

### Research Update:

# Switzerland-Based Aargauische Kantonalbank 'AAA/A-1+' Ratings Affirmed On Bank Criteria Change; Outlook Stable

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## Research Update:

# Switzerland-Based Aargauische Kantonalbank 'AAA/A-1+' Ratings Affirmed On Bank Criteria Change; Outlook Stable

## Overview

- Following a review of Aargauische Kantonalbank (AKB) under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we have affirmed our 'AAA/A-1+' ratings on AKB. The outlook is stable.
- In our view, AKB has an adequate business position, very strong capital and earnings, an adequate risk position, average funding, and strong liquidity, reflecting its stand-alone credit profile (SACP) of 'aa-'.
- We consider AKB to be a government-related entity with an "extremely high" likelihood of extraordinary government support in times of stress, which results in a three-notch rating uplift from the SACP.
- The stable outlook reflects that on AKB's owner and guarantor the Canton of Aargau. We believe AKB will maintain its very strong capital and earnings.

## Rating Action

As previously announced, on Dec. 5, 2011, Standard & Poor's Ratings Services affirmed its 'AAA/A-1+' long-term and short-term counterparty credit ratings on Switzerland-based Aargauische Kantonalbank (AKB). The outlook is stable.

## Rationale

Standard & Poor's bases its assessment of AKB's stand-alone credit profile (SACP) on the bank's "adequate" business position, "very strong" capital and earnings, "adequate" risk position, "average" funding, and "strong" liquidity, as our criteria define these terms. The SACP is at 'aa-'.

Our bank criteria use the economic risk and industry risk scores from our Banking Industry Country Risk Assessment (BICRA) to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for a commercial bank operating only in Switzerland is 'a'.

The BICRA score includes our evaluation of economic risk. In this respect, we view Switzerland as a highly diversified and competitive economy, benefiting from one of the highest GDP per capita in the world and very robust government finances. We believe Switzerland demonstrates a conservative risk and lending culture, which has accompanied recent moderate growth of house prices and loan portfolios. The Swiss banking industry is supported by its sizable and very stable customer deposit base. Pure domestic Swiss banks have

not loosened credit standards in recent years, thanks to sound earnings potential from core products. We consider regulatory standards to be more stringent than in other developed countries.

AKB's business position is considered to be "adequate", in line with Switzerland's industry risk score of '2'. AKB is a midsize cantonal bank in Switzerland, and it reported total assets of Swiss franc (CHF) 20 billion (about \$24 billion) as of midyear 2011. It is also active in asset management and private banking through its Zurich-based subsidiary AKB Privatbank. AKB's concentration risk arising from its geographically limited business profile is partly offset by its management's ability to produce very stable and profitable results as shown over the past decade, while maintaining a low risk profile. AKB's low risk profile is a result of its management's vigilant lending and underwriting policy, in our view, which also applies to its participation in syndicated lending to Swiss counterparties. In its home canton, Aargau, competition is higher than in other cantons, resulting in AKB's comparably smaller market shares than other cantonal banks.

We consider AKB's capital and earnings to be "very strong", underpinned by a risk-adjusted capital (RAC) ratio before diversification and concentrations adjustments of 17.0% to 18.0% over the next 18 months, which is facilitated by a three-year average earnings buffer of more than 150 basis points. These figures are slightly below the average for other Swiss cantonal banks, but they nevertheless add to a superior financial profile. AKB's quality of capital is high, as it is for its peers. In addition, AKB's owner the Canton of Aargau appears supportive of a strong capital position, which minimizes the risk of an owner-driven weakening of AKB's equity position.

AKB's risk position is "adequate", in our opinion. The concentration risk arising from the dependence of AKB's business on residential real estate lending is offset by the high granularity of its real estate loan portfolio. Although AKB's loan growth is broadly in line with its peers' and expected to remain stable, excessive real estate prices in certain regions could become an area of concern for AKB's "adequate" risk position. We also consider that AKB's corporate exposures and syndicated loans could face elevated risks, given that Switzerland's export-oriented industry is currently laboring under the effects of a strong Swiss franc. In addition, we would see challenges arising for AKB in terms of interest rate risk, if the prolonged phase of low interest rates in Switzerland persists for a considerably longer time frame. Overall, we believe that AKB has maintained a generally careful approach in managing credit and market risks. Operational risks are adequately addressed, in our view.

AKB's liquidity is "strong" and its funding position "average", in our view. AKB's funding consists mainly of stable core customer deposits, which accounted for roughly 73% of its funding as of half-year 2011. The remaining amount of AKB's funding is provided by wholesale funding, mainly composed of unsecured and covered bond issuances. Our assessment of AKB's liquidity as "strong" stems from our opinion that AKB will be able to operate for more than 12 months without access to wholesale funding.

In accordance with our criteria for government-related entities (GREs), our view of an "extremely high" likelihood of extraordinary government support is based on our assessment of AKB's:

- "Very important role" as Aargau's largest GRE. A default of AKB could destabilize Switzerland's banking system and tarnish the canton's reputation.; and
- "Integral link" with the canton, owing to a strong and durable relationship with Aargau. AKB benefits from the canton's statutory guarantee, which ultimately covers all of AKB's liabilities, except those of its subsidiaries, subordinated liabilities, and nonvoting participation certificates, if the bank were to issue such obligations in the future. We do not anticipate changes to AKB's ownership structure or the canton's statutory guarantee.

## Outlook

The stable outlook on AKB reflects that on its owner and guarantor the Canton of Aargau. The stable outlook also reflects our expectation that the bank's GRE status and our view of an "extremely high" likelihood of extraordinary government support will not change in the foreseeable future and that AKB will maintain its prudent risk management over the medium term.

Negative rating actions may be triggered by a change of AKB's role for or link with the canton or changes in the statutory guarantee, which may lead to a weaker assessment of its GRE status. However, we currently consider this scenario to be unlikely and would expect AKB's existing obligations to be grandfathered.

We might take a more negative view of AKB's SACP and lower the ratings if our BICRA for Switzerland were to change. Switzerland is currently in BICRA group '1' (lowest risk). Furthermore, a decline in the RAC ratio for AKB could also result in a negative rating action.

An improvement of the SACP is remote at this stage as we do not expect AKB's comparatively concentrated business model to be adjusted in the near future.

## Ratings Score Snapshot

Issuer Credit Rating	AAA
SACP	aa-
Anchor	a
Business Position	Adequate (0)
Capital and Earnings	Very strong (2)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Strong (0)
Support	3

GRE Support	3
Group Support	0
Sovereign Support	0
Additional Factors	0

## Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

## Ratings List

Ratings Affirmed

Aargauische Kantonalbank	
Counterparty Credit Rating	AAA/Stable/A-1+
Certificate Of Deposit	AAA/A-1+

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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