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## Zuger Kantonalbank

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# Zuger Kantonalbank

## Ratings 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	Key risks
Extremely high likelihood of support from the financially strong Swiss Canton of Zug.	Concentrated business model and higher risk appetite than most peers due to its material exposure to the property sector.
Very strong capitalization and sound asset quality.	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) 62.6 million. We forecast ZGKB will maintain its sound return on equity (ROE) of 6.5%-7.5% 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 23.7% at year-end 2022, with 25.5%-26.5% 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--				
	2021a	2022a	2023f	2024f	2025f
Growth in operating revenue	6.0	6.7	16.0-19.6	(4.1)-(5.0)	2.3-2.8
Growth in customer loans	5.6	3.7	4.6-5.6	2.5-3.1	2.3-2.9
Net interest income/average earning assets (NIM)	1.1	1.1	1.2-1.4	1.1-1.2	1.1-1.2
Cost to income ratio	51.6	52.9	49.2-50.5	52.9-54.2	52.8-54.1
Return on average common equity	5.4	6.9	7.7-8.5	6.5-7.2	6.6-7.3
Gross nonperforming assets/customer loans	0.3	0.2	0.2-0.2	0.2-0.2	0.2-0.2
Risk-adjusted capital ratio	23.6	23.7	25.3-26.6	25.3-26.6	25.5-26.8

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 anchor for banks operating mainly in Switzerland, like Bank ZGKB, is 'a-'. We consider the trend for economic and industry risk in Switzerland to be stable.

The Swiss private sector has proven its resilience against multiple external stress scenarios. We expect Swiss households and corporates to maintain credit strength despite the worsening economic outlook. This reflects the superior financial strength of Swiss households and corporations, and banks' prudent underwriting standards (which focus on collateralized lending, mainly residential mortgages or Lombard loans). Overall, we see limited risk to Swiss households on debt servicing capacity from rising rates. At the same time, we believe the deceleration in house price rises should remain manageable for Swiss banks' mortgage exposures. This is because banks' existing stock of mortgage loans are predominately fixed-rate and underwriting standards already integrate much higher interest rates into affordability assessments. In any case, we believe that a strong Swiss labor market, tight and inelastic supply in housing, and ongoing high demand due to persistently high immigration support house prices.

Our view of industry risk in Switzerland encompasses the stability of the domestic banking sector, despite the failure of Credit Suisse. In general, we do not observe a loss in customer confidence in Swiss banking, as many domestic banks profited from inflows of assets under management and deposits from Credit Suisse after outflows escalated in 2022. Money laundering and the threat of additional sanctions remain tail risks for the Swiss banking sector.

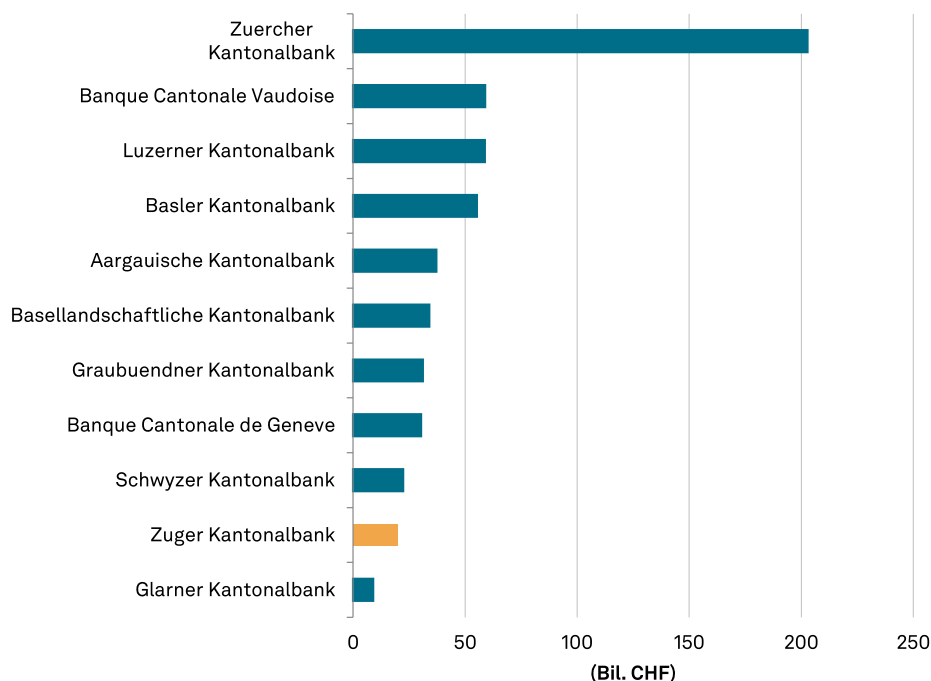
### **Business Position: Strong Home Turf, But Concentrated Business Model Amid Significant Competition**

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, driven by an increasing use of online mortgage agents such as Moneypark. The bank primarily finances retail mortgages and smaller corporate clients as well as more affluent clients in the Zug region.

Assets under management were CHF18.1 billion as of June 30, 2023. ZGKB plans to expand its asset and wealth management business outside the Canton of Zug due to limited growth potential within its home market. Due to several contenders, we consider this business as highly competitive—requiring material investments in infrastructure and personnel.

**Chart 1****Zuger Kantonalbank is a small to midsize Cantonal Bank**

Total assets in first-half 2023



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

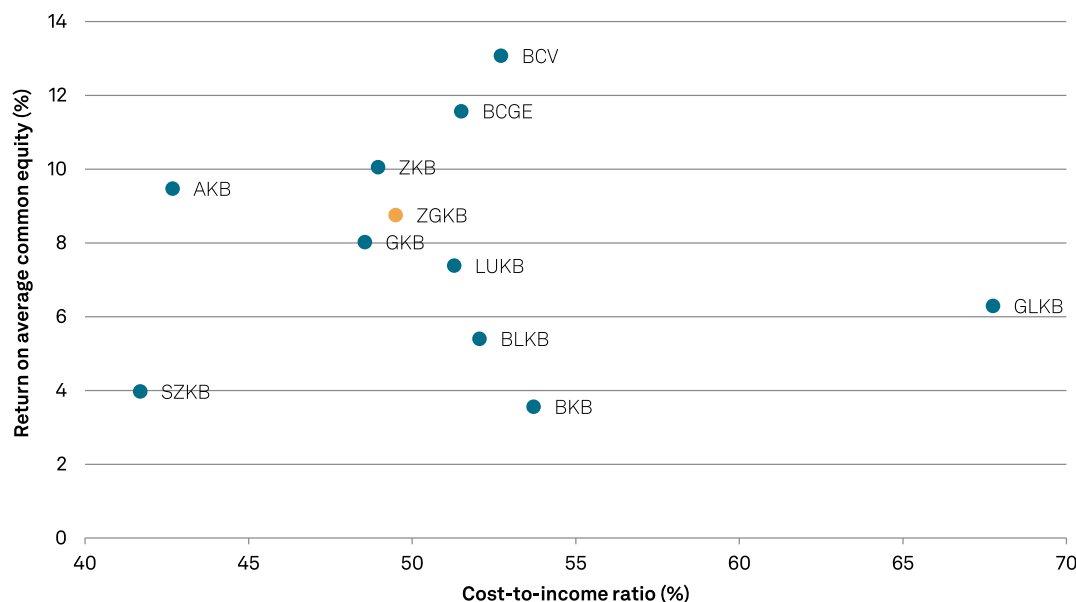
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We see the risk of disruption to ZGKB's business model from new digital competitors as moderate. That said, given its wealthy, dynamic, and international client base, we consider significant investments are needed to keep up and close the gap with competitors. We view the bank's initiative to increase its digital and base product offerings as positive to avoid digital disruption.

With the acquisition of Immofonds Asset Management AG (IFAM) in July 2022, ZGKB exhibits an increase in its cost-to-income ratio at 49.5% as of mid-year 2023, putting it on par with cantonal peers. The bank's return on equity of 8.7% at mid-year 2023 was slightly above those of most domestic peers. As also the case for most domestic peers, we consider return on equity level in the context of ZGKB's very high equity base, which limits insights from a wider international comparison.

**Chart 2****ZGKB's efficiency remains on par with its peers**

Sound return on equity (as of June 30, 2023)



AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. GLKB--Glerner Kantonalbank. GKB--Graubündner Kantonalbank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zürcher Kantonalbank. ZGKB--Zuger Kantonalbank. Source: S&P Global Ratings.

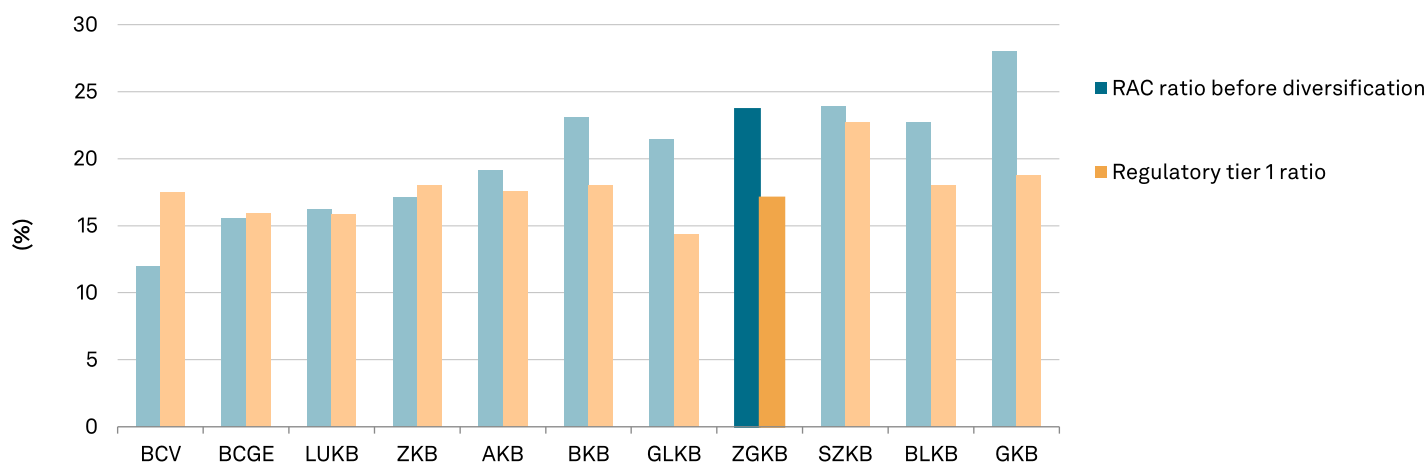
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## Capital And Earnings: Very Strong Capitalization With Sound Earnings Generation Capacity

We consider ZGKB's solid capital position a rating strength, especially in comparison with global peers. We expect the bank's RAC ratio of 23.7% at year-end 2022 to increase and stabilize at about 25.5%-26.5% over our forecast horizon. Our RAC forecast is underpinned by the expectation of increasing retained earnings and only modest credit growth.

**Chart 3****ZGKB has very strong capitalization in a global comparison and in line with peers**

S&amp;P Global Ratings RAC ratio at Dec. 31, 2022



RAC--Risk adjusted capital. AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. GLKB--Glarner Kantonalbank. GKB--Graubuendner Kantonalbank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zuercher Kantonalbank. ZGKB--Zuger Kantonalbank Source: S&P Global Ratings.

We project ZGKB's three-year average earnings buffer, which measures the capacity for a bank's earnings to cover normalized losses, will be strong 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.

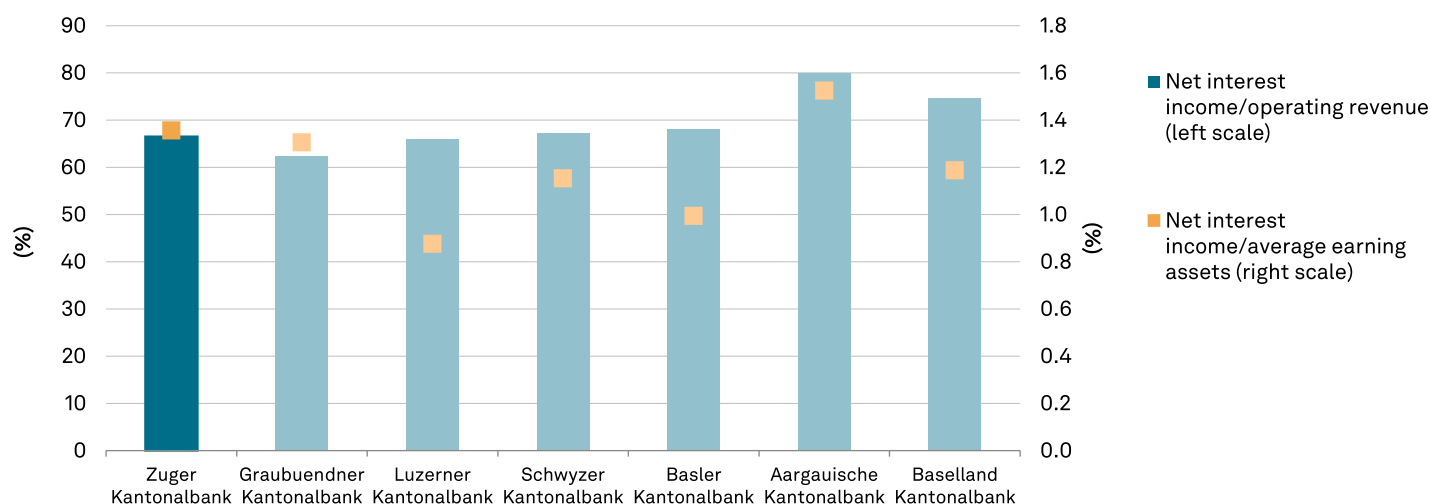
### Risk Position: Sound Underwriting Standards And Very Good Asset Quality

Similar to other cantonal bank peers, ZGKB's nonperforming assets were lower than the system average of 0.5% in 2022 at about 0.2% of customer loans. This is based on sound underwriting standards, demonstrated by very low loan-to-value figures with less than 2.15% of the total portfolio being above 66%. We do not expect the bank will deviate from its underwriting criteria, which supports asset quality through the cycle.



**Chart 4****ZGKB's reliance on interest income similar to Cantonal peers**

Sound interest margins (as of June 2023)



Source: S&amp;P Global Ratings.

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The bank's balance sheet is dominated by mortgage lending at about 68% of the total. ZGKB's approximate 17% share of office and business properties is higher than that of peers, driven by the economic structure in its homecanton which attracts many international corporates due to its favorable tax regime. Due to the material exposure to commercial real estate, we think that the bank is slightly more sensitive to economic downturns than its cantonal bank peers.

Exposures outside the canton currently account for 25% of the total portfolio, which is broadly in line with the peer average. We think that in terms of the risk profile, the activities outside of the canton are similar to those locally.

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.

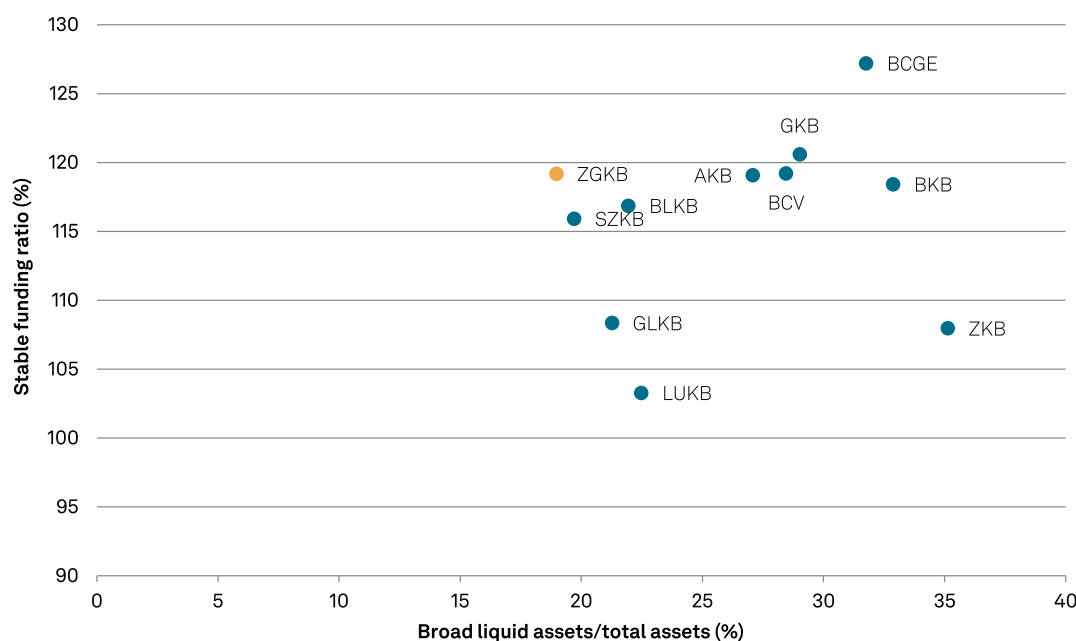
## **Funding And Liquidity: Strong Retail Deposit Franchise, With Low Reliance On Wholesale Funding And Adequate Liquidity**

Our funding assessment for ZGKB remains comfortably in line with domestic peers. The guarantee provided by the canton implicitly supports funding and liquidity, as it reinforces confidence resulting in the stability of customer deposits.

We expect ZGKB's stable funding ratio will remain above 110% over the next two years from 119% as of June 2023, which is in line with that of other domestic banks. Core customer deposits accounted for 76.4% of the funding base at June 30, 2023, and we view this base as stable.

**Chart 5****ZGKB has funding metrics in line with peers**

Adequate liquidity ratios (as of June 30, 2023)



AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. GLKB--Glerner Kantonalbank. GKB--Graubuedne Kantonalbank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zuercher Kantonalbank. ZGKB--Zuger Kantonalbank. Source: S&P Global Ratings.

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We expect customer loans will continue to exceed customer deposits at 105%-115% in the next two years. Wholesale funding accounts for about 21% of the total funding base. Wholesale funding mostly consists of covered bonds, which we view as a reliable and stable source of funding in Switzerland, akin customer deposits. In our view, shareholder and guarantee structure will continue to support the bank's access to low-cost, long-term, wholesale funding.

Our liquidity ratio--broad liquid assets to total assets--was 18.9x 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 7.4x. 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 do not think that the bank would be exposed to large withdrawals of customer deposits in times of stress owing to ZGKB's close ties with, and the statutory guarantee by, the canton. On the contrary, during increased market stress in early 2023, we observed a flight to quality that strengthened ZGKB's funding and liquidity profile.

## 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 (22.4% of loan portfolio at year-end 2022) 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 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 end Dec. 31--					
	YTD Jun-2023	2022	2021	2020	2019
Adjusted assets	19,658	18,558	18,148	16,915	15,694
Customer loans (gross)	14,705	14,279	13,771	13,039	12,720
Adjusted common equity	1,382	1,313	1,334	1,302	1,297
Operating revenues	155	251	236	222	220
Noninterest expenses	77	133	122	114	112
Core earnings	64	100	100	98	91

YTD--Year to date.

Table 2

Zuger Kantonalbank--Business position					
	--Fiscal year end Dec. 31--				
	YTD Jun-2023	2022	2021	2020	2019
Return on average common equity	8.75	6.87	5.45	5.48	5.53

YTD--Year to date.

Table 3

Zuger Kantonalbank--Capital and earnings					
	--Fiscal year end Dec. 31--				
	YTD Jun-2023	2022	2021	2020	2019
Tier 1 capital ratio	16.60	17.10	17.90	18.10	18.20
S&P Global Ratings' RAC ratio before diversification	N/A	23.70	23.57	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	14.17	15.78	N/A	N/A
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00	100.00
Net interest income/operating revenues	66.56	62.71	64.13	67.03	67.20
Fee income/operating revenues	24.91	28.65	27.74	24.48	22.35
Market-sensitive income/operating revenues	6.30	6.42	5.72	5.76	7.02
Cost to income ratio	49.50	52.85	51.58	51.44	51.15
Provision operating income/average assets	0.82	0.64	0.65	0.66	0.70
Core earnings/average managed assets	0.67	0.54	0.57	0.60	0.60

RAC--Risk adjusted capital. N/A--Not applicable.

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 and central banks	3,627,071	59,433	2	9,399	0
Of which regional governments and local authorities	125,858	10,046	8	4,531	4
Institutions and CCPs	43,418	13,062	30	7,379	17
Corporate	2,793,539	2,237,630	80	1,842,406	66
Retail	12,202,508	4,670,267	38	3,147,321	26
Of which mortgage	11,459,894	4,138,038	36	2,657,549	23
Securitization§	0	0	0	0	0
Other assets†	117,041	70,029	60	115,787	99
Total credit risk	18,783,577	7,050,421	38	5,122,292	27
<b>Credit valuation adjustment</b>					
Total credit valuation adjustment	--	4,408	--	0	--
<b>Market Risk</b>					
Equity in the banking book	0	0	0	0	0
Trading book market risk	--	32,901	--	49,352	--
Total market risk	--	32,901	--	49,352	--

Table 4

Zuger Kantonalbank--Risk-adjusted capital framework data (cont.)					
Operational risk					
Total operational risk	--	440,388	--	371,585	--
	Exposure	Basel III RWA	Average Basel II RW (%)	S&P Global Ratings' RWA	% of S&P Global Ratings' RWA
Diversification adjustments					
RWA before diversification	--	7,669,680	--	5,543,229	100
Total diversification/ Concentration adjustments	--	--	--	3,724,879	67
RWA after diversification	--	7,669,680	--	9,268,107	167
	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings' RAC ratio (%)	
Capital ratio					
Capital ratio before adjustments		1,312,592	17.1	1,313,492	23.7
Capital ratio after adjustments†		1,312,592	17.1	1,313,492	14.2

\*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. Sources: Company data as of Dec. 31, 2022, S&P Global Ratings.

Table 5

	--Fiscal year end Dec. 31--				
	YTD Jun-2023	2022	2021	2020	2019
Growth in customer loans	5.97	3.69	5.61	2.51	4.32
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	67.20	49.42	N/A	N/A
Total managed assets/adjusted common equity (x)	14.26	14.17	13.60	12.99	12.10
New loan loss provisions/average customer loans	0.05	0.02	0.00	0.00	0.00
Gross nonperforming assets/customer loans + other real estate owned	0.20	0.21	0.27	0.24	0.44
Loan loss reserves/gross nonperforming assets	N/A	284.14	218.33	242.73	100.20

N/A--Not applicable. RWA--Risk-weighted asset.

Table 6

	--Fiscal year end Dec. 31--				
	YTD Jun-2023	2022	2021	2020	2019
Core deposits/funding base	76.49	73.90	63.17	65.93	68.23
Customer loans (net)/customer deposits	106.01	112.70	130.36	127.66	130.76
Long-term funding ratio	97.40	95.87	84.60	89.49	93.45
Stable funding ratio	119.18	114.75	103.43	107.24	106.82
Short-term wholesale funding/funding base	2.80	4.46	16.70	11.44	7.17
Regulatory net stable funding ratio	152.00	148.00	137.00	N/A	N/A
Broad liquid assets/short-term wholesale funding (x)	7.38	4.10	1.20	1.63	2.00
Broad liquid assets/total assets	18.98	16.76	18.38	16.97	12.98

**Table 6**

<b>Zuger Kantonalbank--Funding and liquidity (cont.)</b>					
	<b>--Fiscal year end Dec. 31--</b>				
	<b>YTD Jun-2023</b>	<b>2022</b>	<b>2021</b>	<b>2020</b>	<b>2019</b>
Broad liquid assets/customer deposits	26.97	24.77	31.76	28.27	21.03
Net broad liquid assets/short-term customer deposits	24.06	19.32	5.37	11.09	10.67
Regulatory liquidity coverage ratio (LCR) (x)	198.00	152.00	140.00	161.00	155.00
Short-term wholesale funding/total wholesale funding	11.89	17.11	45.35	33.58	22.58
Narrow liquid assets/3-month wholesale funding (x)	17.19	5.93	1.54	2.18	3.16

YTD--Year to date. N/A--Not applicable.

<b>Zuger Kantonalbank--Rating component scores</b>	
<b>Issuer credit rating</b>	<b>AA+/Stable/A-1+</b>
SACP	a
Anchor	a-
Economic risk	1
Industry risk	3
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
Additional factors	0

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

## Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- Swiss Banking Sector 2023: Balance Sheets Remain Robust, Sep. 19, 2023
- Banking Industry Country Risk Assessment: Switzerland, Aug. 18 2023

### Ratings Detail (As Of December 1, 2023)\*

#### Zuger Kantonalbank

Issuer Credit Rating AA+/Stable/A-1+

#### Issuer Credit Ratings History

08-Nov-2022 AA+/Stable/A-1+

#### Sovereign Rating

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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