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Ratings On Seven Swiss Cantonal Banks Affirmed On State Ownership And Strong Stand-Alone Credit Quality; Outlooks Stable

Primary Credit Analysts:
Volker von Kruechten, Frankfurt (49) 69-33-999-164; volker_vonkruechten@standardandpoors.com
Dirk Heise, Frankfurt (49) 69-33-999-163; dirk_heise@standardandpoors.com

Secondary Credit Analysts:
Markus Schmaus, Frankfurt (49) 69-33-999-155; markus_schmaus@standardandpoors.com
Harm Semder, Frankfurt (49) 69-33-999-158; harm_semder@standardandpoors.com

- In our view, there is an "extremely high" likelihood of timely and sufficient extraordinary government support for seven Swiss cantonal banks in German-speaking cantons, which is underpinned by statutory guarantees. We assess the stand-alone credit profiles of all seven cantonal banks to be 'AA-'.
- According to our criteria for government-related entities, we continue to equalize the ratings on the cantonal banks with those on their majority canton owners.
- We are therefore affirming our ratings on seven guaranteed cantonal banks.
- The stable outlook on all seven cantonal banks reflects the outlooks of the respective cantons and our expectation that neither their GRE status, nor the banks' very strong financial and risk profiles will change over the medium term.

FRANKFURT (Standard & Poor's) June 17, 2010--Standard & Poor's Ratings Services today affirmed its long- and short-term counterparty credit ratings on seven guaranteed Swiss cantonal banks:

- Aargauische Kantonalbank (AKB; AAA/Stable/A-1+);
- Basellandschaftliche Kantonalbank (BLKB; AAA/Stable/A-1+);
- Basler Kantonalbank (BKB; AA+/Stable/A-1+);
- Graubuendner Kantonalbank (GKB; AA/Stable/A-1+);
- Luzerner Kantonalbank (LUKB; AA+Stable/A-1+);
- Schwyzer Kantonalbank (SZKB; AA+/Stable/A-1+); and
- Zuercher Kantonalbank (ZKB; AAA/Stable/A-1+).

The rating affirmations reflect the cantonal banks' status as government-related entities (GREs) and our view of an "extremely high" likelihood that the cantonal banks would receive timely and sufficient extraordinary government support in the event of financial distress. They also reflect our opinion that the cantonal banks will likely display very high resilience against economic and capital-market stress, based on what we regard as their prudent management and strong financial profiles, which effectively offset weaker business profile characteristics.

In accordance with our criteria for GREs, our view of an "extremely high" likelihood of extraordinary government support is based on our assessment of the cantonal banks:

- "Very important" roles as the respective cantons' largest GREs, because a default could destabilize the entire banking system and tarnish the reputation of the Swiss cantons. In addition, the banks support the cantons in meeting key economic and social objectives; and
- "Integral" link with their canton owners, based on strong and durable relationships with the cantonal governments. All seven cantonal banks benefit from statutory guarantees from their respective cantons for all of their liabilities, except those of their subsidiaries and non-voting profit participation rights. Although the guarantees do not stipulate timely repayment, we believe the cantons would help the cantonal banks meet their obligations promptly to maintain their reputations in the capital markets.

With the exception of LUKB, which was privatized in 2001, all of the guaranteed cantonal banks are public-law institutions. Under cantonal laws, the cantons must regularly retain at least a 51% stake in their respective cantonal banks. The cantons' participation, either through shares or voting rights, is usually higher, as in the case of LUKB (a 63% stake); AKB, BKB, SZKB, and ZKB (100%); and BLKB and GKB (74% in BLKB and 88% in GKB, but 100% of the voting rights). The cantonal governments monitor the banks' performance and could intervene in the unlikely event of serious financial stress.

We also take into consideration the historical track record of tangible extraordinary government support for two other cantonal banks, Banque Cantonale Vaudoise (AA-/Stable/A-1+) and Banque Cantonale de Geneve (A/Stable/A-1), although the cantons do not or only partly guarantee these banks' obligations. We don't expect the ownership or legal status of the seven cantonal banks or the guarantees that cover their liabilities to materially alter in the medium term.

We consider the stand-alone credit profiles of the cantonal banks to be below those of the cantons, but to be very strong at 'AA-'. In general, we regard the cantonal banks as relatively homogeneous, with various common credit characteristics. Consequently, we make no material differentiations in our stand-alone assessments. Cantonal banks are largely retail banks whose core activities are lower-risk residential mortgage lending and deposit-taking in their home cantons, where they usually lead the market. Only ZKB--and to a lesser degree BKB--differ somewhat in size, scope of operations (some nationwide activities such as private banking and commercial lending), and earnings diversification (significant trading operations). BKB owns 58% of Bank Coop (not rated), which operates throughout Switzerland.

In our opinion, all seven cantonal banks should be able to withstand even a severe stress environment, thanks to what we view as their sound earnings capacity and extremely high capitalizations. Our risk-adjusted capital (RAC) ratios (after diversification and concentration effects) show a range of 13%-18% for the seven banks. Further, the banks, in our opinion, have a highly risk-averse management culture and low risk appetite, which have resulted in consistently low credit and market risk. We consider the banks' funding and liquidity positions, which also benefit from the cantonal guarantees, to be very strong. The cantonal banks demonstrate a high share of stable customer deposits that refinance most of their lending business, and they have significantly increased their portfolio of high-quality liquid investments.

In our view, the cantonal banks' financial profiles are very strong and mitigate their comparatively low regional and business diversification and significant exposure to Switzerland's real estate markets. Although we expect the banks' operating profitability to weaken in 2010 because of rising risk provisions and pressure on interest income--the key earnings component--we do not anticipate any material changes to the cantonal banks' strong risk-bearing capacity for the foreseeable future.

The stable outlooks on all seven cantonal banks reflect the stable outlooks on the respective cantons. The ratings and outlooks on the cantonal banks will mirror any rating and outlook changes on the respective cantons. The stable outlooks also reflect our expectation that the current GRE status and the "extremely high" likelihood of extraordinary government support if needed will not change in the foreseeable future and that the cantonal banks will maintain strong financial and risk profiles over the medium term.

A material weakening of our assessment of the cantonal banks' roles and/or links to their respective cantons, including changes to the guarantees and/or ownership structures, could have negative rating implications. However, in the event of changes to the guarantees, which we currently consider unlikely, we expect existing obligations to be grandfathered.

We might lower our stand-alone assessment and our ratings on the cantonal banks if we were to revise our banking industry country risk assessment (BICRA) for the Swiss Confederation (Switzerland; AAA/Stable/A-1+). Switzerland is currently in group 1. A BICRA is our evaluation of the economic and industrywide risk profile of a country's financial system and reflects the general creditworthiness of the country's banking industry. A BICRA signals the systemwide risk of operating in a banking industry for an individual financial institution. We assess that risk on a scale from 1 to 10, ranging from the lowest-risk banking industries (group 1) to the highest-risk (group 10).

We would also consider negative rating actions if we were to perceive economic risks in the cantons or material adverse changes in the banks' management and strategy, including a departure from prudent capital and underwriting policies. Upgrades are remote at this stage, however, and would depend on upgrades on the cantons.