

Research Update:

Aargauische Kantonalbank Upgraded To 'AA+' On Similar Action On Canton of Aargau; Outlook Stable

December 19, 2022

Overview

- On Dec. 16, 2022, S&P Global Ratings upgraded the canton of Aargau to 'AAA/A-1+' from 'AA+/A-1+' and assigned a stable outlook, on the back of a prudent fiscal policy and large cash buffers.
- We consider Aargauische Kantonalbank (AKB) a government-related entity (GRE) with an extremely high likelihood of support from its majority owner and guarantor Aargau in times of stress.
- Consequently, we raised our long-term issuer credit rating on AKB to 'AA+' from 'AA' and affirmed our 'A-1+' short-term rating on the bank.
- The stable outlook mirrors that on the canton of Aargau.

PRIMARY CREDIT ANALYST

Sophie Nehrer
Frankfurt
+ 49 693 399 9242
sophie.nehrer
@spglobal.com

SECONDARY CONTACT

Harm Semder
Frankfurt
+ 49 693 399 9158
harm.semder
@spglobal.com

Rating Action

On Dec. 19, 2022, S&P Global Ratings raised its long-term issuer credit rating on Switzerland-based Aargauische Kantonalbank to 'AA+' (AKB). At the same time, we affirmed our 'A-1+' short-term issuer credit rating on the bank.

The outlook is stable.

Rationale

The upgrade follows our rating action on the canton of Aargau and reflects the canton's improved ability to support AKB in times of stress. We recently upgraded the Swiss canton of Aargau to 'AAA' (see "Swiss Canton of Aargau Upgraded to 'AAA' On Prudent Fiscal Policy And Large Cash Buffers; Outlook Stable," published Dec. 16, 2022, on RatingsDirect) based on our view that the canton's financial management will commit to a prudent fiscal policy and preserve structurally solid budgetary performance. The canton also benefits from an exceptional liquidity position and low debt burden. To reflect the canton's improved capacity to provide support to AKB, we increased the rating uplift for extraordinary support to three notches from two, leading to a

'AA+' long-term rating on the bank, although its stand-alone credit profile (SACP) is unchanged at 'a+'.

We consider AKB a GRE with an extremely high likelihood receiving support from its majority owner and guarantor Aargau in times of stress. In our view, AKB will maintain its integral link with and very important role for Aargau, which is largely facilitated by cantonal bank law. The law stipulates the cantonal ownership and guarantee, as well as the bank's objectives. We expect the canton will maintain the existing guarantee.

AKB's capitalization remains a rating strength and provides cushioning against tail risk. At the same time, we continue to assess the bank's SACP at 'a+', which is strong and very high in global comparison. AKB's risk-adjusted capital ratio stood at 20.7% as of Dec. 31, 2021, and we forecast that it will remain at that level over the next 24 months. The bank's focus on mortgage lending provides business stability but also increases vulnerability to real estate markets, in our view. That said, risks are mitigated by AKB's high-quality loan book as well as by our expectation that the Swiss housing market remains resilient, since a sharp house price correction would likely require a steep rise in unemployment. We positively view the AKB's resilient customer based and prudent lending policies. Despite increasing downside risks due to a challenging economic environment, we expect that AKB's performance will remain sound.

Outlook

The stable outlook on AKB mirrors the outlook on its owner and guarantor, the canton of Aargau. We expect that AKB will continue to benefit from being a GRE with an extremely high likelihood of receiving support from Aargau over the next two years, if needed. We believe that AKB will maintain its sound financial profile, underpinned by its very strong capitalization and sound earnings capacity over that period.

Downside scenario

We would consider revising our outlook on AKB to negative if we revised the outlook on Aargau to negative.

A downgrade could be triggered by a significant weakening of AKB's role for, or link with Aargau, for example, due to changes in the statutory guarantee. However, we consider this scenario unlikely and expect AKB's existing obligations would be grandfathered.

A deterioration of the SACP would not immediately affect the overall rating, because we expect that the owner's support would compensate for weaker stand-alone creditworthiness.

Upside scenario

A positive rating action is very remote. This could only be triggered if we revised upward AKB's SACP, which we view as extremely unlikely, given our already high assessment.

Ratings Score Snapshot

| | To | From |
|-----------------------------|-------------------------|-------------------------|
| Issuer Credit Rating | AA+/Stable/A-1+ | 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 | Adequate (0) | Adequate (0) |
| Funding and liquidity | Adequate and Strong (0) | Adequate and Strong (0) |
| Comparable ratings analysis | 0 | 0 |
| Support | 3 | 2 |
| ALAC support | 0 | 0 |
| GRE support | 3 | 2 |
| Group support | 0 | 0 |
| Sovereign support | 0 | 0 |
| Additional factors | 0 | 0 |

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

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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
- 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

- Swiss Canton of Aargau Upgraded to 'AAA' On Prudent Fiscal Policy And Large Cash Buffers; Outlook Stable, Dec. 16, 2022
- Aargauische Kantonalbank, Nov. 18, 2022
- Banking Industry Country Risk Assessment: Switzerland, May 30, 2022

Ratings List

Upgraded; Outlook Action; Ratings Affirmed

| | To | From |
|---------------------------------|-----------------|------------------|
| Aargauische Kantonalbank | | |
| Issuer Credit Rating | AA+/Stable/A-1+ | AA/Positive/A-1+ |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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; or Stockholm (46) 8-440-5914

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