset quality of the bank's sizable securities portfolio, which is mainly used for liquidity purposes, as very sound.

Table 5

Basler Kantonalbank--Risk Position

	--Year ended Dec. 31--				
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Growth in customer loans	5.3	5.6	3.3	2.2	0.4
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	38.7	38.3	29.8	18.3
Total managed assets/adjusted common equity (x)	12.0	12.2	11.1	10.7	10.8
New loan loss provisions/average customer loans	0.0	(0.2)	(0.0)	(0.0)	0.1
Net charge-offs/average customer loans	N.M.	0.0	(0.0)	0.0	(0.0)
Gross nonperforming assets/customer loans + other real estate owned	N/A	0.1	0.1	0.2	0.3
Loan loss reserves/gross nonperforming assets	N/A	71.7	113.8	87.1	51.4

*Data as of June 30. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: Favorable funding profile from retail deposits and supported by cantonal guarantee

In line with most peers, we believe that BKB's combined funding and liquidity position will remain neutral in our assessment of BKB's stand-alone creditworthiness. We assess BKB's funding as average relative to most peers, but consider its liquidity stronger because of its solid base of customer deposits.

We expect BKB's funding to remain in line with our assessment of low funding risk in the Swiss banking system. The bank's stable core customer deposits account for 63% of its funding base and for 82% of its loan portfolio as of end-year 2018, which is on top of the comparably large equity position on BKB's balance sheet. The bank's sound funding is also indicated by, for example, our calculation of the bank's stable funding ratio that we expect to remain clearly above 100%, after 111% as of mid-year 2019. In addition, we continue to consider the bank's core customer deposit base as very stable, owing to its franchise in its home region and the cantonal guarantee, which we expect will remain in place for the foreseeable future. Moreover, the shareholder and guarantee structure gives BKB access to low-cost, long-term wholesale funding (21% of its total funding base) and the ability to issue covered bonds. Due to the bank's government-related entity (GRE) status, we expect both funding sources would remain stable even in far more testing economic conditions.

BKB's liquidity will remain a strength, in our view, compared with many banks globally, given that its liquidity position would allow it to endure more than 12 months without access to market funding. This is facilitated by its broad liquid assets to short-term wholesale funding being significantly above 1.0x for the past five years. The ratio was 1.7x as of mid-year 2019. This supports our view that BKB's liquid assets comfortably cover its short-term wholesale funding needs. BKB's solid customer base, superior capitalization, and GRE status will likely help it weather potential capital market stress, in our opinion.

Table 6

Basler Kantonalbank--Funding And Liquidity

	--Year ended Dec. 31--				
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Core deposits/funding base	64.0	63.3	67.1	69.2	69.0
Customer loans (net)/customer deposits	120.0	121.5	118.2	118.5	115.7
Long-term funding ratio	87.3	85.6	89.2	89.3	87.6
Stable funding ratio	110.7	109.0	107.0	108.0	104.6
Short-term wholesale funding/funding base	13.9	15.8	12.0	12.0	13.8
Broad liquid assets/short-term wholesale funding (x)	1.7	1.6	1.6	1.7	1.4
Net broad liquid assets/short-term customer deposits	16.4	14.8	11.6	12.7	7.4
Short-term wholesale funding/total wholesale funding	38.5	42.8	36.0	38.5	44.0
Narrow liquid assets/3-month wholesale funding (x)	2.1	1.9	2.4	2.4	2.3

*Data as of June 30.

Support: Four notches of uplift for extremely high likelihood of extraordinary government support

We strongly believe that BKB will remain a GRE, and see an extremely high likelihood that BKB would receive timely and sufficient extraordinary support from the Canton of Basel-City if needed. We base our assessment on our view of the bank's:

- Integral link with the canton. We expect the canton will provide considerable and timely credit support to BKB in all circumstances. Our assessment is underpinned by the canton's full ownership of BKB and possession of 100% of the voting rights, as well as its provision of a statutory guarantee for BKB.
- Very important role in the canton, owing to the large impact of BKB's activities on the local economy.

Because of these factors, we incorporate a four-notch uplift into the long-term rating on BKB. We do not envisage that the bank's GRE status or our view of an extremely high likelihood of extraordinary government support will change in the foreseeable future.

BKB benefits from Basel's statutory guarantee, which ultimately covers all of its liabilities as stipulated by law. We note, however, that the guarantee does not ensure timely repayment, as defined by our criteria, but we believe that the canton has strong incentives to help BKB meet its obligations on time, due to the bank's importance to the regional economy.

Hybrid Issue Ratings

Our 'BBB-' ratings on BKB's junior subordinated (additional Tier 1 instruments) reflect our analysis of the instruments and our assessment of BKB's SACP at 'a'. We understand that the bonds do not benefit from the cantonal guarantee provided by the City of Basel, and consequently we notch down from our SACP assessment for the bank. We rate BKB's additional Tier 1 instruments four notches lower than the SACP, reflecting our deduction of:

- One notch for contractual subordination;
- Two notches for the notes' status as Tier 1 regulatory capital; and
- One notch because the instruments allow for the full or partial temporary write-down of the principal amount

We do not apply additional notching beyond the four notches, given the 5.125% mandatory write-down trigger at BKB level, which we consider to be a nonviability capital trigger. As of Dec. 31, 2018, the relevant common equity Tier 1 ratio for the bank was 17.4%, based on RWAs under Basel III.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Anchor Matrix

Industry Risk	Economic Risk									
	1	**2**	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	**a-**	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of December 17, 2019)*

Basler Kantonalbank	
Issuer Credit Rating	AA+/Stable/A-1+
Junior Subordinated	BBB-
Senior Unsecured	AA+
Issuer Credit Ratings History	
12-Nov-2018	AA+/Stable/A-1+
13-Nov-2017	AA/Positive/A-1+
06-Aug-2013	AA/Stable/A-1+
Sovereign Rating	
Switzerland	AAA/Stable/A-1+
Related Entities	
Basel-City (Canton of)	
Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured	AAA

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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