S&P Global Ratings

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Schwyzer Kantonalbank

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Schwyzer Kantonalbank

SACP	a+		+	Support	+3	+	Additional Factors	0

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

ALAC Support	0
GRE Support	+3
Group Support	0
Sovereign Support	0

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

Major Rating Factors

Strengths:	Weaknesses:
• Close ties with the financially strong Canton of Schwyz, facilitated by full ownership and a statutory guarantee. • Very strong capitalization alongside prudent risk management and dedicated cost efficiency. • Leading franchise in home canton with some earnings diversification due to private banking and investment funds business development.	• Concentration risk in residential mortgage lending in the Canton of Schwyz, accompanied by historically high house prices. • Ongoing growth in retail lending, despite the increasingly high level of indebtedness of Swiss households. • Still strong reliance on net interest income in the challenging, very-low-interest-rate environment.

Outlook: Stable

The stable outlook on Schwyzer Kantonalbank (SZKB) reflects S&P Global Ratings' expectation that the likelihood of support from the Canton of Schwyz—if ever needed--will remain unchanged in the next two years.

Likewise, our rating on SZKB remains sensitive to our assessment of the cantonal owners' superior ability and willingness to support the bank.

A weakening in SZKB's role for or link with the canton, or detrimental changes in the statutory guarantee, could lead us to revise down our support assessment of the bank's status as a government-related entity (GRE). However, we do not envisage such a scenario in the foreseeable future, also in light of their close relationship. If this were to happen, we would expect that SZKB's existing obligations would be grandfathered.

We think it unlikely that we would revise upward our already high assessment of SZKB's 'a+' stand-alone credit profile (SACP), given the bank's size limiting its nationwide competitive position and its comparatively concentrated business profile.

Rationale

Our rating on SZKB reflects its dominating cantonal franchise, supported by its operations in favorable conditions of low banking and industry risk for Swiss banks. The rating also reflects the bank's superior capitalization by global comparison, a key strength that is supported by sound risk policies. We also consider the bank's liquidity position management to be a particular strength, supported by franchise-driven, easy access to customer deposit funding.

The ratings on SZKB continue to markedly benefit from our unchanged assessment that SZKB is a GRE with an extremely high likelihood of receiving timely and sufficient extraordinary government support from its home canton, Schwyz, if necessary. We base this on SZKB's very important role for and integral link with Schwyz. We think the canton has enough resources to support the bank if needed.

Anchor:'a-' for banks operating predominantly 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 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, it also reflects that risks remain, owing to the cumulative rise in Swiss house prices over the past several years. Although imbalances remain moderate in a global context, they have led the regulator to enact macro prudential measures to limit increases in mortgage indebtedness. We recognize that house price growth has cooled down since the beginning of 2014, and lending has recently picked up again after several years of moderate growth. In our view, house prices and household indebtedness remain historically high. The large amount of financial assets, including pensions, held by households in Switzerland, mitigates the very high mortgage debt level.

Our industry risk score of '2' primarily reflects the banking sector stability and a relatively high share of deposit funding. 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 still able to generate returns on core banking products that are adequate to meet their cost of capital. Moreover, in our view, the Swiss regulator's regulatory initiatives are more stringent than those in other European banking industries.

Table 1

Schwyzer Kantonalbank--Key Figures

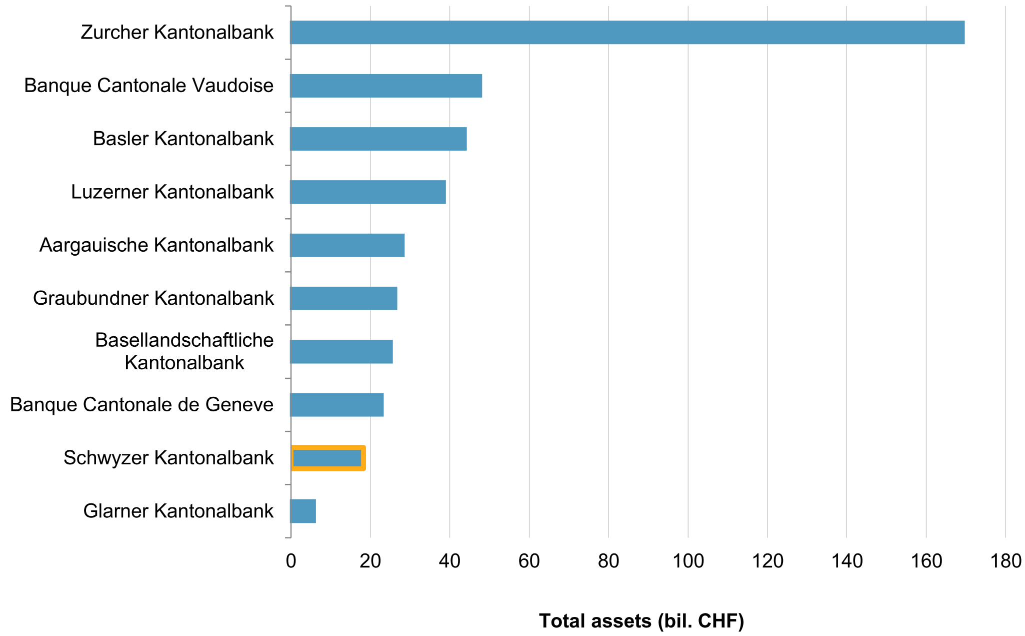
	--Year ended Dec. 31--				
(Mil. CHF)	**2018**	**2017**	**2016**	**2015**	**2014**
Adjusted assets	18,277.5	17,557.5	16,668.8	16,193.6	14,941.1
Customer loans (gross)	15,040.2	14,203.4	13,524.7	12,947.8	12,295.1
Adjusted common equity	1,811.5	1,738.6	1,642.3	1,569.0	1,472.4
Operating revenues	242.0	245.5	234.9	237.7	230.8
Noninterest expenses	115.6	114.6	122.4	119.3	111.4
Core earnings	117.6	145.1	116.7	112.1	115.9

CHF--Swiss franc.

Chart 1

Size Of Swiss Cantonal Banks That We Rate

Schwyzer Kantonalbank remains relatively small in relation to other rated cantonal banks



CHF--Swiss franc. Data as of Dec. 31, 2018. Source: S&P Global Ratings.

Business position: Cost-effective dominant regional business franchise in Schwyz

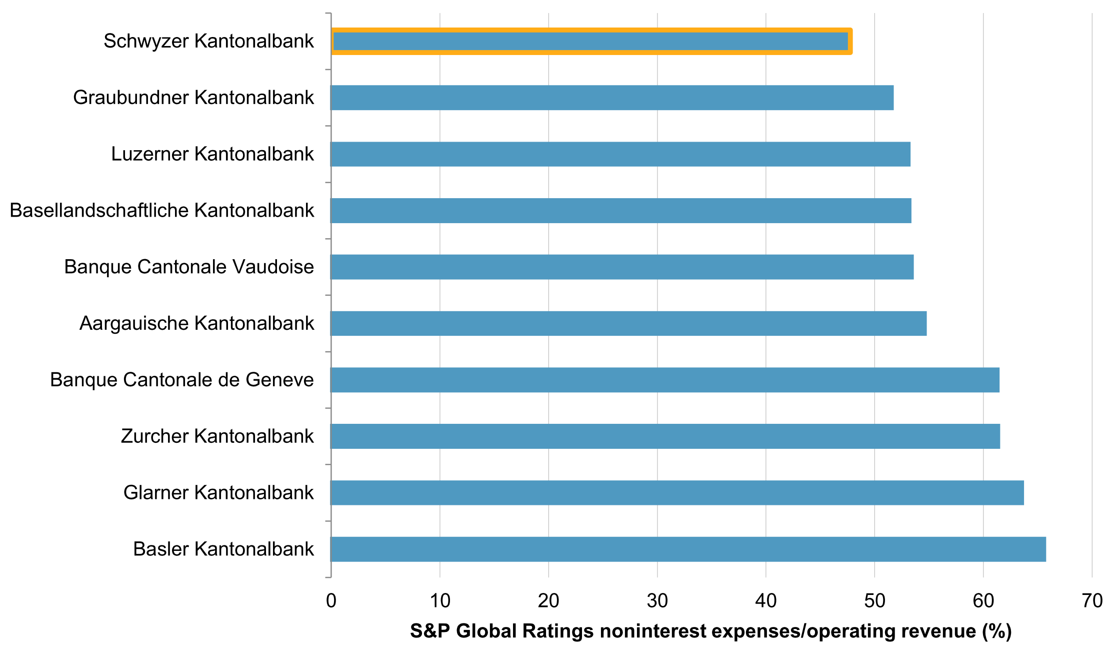
SZKB has an exceptionally stable but regionally focused, franchise-driven market position. We expect that its business profile will remain a neutral rating factor in line with our favorable assessment of Switzerland's low industry risk.

SZKB had total assets of Swiss franc (CHF) 18.3 billion (about €16 billion) as of Dec. 31, 2018, and we expect it to remain a midsize cantonal bank. We view positively SZKB's enforced 2019-2022 strategy, which proactively targets small and midsize enterprises (SME) and retail mortgage clients in German-speaking Switzerland. The share of the outstanding credit exposures outside of its home canton surpassed 30% at the beginning of 2019. We view this as a defensible level in the short to medium term. However, SZKB's key strength and purpose will remain to support the local economy. In our opinion, the canton's general liabilities guarantee serves more to fulfill local policy than to enhance SZKB's expansion across Switzerland. SZKB's strategy is in line with many other cantonal banks' similar regional growth initiatives, but we think residential mortgage lending and lending to SMEs in their home cantons remain the priority, considering the banks' franchise-driven competitive advantages in their respective home regions.

In our view, SZKB has successfully developed a modern digital banking platform, in line with its 2014-2018 strategy. This helps to optimize processes, expand business, and stabilize earnings against a continuous drop in net interest margins. Moreover, the bank increasingly diversifies into investment fund offerings and private banking activities. We expect that SZKB will remain the market leader in its canton, defending its superior franchise and longstanding customer relationships with approximately 80% of the canton's population. Accordingly, we expect SZKB's business profile will remain strongly linked to the Canton of Schwyz' economic cycles. To mitigate regional concentration risk, the bank continues to manage its strength of high efficiencies, as demonstrated by its comparatively low adjusted cost-to-income ratio of less than 50% in recent years.

Chart 2

Top Operating Efficiency Among Rated Cantonal Banks



Data as of Dec. 31, 2018. Source: S&P Global Ratings.

Table 2

Schwyzer Kantonalbank--Business Position

	--Year ended Dec. 31--				
(%)	2018	2017	2016	2015	2014
Loan market share in country of domicile	1.3	1.2	1.2	1.2	1.1
Deposit market share in country of domicile	1.0	1.0	1.0	1.0	0.9
Total revenues from business line (mil. CHF)	245.0	247.8	238.2	267.9	231.2
Commercial & retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on average common equity	4.2	4.6	4.6	4.7	5.0

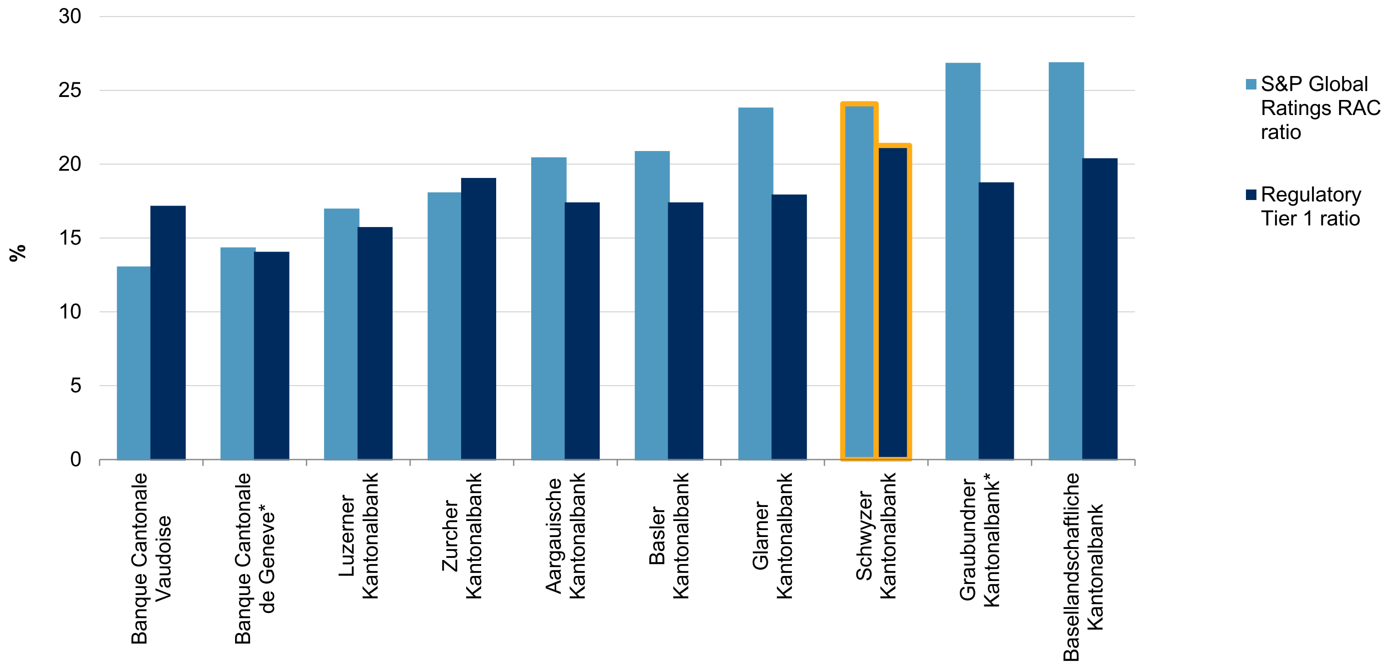
CHF--Swiss franc.

Capital and earnings: Key strength in exceptional capitalization in global comparisons

Chart 3

Schwyzer Kantonalbank's Capital Ratios Are Among The Highest Globally

Cantonal banks as of year-end 2018



RAC--Risk-adjusted capital. *Ratios as of Dec 2017. Source: S&P Global Ratings.

We expect that SZKB's capital and earnings position will remain a particular strength compared with domestic and global peers. For example, we forecast that our measure of the bank's risk-adjusted capital ratio will remain close to 24% for the next two years (24.1% at year-end 2018).

Likewise, we expect SZKB's regulatory capital indictors will continue to compare favorably with other universal banks operating in Switzerland. For example, it had a solid leverage ratio of 10% and a core tier 1 ratio of 21.3% at year-end 2018, despite less favorable regulatory treatment when applying a standardized Basel III approach.

Moreover, we acknowledge SZKB's superior core tier 1 equity, which entirely comprises share capital, capital surplus, and reserves. We also note SZKB's stable, solid earnings capacity and its reasonable dividend policies (CHF48 million from 2018 results after CHF51 million paid for 2017). We remain confident that the Canton of Schwyz will remain supportive of holding superior capital position at SZKB and will not request any extraordinary dividend payouts. SZKB has a high quality of earnings, with a high earnings buffer of about 115 basis points over our risk-weighted assets. We expect that the bank will maintain this high quality as a favorable first line of defense against potential future losses in a bad economic cycle.

Table 3

Schwyzer Kantonalbank--Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	21.3	21.1	21.0	20.9	20.0
S&P Global Ratings' RAC ratio before diversification	24.1	24.4	24.5	23.9	22.5
S&P Global Ratings' RAC ratio after diversification	17.3	17.4	17.8	19.9	18.7
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	74.0	72.9	77.2	76.3	76.4
Fee income/operating revenues	17.4	15.6	13.9	13.0	14.7
Market-sensitive income/operating revenues	6.5	10.6	7.8	8.4	7.6
Noninterest expenses/operating revenues	47.8	46.7	52.1	50.2	48.3
Preprovision operating income/average assets	0.7	0.8	0.7	0.8	0.8
Core earnings/average managed assets	0.7	0.8	0.7	0.7	0.8

Table 4

Schwyzer Kantonalbank--Risk-Adjusted Capital Framework Data

(Mil. CHF)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government & central banks	1,059	375	35	38	4
Of which regional governments and local authorities	1,050	375	36	38	4
Institutions and CCPs	391	188	48	105	27
Corporate	6,194	3,250	52	4,085	66
Retail	8,847	3,700	42	2,162	24
Of which mortgage	8,588	3,513	41	1,992	23
Securitization§	0	0	0	0	0
Other assets†	157	350	223	140	89
Total credit risk	16,648	7,863	47	6,531	39
Credit valuation adjustment					
Total credit valuation adjustment	--	50	--	0	--
Market risk					
Equity in the banking book	76	88	115	475	625
Trading book market risk	--	25	--	38	--
Total market risk	--	113	--	513	--
Operational risk					
Total operational risk	--	438	--	476	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	8,463	--	7,520	100
Total diversification/ concentration adjustments	--	--	--	2,958	39

Table 4

Schwyzer Kantonalbank--Risk-Adjusted Capital Framework Data (cont.)					
RWA after diversification	--	8,463	--	10,477	139
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		1,811.5	21.3	1,811.5	24.1
Capital ratio after adjustments‡		1,811.5	21.3	1,811.5	17.3

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †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). CCP--Central counterparty. CHF--Swiss Franc. RAC--Risk-adjusted capital. RW--Risk weight. RWA--Risk-weighted assets. Sources: Company data as of Dec. 31, 2018, S&P Global Ratings.

Risk position: Prudent risk management in residential mortgage lending balances our concerns from regional concentrations

We expect that SZKB's prudent risk management and cautious lending standards will continue to contribute to the high asset quality of its loan portfolio, which partly mitigates SZKB's regional concentrations.

We expect SZKB's loan growth to moderate toward 4.0% over the next 24 months, thanks to the bank's prudent growth strategy and solid underwriting standards against weakening indicators such as Swiss households' increasing indebtedness. We anticipate that SZKB's asset quality will continue to benefit from the bank's high share in granular, lower-risk residential real estate loans, which represent roughly 75% of SZKB's CHF15.0 billion total loan portfolio at Dec. 31, 2018. Less diversified commercial real estate loans represent about 12%. SZKB's high granularity and collateralization in its real estate portfolio partly offset high concentration risk to regional real estate loans. We estimate the average loan-to-value ratio (LTV) to be slightly below 60% for residential and commercial real estate loans. However, the average LTV for the commercial real estate portfolio increased by 60 bps to 58.6% in 2018 since 2017. Although it is not yet a major issue, we note that the risk of corrections in real estate markets is increasing and we see higher vacancy rates for rental apartments in the Canton of Schwyz while the canton grew at a slightly slower pace than the Swiss average.

We expect SZKB will continue to benefit from its comprehensive risk management philosophy to operate only in markets and with products it knows well and can manage conservatively. For example, the bank mostly avoids engaging in complex products. We also think SZKB's management will continue to prudently manage its limited market risk. Its market risk mainly comprises interest rate risk from mismatches in asset-liability management activities, which SZKB adequately hedges, in our view. SZKB engages in very limited trading activities, mostly reflecting the active management of own and clients' foreign currency holdings. Other non-foreign-exchange transactions generally remain initiated by clients.

We understand that SZKB's private banking activities have never focused on business outside Switzerland, which significantly limits SZKB's related legal, financial, or reputational risk. SZKB only had a low 1.2% of assets outside Switzerland as of March 31, 2019, below the bank's own prudent, long-lived 5% limit. Although registered as a compliant Foreign Account Tax Compliance Act (FATCA) foreign financial institution, SZKB is primarily a local bank. It does not currently participate in cross-border transactions that could qualify for the U.S. tax program.

Table 5

Schwyzer Kantonalbank--Risk Position

	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	5.9	5.0	4.5	5.3	3.9
Total diversification adjustment/S&P Global Ratings' RWA before diversification	39.3	40.0	37.5	20.1	20.6
Total managed assets/adjusted common equity (x)	10.1	10.1	10.1	10.3	10.1
New loan loss provisions/average customer loans	0.1	(0.1)	(0.0)	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	0.1	0.1	0.2	0.1	0.1
Loan loss reserves/gross nonperforming assets	841.0	727.1	669.3	957.6	1,203.4

RWA--Risk-weighted assets.

Funding and liquidity: Favorable market conditions and cantonal guarantee bolster prudent liquidity and funding management

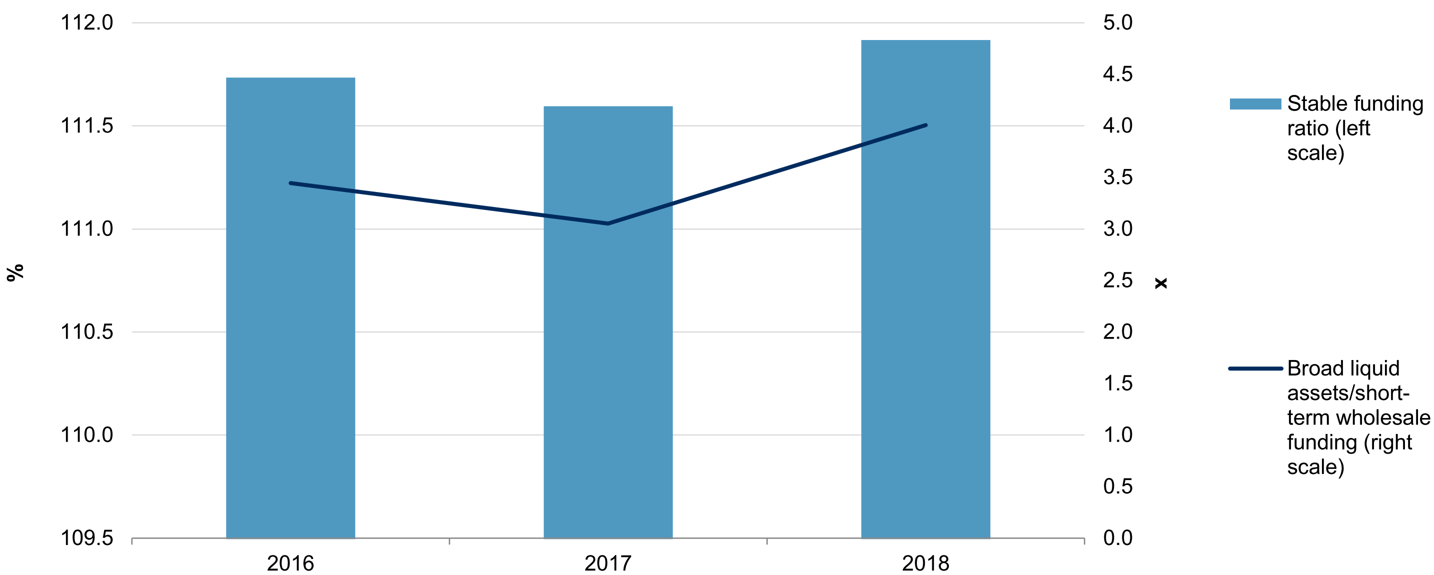
We expect SZKB's funding management and position to remain in line with that of other domestic banks benefitting from the currently very favorable operating conditions in the Swiss market. We anticipate that the bank's prudent management and an explicit guarantee by the Canton of Schwyz will ensure that SZKB's liquidity position remains a particular strength.

We anticipate that SZKB's funding continues to strongly benefit from its stable and sticky customer deposit base owing to the bank's leading franchise and intimate knowledge of customers in the Canton of Schwyz, which is bolstered by its cantonal guarantee and by a stable relationship with its owner, Canton of Schwyz. For example, franchise driven core customer deposits accounted for high 77% of its funding base as of year-end 2018, while the remainder is 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 SZKB's stable funding ratio will remain at favorable levels between 110%-115% (112% at year-end 2018).

We assess SZKB's liquidity as a particular strength considering the bank's ongoing sound management of its liquidity position, which would enable the bank to endure more than 12 months without access to market funding in an adverse scenario. This includes our view that SZKB will maintain its prudent securities portfolio composition. We anticipate that SZKB will maintain its superior ratio of broad liquid assets to short-term wholesale funding (4.0x at year-end 2018). This ratio, which is above the Swiss average, supports SZKB's very favorable liquidity position.

Chart 4

Schwyzer Kantonalbank - Stable Funding And Liquidity Metrics Over Time



Source: S&P Global Ratings.

Table 6

Schwyzer Kantonalbank--Funding And Liquidity

	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	77.3	76.5	77.9	76.7	81.5
Customer loans (net)/customer deposits	117.7	117.0	115.0	117.0	114.6
Long-term funding ratio	96.4	94.9	95.6	93.9	97.7
Stable funding ratio	111.9	111.6	111.7	109.8	108.6
Short-term wholesale funding/funding base	4.0	5.7	4.9	6.8	2.6
Broad liquid assets/short-term wholesale funding (x)	4.0	3.1	3.4	2.6	5.4
Net broad liquid assets/short-term customer deposits	16.1	15.8	15.8	14.8	14.3
Short-term wholesale funding/total wholesale funding	17.6	24.2	22.1	29.4	13.9
Narrow liquid assets/three-month wholesale funding (x)	4.5	3.3	4.3	4.3	20.0

Support: Extremely high likelihood of extraordinary local government support

We expect SZKB to remain a GRE. The long-term rating on SZKB is three notches above the SACP, reflecting our view that there is an extremely high likelihood of timely and sufficient extraordinary support from its sole owner, the Canton of Schwyz, if needed. We base this on our view of the bank's integral link with and very important role for the canton. This view is mainly underpinned by SZKB's importance to the regional economy and the cantonal guarantee. We think a default by SZKB would have a significant systemic impact on the local economy. We do not anticipate any change to the bank's current integral link with and very important role for the canton in the medium term.

We think the prospect of extraordinary government support for Swiss banks is uncertain because Switzerland has implemented several legislative measures in recent years and established a functioning resolution regime. However, we generally consider resolution frameworks less likely to impede the cantonal owners' willingness to provide extraordinary support to GRE banks, including SZKB. Despite the reduced predictability of government support to systemically important commercial banks, we expect the canton's government will remain highly supportive of SZKB. Furthermore, the cantonal government has sufficient financial resources to support SZKB.

Owing to SZKB's low systemic importance at the national level, and because its GRE status is already a benefit to the bank's SACP, we do not estimate any additional uplift from additional loss-absorbing capital to our assessment.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria

- 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

Related Research

- Summary: Switzerland, Aug. 23, 2019
- Banking Industry Country Risk Assessment Update: July 2019, July 30, 2019
- Swiss Cantonal Banks: Ratings As High As The Alps, Jan. 31, 2019
- Banking Industry Country Risk Assessment: Switzerland, Nov. 30, 2018

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 September 2, 2019)*

Schwyzer Kantonalbank	
Issuer Credit Rating	AA+/Stable/A-1+
Issuer Credit Ratings History	
25-Aug-2016	AA+/Stable/A-1+
25-Feb-2015	AA+/Negative/A-1+
01-Dec-2014	AA+/Stable/A-1+
Sovereign Rating	
Switzerland	AAA/Stable/A-1+

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