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Graubuendner Kantonalbank

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Related Criteria

Graubuendner 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:
• Very strong capitalization, supported by stable earnings. • A strong retail franchise in the home market. • Close ties with the Swiss canton of Graubuenden, due to the canton's majority ownership of the bank and a statutory guarantee.	• Limited growth potential due to regional focus and lack of diversity. • Concentration risk, owing to focus on residential real estate lending and exposure to the volatile tourism sector in the home market, Graubuenden. • Low interest rates, which make it difficult to maintain high earnings capacity.

Outlook : Stable

S&P Global Ratings' stable outlook on Switzerland-based Graubuendner Kantonalbank (GKB) reflects its view that GKB benefits from being a government-related entity (GRE). We consider that there is an extremely high likelihood that Graubuenden would provide timely and sufficient extraordinary support to GKB in the event of financial distress. Moreover, the stable outlook reflects our view that GKB's capital and earnings sufficiently buffer potential domestic financial risks.

The likelihood of a downgrade is very low as long as the bank's stand-alone credit profile (SACP) is at or above 'bb+'. In the event of a small deterioration of the SACP, the ratings would be cushioned by potential extraordinary support from the canton. However, negative rating actions may be triggered by a change in GKB's role for or link with Graubuenden, or changes in the statutory guarantee, which may lead to a weaker assessment of GKB's status as a GRE. However, we currently consider this scenario unlikely and would expect GKB's existing obligations to be grandfathered.

We are unlikely to raise the ratings in the next 12-24 months. However, all else remaining equal, we could raise the ratings on GKB if revised upward our assessment of Graubuenden's creditworthiness.

Rationale

Our ratings on GKB reflect our 'a-' anchor for Swiss banks, GKB's adequate business position, very strong capital and earnings, adequate risk position, average funding, and strong liquidity. The SACP is at 'a+'.

We consider GKB to be a government-related entity (GRE) with an extremely high likelihood of receiving timely and sufficient extraordinary support from Graubuenden if needed. We base this opinion on GKB's very important role for, and integral link with, the local government, the canton of Graubuenden. This provides a two-notch uplift to our assessment of GKB's SACP, leading to the long-term rating of 'AA'. In our view, the Swiss bank resolution regime that came into effect on Jan. 1, 2016, does not impede cantonal owners' ability to provide extraordinary support to banks, like GKB, that we consider to be GREs.

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

Our criteria use our Banking Industry Country Risk Assessment's 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.

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 the past 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 debt. We recognize that house-price and lending growth has cooled since the beginning of 2014. However, in our view, house prices and household debt remain historically high, in particular when considering the low rate of home ownership in Switzerland. The very high mortgage debt is mitigated by the large amount of financial assets, including pensions, held by Swiss households.

Our industry risk score of '2' primarily reflects the banking sector's stability and a high share of deposit funding. Banks' net interest margins continue to decline, 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

Graubuendner Kantonalbank Key Figures					
		--Year-ended Dec. 31--			
(Mil. CHF)	**2016***	**2015**	**2014**	**2013**	**2012**
Adjusted assets	23,653.9	23,284.0	20,591.0	20,000.7	19,363.6
Customer loans (gross)	17,652.4	17,706.5	16,365.2	15,840.4	15,296.2
Adjusted common equity	2,373.7	2,300.6	2,204.0	2,116.3	2,033.7
Operating revenues	175.5	370.5	382.4	386.7	393.0
Noninterest expenses	84.9	186.8	186.8	183.4	188.0
Core earnings	90.9	176.2	185.4	190.6	193.8

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

Business position: A strong regional franchise, complemented by private banking activities

We consider GKB's business position to be adequate compared with that of domestically focused Swiss banks because we expect that GKB's extraordinary business stability will continue, partly offsetting its highly concentrated business model by region and product.

GKB is a midsize cantonal bank with total assets of Swiss franc (CHF) 23.7 billion (about €22.0 billion) as of June 30, 2016. It is the leading commercial bank in its home canton, enjoying continued high and stable market shares in retail and corporate banking (50% of business customers and 45% of private customers). The customer base has proven to be very stable, and we expect it will continue to provide GKB a sustainable source of revenues for the next two years. Operating revenues at midyear 2016 were derived from net interest income (about 68%), fee income (25%), and market-sensitive income (5%). We expect the distribution to stay about the same over the next two years. Consequently, we expect the bank's stability in the future will be superior to that of larger domestic and international peers in countries with similar industry risk as Switzerland.

Like most other Swiss cantonal banks, GKB operates almost solely in its home region, Graubuenden, with a focus on residential mortgage lending and lending to small and midsize companies, a business model we do not think the bank will change any time soon. GKB engages selectively in corporate syndicated lending across Switzerland as a partner to larger cantonal or commercial banks, mainly to highly rated large Swiss corporate entities. However, in our opinion, this selected expansion does not provide any meaningful diversification in terms of risk and earnings.

The lending activities are complemented by the private banking operations with total assets under management estimated at CHF13 billion, which focus mainly on domestic clients and some cross-border business with German and Italian clients, owing to the geographic proximity. For its growth strategy, GKB has reorganized these activities in its subsidiaries Privatbank Bellerive AG (not rated; 55% participation) and Albin Kistler AG (25% participation, acquired in July 2016), after selling its 50% participation in Private Client Bank AG on Jan. 1, 2016, retroactively. We believe that this niche activity will benefit from a more efficient growth strategy fueled by domestic clients and stable earnings of about 15%-20%. We also think that the private banking operations will provide some diversification, but not lead us to revise our business position assessment upward.

In our view, the bank's management continues to demonstrate a strong track record, underpinned by prudent underwriting standards and conservative risk management. We expect this will provide ongoing stability to GKB's sound financial position.

Table 2

Graubuendner Kantonalbank Business Position					
		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Total revenues from business line (mil. CHF)	183.9	387.7	383.5	388.6	394.9
Return on equity	7.5	7.1	7.1	7.3	7.4

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

Capital and earnings: One of the highest risk-adjusted capital ratios worldwide, supported by strong earnings capacity

We view GKB's very strong capital and earnings position, in a domestic and global context, as a key rating strength. Our view is based primarily on our projection that the risk-adjusted capital ratio (RAC) for GKB will gradually increase to 25%-26% in the next 12-18 months, from 24.5% at year-end 2015. We continue to believe that GKB's capitalization will remain at the upper end of our range for a very strong assessment and superior to that of other cantonal banks, and most other banks we rate globally.

In our view, GKB's earnings are predictable and stable, and we do not expect any changes to the bank's dividend policy of distributing 50%-60% to the home canton and other shareholders. The low-interest-rate environment continues to put pressure on GKB's net interest margin and operating revenues, and we estimate operating income after loss provisions at CHF175 million-CHF200 million, about in line with the previous four years. However, this will enable GKB to at least maintain its outstanding capital position. We estimate GKB's three-year average earnings buffer at 136 basis points (bps), which indicates superior capacity for its earnings to cover normalized losses.

We view GKB's capital as very high quality because it includes only core Tier 1 capital in the form of share capital, a capital surplus, and reserves. We anticipate that GKB's majority owner, the canton of Graubuenden, which holds 84.3% of its capital with 100% of the voting rights, will remain supportive of the current capital levels. We also believe that GKB will not experience pressure from major dividend distributions that could weaken its RAC ratio.

Table 3

Graubuendner Kantonalbank Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Tier 1 capital ratio	18.4	18.7	18.9	18.9	18.4
S&P RAC ratio before diversification	N.M.	24.5	24.0	25.7	25.3
S&P RAC ratio after diversification	N.M.	21.7	22.5	24.8	24.4
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	67.9	62.3	62.1	63.0	64.4
Fee income/operating revenues	25.4	28.6	29.6	29.2	27.8
Market-sensitive income/operating revenues	4.6	6.7	6.4	5.3	5.2
Noninterest expenses/operating revenues	48.4	50.4	48.8	47.4	47.8
Preprovision operating income/average assets	0.8	0.8	1.0	1.0	1.1
Core earnings/average managed assets	0.8	0.8	0.9	1.0	1.0

*Data as of June 30. N.M.--Not meaningful.

Table 4

Graubuendner Kantonalbank RACF [Risk-Adjusted Capital Framework] Data

(CHF 000s)	**Exposure***	**Basel II RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government and central banks	3,321,274	55,323	2	99,638	3
Institutions	2,480,824	1,063,173	43	275,897	11
Corporate	5,690,107	3,045,913	54	4,063,546	71
Retail	11,731,638	6,423,944	55	3,010,927	26
Of which mortgage	11,317,064	6,149,717	54	2,716,095	24
Securitization§	0	0	0	0	0
Other assets	510,088	504,725	99	439,094	86
Total credit risk	23,733,931	11,093,080	47	7,889,102	33
Market risk					
Equity in the banking book†	62,256	144,364	232	314,760	506
Trading book market risk	--	43,273	--	64,909	--
Total market risk	--	187,637	--	379,669	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	705,168	--	1,107,308	--
(CHF 000s)		Basel II RWA		S&P Global Ratings RWA	% of S&P Global Ratings RWA
Diversification adjustments					
RWA before diversification		12,212,947		9,376,079	100
Total Diversification/Concentration Adjustments		--		1,216,740	13

Table 4

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

(CHF 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
RWA after diversification		12,212,947		10,592,819	113
(CHF 000s)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)
Capital ratio					
Capital ratio before adjustments		2,282,943	18.7	2,300,584	24.5
Capital ratio after adjustments‡		2,282,943	18.7	2,300,584	21.7

*Exposure at default. §Securitisation Exposure includes the securitisation 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, 2015, S&P Global Ratings .

Risk Position: Exceptional loan loss experience despite regional concentration in Graubuenden

We consider GKB's risk position to be adequate, owing to its business model, which is focused mainly on low-risk collateralized residential mortgage lending, and lending to small and midsize companies based on prudential underwriting standards.

We still regard GKB's regional concentration in a canton that relies considerably on the cyclical tourism sector as a key risk to its lending activities. This is because it exposes the bank to fluctuations in the local economy. However, thanks to GKB's prudent management of risks and consistent very low risk appetite, we expect it will be able to demonstrate resilience against economic stress. We believe, however, that risk costs will gradually surpass the currently unsustainably low level of 3bps-6bps, as shown in the past four years.

Residential real estate loans, mainly from the home region, represented about 60% of GKB's loan book on June 30, 2016. High granularity and adequate collateralization on the loan portfolio mitigate the concentration risk; we estimate the average loan-to-value ratio at about 60% for mortgage loans. Moreover, we observe that the share of nonresidential mortgage loans, at about 15% of GKB's portfolio, is a bit higher than that of its cantonal bank peers. Although we consider that this elevates GKB's risk compared with that of peers, we believe that the financing is mainly to small and midsize corporate clients in the home canton, and our RAC framework adequately captures these exposures. We expect GKB's lending growth will stay at 3% in the coming two years, similar to that at midyear 2016 and in 2015, in line with the trend we have observed at some other cantonal banks.

Like its domestic peers, GKB is exposed to risks related to the steady increases in residential real estate prices in Switzerland. We continue to observe a moderately high rise in real estate prices in Graubuenden, especially in the winter-tourism resort areas. We view as positive, however, that the majority of the bank's mortgage loan book relates to borrowers in residential rather than tourist areas, and that the tourism sector represents less than 10% of the overall mortgage portfolio by object type.

Furthermore, we expect the bank will maintain its conservative underwriting practices in mortgage lending. According to our projections, we will see this in the high asset quality of the bank's credit portfolio, with projected nonperforming loans at about 0.3% of customer loans in the next two years, about in line with previous years. However, we expect this level to be unsustainable over the full economic cycle.

To diversify its loan book geographically and by sector, GKB participates in syndicated corporate loans across Switzerland. Although corporate lending increases the credit risk in GKB's loan book, mitigating factors are that borrowers are mainly large rated Swiss corporations, and GKB participates selectively and with small amounts. We don't believe that this activity, today representing less than 5% of GKB's loan book, will provide any significant diversification benefit nor, at its current magnitude, increase GKB's credit risk to an extent that would lead us to revise down our capital or risk assessments.

On Sept. 25, 2015, GKB announced its settlement in a non-prosecution agreement with the U.S. Department of Justice's investigation of Swiss banks' role in tax evasion against a one-time payment of $3.6 million. We also understand that GKB had prudently provisioned to meet fines relating to its acceptance of undeclared funds from U.S. clients in previous years. In line with our base case, the fine was offset by these provisions and GKB's annual earnings capacity in 2015 was not affected, partly because GKB's private banking activities have never focused on offshore business.

Table 5

Graubuendner Kantonalbank Risk Position					
		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Growth in customer loans	(0.6)	8.2	3.3	3.6	5.3
Total diversification adjustment / S&P RWA before diversification	N.M.	13.0	6.4	3.7	3.4
Total managed assets/adjusted common equity (x)	10.0	10.1	9.3	9.5	9.5
New loan loss provisions/average customer loans	(0.0)	0.0	0.0	0.1	0.1
Net charge-offs/average customer loans	N.M.	0.0	0.1	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	0.3	0.3	0.2	0.4	0.3
Loan loss reserves/gross nonperforming assets	N/A	389.1	847.3	351.3	462.0

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

Funding and liquidity: A favorable funding profile, owing to stable retail deposits

We assess GKB's funding as average and its liquidity position as strong because of its strong base of customer deposits. GKB holds a very granular and stable core deposit base, which accounted for 73% of its total funding on June 30, 2016. We also view favorably the bank's superior capital base. We don't consider GKB's deposits to be very confidence sensitive because of the bank's public-sector ownership, the statutory guarantee from the canton of Graubuenden, and GKB's sound brand. Moreover, the shareholder and guarantee structure gives GKB access to low-cost unsecured funding (15% of the funding base) and the ability to issue covered bonds (9%). In our view, GKB will continue to benefit from a so-called flight to quality, with customers steering away from riskier banks during difficult economic periods toward banks with a sound reputation. Therefore, we expect GKB's stable funding ratio to remain at a comfortable 105%-110% over 2016-2018, compared with 109% as of June 30, 2016.

Our assessment of GKB's strong liquidity reflects our estimate that the bank's one-year liquidity ratio (broad liquid assets to short-term funding) was 1.7x at year-end 2015. In our view, the bank should be able to withstand a market stress for more than 12 months, without access to capital market funding. GKB's liquid assets comfortably cover its short-term wholesale funding needs, minimizing the risk of a gap in its liquidity profile. GKB's solid customer base will likely help it weather potential capital market stress, in our opinion.

Table 6

Graubuendner Kantonalbank Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	**2016***	**2015**	**2014**	**2013**	**2012**
Core deposits/funding base	72.6	72.9	81.4	82.1	82.7
Customer loans (net)/customer deposits	115.7	116.9	111.6	110.8	109.8
Long term funding ratio	89.1	88.3	95.8	95.1	94.5
Stable funding ratio	108.6	108.5	107.3	106.8	105.8
Short-term wholesale funding/funding base	12.1	13.1	4.7	5.5	6.2
Broad liquid assets/short-term wholesale funding (x)	1.7	1.6	3.3	2.9	2.6
Net broad liquid assets/short-term customer deposits	11.9	11.9	13.7	13.5	12.5
Short-term wholesale funding/total wholesale funding	44.4	48.3	25.4	30.7	35.6
Narrow liquid assets/3-month wholesale funding (x)	2.1	1.8	4.1	5.3	4.7

*Data as of June 30.

External support: Two notches of uplift for likely support from Graubuenden

We regard GKB as a GRE and assess the likelihood that GKB's owner, the canton of Graubuenden, would provide timely and sufficient support to GKB as extremely high. We base our assessment on our view of the bank's:

- Integral link with the canton. We expect Graubuenden to provide considerable and timely credit support in all circumstances to GKB, due to the canton's majority ownership of GKB and possession of 100% of the voting rights, as well as its provision of a statutory guarantee for GKB; and
- Very important role in the canton, owing to the large impact of GKB's activities on the local economy.

Because of these factors, we incorporate a two-notch uplift into the long-term rating on GKB. We do not envisage that the bank's GRE status or our view of an extremely high likelihood of extraordinary government support will change in the foreseeable future.

GKB benefits from Graubuenden's statutory guarantee, which ultimately covers all of its liabilities, excluding those of its subsidiary Privatbank Bellerive, subordinated liabilities, and nonvoting participation certificates (Partizipationskapital). We note, however, that the guarantee does not ensure timely repayment, as defined by our criteria, but we believe that the canton has strong incentives to help GKB meet its obligations on time, due to the bank's importance to the regional economy.

Additional rating factors: None

No additional factors affect the ratings.

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015

- #General Criteria: Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 09, 2011
- Bank Capital Methodology And Assumptions, Dec. 06, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

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 15, 2016)

Graubuendner Kantonalbank	
Counterparty Credit Rating	AA/Stable/A-1+
Counterparty Credit Ratings History	
01-Dec-2014	AA/Stable/A-1+
03-Jul-2012	AA+/Negative/A-1+
17-Dec-2010	AA+/Stable/A-1+
Sovereign Rating	
Swiss Confederation	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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