S&P Global Ratings

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Glarner Kantonalbank

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Glarner Kantonalbank

SACP: a-		
Anchor	a-	
Business position	Moderate	-1
Capital and earnings	Very strong	+2
Risk position	Adequate	0
Funding	Moderate	-1
Liquidity	Adequate	
CRA adjustment		0

Support: +4	
ALAC support	0
GRE support	+4
Group support	0
Sovereign support	0

Additional factors: -1
Issuer credit rating
AA-/Negative/A-1+

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

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

Overview

Key strengths	Key risks
Sound retail banking franchise in the small canton and a loan book dominated by well-collateralized residential mortgages.	Uncertainties as a result of proposed changes to the cantonal bank law.
Very strong and sustainably high capitalization.	Weaker cost efficiency than most rated cantonal peers and concentration risk from focus on residential mortgage lending in Glarus and the neighboring economic area.
Extremely high likelihood of receiving extraordinary government support from the Canton of Glarus, if needed.	

We consider GLKB has a franchise weaker than those of peers in Switzerland and European markets with a similar industry risk profile, such as Germany, Austria, and France. This stems from its focus on expanding its loan book outside its home canton. In our view, this results in a more price-sensitive and less stable customer base. That said, the bank has demonstrated resilience during the pandemic and has felt no significant financial impact.

Our ratings on GLKB include uplift for potential extraordinary government support on top of its 'a-' SACP, resulting in the 'AA-' long-term issuer credit rating. While we still expect GLKB to receive timely and sufficient extraordinary support from Glarus if needed, the local government's intentions to change the cantonal bank law will gradually weaken GLKB's ties to its owner, in our view.

GLKB's SACP also currently incorporates significant ongoing implicit support benefits--for example lower funding costs and a sticky deposit base--which support the bank's overall profitability and stability. Following more clarity on how quickly the likelihood of government support could deteriorate, we would also reassess the implicit ongoing benefits that we currently incorporate into the SACP.

Outlook

The negative outlook reflects S&P Global Ratings' view that we could lower the rating on GLKB over the next 12-24 months, during which time we expect more clarity with respect to the local government's supportive stance toward the bank and planned change of the cantonal bank law. These factors will affect our assessment of the likelihood of extraordinary and ongoing local government support, which we incorporate into the rating.

Downside scenario

We could lower the rating if we concluded that the canton's ties to the bank had deteriorated in light of the ongoing discussion and if the measures under the current proposal became effective after a final vote by the people of Glarus. This would likely lead us to reduce the number of notches we factor in for government-related entity (GRE) uplift and the bank's stand-alone credit profile (SACP) and subsequently lead to a multiple-notch downgrade.

Upside scenario

We could revise the outlook to stable if the planned change to the existing cantonal bank law does not materialize and the legislative process indicates that the bank's link to and role for the canton are not going to weaken over the next two years. Improvements in GLKB's SACP, which we consider very remote, would not translate into an upgrade.

Key Metrics

Glarner Kantonalbank Key Ratios And Forecasts

	--Fiscal year ended Dec. 31 --				
(%)	**2019a**	**2020a**	**2021f**	**2022f**	**2023f**
Growth in operating revenue	6.9	3.7	2.2-2.7	8.5-10.3	4.2-5.1
Growth in customer loans	7.3	4.8	3.6-4.4	2.7-3.3	2.7-3.3
Growth in total assets	7.1	10.1	9.6-11.7	1.9-2.4	2.0-2.4
Net interest income/average earning assets (NIM)	1.1	1.2	1.1-1.2	1.1-1.2	1.1-1.2
Cost to income ratio	62.6	60.6	59.4-62.5	55.9-58.8	55.0-57.9
Return on average common equity	7.5	7.4	6.9-7.6	7.4-8.2	7.5-8.3
Return on assets	0.4	0.4	0.3-0.4	0.4-0.4	0.4-0.5
New loan loss provisions/average customer loans	0.1	0.1	0.1-0.1	0.1-0.1	0.1-0.1
Gross nonperforming assets/customer loans	0.2	0.3	0.3-0.3	0.3-0.3	0.2-0.3
Risk-adjusted capital ratio	22.8	22.6	23.6-24.9	22.9-24.1	23.3-24.5

All figures are S&P Global Ratings-adjusted. a--Actual. e--Estimate. f--Forecast. NIM--Net interest margin.

Anchor: 'a-' For Banks Operating Only In Switzerland.

Our criteria use our Banking Industry Country Risk Assessment economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an ICR. Our anchor for a bank operating mainly in Switzerland is 'a-'. We consider the trend for economic and industry risk in Switzerland as stable.

We think that the Swiss economy has almost fully recovered from the effects of the pandemic. We view positively the country's very high household income levels, proven stress-resilient corporate sector, and prudent loan underwriting standards and high collateralization of residential mortgage loans in the banking sector--which dominate most banks' customer portfolios. Considering these factors, we forecast only limited credit losses over the coming years, at slightly above historical lows observed pre-pandemic. We also expect that price growth in the owner-occupier real estate segment will remain at moderate levels. However, in our view, the investment property segment remains a particular risk after showing signs of a price correction before the pandemic.

Our view of industry risk in Switzerland encompasses the stability of the domestic banking sector and our expectation that damage from the pandemic will remain negligible. We view positively banks' high capitalization levels in an international comparison, and their low reliance on capital markets for funding. In our view, the Swiss Financial Market Supervisory Authority (FINMA) remains ahead of its peers in terms of both regulatory oversight and innovations. We think FINMA's thorough investigations of large-scale international money-laundering cases have improved market discipline. Notably, in our view, compliance with the highest anti-money-laundering standards is crucial for banking sector stability, reflecting the importance of the wealth management industry. We consider Swiss banks to currently face limited risks from technology disruption given the small size of the market, with high barriers to entry and technologically well-equipped banks.

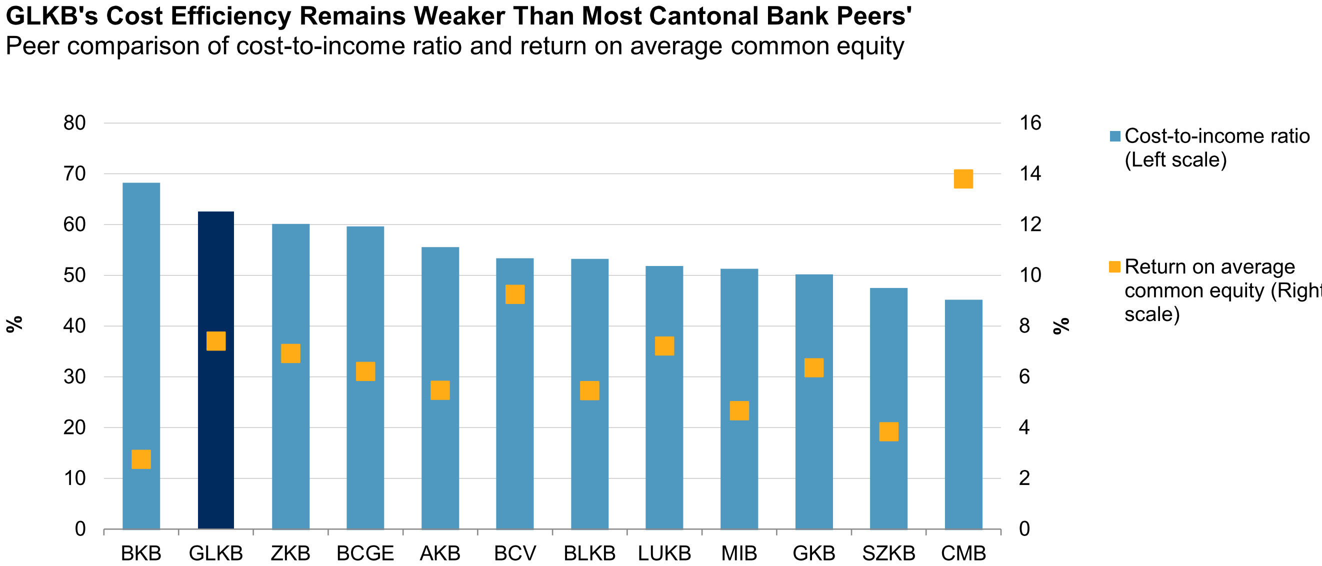
Business Position: Growth Strategy Outside Home Canton Weakens Business Stability

We consider GLKB's banking franchise to be weaker than that of most rated cantonal banks. This is because it materially relies on a less stable and more-price-sensitive customer base outside Glarus.

GLKB is a small Swiss cantonal bank and the leading bank for retail and corporate clients in its home canton with a population of roughly 40,000 people. It focuses on residential mortgage lending near Glarus and online mortgages in German-speaking Switzerland through its online platform, hypomat. Small-scale corporate banking and asset management activities round out GLKB's franchise. The bank generates additional income by offering administration services for mortgage loans to third parties and selling hypomat licenses. Both initiatives support our view that GLKB is proactively executing strategic measures to cope with the trends in retail banking toward full digitalization and, in particular, platforms.

GLKB has demonstrated sound profitability with increasing revenues in the last decade, backed by its growth strategy, which we expect to continue. That said, the bank's cost-efficiency is weaker than for most of its main cantonal peers, which are typically at 50%-60%.

Chart 1



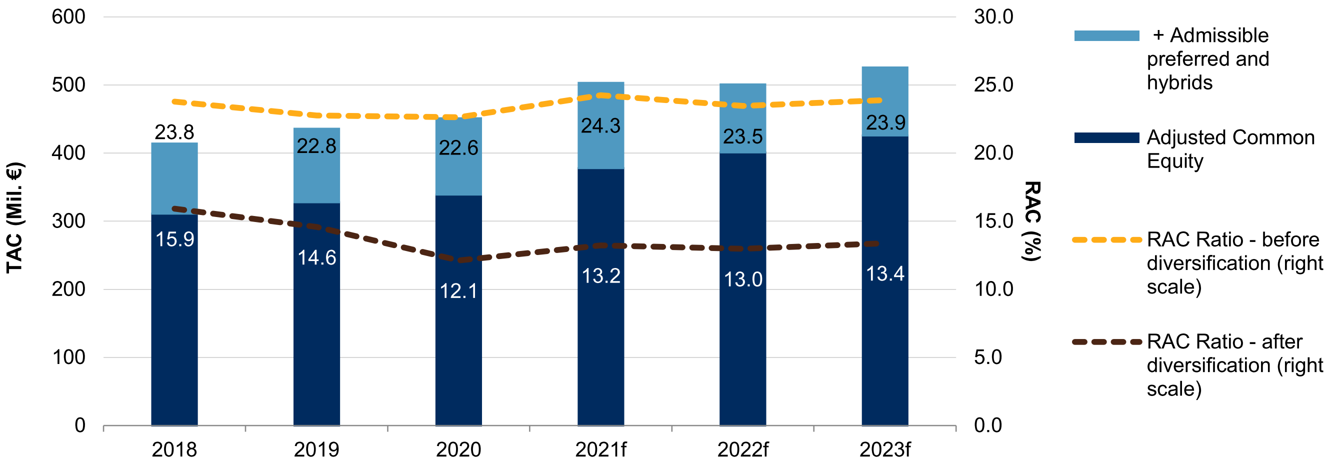
Cost-to-income ratio is defined as noninterest expense as % of operating revenues. Data relates to FY-2020. AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. CMB - CEMBRA Money Bank. GLKB--Glarner Kantonalbank. GKB--Graubuendner Kantonalbank. MIB--Migros Bank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zuercher Kantonalbank. Source: S&P Global Ratings.

Capital And Earnings: Solid Capitalization Remains A Key Rating Strength

GLKB's capital is its main rating strength, highlighted by our expectation that its RAC ratio will remain 23.0%-24.0% over the next 18-24 months, compared with 22.6% as of Dec. 31, 2020.

Chart 2

GLKB's Risk-Adjusted Capital Ratio Expected To Remain Between 23.0%-24.0% In The Next 12-24 Months
GLKB's risk adjusted capital developments



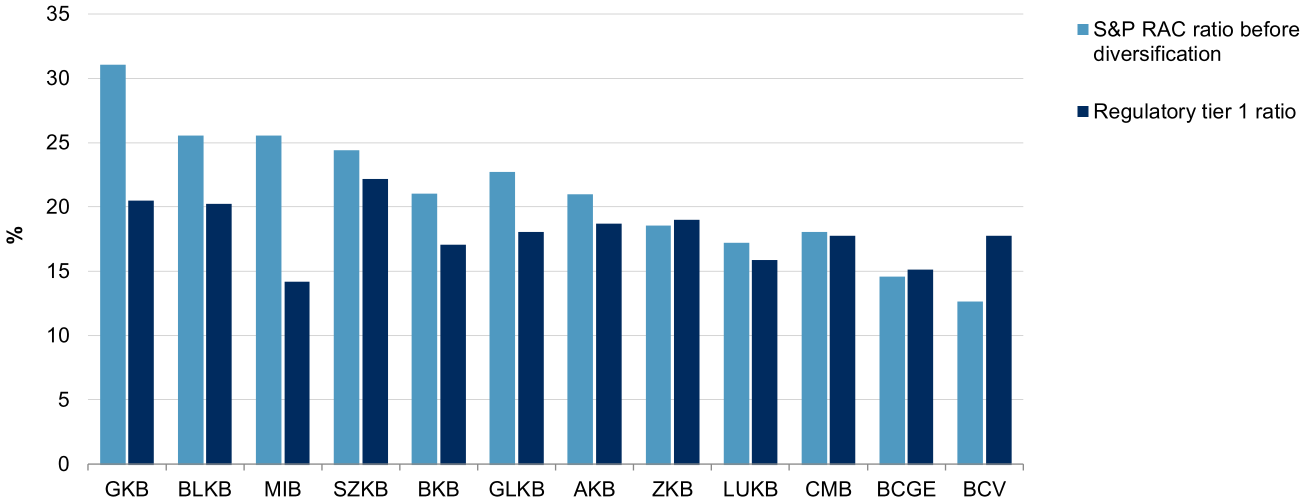
TAC--Total adjusted capital. RAC--Risk-adjusted capital. f--Forecast

The ratio is stronger than many rated banks globally and in line with other cantonal banks in Switzerland. GLKB's regulatory Tier 1 ratio was, at 18.0% at Dec. 31, 2020, comparably lower than its RAC ratio because we apply lower risk weights than the Swiss regulator to Swiss retail loans.

Chart 3

GLKB's Capitalization Remains Very Strong Among Rated Cantonal Banks

Peer comparison of RAC and regulatory tier 1 ratio



Ratios as of Dec 2020. RAC--Risk-adjusted capital. AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. CMB--CEMBRA Money Bank. GLKB--Glarner Kantonalbank. GKB--Graubuendner Kantonalbank. MIB--Migros Bank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zuercher Kantonalbank. Source: S&P Global Ratings.

The bank has outstanding CHF100 million additional tier 1 (AT1) instruments that we classify as a component of our total adjusted capital (TAC), S&P Global Ratings' core capital metric. The proportion of these hybrid instruments in TAC is higher for GLKB (20%) than most cantonal peers, and we therefore assess the bank's capital quality as slightly weaker than peers'.

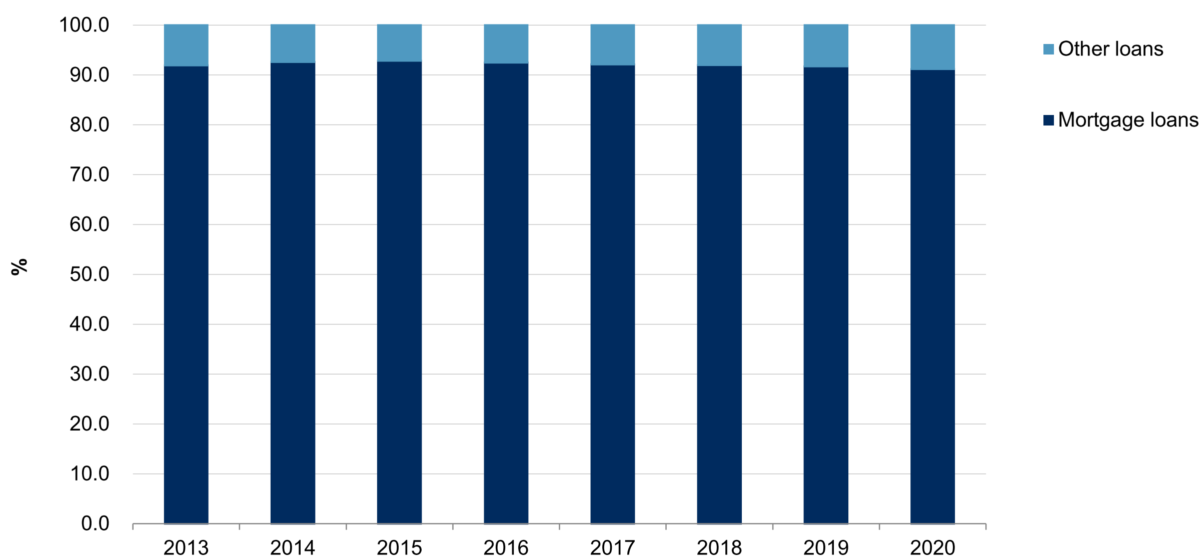
In our base-case scenario, we forecast net income after taxes will be CHF25 million-CHF30 million until 2023 and expect GLKB will maintain its dividend payout ratio at 50%-60%. The bank is publicly traded with about 31.7% of shares sold to external investors. The canton of Glarus aims to reduce its current majority ownership toward 33% over the next two-to-four years, if planned changes to the cantonal bank law becomes effective. In our view, this could increase the payout ratio as new investors will scrutinize GLKB's high capital ratios.

Risk Position: Concentration In Residential Mortgage Lending Buffered By Sound Collateralization

GLKB's business model focuses on well-collateralized lending categories, such as mortgages, small and midsize enterprises, and consumer financing. The bank's risk profile is characterized by concentration risks in its mortgage loan portfolio, mitigated by sound overcollateralization levels. The solid collateralization somewhat offsets concentrations risks, in our view.

Chart 4

Concentration Risk Due To High But Well-Collateralized Mortgage Loan Book
GLKB's loan portfolio development



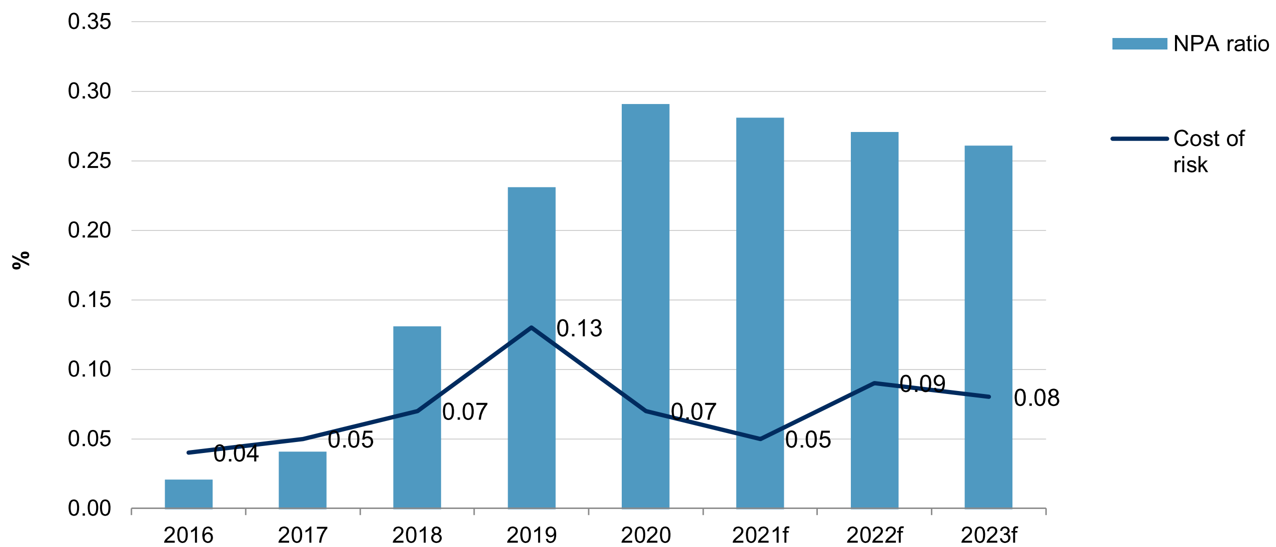
Source: Glarner Kantonalbank. S&P Global Ratings

Despite offering online mortgages nationwide, the bank's regional concentration in mortgage lending remains significant, especially when accounting for exposure to the nearby canton of Zurich and Glarus' direct neighbors. We believe it exposes GLKB to concentration risks, which are partially offset by high collateralization of the mortgage loan portfolio (average loan-to-value ratio of 51% as of June 30, 2021).

The bank avoids complex products, and we expect it to maintain its sound underwriting practices in new mortgage lending, helping it continue to report low levels of nonperforming loans (NPLs; 90 days past due) in its loan book (about 0.3% of the total at Dec. 31, 2020). This supports our estimate that the cost of risk will increase only slightly over the next two years and will stay close to 10 basis points.

Chart 5

GLKB's NPA And Cost Of Risk Remain Low
NPA ratio and cost of risk between 2016 and 2023f



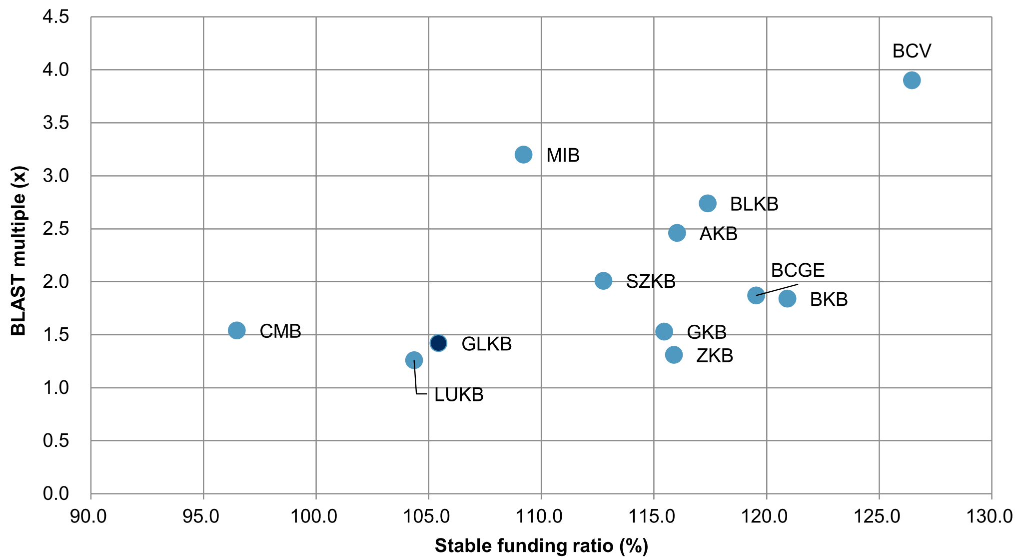
Source: S&P Global Ratings. Cost of risk defined as new loan loss provisions as % of average customer loans.
NPA ratio defined as gross nonperforming assets as % of customer loans + other real estate owned.
f--Forecast.

Funding And Liquidity: Below-Average Metrics, But Funding Stability Is Aided By Cantonal Ownership

We view GLKB's funding profile as weaker than those of most domestic peers, because the bank has a higher dependency on wholesale funding sources mainly through interbank and capital market funding. This is owing to a lack of sufficient customer deposits to fund ongoing strong balance sheet growth.

Chart 6

GLKB Among The Rated Cantonal Banks With The Weakest Funding Metrics
Peer comparison of funding and liquidity ratios



BLAST multiple is calculated as broad liquid assets divided by short-term wholesale funding. Ratios as of Dec. 2020. AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. CMB--CEMBRA Money Bank. GLKB--Glarner Kantonalbank. GKB--Graubuendner Kantonalbank. MIB--Migros Bank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zuercher Kantonalbank. Source: S&P Global Ratings.

GLKB's core customer deposits accounted for 60% of its funding base as of June 30, 2021. However, due to the cantonal guarantee, we expect this to remain very stable for the time being. We do not think that a potential removal of the guarantee will materially change the funding composition. We expect the bank's stable funding ratio will remain close to 100% over the next years.

GLKB benefits from its close ties with, and being guaranteed by, Glarus. We expect the bank's access to liquidity to potentially benefit from a "flight to quality" effect in more challenging economic conditions. The bank's loyal customer deposit base supports its liquidity, and we would not expect large-scale withdrawals in times of stress.

We expect the bank to maintain an adequate coverage of short-term wholesale funding sources of total funding by liquid assets (BLAST ratio; 1.0-1.5x). However, most peer cantonal banks demonstrate materially stronger metrics and GLKB's weaker liquidity ratio mirrors the bank's relatively lower cash reserves held at central banks and, in our view, a smaller and less liquid security portfolio than some peers.

Support: Likelihood Of Extraordinary Local Government Support Will Likely Reduce Over Time

We consider GLKB a government-related entity (GRE). The 'AA-' long-term rating on the bank reflects our view that there is an extremely high likelihood of timely and sufficient extraordinary support from Glarus, if needed. We base this on our view of the bank's still integral link with and very important role for the canton. That said, we expect a gradual weakening of GLKB's role and link to the majority owner over time as a result of the local government's intentions and the proposed changes to the cantonal bank law.

We think that the ongoing discussion and the planned measures to reduce the government's ownership toward 33% and to remove the cantonal guarantee are significant factors, indicating that the government's propensity for timely and sufficiently support GLKB in a stressed scenario is weakening over time. We will monitor the developments until the citizens of Glarus cast their final vote. We could lower or even remove our assessment of the bank's status as a GRE. This would result in our lowering the rating, potentially by multiple notches.

That said, the bank remains one of the most important financial institutions in Glarus with its market share of roughly 50% in mortgage loans and 40% in retail deposits. We do not believe that the link with and role for the local government will change abruptly, but rather will likely gradually deteriorate over time, with the pace depending on the outcome of the people's vote.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have an overall neutral influence on our credit rating analysis of GLKB. The cantonal bank's franchise and mandate are focused on providing basic services to the canton's population and supporting economic development in the region. That said, the bank has expanded its mortgage business to regions outside its home canton in recent years. As part of its ESG strategy, GLKB excludes certain corporate sectors from its business undertakings and commits to sustainability goals. However, these environmental and social factors are only marginally supportive of our credit rating analysis.

Key Statistics

Table 1

Glarner Kantonalbank--Key Figures

	--Year-ended Dec. 31--				
(Mil. CHF)	**2021***	**2020**	**2019**	**2018**	**2017**
Adjusted assets	7,718.7	7,044.4	6,400.8	5,978.7	5,637.5
Customer loans (gross)	5,725.2	5,566.7	5,310.8	4,950.5	4,798.3
Adjusted common equity	346.7	338.9	328.1	311.0	301.0
Operating revenues	67.2	87.4	84.3	78.8	73.8
Noninterest expenses	44.1	53.0	52.8	50.2	48.2
Core earnings	17.8	25.9	20.9	21.3	19.4

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

Table 2

Glarner Kantonalbank--Business Position

	--Year-ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Loan market share in country of domicile	N/A	0.4	0.4	0.4	0.4
Deposit market share in country of domicile	N/A	0.4	0.3	0.3	0.3
Total revenues from business line (currency in millions)	67.2	87.4	89.4	79.5	74.5
Other revenues/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on average common equity	6.6	7.4	7.5	6.9	6.5

*Data as of Sept. 30. N/A--Not applicable.

Table 3

Glarner Kantonalbank--Capital And Earnings

	--Year-ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Tier 1 capital ratio	N/A	18.0	18.5	17.9	17.0
S&P Global Ratings' RAC ratio before diversification	N/A	22.6	22.8	23.8	23.0
S&P Global Ratings' RAC ratio after diversification	N/A	12.1	14.6	15.9	16.7
Adjusted common equity/total adjusted capital	75.2	75.2	75.2	75.2	75.2
Net interest income/operating revenues	78.3	77.1	73.1	76.0	75.2
Fee income/operating revenues	16.0	14.9	14.7	13.7	13.7
Market-sensitive income/operating revenues	4.8	6.2	8.7	8.8	9.5
Cost to income ratio	65.6	60.6	62.6	63.6	65.3
Preprovision operating income/average assets	0.4	0.5	0.5	0.5	0.5
Core earnings/average managed assets	0.3	0.4	0.3	0.4	0.4

*Data as of Sept. 30. N/A--Not applicable. RAC--Risk-adjusted capital.

Table 4

Glarner Kantonalbank RACF [Risk-Adjusted Capital Framework] Data

(CHF 000s)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global RWA**	**Average S&P Global RW (%)**
Credit risk					
Government & central banks	1,054,851	0	0	0	0

Table 4

Glarner Kantonalbank RACF [Risk-Adjusted Capital Framework] Data (cont.)					
Of which regional governments and local authorities	0	0	0	0	0
Institutions and CCPs	238,160	81,899	34	53,062	22
Corporate	275,351	154,982	56	181,601	66
Retail	5,428,395	2,525,091	47	1,508,410	28
Of which mortgage	4,844,786	2,039,808	42	1,123,506	23
Securitization§	0	0	0	0	0
Other assets†	0	0	0	0	0
Total credit risk	6,996,757	2,761,972	39	1,743,073	25
Credit valuation adjustment					
Total credit valuation adjustment	--	27,340	--	0	--
Market Risk					
Equity in the banking book	9,776	61,100	625	73,320	750
Trading book market risk	--	2,614	--	3,921	--
Total market risk	--	63,714	--	77,241	--
Operational risk					
Total operational risk	--	147,334	--	171,648	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification	--	3,000,361	--	1,991,962	100
Total Diversification/ Concentration Adjustments	--	--	--	1,725,179	87
RWA after diversification	--	3,000,361	--	3,717,141	187
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		543,250	18.1	450,688	22.6
Capital ratio after adjustments‡		543,250	18.0	450,688	12.1

*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 2020', S&P Global Ratings.

Table 5

Glarner Kantonalbank--Risk Position					
	--Year-ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Growth in customer loans	3.8	4.8	7.3	3.2	4.2
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	86.6	56.2	49.3	37.5
Total managed assets/adjusted common equity (x)	22.3	20.8	19.5	19.2	18.7
New loan loss provisions/average customer loans	0.1	0.1	0.1	0.1	0.0
Gross nonperforming assets/customer loans + other real estate owned	N/A	0.3	0.2	0.1	0.0

Table 5

Glarner Kantonalbank--Risk Position (cont.)					
	--Year-ended Dec. 31--				
(%)	2021*	2020	2019	2018	2017
Loan loss reserves/gross nonperforming assets	N/A	201.7	260.2	485.3	1,693.4

*Data as of Sept. 30. N/A--Not applicable. RWA--Risk-weighted assets.

Table 6

Glarner Kantonalbank--Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2021*	2020	2019	2018	2017
Core deposits/funding base	64.6	65.3	63.1	66.5	66.2
Customer loans (net)/customer deposits	124.8	131.7	144.3	136.8	141.3
Long-term funding ratio	89.0	87.5	86.1	89.2	86.0
Stable funding ratio	110.8	104.7	98.6	102.0	96.3
Short-term wholesale funding/funding base	11.8	13.5	15.2	11.8	15.4
Broad liquid assets/short-term wholesale funding (x)	1.9	1.4	1.0	1.3	0.8
Broad liquid assets/total assets	20.2	17.0	13.5	13.5	11.5
Broad liquid assets/customer deposits	34.0	28.6	23.6	22.5	19.2
Net broad liquid assets/short-term customer deposits	16.5	8.3	(0.6)	5.1	(4.3)
Short-term wholesale funding/total wholesale funding	31.0	35.8	37.7	31.8	41.4
Narrow liquid assets/3-month wholesale funding (x)	3.2	2.4	2.7	4.8	1.6

*Data as of Sept. 30.

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
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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 and Liechtenstein Bank Ratings Affirmed Under Revised FI Criteria, Feb. 8, 2022
- Banking Industry Country Risk Assessment: Switzerland, Jan. 06, 2021

Ratings Detail (As Of February 17, 2022)*	
Glarner Kantonalbank	
Issuer Credit Rating	AA-/Negative/A-1+
Subordinated	BBB
Issuer Credit Ratings History	
11-Dec-2020	AA-/Negative/A-1+
09-Mar-2017	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.