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## Zuger Kantonalbank

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# Zuger Kantonalbank

## Rating Score Snapshot

### Issuer Credit Rating

AA+/Stable/A-1+

SACP: a



Support: +4



Additional factors: 0

Anchor	a-	
Business position	Adequate	0
Capital and earnings	Very strong	+2
Risk position	Adequate	0
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment	-1	

ALAC support	0
GRE support	+4
Group support	0
Sovereign support	0

Issuer credit rating
<b>AA+/Stable/A-1+</b>

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

## Credit Highlights

### Overview

#### Key strengths

Extremely high likelihood of support from the financially strong Swiss Canton of Zug.

Very strong capitalization and sound asset quality.

One of the lowest cost-to-income ratios of its peer group, reflecting ZGKB's cost discipline and solid margins.

#### Key risks

Concentrated business model and higher risk appetite than most peers due to its more material exposure to the property sector.

Significant competition from neighboring cantonal and cooperative banks in the small canton of Zug.

**S&P Global Ratings expects Zuger Kantonalbank (ZGKB) to show resilience amid increasing macroeconomic pressure.**

Despite higher inflation and a more volatile business environment, ZGKB has so far proved remarkably resilient with a net profit of Swiss franc (CHF) 53.6 million. We forecast ZGKB will maintain its sound return on equity (ROE) of 4.5%-5.5% in the next two years, supported by its solid franchise in Zug and expanding asset management business.

**ZGKB's very strong capitalization and sound asset quality are a rating strength.** We expect ZGKB to maintain its superior capitalization, as measured by our risk-adjusted capital (RAC) ratio of 23.6% at year-end 2021, with 23.5%-25.0% anticipated over our forecast horizon of two years. Increasing earnings, stable and low payouts, and moderate business growth support our assessment.

*We expect ZGKB will maintain its integral link with and very important role for the Canton of Zug.* ZGKB has a very important role in, and integral link with, the Canton of Zug given its high market share of 50%. If it were to default, this would cause significant financial stress for the canton. Our analysis is also supported by the cantonal guarantee, which is stipulated by law. We believe there is an extremely high likelihood that the canton would provide sufficient and timely support to the bank if needed.

## Outlook

The stable outlook on ZGKB reflects our expectation that the bank's government-related entity (GRE) status, entailing an extremely high likelihood of support from the Canton of Zug, will remain unchanged over the next 24 months. Our ratings on ZGKB are sensitive to our assessment of the owner's ability and willingness to support the bank.

### Downside scenario

If we perceived a weakening in ZGKB's role for or link with the canton, this could lead us to revise our assessment of the bank's GRE support. However, we do not envisage such a scenario in the next two years. Also, if this were to happen, we would expect ZGKB's existing obligations to be grandfathered. The sensitivity of the rating to a potential downward revision of the stand-alone credit profile (SACP) is very limited.

### Upside scenario

We consider rating upside to be remote. We could consider revising ZGKB's SACP upward if the bank demonstrates sustained and stable operations over the cycle without signs of weakening asset quality or earnings. However, a one-notch improvement of the SACP would not translate into a higher issuer credit rating.

## Key Metrics

### Zuger Kantonalbank--Key Ratios And Forecasts

(%)	--Fiscal year ended Dec. 31--				
	2020a	2021a	2022f	2023f	2024f
Growth in operating revenue	1.2	6.0	3.4-4.1	4.7-5.8	4.4-5.4
Growth in customer loans	2.5	5.6	3.9-4.7	3.2-4.0	3.5-4.3
Growth in total assets	7.8	7.2	4.1-5.1	3.3-4.1	3.6-4.4
Net interest income/average earning assets (NIM)	1.1	1.1	1.0-1.2	1.0-1.2	1.0-1.2
Cost to income ratio	51.4	51.6	49.9-52.4	49.1-51.6	48.0-50.4
Return on average common equity	5.5	5.4	5.1-5.7	4.8-5.4	5.2-5.7
Risk-adjusted capital ratio	26.0	23.6	23.9-25.1	23.8-25.0	23.8-25.0

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast. NIM--Net interest margin.

## **Anchor: 'a-' For Banks Solely Operating In Switzerland**

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

Despite a weaker economic outlook and further risks to the region's economic trajectory from the unclear consequences of the Russia-Ukraine conflict, we expect Swiss banks will demonstrate robust asset quality and lower credit losses than most peers, close to levels observed pre-pandemic. This resilience stems from the superior financial strength of both the household and corporate sectors, as well as banks' prudent underwriting standards focusing on collateralized lending, mainly in residential mortgages.

We also do not expect material constraints on customers' debt service capacity from higher rates given the dominance of fixed-rate mortgage contracts with an average 10-year interest period. Our view of industry risk in Switzerland factors the stability of the domestic banking sector.

We view positively that, despite high competition among local players, domestic banks can still earn their cost of capital. We expect that Swiss banks will see a net revenue benefit from rises in policy rates.

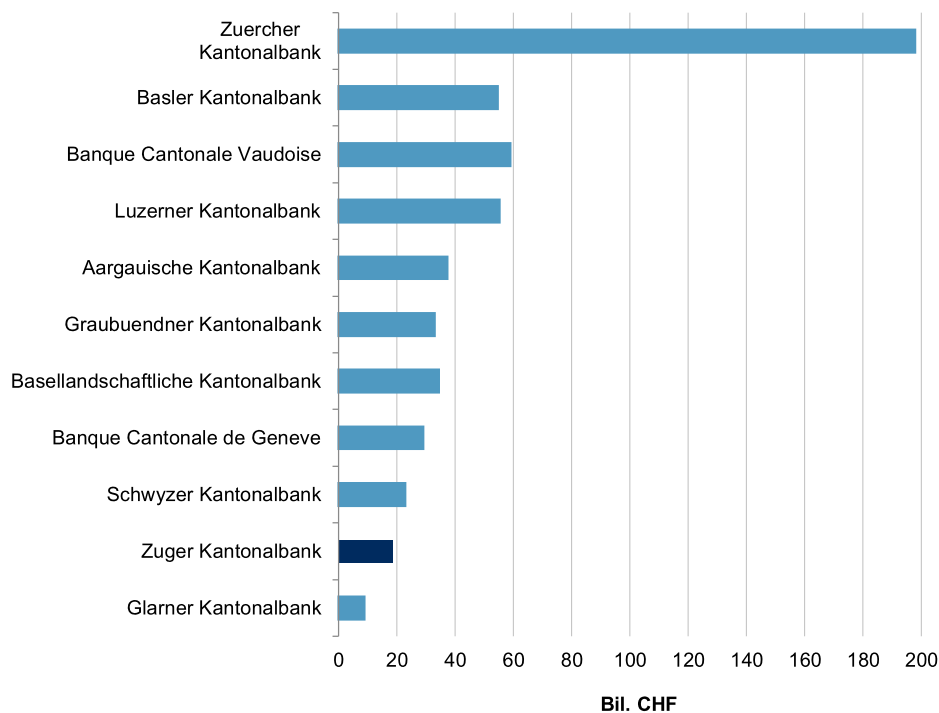
We also note banks' high capitalization and heavy reliance on stable customer deposits and equity for funding. In our view, the Swiss Financial Market Supervisory Authority is on top of both regulatory oversight and innovations, and overall we think Swiss banks face limited risks from technology disruption.

## **Business Position: Strong Home Turf, But Concentrated Business Model Amid Significant Competition**

Based on ZGKB's stable but predominantly regionally focused market position, we view its business profile as on par with domestically focused Swiss peers. ZGKB is a midsize cantonal bank with a high market share of about 50% in retail and corporate banking in the Canton of Zug and less so in the surrounding cantons, financing primarily retail mortgages and smaller corporate clients.

**Chart 1****Zuger Kantonalbank Is A Small To Midsize Cantonal Bank**

Total assets in first-half 2022



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

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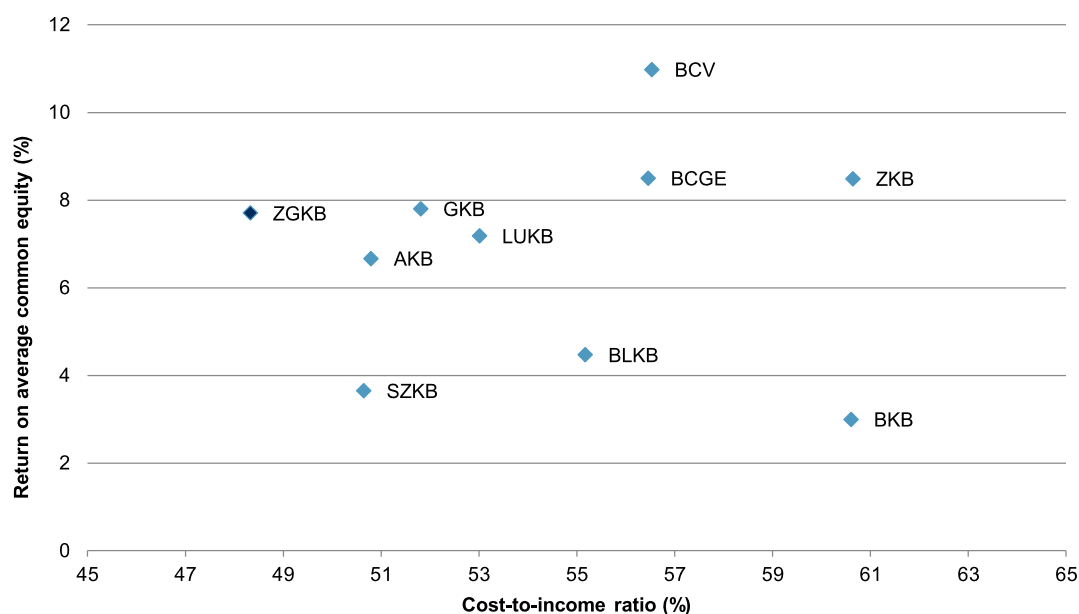
We expect the bank to expand its business, especially asset and wealth management services, outside the Canton of Zug due to limited growth potential within its home market. Assets under management of CHF14.9 billion as of June 30, 2022, and the envisaged growth in Northwestern Switzerland could boost the bank's net fee and commission income in the coming years.

We see the risk of disruption to ZGKB's business model from new digital competitors, as for the Swiss banking sector, as moderate. That said, given its wealthy, dynamic, and international client base, we consider significant investments are needed to keep up and close the gap with competitors.

At the same time, ZGKB exhibits one of the lowest cost-to-income ratios of its cantonal bank peer group, at only 48% as of mid-year 2022, reflecting its cost discipline. The bank's return on equity of 7.7% at mid-year 2022 was slightly above those of most domestic peers.

**Chart 2****ZGKB Has The Best Cost-To-Income Ratio In The Peer Group**

... and sound return on equity (as of June 30, 2022)



AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise.

BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. GLKB--Glerner Kantonalbank.

GKB--Graubuendner Kantonalbank LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank.

ZKB--Zuercher Kantonalbank. ZGKB--Zuger Kantonalbank. Source: S&P Global Ratings.

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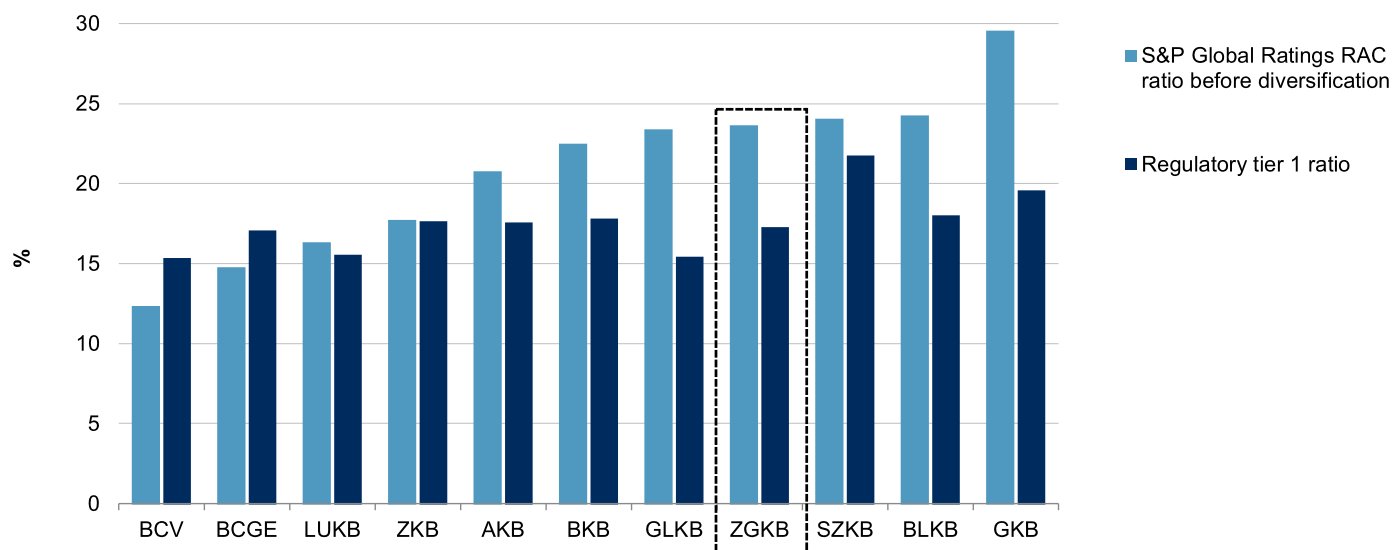
## Capital And Earnings: Very Strong Capitalization With Sound Earnings Generation Capacity

We expect ZGKB's RAC ratio of 23.6% at year-end 2021 will increase and stabilize at about 23.5%-25.0% over our forecast horizon, which we consider very strong in a global comparison. Our RAC forecast is underpinned by the expectation of increasing retained earnings on the back of a stable payout per share of CHF220 and only modest credit growth.

## Chart 3

### ZGKB Has Very Strong Capitalization In A Global Comparison And In Line With Peers

...measured by S&P Global Ratings' RAC ratio at Dec. 31, 2021



RAC--Risk-adjusted capital. Source: S&P Global Ratings.

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We project ZGKB's three-year average earnings buffer, which measures the capacity for a bank's earnings to cover normalized losses, will be comfortable at about 1.5% over the medium term, supported by its predictable and stable earnings. We do not assume any changes to the bank's dividend policy of distributing CHF220 per share, which amounts to about CHF65 million, to the Canton of Zug and other shareholders.

We view ZGKB's capital as very high quality because we currently do not consider hybrid instruments in our calculation. This reflects that its capital base consists solely of common equity.

## Risk Position: Sound Underwriting Standards And Very Few Nonperforming Loans

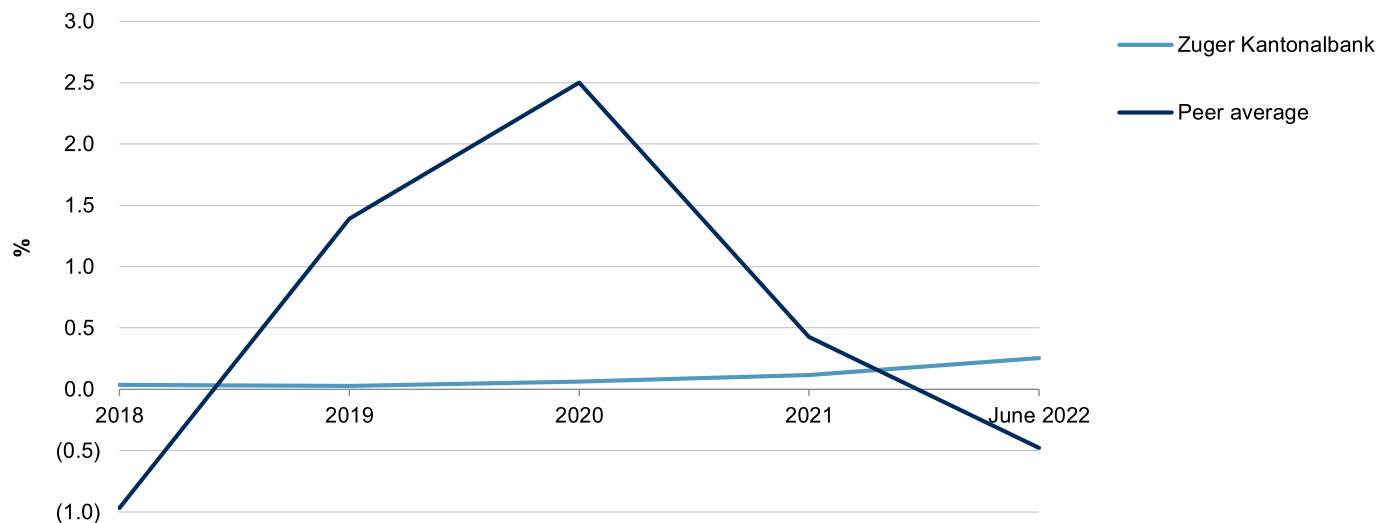
Similar to other cantonal bank peers, ZGKB's nonperforming assets were lower than the system average of 0.72% in 2021 at less than 0.01% of customer loans. This is based on sound underwriting standards, demonstrated by very low loan-to-value figures with less than 2% of the total portfolio being above 66%. We do not expect the bank will deviate from its underwriting criteria, which supports asset quality, through 2024.



Chart 4

### ZGKB Had Lower Loan Loss Provisions Than The Peer Group In Recent Years

New loan loss provisions/operating revenue



Peer group includes: AKB, BCGE, BCV, BLKB, BKB, GLKB, GKB, LUKB, SZKB, ZKB. Source: S&P Global Ratings. Copyright © 2023 by Standard & Poor's Financial Services LLC. All rights reserved.

The bank's balance sheet is dominated by mortgage lending at about 72% of the total. ZGKB's about 6% share of office and business properties is higher than that of peers, driven by the economic structure in its home, the Canton of Zug, which attracts many international corporates due to its favorable tax regime.

Exposures outside the canton currently account for 20% of the total portfolio, which is broadly in line with the peer average.

ZGKB engages in very limited trading activities, generating only marginal market risk, comprising mainly interest rate risk from mismatches in asset-liability management, which are adequately hedged, in our view.

### Funding And Liquidity: Strong Retail Deposit Franchise, With Low Reliance On Wholesale Funding And Adequate Liquidity

We expect ZGKB's stable funding ratio will remain comfortable at about 105% over the next two years, which is in line with that of other domestic banks.

Core customer deposits accounted for 62.8% of the funding base at June 30, 2022, and we view this base as stable. It is also supported by the cantonal guarantee and its strong market position in Zug.

The bank makes only limited use of wholesale funding, which accounts for about 21% of the total funding base and

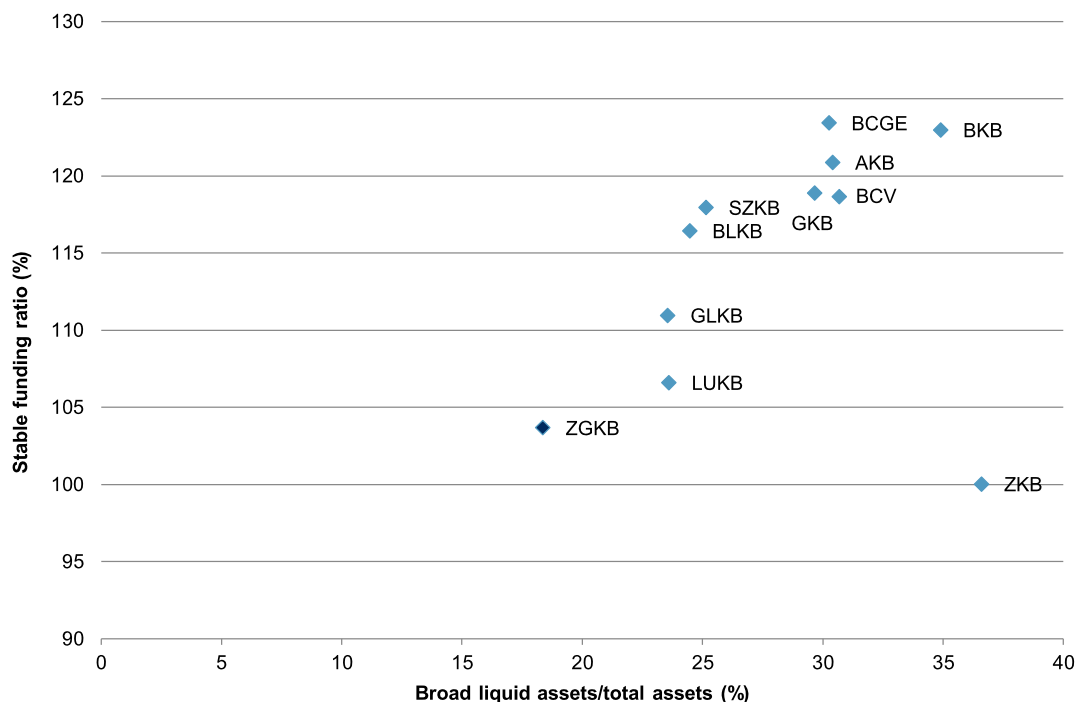
mostly consists of covered bonds.

We expect customer loans will continue to exceed customer deposits by 130%-135%, which indicates ZGKB's dependency on other means of funding. However, the shareholder and guarantee structure support the bank's access to low-cost, long-term, wholesale funding.

### Chart 5

#### ZGKB Has Funding Metrics In Line With Peers

... and adequate liquidity ratios (as of June 30, 2022)



Source: S&P Global Ratings.

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Our liquidity ratio--broad liquid assets to total assets--was 18.3x for the same period, indicating a good buffer to cover an extended period without access to market funding in an adverse scenario. Broad liquid assets to short-term wholesale funding equals 1.27x. These ratios are in line with most domestic peers', but do not exceed superior ratios of other banks where we assign a stronger score.

We note that the cantonal backbone improves availability and lowers the cost of market funding for the bank, which we factor into our SACP.

## Comparable Rating Analysis

We deduct one notch from the group's SACP under our comparable ratings analysis. We view the bank as more

exposed to the economic cycle due to its substantial commercial real estate portfolio (24.5% of loan portfolio at year-end 2021) and exposure to real estate developers in the Canton of Zug. We believe that single-name concentrations in the corporate portfolio, driven by the canton's attractive tax regime, contribute to a weaker overall assessment, which is more in line with other Swiss peers at the 'a' level such as Luzerner Kantonalbank, Banque Cantonale de Geneve, and Banque Cantonale Vaudoise.

## Support: Four Notches Of Uplift For Extremely High Likelihood Of Extraordinary Support

The long-term rating on ZGKB is four notches higher than its SACP. This reflects our opinion of an extremely high likelihood of timely and sufficient extraordinary government support from its owner, given the bank's integral link with and very important role for the canton.

This view is supported by ZGKB's contribution to the development of the canton and its state guarantee, incorporated in the law. The guarantee does not ensure timely repayment, under our definitions, but we believe that the canton has strong incentives to help the bank meet its obligations on time given the bank's importance to the regional economy.

We believe there is an extremely high likelihood that the canton would provide sufficient and timely support to the bank given that a default could severely damage Zug's reputation.

## Environmental, Social, and Governance

### ESG Credit Indicators



ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have no material influence on our credit rating analysis of ZGKB. As stipulated by law, the cantonal bank's mandate is focused on providing basic financial services to the canton's population, and supporting economic development in the region. We view the bank's offering of transformation advice to clients as well as its sustainability in asset management as positive. However, environmental and social factors are only marginally supportive of our credit rating analysis.

## Key Statistics

Table 1

Zuger Kantonalbank--Key Figures					
--Fiscal year ended Dec. 31--					
(Mil. CHF)	2022*	2021	2020	2019	2018
Adjusted assets	18,743.4	18,147.8	16,915.3	15,693.7	14,738.9
Customer loans (gross)	14,214.6	13,770.7	13,039.1	12,720.3	12,194.0
Adjusted common equity	1,387.7	1,334.3	1,301.9	1,297.0	1,270.4
Operating revenues	122.1	235.6	222.2	219.6	220.4
Noninterest expenses	59.0	121.5	114.3	112.3	111.9
Core earnings	55.0	99.5	97.7	91.2	96.3

\*Data as of June 30. CHF--Swiss franc.

Table 2

Zuger Kantonalbank--Business Position					
--Fiscal year ended Dec. 31--					
(%)	2022*	2021	2020	2019	2018
Return on average common equity	7.7	5.4	5.5	5.5	N/A

\*Data as of June 30. N/A--Not applicable.

Table 3

Zuger Kantonalbank--Capital And Earnings					
--Fiscal year ended Dec. 31--					
(%)	2022*	2021	2020	2019	2018
Tier 1 capital ratio	17.2	17.9	18.1	18.2	18.5
S&P Global Ratings' RAC ratio before diversification	N/A	23.6	N/A	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	15.8	N/A	N/A	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	63.1	64.1	67.0	67.2	67.7
Fee income/operating revenues	27.6	27.7	24.5	22.4	21.0
Market-sensitive income/operating revenues	5.9	5.7	5.8	7.0	7.9
Cost to income ratio	48.3	51.6	51.4	51.2	50.8
Preprovision operating income/average assets	0.7	0.7	0.7	0.7	N/A
Core earnings/average managed assets	0.6	0.6	0.6	0.6	N/A

\*Data as of June 30. N/A--Not applicable. RAC--Risk-adjusted capital.

Table 4

Zuger Kantonalbank--Risk-Adjusted Capital Framework Data						
(CHF 000s)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)	
<b>Credit risk</b>						
Government & central banks	3,583,114.3	56,117.4	1.6	9,241.1	0.3	
Of which regional governments and local authorities	151,144.5	46,039.1	30.5	5,441.2	3.6	
Institutions and CCPs	33,007.7	3,901.7	11.8	3,388.8	10.3	
Corporate	2,675,335.1	2,198,521.5	82.2	1,764,447.2	66.0	

Table 4

Zuger Kantonalbank--Risk-Adjusted Capital Framework Data (cont.)					
Retail	11,692,905.3	4,511,463.9	38.6	3,022,948.6	25.9
Of which mortgage	10,964,779.7	3,963,576.7	36.1	2,542,732.4	23.2
Securitization§	0.0	0.0	0.0	0.0	0.0
Other assets†	287,794.2	80,533.8	28.0	284,710.6	98.9
Total credit risk	18,272,156.6	6,850,538.3	37.5	5,084,736.3	27.8
<b>Credit valuation adjustment</b>					
Total credit valuation adjustment	--	4,396.5	--	0.0	--
<b>Market Risk</b>					
Equity in the banking book	22,590.0	33,871.0	149.9	169,390.0	749.8
Trading book market risk	--	35,635.0	--	53,452.5	--
Total market risk	--	69,505.9	--	222,842.5	--
<b>Operational risk</b>					
Total operational risk	--	421,681.7	--	352,341.1	--
	<b>Exposure</b>	<b>Basel III RWA</b>	<b>Average Basel II RW (%)</b>	<b>S&amp;P Global Ratings RWA</b>	<b>% of S&amp;P Global Ratings RWA</b>
<b>Diversification adjustments</b>					
RWA before diversification	--	7,468,145.4	--	5,659,919.9	100.0
Total diversification/ concentration adjustments	--	--	--	2,796,950.7	49.4
RWA after diversification	--	7,468,145.4	--	8,456,870.6	149.4
		<b>Tier 1 capital</b>	<b>Tier 1 ratio (%)</b>	<b>Total adjusted capital</b>	<b>S&amp;P Global Rating RAC ratio (%)</b>
Capital ratio					
Capital ratio before adjustments		1,333,460.0	17.9	1,334,320.6	23.6
Capital ratio after adjustments‡		1,333,460.0	17.9	1,334,320.6	15.8

\*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. CCPs--Central counterparty clearing house. Sources: Company data as of Dec. 31, 2021, S&P Global Ratings.

Table 5

Zuger Kantonalbank--Risk Position					
--Fiscal year ended Dec. 31--					
(%)	2022*	2021	2020	2019	2018
Tier 1 capital ratio	17.2	17.9	18.1	18.2	18.5
S&P Global Ratings' RAC ratio before diversification	N/A	23.6	N/A	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	15.8	N/A	N/A	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	63.1	64.1	67.0	67.2	67.7
Fee income/operating revenues	27.6	27.7	24.5	22.4	21.0
Market-sensitive income/operating revenues	5.9	5.7	5.8	7.0	7.9
Cost to income ratio	48.3	51.6	51.4	51.2	50.8

**Table 5**

<b>Zuger Kantonalbank--Risk Position (cont.)</b>					
	<b>--Fiscal year ended Dec. 31--</b>				
<b>(%)</b>	<b>2022*</b>	<b>2021</b>	<b>2020</b>	<b>2019</b>	<b>2018</b>
Preprovision operating income/average assets	0.7	0.7	0.7	0.7	N/A
Core earnings/average managed assets	0.6	0.6	0.6	0.6	N/A

\*Data as of June 30. N/A--Not applicable. RAC--Risk-adjusted capital.

**Table 6**

<b>Zuger Kantonalbank--Funding And Liquidity</b>					
	<b>--Fiscal year ended Dec. 31--</b>				
<b>(%)</b>	<b>2022*</b>	<b>2021</b>	<b>2020</b>	<b>2019</b>	<b>2018</b>
Core deposits/funding base	62.8	63.2	65.9	68.2	72.6
Customer loans (net)/customer deposits	131.4	130.4	127.7	130.8	125.9
Long-term funding ratio	85.4	84.6	89.5	93.5	98.3
Stable funding ratio	103.7	103.4	107.2	106.8	110.1
Short-term wholesale funding/funding base	15.8	16.7	11.4	7.2	1.9
Regulatory net stable funding ratio	N/A	137.0	N/A	N/A	N/A
Broad liquid assets/short-term wholesale funding (x)	1.3	1.2	1.6	2.0	6.7
Broad liquid assets/total assets	18.4	18.4	17.0	13.0	11.1
Broad liquid assets/customer deposits	31.8	31.8	28.3	21.0	17.0
Net broad liquid assets/short-term customer deposits	6.7	5.4	11.1	10.7	14.7
Regulatory liquidity coverage ratio (LCR) (x)	N/A	140.0	161.0	155.0	178.0
Short-term wholesale funding/total wholesale funding	42.5	45.3	33.6	22.6	6.8
Narrow liquid assets/3-month wholesale funding (x)	2.2	1.5	2.2	3.2	140.3

\*Data as of June 30. N/A--Not applicable.

<b>Zuger Kantonalbank--Rating Component Scores</b>	
<b>Issuer Credit Rating</b>	AA+/Stable/A-1+
SACP	a
Anchor	a-
Economic risk	2
Industry risk	2
Business position	Adequate
Capital and earnings	Very strong
Risk position	Adequate
Funding	Adequate
Liquidity	Adequate
Comparable ratings analysis	-1
Support	+4
ALAC support	0
GRE support	+4
Group support	0
Sovereign support	0

**Zuger Kantonalbank--Rating Component Scores (cont.)**

<b>Issuer Credit Rating</b>	AA+/Stable/A-1+
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

**Related Criteria**

- 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**

- Zuger Kantonalbank Assigned 'AA+/A-1+' Ratings; Outlook Stable, Nov. 8, 2022
- Banking Industry Country Risk Assessment: Switzerland, May 30, 2022

**Ratings Detail (As Of January 18, 2023)\***

<b>Zuger Kantonalbank</b>	
Issuer Credit Rating	AA+/Stable/A-1+
<b>Issuer Credit Ratings History</b>	
08-Nov-2022	AA+/Stable/A-1+
<b>Sovereign Rating</b>	
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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