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Research Update:

Basler Kantonalbank Upgraded To 'AA+' On Similar Action On Canton of Basel-City; Outlook Stable

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Overview

- On Nov. 9, 2018, we raised our rating to 'AAA' from 'AA+' on the Canton of Basel-City, owner and support provider of Basler Kantonalbank (BKB).
- We continue to consider BKB a government-related entity (GRE), and, in our view, the canton's capacity to provide extraordinary support to BKB in times of stress has increased.
- Accordingly, we are raising our long-term issuer rating on BKB to 'AA+' from 'AA', and affirmed our 'A-1+' short-term rating on the bank.
- The stable outlook on BKB mirrors the outlook on Canton of Basel-City, and reflects our expectation that the bank will continue to benefit from being a robust GRE over at least the next two years.

Rating Action

On Nov. 12, 2018, S&P Global Ratings raised to 'AA+' from 'AA' its long-term issuer credit rating on Switzerland-based Basler Kantonalbank (BKB). The outlook is stable.

At the same time, we affirmed our 'A-1+' short-term issuer credit rating on the bank, and our 'BBB-' issue rating on BKB's junior subordinated debt.

Rationale

The upgrade reflects a similar action on the Canton of Basel-City, BKB's owner and support provider (see "Canton of Basel-City Upgraded To 'AAA' On Greater Predictability Despite Tax Reforms; Outlook Stable," published Nov. 9, 2018, on RatingsDirect).

We continue to see BKB's creditworthiness as closely connected to that of its cantonal owner. We also continue to consider BKB a government-related entity (GRE), with an extremely high likelihood of receiving extraordinary support from the Canton of Basel-City in times of stress. We base this view on BKB's very important role for and integral link with the Canton of Basel-City.

In our view, the canton now has greater capacity to provide extraordinary support to BKB if needed. We therefore increased the rating uplift for

extraordinary support to four notches from three, leading to the 'AA+' long-term rating on BKB, four notches above its unchanged 'a' stand-alone credit profile (SACP).

The canton's stronger credit standing, in our view, did not have any immediate effect on BKB's stand-alone creditworthiness. We continue to take into account that BKB benefits from operating in Switzerland's highly diversified and competitive economy, the country's very high household income levels, and Swiss banks' prudent loan underwriting standards. Therefore, considering these factors, BKB's anchor remains 'a-', which is the starting point of our ratings assessment for banks mainly operating in Switzerland. We also continue to consider BKB's business profile as neutral to its standalone creditworthiness, based on the bank's strong, sustainable, but regionally concentrated market position as the eighth-largest bank in Switzerland. We continue to consider the bank's capital position and earnings as a particular rating strength, mainly reflecting our projection that its risk-adjusted capital ratio will stay around a very strong 22%.

We also continue to believe that the BKB's risk position is a relative weakness compared to many Swiss Cantonal peers, reflecting its lower earnings buffer due to lower efficiency, comparably higher single name concentrations, and a higher share of more cyclical commercial real estate lending. We also take into account an untested track record of managing Bank Cler through the cycle, and its related above market growth in nationwide residential mortgage lending and small and midsize enterprise lending. BKB had increased its stake in Bank Cler to 99% by October 2018, from 76% at year-end 2017.

On a positive note BKB has demonstrated significant progress in improving its risk management systems in recent years. Moreover, the bank recently settled its legal prosecution by the U.S. tax authorities related to the acceptance of undeclared funds from U.S. clients against a payment of \$60.4 million. This resolution resulted in a Swiss franc (CHF) 33 million one-time gain in 2018 due to the release of related conservative over provisioning from previous years.

We also continue to assess BKB's combined funding and liquidity as a neutral rating factor, and in line with that of most of its Swiss cantonal bank peers, because of its solid base of granular customer deposits and the cantonal guarantee.

Our issue ratings on BKB's additional perpetual Tier 1 Capital notes remained unchanged, because we don't expect the issues to benefit from the extraordinary government support from the City of Basle. Consequently, we notch down from our SACP assessment for the bank.

Outlook

The stable outlook on BKB reflects that on its owner and guarantor, Canton of Basel-City. Over at least the next two years, we expect BKB will continue to

benefit from an extremely high likelihood of timely and sufficient extraordinary support from the Canton of Basel-City in the event of financial distress.

In addition, we expect that BKB will maintain its sound market position and financial profile, underpinned by its very strong capitalization over our two year horizon.

Downside scenario

In our view, a downside scenario is currently remote. It could be triggered if the ratings of Canton of Basel-City were to be lowered by one or more notches, which is a very unlikely scenario considering the canton's stable outlook.

Alternatively, we could consider a negative rating action if there is a change in BKB's role for or link with the Canton of Basel-City, or changes in the statutory guarantee, potentially leading to a weaker assessment of BKB's status as a GRE. However, we currently consider this scenario as very unlikely and would expect BKB's existing obligations to be grandfathered. In our view, unchanged potential 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 remaining unchanged. Ratings on the subordinated instruments could, however, be directly affected if the bank's SACP deteriorated.

Upside scenario

A positive rating action is currently very remote. This could only be triggered if BKB's standalone creditworthiness improved by two or more notches, which we regard as unlikely given our expectation that the bank will not materially change its concentrated business model, or be able to materially improve its funding position in addition to improving its risk to be on par with cantonal peers. However, ratings on the subordinated instruments could be directly affected if the bank's SACP improved.

Ratings Score Snapshot

Issuer Credit Rating	To AA+/Stable/A-1+	From AA/Positive/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	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Strong (0)	Average and Strong (0)
Support	(4)	(3)

ALAC Support	(0)	(0)
GRE Support	(4)	(3)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional Factors	(0)	(0)

Related Criteria

- 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: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded; Ratings Affirmed

	To	From
Basler Kantonalbank		
Issuer Credit Rating	AA+/Stable/A-1+	AA/Positive/A-1+
Senior Unsecured	AA+	AA

Ratings Affirmed

Basler Kantonalbank	
Junior Subordinated	BBB-

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