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## Research Update:

# Schwyzer Kantonalbank 'AAA/A-1+' Ratings Affirmed; Outlook Stable

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## Research Update:

# Schwyzer Kantonalbank 'AAA/A-1+' Ratings Affirmed; Outlook Stable

## Overview

- Following a review of Schwyzer Kantonalbank (SZKB) under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we have affirmed our 'AAA/A-1+' ratings on SZKB. The outlook is stable.
- In our view, SZKB has an adequate business position, very strong capital and earnings, an adequate risk position, average funding, and strong liquidity, reflecting its stand-alone credit profile (SACP) of 'aa-'.
- We continue to consider SZKB to be a government-related entity with an "extremely high" likelihood of extraordinary government support in times of stress, which results in a three-notch rating uplift from the SACP.
- The stable outlook reflects that on SZKB's owner and guarantor the Swiss Canton of Schwyz. We believe that SZKB will continue to maintain its very strong capital position and its prudent approach to managing its risk position.

## Rating Action

As previously announced, on Dec. 5, 2011, Standard & Poor's Ratings Services affirmed its 'AAA' long-term and 'A-1+' short-term counterparty credit ratings on Switzerland-based Schwyzer Kantonalbank (SZKB). The outlook is stable.

## Rationale

Standard & Poor's bases its assessment of SZKB's stand-alone credit profile (SACP) on the company's "adequate" business position, "very strong" capital and earnings, "adequate" risk position, "average" funding, and "strong" liquidity, as our criteria define these terms. The stand-alone credit profile (SACP) is at 'aa-'.

Our bank criteria use the economic risk and industry risk scores from our Banking Industry Country Risk Assessment (BICRA) to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for a commercial bank operating only in Switzerland is 'a'.

The BICRA score includes our evaluation of economic risk. In this respect, we view Switzerland as a highly diversified and competitive economy, benefiting from one of the highest GDPs per capita in the world and very robust government finances. We believe Switzerland demonstrates a conservative risk and lending culture, which has accompanied recent moderate growth of house prices and loan portfolios. The Swiss banking industry is supported by its sizable and very stable customer deposit base. Pure domestic Swiss banks have

not loosened credit standards in recent years, thanks to sound earnings potential from core products. We consider regulatory standards to be more stringent than in other developed countries.

SZKB's "adequate" business position reflects our view of the bank's high business stability and prudent management, which mitigate its geographic concentration on primarily a single canton. SZKB is able to generate stable and durable revenue streams, as demonstrated during the recent economic downturn. This stems from its superior market position in its home canton, based on its loyal customer base. In our view, SZKB's management is committed to conservative lending standards, which reduce the concentration risks of its syndicated loan portfolio to counterparties domiciled in Switzerland.

We assess SZKB's capital and earnings as "very strong". SZKB's capitalization reflects its low risk profile and strong equity position, which results in a projected risk-adjusted capital (RAC) ratio of 20% before concentration and diversification effects over the next 18 months. The quality of capital is very high. SZKB's total adjusted capital consists solely of core Tier 1 equity. Furthermore, SZKB's owner, the Canton of Schwyz (AAA/Stable/A-1+), supports SZKB's strong capital position, which limits the risk of larger payouts to the canton. In general, we expect SZKB to continue to report substantial profits in the foreseeable future and to further maintain or even strengthen its very strong capital position through ongoing retention of earnings.

We consider the bank's risk position as "adequate", which is characterized by what we regard as conservative underwriting standards and a low risk appetite. SZKB's prudent and cautious lending standards are also demonstrated by its very low risk provisioning needs in past years. Although SZKB is broadly exposed to residential real estate lending in the Canton of Schwyz, we regard the granularity of its real estate portfolio as partly offsetting this weakness. However, a sudden decline in real estate prices in central Switzerland could become an area of concern for the rating. We believe SZKB's increasing participation in syndicated lending could expose it to elevated risks, given that Switzerland's export-oriented industry is currently suffering under the effects of a strong Swiss franc. We also believe that a lengthy period of low interest rates in Switzerland might heighten SZKB's interest rate risks and squeeze its net interest margin.

SZKB's funding is "average" and its liquidity position is "strong", in our view. The bank's major source of funding is its customer deposits, which have proven to be very stable due to the canton's guarantee. Like other cantonal banks, SZKB even profited from a "flight to quality" during the recent financial market crisis. Core customer deposits accounted for approximately 74% of SZKB's total funding base as of midyear 2011; however, this share is smaller than that of other cantonal banks. The rest of SZKB's funding mix consists of unsecured and covered bond issuances at very low costs. SZKB profits from a very favorable liquidity position, which should allow it to operate for a long time without resorting to the capital markets.

We continue to consider SZKB to be a government-related entity (GRE) under our criteria. In accordance with our criteria for GREs, our view of an "extremely high" likelihood of timely and sufficient extraordinary support provides a three-notch uplift to our assessment of SZKB's SACP. Our view of an "extremely high" likelihood of support reflects our assessment of SZKB's:

- "Very important" role as Schwyz's largest GRE. SZKB's default could destabilize the regional economy and damage the canton's reputation; and
- "Integral" link with the canton, owing to a strong and durable relationship. SZKB benefits from the canton's statutory guarantee, which ultimately covers all of its liabilities, except subordinated debt. We don't anticipate changes to SZKB's ownership structure, its legal status, or the canton's statutory guarantee.

## Outlook

The stable outlook on SZKB reflects that on its owner and guarantor the Canton of Schwyz. The stable outlook also reflects our expectation that the bank's GRE status and "extremely high" likelihood of extraordinary government support will not change in the foreseeable future and that SZKB will maintain its strong financial and risk profile over the medium term.

Negative rating actions may result from a weakening of SZKB's role for or link with the canton, or from changes in the statutory guarantee that may lead to a loosening of its ties with the canton. However, we currently consider this scenario to be unlikely and would expect SZKB's existing obligations to be grandfathered.

We might take a negative view of SZKB's SACP and lower our ratings on SZKB if we revised our BICRA for Switzerland (currently in group '1'). Furthermore, a drop in real estate prices in central Switzerland or a change in SZKB's prudent and conservative lending and underwriting standards could lead to a downgrade.

An improvement in SZKB's SACP is unlikely at this stage, in view of the bank's comparatively concentrated business model.

## Ratings Score Snapshot

Issuer Credit Rating	AAA
SACP	aa-
Anchor	a
Business Position	Adequate (0)
Capital and Earnings	Very strong (+2)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Strong (0)
Support	3
GRE Support	3

Group Support	0
Sovereign Support	0
Additional Factors	0

## Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

## Ratings List

Ratings Affirmed

Schwyzer Kantonalbank

Counterparty Credit Rating	AAA/Stable/A-1+
Certificate Of Deposit	AAA/A-1+
Senior Unsecured	AAA

### Additional Contact:

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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