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Research Update:

Basler Kantonalbank 'AA+' Rating Affirmed; Stand-Alone Credit Profile Revised To 'a+' On Improved Risk Position

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Overview

- Basler Kantonalbank (BKB) continues to benefit from its strong and sustainable franchise as the local cantonal bank, upholding its superior capital buffers and excellent asset quality, while we expect it to continue improving its efficiency and profitability, mainly on the integration of Bank Cler.
- In our view, BKB's risk position is no longer a relative weakness compared with that of Swiss cantonal peers, as we now see concentrations in the loan book to be on par with the peer average.
- As a result, we revised our stand-alone credit profile (SACP) on BKB to 'a+' from 'a' and raised our rating on the bank's junior subordinated debt to 'BBB' from 'BBB-'.
- We also affirmed our 'AA+/A-1+' long-term and short-term rating on BKB.
- The stable outlook reflects that on its owner and guarantor, the Canton of Basel-City.

Rating Action

On Sept. 22, 2022, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit rating on Basler Kantonalbank (BKB). At the same time, we raised our rating on BKB's junior subordinated debt to 'BBB' from 'BBB-'. The outlook is stable.

Rationale

In our view, BKB's risk position is now in line with Swiss Cantonal peers and we expect asset quality to remain robust. The bank engages primarily in low-risk collateralized residential mortgage lending, accounting for about 74% of its loan portfolio as of year-end 2021, with conservative loan-to-value. We now consider the concentrations in the corporate portfolio in line with the peer average. Asset quality has proven resilient during the pandemic, and we expect it to remain very robust. BKB's loan loss provisions have historically been very low and we do not forecast a significant increase. Its nonperforming loan ratio is very low compared with international standards, standing at 0.66% at year-end 2021. We also think that the bank has not suffered a reputational damage following the settlement of its legal prosecution by the U.S. tax authorities.

We think that BKB is on track to meet its 2025 financial targets, which further supports its creditworthiness. We expect the bank's ongoing efforts to streamline its operations with subsidiary Bank Cler to support further efficiency gains. BKB is well on track to achieve its internal targets for a better return on equity and a cost-to-income ratio until 2025, which supported improved efficiency and profitability in recent years. The bank's S&P Global Ratings-calculated cost to income ratio of 60.6% as of June 30, 2022, remains below that of many local peers, but we expect further improvement and broad alignment with the peer average over the next two years. We also expect that BKB's earnings buffer, which measures the capacity for a bank's earnings to cover normalized losses through the credit cycle, will further improve to about 75 basis points until 2024, which is still on the lower end for the peer group but now more comparable with the average.

BKB's very strong customer franchise in its home region and very strong capitalization continue to be key strengths for the rating. We expect that the bank will continue to benefit from its strong and sustainable franchise as the local cantonal bank, supported by its developed digital-banking platform. A key rating strength remains BKB's very high capitalization, in a global comparison, with a risk-adjusted capital ratio of 22.4% at year-end 2021 which we expect to be stable over the coming two years. Furthermore, the bulk of capital consists of common shareholder equity, with only marginal contribution of hybrid instruments. BKB is not exposed to direct risks stemming from the conflict in Ukraine and, in our base-case scenario, we expect the indirect impact to be very limited.

Overall rating continues to benefit from the expected extraordinary support from the owner. BKB is 100% owned by the Canton of Basel-City (AAA/Stable/A-1+) and benefits from a guarantee stated in the law governing the bank. We expect BKB to maintain its integral link and very important role to the canton, contributing to the development of the local economy. We continue to see an extremely high likelihood of support from the canton in case of financial distress. While revisions to BKB's law are expected, we think these will solely relate to the governance of BKB group and not to the role for or guarantee of the canton.

Issue Ratings

The raised 'BBB' rating on BKB's junior subordinated debt (additional tier 1) reflects our analysis of the instruments and our assessment of the bank's SACP at 'a+'. We understand that the bonds do not benefit from the cantonal guarantee, such that we would question the timely and sufficient support to these subordinated instruments.

We consequently notch down from our SACP assessment for the bank. We rate BKB's additional tier 1 instrument four notches lower than the SACP, reflecting our deduction of:

- One notch for contractual subordination.
- Two notches for the notes' status as tier 1 regulatory capital.

- One notch because the instruments allow for the full or partial temporary write-down of the principal amount.

Outlook

The stable outlook on BKB reflects that on its owner and guarantor, the canton. We expect BKB will, for the foreseeable future, continue to benefit from an extremely high likelihood of timely and sufficient extraordinary support from the canton in the event of financial distress. In addition, we expect BKB will maintain its sound market position and financial risk profile, underpinned by its very strong capitalization over the next 24 months.

Downside scenario

In our view, the possibility of a negative rating action is remote. It could be triggered if we lowered our ratings on the canton--currently unlikely given our stable outlook on it. Alternatively, we could consider a negative rating action if there was a change in BKB's role for or link with the canton, or changes in the statutory guarantee, leading to a weaker assessment of the bank's status as a government-related entity. However, we consider this very unlikely and would expect BKB's existing obligations to be grandfathered in.

We believe extraordinary support from the canton would cushion a material multi-notch deterioration of BKB's stand-alone creditworthiness, with the ratings on the senior unsecured debt not changing. The ratings on the subordinated instruments could, however, be directly affected if the bank's SACP deteriorated, which could happen, for example, if BKB depleted its strong capital base due to high unexpected losses caused by an adverse shock, or efficiency and profitability did not improve over the medium term as we expect.

Upside scenario

A positive rating action is currently unlikely. This could only be triggered if BKB's SACP improved, which we view as extremely unlikely, given our already-high assessment.

Ratings Score Snapshot

	To	**From**
Issuer Credit Rating	**AA+/Stable/A-1+**	**AA+/Stable/A-1+**
SACP	a+	a
Anchor	a-	a-
Business position	Adequate (0)	Adequate (0)
Capital and earnings	Very strong (2)	Very strong (2)
Risk position	Adequate (0)	Moderate (-1)
Funding	Adequate and	Adequate and
Liquidity	Adequate (0)	Adequate (0)
Comparable ratings analysis	(0)	(0)
Support	(+3)	(+4)

	To	From
Issuer Credit Rating	**AA+/Stable/A-1+**	**AA+/Stable/A-1+**
ALAC support	(0)	(0)
GRE support	(+3)	(+4)
Group support	(0)	(0)
Sovereign support	(0)	(0)
Additional factors	(0)	(0)

SACP--Stand-alone credit profile.

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Banking Industry Country Risk Assessment: Switzerland, May 30, 2022
- Swiss and Liechtenstein Bank Ratings Affirmed Under Revised FI Criteria, Feb. 8, 2022
- Basler Kantonalbank, Dec. 1, 2021
- Basel-City (Canton of), Nov. 8, 2021

Ratings List

Ratings Affirmed		
Basler Kantonalbank		
Issuer Credit Rating	AA+/Stable/A-1+	
Senior Unsecured	AA+	
Upgraded		
	To	**From**
Basler Kantonalbank		
Junior Subordinated	BBB	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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; or Stockholm (46) 8-440-5914