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Basler Kantonalbank

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Major Rating Factors

Strengths:

- "Integral" link with and "very important" role for the Canton of Basel-City through full ownership and a statutory guarantee.
- Continually sound asset quality and very strong capitalization.
- Strong and sustainable profitability and cost efficiency.

Counterparty Credit Rating

AA+/Stable/A-1+

Weaknesses:

- Lower profitability of subsidiary, Bank Coop.
- Slightly higher concentration risk by single names, region, and industry (real estate) compared with other cantonal banks.
- Limited growth potential in the saturated home market.

Rationale

The ratings on Switzerland-based, public-law institution Basler Kantonalbank (BKB) are based on an equalization with the ratings on BKB's sole owner, the Swiss Canton of Basel-City (Basel-City; AA+/Stable/A-1+). The ratings reflect Standard & Poor's Ratings Services' opinion that there is an "extremely high" likelihood that Basel-City would provide timely and sufficient extraordinary support to BKB in the event of financial distress, which provides a two-notch uplift from our assessment of BKB's stand-alone credit profile. Furthermore, the ratings reflects BKB's high resilience, in our view, against economic and capital market stress scenarios, based on prudent management and its strong risk profile, which offset weaker business profile characteristics.

In accordance with our criteria for government-related entities (GREs), our rating approach is based on our view of BKB's:

- "Very Important" role as a large GRE, because a default could destabilize the entire banking system and tarnish the canton's reputation. In addition, BKB supports the canton in meeting key economic and social objectives; and
- "Integral link" with the canton because of the statutory guarantee provided by Basel-City for all of BKB's liabilities, except those of BKB's subsidiaries (specifically Bank Coop), subordinated liabilities, or nonvoting participation certificates (Partizipationskapital) if the bank were to issue such obligations in the future. We don't anticipate changes to BKB's ownership structure or the canton's statutory guarantee.

With total consolidated assets of Swiss franc (CHF) 33 billion (about \$29 billion) and adjusted common equity of CHF2.8 billion as of Dec. 31, 2009, BKB is the third-largest cantonal bank in Switzerland and one of the largest Swiss banking groups. Through the nationwide retail network of its subsidiary, Bank Coop, the BKB group has better geographic diversity than most other cantonal banks. Bank Coop represented 41% of BKB's consolidated assets and about 20% of its pretax income in 2009, with business focused on residential real estate loans and lending to small and midsize enterprises (SMEs). The parent bank, BKB, mainly focuses on the wealthy Basel region, where it has a strong market share in retail banking, mortgage lending, and lending to SMEs.

We expect BKB to maintain its two-brand strategy, based on strong recognition of the BKB brand in Basel-City and

that of Bank Coop on a national basis. BKB intends to increase its revenues in line with cautious business-growth targets and to maintain a stable stream of income by better exploiting its customer base, while maintaining sound asset quality. BKB acquired AAM Privatbank AG in 2009, which will be fully absorbed into its private-banking infrastructure in 2010. Nevertheless, we expect BKB's mass-affluent banking and asset-management operations to keep expanding organically through expert teams rather than via takeovers. However, BKB could face higher earnings volatility because of the weaker capital market environment.

Although the lending business dominates the group's risk profile, mitigated by diversification and sufficient collateralization of exposures, market risk in both the banking and trading books is prudently limited, in our view. Asset quality is strong, in our opinion, largely reflecting the loan portfolio's granular and low-risk residential mortgages. However, BKB has a comparably higher sensitivity to general swings in the Swiss economy because the loan portfolio comprises a comparably high level of single-name and industry concentrations (mainly residential mortgages). Funding has benefited from strong new deposit inflows over the past two years, with customer deposits increasing by almost CHF5 billion or about 30%. Liquidity remains strong, in our view, supported by a portfolio of low-risk and actively traded securities, whereas high standardization of groupwide processes addresses operational risks.

We expect profitability to stem largely from interest income, and fee income from private banking to increase slightly from the currently low level. As we expected, BKB's bottom-line profitability in 2009 improved from that of 2008, which resulted from a variety of extraordinary factors, including the implementation of a new information-technology infrastructure. We expect BKB to maintain its focus on profitable growth of its core business segments while maintaining a conservative lending profile. However, we don't expect loan loss provisions to stay at the very low levels of the past few years, that is lower than or equal to 10 basis points (bps) in relation to customer loans. We believe loan loss provisions will likely return to a more sustainable level of about 20 bps-30 bps in 2010, owing to slightly higher--although still very low--provisioning for mortgage business and more corporate/SME defaults as a lagging effect of the recession, which has so far been mild in BKB's home market.

According to our classifications under our risk-adjusted capital (RAC) framework, we continue to see BKB as strongly capitalized, reflected in a RAC ratio of 15.7% before diversification and 13.1% after diversification. This ratio is much higher than the average of global banks, but at the lower end of the range for Swiss cantonal banks. The RAC ratio after diversification is lower than the regulatory Tier 1 ratio of 14.7% mainly because of our adjustments for BKB's regional concentration. We expect BKB to maintain strong regulatory and risk-adjusted capitalization; BKB's own target is to double the regulatory requirement. As of Dec. 31, 2009, the total regulatory ratio was 14.7%, that is, 84% higher than the regulatory limit. We anticipate that the RAC ratio will remain much higher than 10% and assume that BKB will not adopt a more generous dividend pay-out policy. The currently outstanding volume of nonvoting participation certificates (CHF50.1 million), which account for about 20% of the share capital ("Dotationskapital"), are expected to remain unchanged in volume.

Outlook

The stable outlook on BKB reflects that on Basel-City, BKB's owner and guarantor. Rating actions on Basel-City would therefore trigger similar rating actions on BKB.

The stable outlook also reflects 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. We expect BKB to maintain

what we see as its sound financial and risk profiles.

A material weakening of BKB's role for and/or the link to the canton, including changes to the guarantee and/or ownership structure, could have negative rating implications for BKB. However, in the event of changes to BKB's legal status or the guarantee, which we currently consider unlikely, BKB's existing obligations would be grandfathered.

We might lower our stand-alone assessment and our ratings on BKB if we were to revise our banking industry country risk assessment (BICRA) for Switzerland, which is currently in group 1. 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 material adverse changes in BKB's management and strategy, including a departure from prudent capital and underwriting policies. An upgrade is remote at this stage, however, and would depend on an upgrade of the canton.

Related Criteria And Research

- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009
- FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004

Table 1

Basler Kantonbank Profitability Ratios					
	--Year-ended Dec. 31--				
(%)	2009	2008	2007	2006	2005
Net interest income/average earning assets	1.3	1.5	1.7	1.7	N/A
Net interest income/revenues	51.7	61.7	56.1	55.5	56.0
Fee income/revenues	26.5	27.1	29.2	29.4	29.2
Market-sensitive income/revenues	19.8	9.0	10.8	12.6	11.7
Personnel expense/revenues	29.1	31.8	27.0	26.9	26.7
Noninterest expenses/revenues	60.6	62.1	48.0	46.0	45.9
New loan loss provisions/revenues	3.8	4.4	4.1	4.3	7.5
Net operating income before loan loss provisions/loan loss provisions	1,026.0	858.1	1,261.6	1,247.6	717.7
Net operating income after loan loss provisions/revenues	35.5	33.5	47.9	49.7	46.6
Pretax profit/revenues	34.3	28.9	42.0	43.3	42.1
Tax/pretax profit	5.4	10.3	9.5	7.3	7.0
Core earnings/revenues	33.6	30.0	43.3	46.0	43.3
Core earnings/average adjusted assets	0.8	0.7	1.2	1.3	N/A
Noninterest expenses/average adjusted assets	1.4	1.4	1.3	1.3	N/A
Core earnings/average risk-weighted assets	1.2	2.3	1.9	2.0	1.8
Core earnings/average adjusted common equity	9.3	7.9	13.1	14.3	13.4
Pretax profit/average common equity	10.3	8.2	13.8	15.0	N/A

N/A--Not applicable.

Table 2

Basler Kantonalbank Capital Ratios					
	--Year-ended Dec. 31--				
(%)	2009	2008	2007	2006	2005
Adjusted common equity/risk assets	13.1	N.M.	14.1	14.4	13.5
Tier 1 capital ratio	13.5	13.6	14.6	14.7	13.7
Adjusted total equity/adjusted assets	8.1	8.0	8.6	8.9	8.5
Adjusted total equity/managed assets	8.1	8.0	8.6	8.9	8.5
Adjusted total equity plus loan loss reserves (specific)/customer loans (gross)	13.8	13.8	14.2	14.4	13.8
Common dividend payout ratio	0.0	0.0	0.0	0.0	0.0

N.M.--Not meaningful.

Table 3

Basler Kantonalbank Summary Balance Sheet					
	--Year-ended Dec. 31--				
(Mil. CHF)	2009	2008	2007	2006	2005
Assets					
Cash and money market instruments	411.9	306.0	195.3	199.5	186.5
Securities	4,660.5	3,264.5	2,586.9	2,601.5	2,131.1
Trading securities (marked to market)	1,973.1	1,606.0	1,451.1	1,294.8	622.6
Nontrading securities	2,687.4	1,658.5	1,135.8	1,306.7	1,508.5
Loans to banks (net)	2,151.8	3,821.2	2,511.8	2,348.8	2,497.9
Customer loans (gross)	22,917.8	21,485.3	20,355.7	19,151.0	18,484.6
Loan loss reserves	500.6	479.0	487.4	470.8	465.6
Customer loans (net)	22,417.2	21,006.3	19,868.3	18,680.2	18,019.0
Earning assets	29,734.1	28,573.8	25,462.7	24,106.5	23,118.5
Investments in unconsolidated subsidiaries (financial companies)	98.5	85.9	106.0	95.5	89.3
Intangibles (nonservicing)	30.1	30.5	36.6	39.6	33.3
Fixed assets	216.7	222.2	206.0	201.2	204.6
Derivatives credit amount	1,682.5	1,628.7	694.2	455.7	647.0
Accrued receivables	151.8	122.9	120.6	130.7	113.2
All other assets	516.0	282.2	1,055.1	445.0	266.5
Total assets	32,837.4	31,249.3	27,868.2	25,668.5	24,654.2
Intangibles (nonservicing)	30.1	30.5	36.6	39.6	33.3
Adjusted assets	32,807.3	31,218.9	27,831.6	25,628.9	24,620.9
Liabilities					
Total deposits	22,258.7	19,850.8	17,332.2	15,916.0	15,346.4
Noncore deposits	1,519.8	1,620.3	1,454.4	1,047.0	1,021.9
Core/customer deposits	20,738.9	18,230.5	15,877.8	14,869.0	14,324.5
Other borrowings	3,543.3	4,284.5	4,516.3	4,307.0	3,973.5
Other liabilities	2,459.1	2,473.6	1,536.8	1,218.2	1,476.0
Total liabilities	29,947.2	28,550.1	25,228.3	23,170.2	22,368.9
Total equity	2,890.2	2,699.3	2,640.0	2,498.2	2,285.3
Minority interest-equity	359.4	337.3	329.0	334.7	341.2

Table 3

Basler Kantonalbank Summary Balance Sheet (cont.)						
Common shareholders' equity (reported)	2,530.8	2,361.9	2,311.0	2,163.5	1,944.1	
Share capital and surplus	254.2	254.2	254.2	269.1	269.1	
Retained profits	238.9	172.8	280.3	284.9	263.0	
Total liabilities and equity	32,837.4	31,249.4	27,868.2	25,668.5	24,654.2	

CHF--Swiss franc.

Table 4

Basler Kantonalbank Equity Reconciliation Table						
--Year-ended Dec. 31--						
(Mil. CHF)	2009	2008	2007	2006	2005	
Common shareholders' equity (reported)	2,530.8	2,361.9	2,311.0	2,163.5	1,944.1	
Plus minority interest (equity)	359.4	337.3	329.0	334.7	341.2	
Minus dividends (not yet distributed)	(96.2)	(87.2)	(99.8)	(78.8)	(75.5)	
Minus nonservicing intangibles	(30.1)	(30.5)	(36.6)	(39.6)	(33.3)	
Adjusted common equity	2,763.9	2,581.6	2,503.5	2,379.8	2,176.5	
Minus equity in unconsolidated subsidiaries	(98.5)	(85.9)	(106.0)	(95.5)	(89.3)	
Adjusted total equity	2,665.4	2,495.7	2,397.5	2,284.4	2,087.2	

CHF--Swiss franc.

Table 5

Basler Kantonalbank Profit And Loss						
--Year-ended Dec. 31--						
(Mil. CHF)	2009	2008	2007	2006	2005	
Net interest income	380.2	411.0	413.4	393.3	375.7	
Interest income	697.0	863.1	805.0	694.7	656.1	
Interest expense	316.9	452.1	391.7	301.4	280.4	
Operating noninterest income	355.8	254.8	323.3	315.8	295.5	
Fees and commissions	195.1	180.3	214.9	208.4	195.8	
Net brokerage commissions	176.1	165.8	206.5	200.2	185.9	
Trading gains	143.7	67.4	75.1	74.5	64.8	
Other market-sensitive income	2.2	(7.8)	4.3	14.7	13.9	
Equity in earnings of unconsolidated subsidiaries	8.0	6.7	20.2	10.1	8.3	
Other noninterest income	6.8	8.3	8.8	8.1	12.7	
Operating revenues	736.0	665.9	736.6	709.1	671.3	
Noninterest expenses	446.3	413.4	353.6	326.3	308.2	
Personnel expenses	214.3	211.6	198.7	190.8	179.5	
Other general and administrative expense	174.6	145.1	123.3	109.9	106.0	
Net operating income before loss provisions	289.7	252.4	383.0	382.8	363.1	
Credit loss provisions (net new)	28.2	29.4	30.4	30.7	50.6	
Net operating income after loss provisions	261.5	223.0	352.6	352.1	312.5	
Nonrecurring/special income	31.3	2.8	2.3	0.1	1.4	
Nonrecurring/special expense	40.1	33.2	45.2	44.9	31.2	
Pretax profit	252.6	192.6	309.7	307.4	282.7	

Table 5

Basler Kantonalbank Profit And Loss (cont.)					
Tax expense/credit	13.7	19.9	29.4	22.5	19.7
Net income (before minority interest)	238.9	172.8	280.3	284.9	263.0
Minority interest in consolidated subsidiaries	16.2	27.2	35.8	32.3	29.4
Net income before extraordinaries	222.7	145.6	244.5	252.6	233.6
Net income after extraordinaries	222.7	145.6	244.5	252.6	233.6

CHF--Swiss franc.

Table 6

Basler Kantonalbank Core Earnings Reconciliation Table					
--Year-ended Dec. 31--					
(Mil. CHF)	2009	2008	2007	2006	2005
Net income (before minority interest)	238.9	172.8	280.3	284.9	263.0
Minus nonrecurring/special income	(31.3)	(2.8)	(2.3)	(0.1)	(1.4)
Plus nonrecurring/special expense	40.1	33.2	45.2	44.9	31.2
Plus or minus tax impact of adjustments	(0.5)	(3.1)	(4.1)	(3.3)	(2.1)
Core earnings	247.2	200.0	319.1	326.4	290.7

CHF--Swiss franc.

Table 7

Basler Kantonalbank Risk-Adjusted Capital Data						
(CHF 000s)	Exposure at default	Basel II risk-weighted assets (RWA)	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)	
Credit risk						
Government and central banks	651,337.0	50.0	0.0	20,354.3	3.1	
Institutions	6,033,371.0	2,307,587.5	38.2	808,601.7	13.4	
Corporate	4,860,453.0	3,342,737.5	68.8	3,665,396.4	75.4	
Retail	18,905,596.0	9,070,850.0	48.0	4,292,926.3	22.7	
Of which mortgage	17,467,275.0	7,692,200.0	44.0	3,301,580.8	18.9	
Securitization	0.0	0.0	0.0	0.0	0.0	
Other assets	857,233.0	1,140,087.5	133.0	1,285,849.5	150.0	
Total credit risk	31,307,990.0	15,861,312.5	50.7	10,073,128.2	32.2	
Market risk						
Equity in the banking book*	306,064.0	1,096,525.0	517.1	2,632,121.3	860.0	
Trading book market risk	--	2,235,625.0	--	3,353,437.5	--	
Total market risk	--	3,332,150.0	--	5,985,558.8	--	
Operational risk						
Total operational risk	--	1,327,112.5	--	1,499,181.3	--	
(CHF 000s)		Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA	
Diversification adjustments						
RWA before diversification		20,520,575.0		17,557,868.2	100.0	

Table 7

Basler Kantonalbank Risk-Adjusted Capital Data (cont.)				
Total adjustments to RWA	--		3,562,478.1	20.3
RWA after diversification	20,520,575.0		21,120,346.3	120.3
(CHF 000s)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio				
Capital ratio before adjustments	2,860,167.0	13.9	2,759,000.0	15.7
Capital ratio after adjustments [¶]	2,860,167.0	14.7	2,759,000.0	13.1

*Exposure and Standard & Poor's 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 (such as transitional floor or Pillar 2 add-ons). RW--Risk weight. RAC--Risk-adjusted capital. CHF--Swiss franc. Sources: Company data as of Dec. 31, 2009, and Standard & Poor's calculations.

Ratings Detail (As Of July 14, 2010)*	
Basler Kantonalbank	
Counterparty Credit Rating	AA+/Stable/A-1+
Certificate Of Deposit	AA+/A-1+
Senior Unsecured (4 Issues)	AA+
Counterparty Credit Ratings History	
16-Jun-2009	AA+/Stable/A-1+
30-May-2008	AA+/Positive/A-1+
17-Jan-2006	AA+/Stable/A-1+
Sovereign Rating	
Swiss Confederation	AAA/Stable/A-1+
Related Entities	
Basel-City (Canton of)	
Issuer Credit Rating	AA+/Stable/A-1+
Senior Unsecured (3 Issues)	AA+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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