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Schwyzer Kantonalbank

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Schwyzer Kantonalbank

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

\+

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

\+

Additional Factors	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. • Leading franchise in home canton.	• Concentration risk in residential mortgage lending in the Canton of Schwyz. • Strong reliance on net interest income amid the challenging low-interest-rate environment.

Outlook: Stable

The stable outlook on Schwyzer Kantonalbank (SZKB) mainly indicates that we expect the likelihood of support from the Canton of Schwyz to remain unchanged in the next two years. Our rating on SZKB remains sensitive to our assessment of the cantonal owners' 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, 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 the rating based on an improvement of SZKB's 'a+' stand-alone credit profile (SACP), given the bank's comparatively concentrated business profile. A deterioration of the SACP would not immediately affect the overall rating, as we expect that the owner's support would compensate for the stand-alone weakness.

Rationale

Our rating on SZKB reflects its dominating cantonal franchise and the favorable conditions of operating in the low-risk Swiss banking market. The rating also indicates the bank's superior capitalization by global comparison, a key strength that is supported by sound risk policies. We believe the bank will not be significantly affected by the COVID-19-induced recession of 2020. We also consider the bank's liquidity position management to be a strength, supported by franchise-driven, easy access to customer deposit funding.

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

Anchor:'a-' for banks operating predominantly in Switzerland

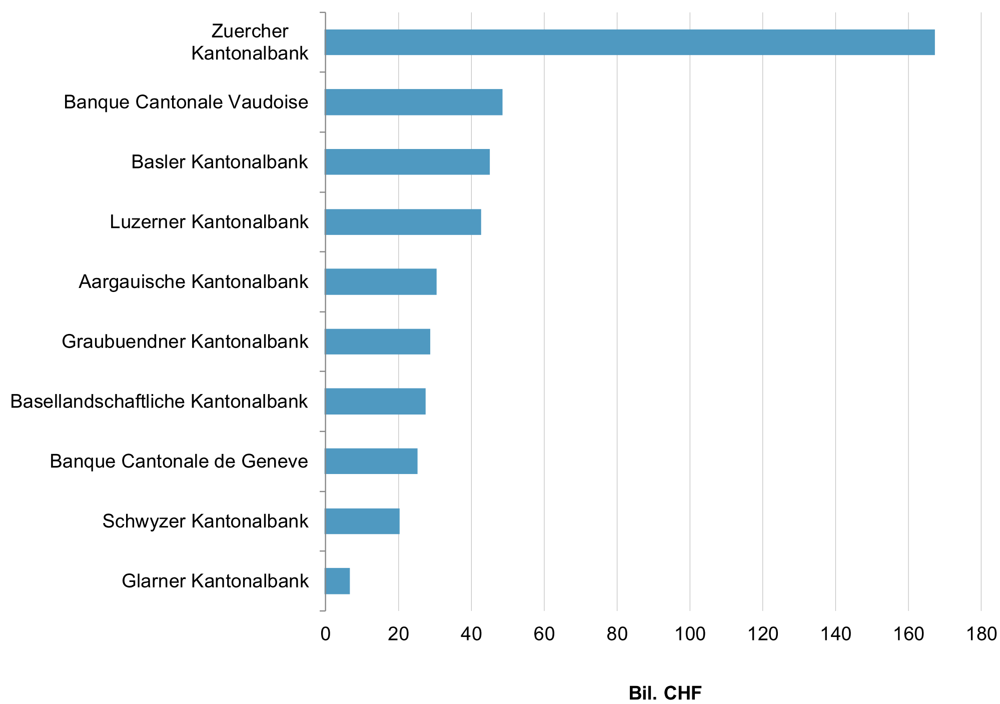
Our criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor SACP, the starting point in assigning an issuer credit rating (ICR). Our anchor for a bank operating mainly in Switzerland is 'a-'. We consider the trend for economic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

We expect Switzerland's economy to contract in 2020 due to the pandemic, but to fully recover over the coming two years. Under this base case, we think the Swiss banking sector will remain resilient, supported by the country's diversified and competitive economy, very high household income levels, and a proven stress-resilient corporate sector. We think Swiss authorities' support measures for domestic firms and households should cushion the short-term effect on Swiss banks' loan books. Additionally, we view positively banks' prudent loan underwriting standards and the high collateralization of residential mortgage loans, which dominate most banks' customer portfolios. Considering these factors, we expect only a limited increase in credit losses, from historical low levels. We also expect that affordability risk in the housing market could slightly reduce over the coming years as price growth in the owner-occupied segment is likely to remain muted in the wake of the pandemic. However, a particular, ongoing risk is the investment property segment (estimated 30% of the market), where we already observed signs of a price correction before the pandemic.

Our view of industry risk in Switzerland encompasses the stability of the domestic banking sector and our expectation that damage from the pandemic will remain contained. We view positively the limited presence of foreign players, the banks' high capitalization levels in an international comparison, and their low reliance on capital markets for funding. In our view, the Swiss regulator's initiatives remain more stringent than those in other European banking sectors. We expect that banks' net interest margins will continue to decline gradually in a long-term-expected low-interest-rate environment, as higher-yield assets mature and retail deposit rates remain floored at zero. However, we expect that repricing of lending products, additional fee income from investment advisory-related activities, and ongoing cost management can offset some of the pressure. We consider the risk from tech disruption for Swiss banks as limited, given the population's preference for cash payments, the small size of the market with high barriers to entry, and technologically well-equipped banks.

Chart 1

Swiss Cantonal Banks By Total Assets--Fiscal Year 2019
Schwyzer Kantonalbank is relatively small in relation to other rated cantonal banks



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

Table 1

Schwyzer Kantonalbank--Key Figures						
	--Year ended Dec. 31--					
(Mil. CHF)	**2020***	**2019**	**2018**	**2017**	**2016**	**2015**
Adjusted assets	20,990.0	20,081.0	18,278.0	17,558.0	16,669.0	16,194.0
Customer loans (gross)	15,694.0	15,549.0	15,040.0	14,203.0	13,525.0	12,948.0
Adjusted common equity	1,919.0	1,884.0	1,811.0	1,739.0	1,642.0	1,569.0
Operating revenues	123.0	251.0	242.0	246.0	235.0	238.0
Noninterest expenses	63.0	119.0	116.0	115.0	122.0	119.0
Core earnings	59.0	122.0	118.0	145.0	117.0	112.0

*Data as of June 2020. CHF--Swiss franc.

Business position: Cost-efficient strong franchise in Schwyz

SZKB has a stable but regionally focused, franchise-driven market position. We expect that its business profile will remain a neutral rating factor, in line with peers operating in favorably low industry risk.

SZKB had total assets of Swiss franc (CHF) 21.0 billion (about €19.6 billion) as of June 30, 2020, and we expect the size of the bank to remain at a similar level in the coming years--relatively small, compared with most of its Swiss peers (see chart 1). For regional diversification, SZKB's enforced 2019-2022 strategy 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 already surpasses 30%. We view this as a defensible level in the short to medium term. However, SZKB's most important market strategy will still be to support the local economy.

We see the risk of disruption for SZKB's business model from new fintech competitors as relatively low in the foreseeable future, given a loyal and conservative client base, which will likely also favor a relationship-based bank over pure digital banks in the future. We also believe that SZKB has successfully developed a modern digital banking platform. 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 S&P Global Ratings-adjusted cost-to-income ratio of less than 50% in recent years.

Table 2

Schwyzer Kantonalbank--Business Position						
	--Year ended Dec. 31--					
(Mil. CHF)	**2020***	**2019**	**2018**	**2017**	**2016**	**2015**
Loan market share in country of domicile	N/A	1.3	1.3	1.2	1.2	1.2
Deposit market share in country of domicile	N/A	1.0	1.0	1.0	1.0	1.0
Total revenues from business line (currency in millions)	123.0	251.0	245.0	248.0	238.0	268.0
Commercial & retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0	100.0
Return on average common equity	3.5	4.1	4.2	4.6	4.6	4.7

*Data as of June 2020. CHF--Swiss franc. N/A--Not applicable.

Capital and earnings: Exceptional capitalization in global comparisons

We expect that SZKB's capital and earnings position will remain a particular strength to the rating. We forecast our measure of the bank's risk-adjusted capital ratio will remain above 20% for at least the next two years (23.5% at year-end 2019).

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 9.6% and a core tier 1 ratio of 21.8% at mid-year 2020, 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. SZKB also has stable, solid earnings capacity and reasonable dividend policies (CHF48 million from 2019 results after a similar amount paid for 2018).

We remain confident that the Canton of Schwyz will continue to hold its 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 quality as a favorable first line of defense against potential future losses in a tough economic cycle.

Table 3

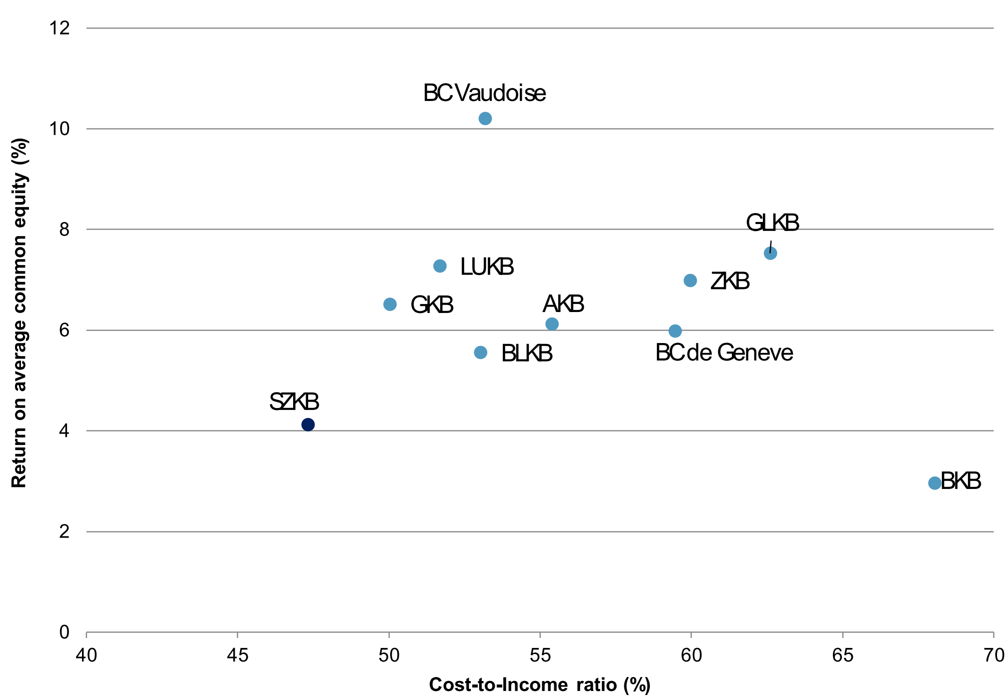
Schwyzer Kantonalbank--Capital And Earnings

	--Year ended Dec. 31--					
(Mil. CHF)	**2020***	**2019**	**2018**	**2017**	**2016**	**2015**
Tier 1 capital ratio	N/A	21.2	21.3	21.1	21.0	20.9
S&P Global Ratings' RAC ratio before diversification	N/A	23.5	24.1	24.4	24.5	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	18.1	17.3	17.4	17.8	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	71.1	71.5	74.0	72.9	77.2	76.3
Fee income/operating revenues	19.6	17.7	17.4	15.6	13.9	13.0
Market-sensitive income/operating revenues	8.0	9.5	6.5	10.6	7.8	8.4
Cost to income ratio	51.1	47.3	47.8	46.7	52.1	50.2
Preprovision operating income/average assets	0.6	0.7	0.7	0.8	0.7	0.8
Core earnings/average managed assets	0.6	0.6	0.7	0.9	0.7	0.7

*Data as of June 2020. CHF--Swiss franc. N/A--Not applicable.

Chart 2

Low Profitability But Exceptional Efficiency Metrics
Relative to cantonal bank peers



Source: S&P Global Ratings.All data as per FY 2019.

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	3,688.0	362.5	9.8	116.8	3.2
Of which regional governments and local authorities	1,028.0	362.5	35.3	37.0	3.6
Institutions and CCPs	651.0	225.0	34.6	141.2	21.7
Corporate	6,530.0	3,312.5	50.7	4,306.7	66.0
Retail	9,800.0	4,287.5	43.8	2,681.9	27.4
Of which mortgage	8,843.0	3,525.0	39.9	2,050.7	23.2
Securitization§	0.0	0.0	0.0	0.0	0.0
Other assets†	161.0	125.0	77.6	140.9	87.5
Total credit risk	20,830.0	8,312.5	39.9	7,387.5	35.5
Credit valuation adjustment					
Total credit valuation adjustment	--	50.0	--	0.0	--
Market risk					
Equity in the banking book	34.0	37.5	110.3	103.6	304.7
Trading book market risk	--	25.0	--	37.5	--
Total market risk	--	62.5	--	141.1	--
Operational risk					
Total operational risk	--	450.0	--	494.7	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	8,875.0	--	8,023.2	100.0
Total Diversification/ Concentration Adjustments	--	--	--	2,400.3	29.9
RWA after diversification	--	8,875.0	--	10,423.6	129.9
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		1,884.4	21.2	1,884.4	23.5
Capital ratio after adjustments‡		1,884.4	21.2	1,884.4	18.1

*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). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. CHF--Swiss Franc. Sources: Company data as of Dec. 31, 2019, S&P Global Ratings.

Risk position: Prudent risk management in residential mortgage lending and Swiss customers' financial health balances our concerns regarding 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 together with the strong financial health of Swiss customers mitigates risks arising from SZKB's regional concentrations.

We expect SZKB's loan growth to moderate toward 3.0% over the next 24 months, reflecting cautious underwriting standards amid difficult operating environments due to the COVID-19 pandemic. 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. 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. The average loan-to-value (LTV) ratio for both residential and commercial real estate loans fluctuates around 60%. Although it is not yet a major issue, the risk of corrections in real estate markets is increasing, and we have seen 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. 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 had only 1.1% of assets outside Switzerland as of March 31, 2020, 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 participate in cross-border transactions.

Table 5

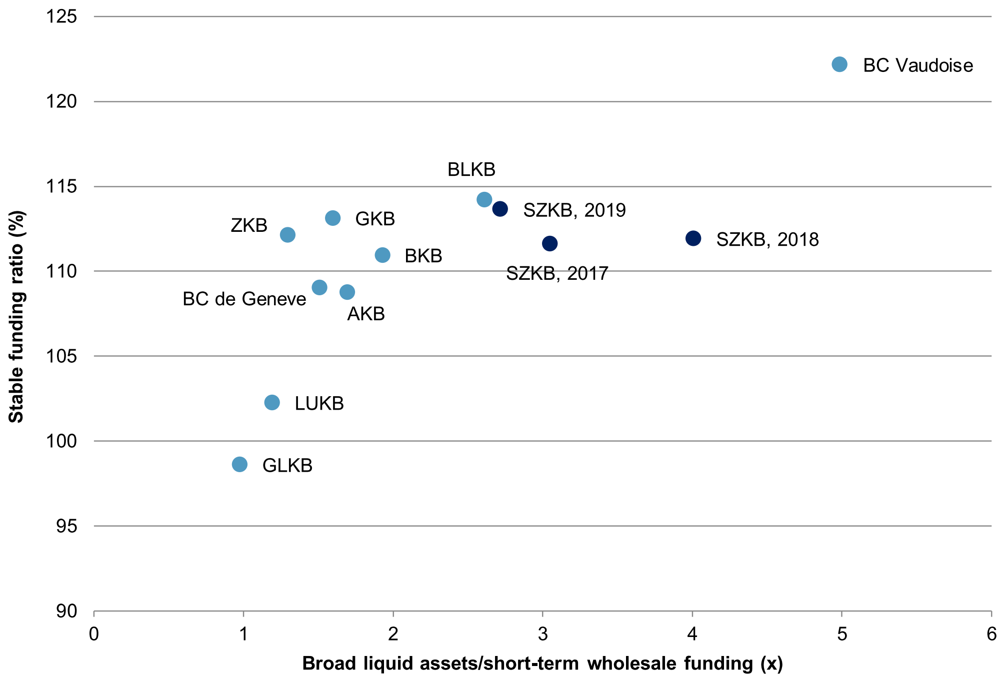
Schwyzer Kantonalbank--Risk Position

	--Year ended Dec. 31--					
(%)	**2020***	**2019**	**2018**	**2017**	**2016**	**2015**
Growth in customer loans	(0.3)	3.4	5.9	5.0	4.5	5.3
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	29.9	39.3	40.0	37.6	20.1
Total managed assets/adjusted common equity (x)	10.9	10.7	10.1	10.1	10.2	10.3
New loan loss provisions/average customer loans	0.0	0.1	0.1	(0.1)	(0.0)	0.1
Net charge-offs/average customer loans	N.M.	0.0	0.0	0.0	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	0.0	0.3	0.1	0.2	0.2	0.1
Loan loss reserves/gross nonperforming assets	N/A	333.6	841.0	727.1	669.3	957.6

*Data as of June 2020. N.M.--Not meaningful. N/A--Not applicable.

Chart 3

Funding and Liquidity Metrics
Both strong in peer comparison and stable over time



Source: S&P Global Ratings.All data for FY2019 unless indicated otherwise.

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, benefiting from the very favorable operating conditions in the Swiss market. In our view, the bank's prudent management and an explicit guarantee by the Canton of Schwyz will continue to back SZKB's strong liquidity position.

We anticipate that SZKB's funding will continue to 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, bolstered by its cantonal guarantee and by a stable relationship with its owner, Canton of Schwyz. For example, core customer deposits accounted for 73% of its funding base as of year-end 2019, 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% (113.6% at year-end 2019).

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 (2.7x at year-end 2019). This ratio, which is above the Swiss average, supports SZKB's very favorable liquidity position.

Table 6

Schwyzer Kantonalbank--Funding And Liquidity

	--Year ended Dec. 31--					
(%)	**2020***	**2019**	**2018**	**2017**	**2016**	**2015**
Core deposits/funding base	72.5	73.2	77.3	76.5	77.9	76.7
Customer loans (net)/customer deposits	113.2	116.8	117.7	117.0	115.0	117.0
Long-term funding ratio	91.4	93.0	96.4	94.9	95.6	93.9
Stable funding ratio	115.4	113.6	111.9	111.6	111.7	109.8
Short-term wholesale funding/funding base	9.5	7.8	4.0	5.7	4.9	6.8
Broad liquid assets/short-term wholesale funding (x)	2.5	2.7	4.0	3.1	3.5	2.6
Net broad liquid assets/short-term customer deposits	20.1	18.8	16.1	15.8	15.8	14.8
Short-term wholesale funding/total wholesale funding	34.6	29.0	17.6	24.2	22.1	29.4
Narrow liquid assets/3-month wholesale funding (x)	3.3	3.8	4.5	3.3	4.3	4.4

*Data as of June 2020.

Support: Extremely high likelihood of extraordinary local government support

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 SZKB'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 the ratings.

Environmental, social, and governance

We consider ESG credit factors for SZKB to be broadly in line with industry and country peers and to have a neutral impact in our assessment of SZKB's credit worthiness.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 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

Related Research

- COVID-19: Swiss Banking Sector To Remain Resilient, June 17, 2020
- Banking Industry Country Risk Assessment: Switzerland, Nov. 20, 2019

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 November 17, 2020)*	
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+

Ratings Detail (As Of November 17, 2020)*(cont.)	
01-Dec-2014	AA+/Stable/A-1+
Sovereign Rating	
Switzerland	AAA/Stable/A-1+

*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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