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Basellandschaftliche Kantonalbank

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Basellandschaftliche Kantonalbank

SACP	a+

Anchor	a-	
Business Position	Adequate	0
Capital and Earnings	Very Strong	+2
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Strong	

+

Support	+2

ALAC Support	0
GRE Support	+2
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating

AA/Stable/A-1+

Major Rating Factors

Strengths:	Weaknesses:
• Strong retail banking franchise in the Canton of Basel-Country and in some of the nearby cantons. • Sound financial profile, underpinned by very strong capitalization and stable earnings. • High quality loan book dominated by granular and well-collateralized residential mortgages.	• Concentration risk due to focus on the home region. • Limited geographic, business, and earnings diversification. • Limited growth potential.

Outlook: Stable

S&P Global Ratings' stable outlook on Switzerland-based Basellandschaftliche Kantonalbank (BLKB) reflects that on the bank's majority owner and guarantor, the Canton of Basel-Country. The stable outlook also reflects our expectation that the bank's status as a government-related entity (GRE) and the "extremely high" likelihood of support will not change in the foreseeable future. Moreover, we expect that BLKB will maintain its sound financial profile, underpinned by its very strong capitalization and sound earnings capacity over the next two years.

We could take a negative rating action on the issuer credit ratings (ICR) on BLKB if its ties with Basel-Country were to loosen or if changes to the canton's statutory guarantee were made that would weaken the likelihood of extraordinary support from the canton if needed. However, we currently consider this scenario unlikely and we expect BLKB's existing obligations to be grandfathered.

An improvement in BLKB's stand-alone credit profile (SACP) is remote at this stage, in our view, as we do not expect BLKB to adjust its comparatively concentrated business model. However, a positive rating action on the Canton would trigger an upgrade of the ICR on BLKB.

Rationale

Our ratings on BLKB are based on its anchor of 'a-', its adequate business position mainly reflecting the bank's strong franchise in its home region Basel-Country, very strong capital and earnings mirroring our projected risk-adjusted capital ratio (RAC) ratio of above 26.5% in the next 24 months, adequate risk position balancing concentration risks in the loan portfolio with sound asset quality, average funding, and strong liquidity, supported by sound metrics. The stand-alone credit profile (SACP) is 'a+'.

We continue to consider BLKB to be a GRE with an extremely high likelihood of receiving timely and sufficient extraordinary support from Basel-Country if needed. We base this opinion on BLKB's very important role and integral link to its home canton. This provides a two-notch uplift from the 'a+' SACP to arrive at the 'AA' issuer credit rating on BLKB.

Anchor: 'a-' for banks operating only in Switzerland

The anchor reflects BLKB's Swiss headquarters and its credit exposures, which are almost exclusively to Swiss-domiciled counterparties.

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 (ICR). Our anchor for a bank operating mainly in Switzerland is 'a-'. We view the trends for both economic and industry risk as stable.

Our economic risk score of '2' for Switzerland is supported by the country's highly diversified and competitive economy, very high household income levels, and banks' prudent loan underwriting standards. However, it also reflects that risks have increased, owing to the cumulative rise in Swiss house prices and domestic lending over several years. Although these imbalances are still low in a global context, they have also led the regulator to enact macroprudential measures to rein in robust growth in mortgage indebtedness. We recognize that house price and lending growth have cooled since the beginning of 2014. However, in our view, house prices and household indebtedness remain historically high, in particular when considering the low rate of home ownership in Switzerland. The very high mortgage debt level is mitigated by the large amount of financial assets, including pensions, held by households in Switzerland.

Our industry risk score of '2' primarily reflects the banking sector stability and a high share of deposit funding. Banks' net interest margins continue to decline gradually, given the pressure on deposit margins from the negative-yield environment. This is partly offset, however, by higher margins on lending products, fee income from investment advisory-related activities, and cost management. As a result, banks are still able to generate returns on core banking products that are adequate to meet their cost of capital. Moreover, in our view, the Swiss regulator's regulatory initiatives are more stringent than those in other European banking industries.

Table 1

Basellandschaftliche Kantonalbank Key Figures

		--Year-ended Dec. 31--			
(Mil. CHF)	**2018***	**2017**	**2016**	**2015**	**2014**
Adjusted assets	24,601.1	24,203.9	23,681.6	23,171.7	21,743.8
Customer loans (gross)	19,765.6	19,636.1	19,097.6	18,645.8	18,301.6
Adjusted common equity	2,243.7	2,223.4	2,106.9	1,989.4	1,853.6
Operating revenues	180.0	370.3	372.4	375.1	356.5
Noninterest expenses	95.3	194.4	184.9	178.8	172.9
Core earnings	82.1	171.8	183.1	191.0	180.2

*Data as of June 30.

Business position: Well-established regional franchise in the Canton of Basel-Country

We consider BLKB's business position to be adequate in comparison with other domestic banks, balancing its regional concentration with its exceptional business stability over the economic cycle.

BLKB is a midsize cantonal bank in Switzerland in terms of assets and operates in the economically strong region of Northwestern Switzerland. As of June 30, 2018, the bank's total assets equaled Swiss franc (CHF) 24.6 billion (€21.5 billion). Similar to most cantonal banks, BLKB's business activities remain strongly focused on mortgage lending (more than 90% of its CHF19.6 billion total loan book as of year-end 2017), followed by lending to small and midsize enterprises in the region (around 10%). BLKB's business activities are accompanied by asset management and private banking operations and, to a smaller extent, by client-initiated trading activities, a business model that we do not expect to change in the next years.

We expect BLKB to remain the market leader in its home canton, but continue to view the concentration of its business on primarily one Swiss canton as a rating weakness. However, we consider that the bank's very prudent approach to managing credit risks will enable it to continue generating stable revenues and to deal with challenges arising from its business concentration.

Furthermore, we also note BLKB's investment in Swiss direct bank Swissquote Group and the joint launch of an online platform for e-mortgage loans to offer loans countrywide, allowing some diversification outside the home region. The amount of e-loans used to grow materially faster than the mortgage business in the home canton, though this has now slowed. We expect the share to remain at the current 5% of BLKB's mortgage loan book in the near term. While this activity provides BLKB with a limited additional source of revenues, we generally observe that BLKB is proactively executing strategic initiatives in order to adapt to the changing landscape in the retail banking industry that results from ongoing trends toward digitalization and standardization.

As a further example, BLKB launched a strategic partnership with a Swiss robot advisory corporation, which includes participation as a minority shareholder. We do not expect the business profile to change significantly as a result of these partnerships, but we are generally confident that BLKB is capable of meeting challenges in order to secure its current business position.

Table 2

Basellandschaftliche Kantonalbank Business Position

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Loan market share in country of domicile	N/A	1.7	1.7	1.7	1.7
Deposit market share in country of domicile	N/A	1.4	1.4	1.4	1.4
Total revenues from business line (currency in millions)	198.3	394.0	385.0	397.4	357.4
Commercial & retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on average common equity	4.5	5.9	6.3	6.5	6.1

*Data as of June 30. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Capital and earnings: Very strong capitalization supported by stable earnings

We anticipate that BLKB's stable earnings generation and its conservative capital policy will not change. Therefore, we assess BLKB's capital and earnings as very strong.

We expect BLKB's RAC to gradually increase further towards 27% over the next 18-24 months, compared with 26.1% at year-end 2017. We continue to expect that capital buildup will exceed the growth in S&P Global Ratings' risk-weighted assets of about 3% annually over the projection period. This will allow the bank to maintain a RAC ratio that is very strong on a global comparison.

We view BLKB's earnings capacity as strong and predictable, even compared with that of other cantonal banks. We expect BLKB's loan growth to be in line with or slightly below market growth rates, at around 2%-4% in the next two years. At the same time, we anticipate that BLKB will continue to focus on keeping lending margins at high levels in the mortgage loan business, instead of growing its volume.

We project that earnings will also be supported by stable fee and commission income, mainly driven by the securities and wealth management business. We expect the bank's dividend policy to remain in line with that of previous years, with a total payout of about CHF80 million-CHF90 million yearly. BLKB's three-year average earnings buffer, which measures the capacity for a bank's earnings to cover its normalized credit losses, is expected to decrease slightly, but to remain at about 1.30% of our risk-weighted assets (an earnings buffer of about 1.0% indicates adequate earnings capacity). This will, in our view, support the bank's further capital buildup.

BLKB's regulatory core equity Tier 1 ratio stood at high 20% at year-end 2017, which remains lower than the bank's RAC ratio as we apply lower risk weights on Swiss retail loans than applied by the Swiss regulator.

We believe that Basel-Country, BLKB's 74% owner (and holder of 100% of voting rights), remains supportive of BLKB's capital position, and that BLKB won't be required to make major or extraordinary dividend distributions that might weaken its RAC ratio.

Table 3

Basellandschaftliche Kantonalbank Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	N/A	20.0	19.9	19.2	19.0
S&P Global Ratings' RAC ratio before diversification	N/A	26.1	26.1	25.7	22.7
S&P Global Ratings' RAC ratio after diversification	N/A	19.1	18.8	20.4	18.4
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	74.1	74.6	77.5	76.0	75.5
Fee income/operating revenues	18.8	17.6	15.4	16.6	18.5
Market-sensitive income/operating revenues	4.9	6.3	5.8	5.7	5.5
Noninterest expenses/operating revenues	52.9	52.5	49.7	47.7	48.5
Preprovision operating income/average assets	0.7	0.7	0.8	0.9	0.9
Core earnings/average managed assets	0.7	0.7	0.8	0.9	0.9

*Data as of June 30. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 4

Basellandschaftliche Kantonalbank RACF [Risk-Adjusted Capital Framework] Data

	Exposure*	**Basel III RWA**	**Average Basel III RW (%)**	**S&P Global RWA**	**Average S&P Global RW (%)**
Credit risk					
Government and central banks	3,629,105,015	235,448,398	6	28,158,459	1
Of which regional governments and local authorities	0	0	0	0	0
Institutions and CCPs	1,277,145,489	420,389,344	33	209,582,139	16
Corporate	1,674,876,058	1,498,042,187	89	1,103,536,436	66
Retail	18,535,995,080	7,960,116,065	43	5,596,337,905	30
Of which mortgage	15,522,554,421	6,025,859,164	39	3,608,491,200	23
Securitization§	0	0	0	0	0
Other assets†	0	0	0	0	0
Total credit risk	25,117,121,642	10,113,995,993	40	6,937,614,939	28
Credit valuation adjustment					
Total credit valuation adjustment	--	11,087,500	--	0	--
Market risk					
Equity in the banking book	98,662,565	124,167,587	126	680,481,711	690
Trading book market risk	--	32,137,500	--	48,206,250	--
Total market risk	--	156,305,087	--	728,687,961	--

Table 4

Basellandschaftliche Kantonalbank RACF [Risk-Adjusted Capital Framework] Data (cont.)

Operational risk					
Total operational risk	--	0	--	839,763,498	--
		Basel III RWA		**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification		10,281,388,580		8,506,066,398	100
Total Diversification/Concentration Adjustments	--			3,152,167,441	37
RWA after diversification		10,281,388,580		11,658,233,839	137
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		2,231,676,000	21.7	2,223,359,000	26.1
Capital ratio after adjustments‡		2,231,676,000	21.7	2,223,359,000	19.1

*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. ‡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. Sources: Company data as of Dec. 31, 2017, S&P Global.

Risk position: Conservative underwriting standards in new mortgage lending maintains low level of NPLs

We assess BLKB's overall risk position as adequate, reflecting our opinion that the bank's RAC ratio adequately captures its risk profile. We also note positively that BLKB's business model concentrates on well-collateralized lending categories, such as mortgages, small and midsize enterprises, and corporates, with only a small exposure to market-sensitive business.

BLKB's loan book of about CHF19.6 billion at year-end 2017 remains dominated by residential real estate loans in Basel-Country and neighboring cantons and will, in our view, continue showing very strong asset quality. We expect the loan book to continue growing at a somewhat slower pace than the industry average, as management is putting more emphasis on risk-adjusted margins over volume growth.

That said, we still consider that the regional focus of the loan book exposes the bank to concentration risks. These concentration risks are partly offset by the high granularity and collateralization of the mortgage loan portfolio (estimated average loan-to-value ratio of 55% for mortgage loans) and average credit limits that compare well with other domestic banks. However, like its domestic peers, BLKB remains exposed to the risks related to a potential correction phase in Swiss residential real estate markets, in particular in its home canton, following continued price increases in past years.

Positively, we believe that the bank will maintain its conservative underwriting standards in new mortgage lending, helping it to report a low level of nonperforming loans in its loan book. This supports our estimate that the cost of risk will be less than 5 bps over the next two years, which we expect to be below the industry average.

In order to diversify its loan book, BLKB selectively participates in syndicated corporate loans to large corporations across Switzerland. However, we don't believe that this activity, which currently represents less than 5% of BLKB's lending and predominately focuses on highly rated corporations, will expose BLKB to any elevated credit risks that would impair our assessment of its risk position.

We observe that BLKB is mitigating its asset-liability risk by running its lending and refinancing activities with matching maturities and additionally uses interest rate swaps in order to lock in the desired interest rate risk exposure.

Table 5

Basellandschaftliche Kantonalbank Risk Position					
		--Year-ended Dec. 31--			
(%)	**2018***	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	1.3	2.8	2.4	1.9	5.5
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	37.1	39.3	26.2	23.6
Total managed assets/adjusted common equity (x)	11.0	10.9	11.2	11.7	11.7
Gross nonperforming assets/customer loans + other real estate owned	N/A	0.1	0.2	0.1	0.1
Loan loss reserves/gross nonperforming assets	N/A	674.3	422.7	678.3	966.6

*Data as of June 30. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: Strong retail franchise provides funding stability

We consider BLKB's funding to be average and its liquidity to be strong, mainly because the bank has limited reliance on wholesale funding.

We expect that BLKB's stable funding ratio will remain at a comfortable level of about 110%-115% over the next two years, underpinning our assessment of its funding profile as average. The bank's funding will continue to benefit from a high level of core customer deposits, which constituted 77% of the total funding base on Dec. 31, 2017, as well as from the strong equity stake on its balance sheet, comprising about 9% of total assets. We consider that the bank's customer deposits will remain very durable, owing to BLKB's business stability and the statutory guarantee of its liabilities from Basel-Country.

However, the loan portfolio continues to exceed the deposit base as demonstrated by BLKB's customer loans-to-deposit ratio, which has ranged between 115% and 120% over the past five years (117% as of Dec. 31, 2017), which indicates BLKB's reliance on other means of funding. Consequently, BLKB takes advantage of wholesale funding, mainly covered bonds (10% of funding base) and unsecured bonds (10% of funding base).

We believe that BLKB's funding profile would not weaken during an economic downturn. Evidence for this is in the "flight to quality" observed during the most recent crises, and the continuous increase in customer deposits over recent years, despite the low interest rates the bank has offered.

Our assessment of BLKB's liquidity as strong reflects our estimate of the bank's strong one-year liquidity ratio (broad liquid assets to short-term wholesale funding) at about 3x on Dec. 31, 2017. Its use of short-term wholesale funding remains at a low 4% of the funding base. We consider the bank's liquidity coverage--mainly consisting of securities eligible for repurchase at the Swiss central bank--to be strong, indicating the availability of sufficient liquid assets to withstand a lack of access to wholesale funding for more than 12 months.

Table 6

Basellandschaftliche Kantonalbank Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	2018*	2017	2016	2015	2014
Core deposits/funding base	72.3	76.8	73.9	74.0	79.2
Customer loans (net)/customer deposits	123.6	116.7	120.3	119.3	118.1
Long-term funding ratio	93.7	96.4	94.1	94.6	98.2
Stable funding ratio	103.7	107.0	112.3	112.9	109.7
Short-term wholesale funding/funding base	7.0	4.0	6.5	5.9	2.0
Broad liquid assets/short-term wholesale funding (x)	1.7	3.0	2.9	3.1	6.9
Net broad liquid assets/short-term customer deposits	6.5	10.3	16.8	19.7	15.2
Short-term wholesale funding/total wholesale funding	25.2	17.2	24.9	22.9	9.5
Narrow liquid assets/3-month wholesale funding (x)	4.5	4.1	4.3	11.8	10.3

External support:Two notches of support from the Canton of Basel-Country

We regard BLKB as a GRE and assess as extremely high the likelihood that BLKB's owner, Basel-Country, would provide timely and sufficient support to BLKB. We base our assessment on the bank's integral link with Basel-Country, which we expect to provide timely support to BLKB. Our assessment is underpinned by the owner's full control of the bank (100% of voting rights) and its provision of a statutory guarantee for the bank's liabilities. Our assessment is also based on BLKB's very important role for the canton, owing to the significant impact of the bank's activities for the local economy. Because of this, we incorporate a two-notch uplift from BLKB's 'a+' SACP to the long-term rating. We do not envisage that the bank's GRE status and our view of an extremely high likelihood of extraordinary government support will change in the medium term.

We expect the existing cantonal guarantees to remain in place in the medium term. However, while being outside our outlook horizon, we consider the potential risk that future agreements between Switzerland and the European Union (EU) regarding preferential market access for Switzerland might include the removal of remaining cantonal guarantees for all banks.

BLKB benefits from Basel-Country's statutory guarantee, which ultimately covers all of BLKB's liabilities, excluding nonvoting participation certificates ("Partizipationskapital"). However, we note that the guarantee does not explicitly ensure timely repayment, as defined by our criteria. Nevertheless, we believe that the canton has strong incentives to help BLKB meet its obligations on time, owing to the bank's importance to the regional economy and to prevent reputational damage.

Additional rating factors: None

No additional factors affect this rating

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
- 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: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment: Switzerland, Nov. 30, 2018

Anchor Matrix

Industry Risk	Economic Risk									
	1	**2**	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	**a-**	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of December 5, 2018)	
Basellandschaftliche Kantonalbank	
Issuer Credit Rating	AA/Stable/A-1+
Senior Unsecured	AA
Issuer Credit Ratings History	
01-Dec-2014	AA/Stable/A-1+
20-Jan-2014	AA+/Negative/A-1+
03-Jul-2012	AAA/Negative/A-1+
Sovereign Rating	
Switzerland	AAA/Stable/A-1+

Ratings Detail (As Of December 5, 2018) (cont.)	
Related Entities	
Basel-Country (Canton of)	
Issuer Credit Rating	AA+/Stable/A-1+
Senior Unsecured	AA+

*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.