

Research Update:

# Swiss Glarner Kantonalbank Downgraded To 'AA-' On Expected Weakening Of Local Government Support; Outlook Negative

December 11, 2020

## Overview

- The Swiss canton of Glarus aims to amend the existing cantonal bank law in order to reduce its current 68% ownership in Glarner Kantonalbank (GLKB) and remove the cantonal guarantee for eligible debt obligations by December 2024.
- We think the measures indicate a gradual weakening of the likelihood of timely and sufficient extraordinary government support to the bank from Glarus.
- We are therefore lowering the long-term issuer credit rating on GLKB to 'AA-' from 'AA', and affirming our 'A-1+' short-term rating.
- The negative outlook indicates that we might lower our assessment of extraordinary and ongoing government support once there is more clarity on the canton's stance toward the bank and the decision on amendment is final, which we expect within the next 12-24 months following the people's vote.

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## Rating Action

On Dec. 11, 2020, S&P Global Ratings lowered its long-term issuer credit rating on Glarner Kantonalbank (GLKB) to 'AA-' from 'AA' and affirmed the 'A-1+' short-term rating. The outlook is negative.

## Rationale

The downgrade follows our review of GLKB's creditworthiness in light of the potential amendments to the cantonal bank law to be discussed in the cantonal parliament and presented to Glarus' citizens for a direct vote, at the earliest in May 2021. We expect a gradual weakening of GLKB's role and link to the majority owner, the Canton of Glarus, and a gradual decline in the likelihood of extraordinary government support to the bank over time as a result of the local

government's intentions and the proposed changes to the legislation.

On June 9, 2020, Glarus' government started a public consultation on an amendment of the existing cantonal bank law that lasted until mid-August 2020. The final proposal has been submitted to the regional parliament for two rounds of discussion, in January and February 2021. If brought forward, the final decision remains with the people of Glarus through direct vote, which we understand will take place in May 2021 at the earliest. We understand that a vote to change the law would lead to swift implementation by July 2022.

Under the current proposal, important elements of the existing law will be amended:

- GLKB's legal entity would change from a public limited company under special law into a public company under private law by April 2022 in order to allow subsequent changes under existing Swiss law;
- The canton's existing 68% equity stake and voting rights would gradually reduce toward a minimum of 33% after July 2022;
- The cantonal guarantee for new debt obligations of GLKB would be removed after December 2024. We understand the bank's existing obligations would be grandfathered until maturity.

We think that the ongoing discussion and the planned measures to reduce the government's ownership and to remove the cantonal guarantee are significant factors, indicating that the government's propensity to 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 government-related entity (GRE), depending on the people's vote. This would result in our lowering the rating, potentially by multiple notches, as reflected in our negative rating outlook.

That said, the bank is 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 understand that the government aims to remain an important shareholder in the future with its targeted 33% equity and voting stake to steer important strategic decisions of the bank. As a result, 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. We currently assess the likelihood that the Canton of Glarus would provide timely and sufficient support to the bank as extremely high, based on the bank's integral link with and very important role for the canton.

Our ratings on GLKB include multiple notches of uplift for potential extraordinary government support on top of its 'a-' stand-alone credit profile (SACP), resulting in the 'AA-' long-term issuer credit rating. In our view, a weakening of GLKB's ties with the government would also likely lead to a weaker banking franchise and profitability. Our assessment of GLKB's SACP currently incorporates significant ongoing implicit support benefits, e.g., through lower funding costs and a sticky deposit base, which support the overall profitability and stability of the bank's performance. Following more clarity on the pace of the deterioration of the likelihood of the government support, we would also reassess the implicit ongoing benefits that we currently incorporate in the SACP.

## **Outlook**

The negative outlook reflects that we could lower our 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, which will affect our assessment of the likelihood of extraordinary and ongoing local government support that we incorporate in 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 would become effective after a final vote by the people of Glarus. This would likely lead us to revise down the number of notches we factor in for GRE uplift and the SACP of the bank 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 weakening over the next two years.

Improvements in GLKB's stand-alone credit profile, which we consider very remote, would not translate into an upgrade.

## Ratings Score Snapshot

### Glarner Kantonalbank

	To	From
Issuer Credit Rating	AA-/Negative/A-1+	AA/Stable/A-1+
SACP	a-	a-
Anchor	a-	a-
Business Position	Moderate (-1)	Moderate (-1)
Capital and Earnings	Very Strong (+2)	Very Strong (+2)
Risk Position	Adequate (0)	Adequate (0)
Funding	Below Average	Below Average
and Liquidity	Adequate (-1)	Adequate (-1)
Support	(+4)	(+4)
ALAC Support	(0)	(0)
GRE Support	(+4)	(+4)
Group Support	(0)	(0)
GRE Support	(0)	(0)
Additional Factors	(-1)	(0)

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

## Related Criteria

- 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
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Research Update: Switzerland 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Aug. 21, 2020
- COVID-19: Swiss Banking Sector To Remain Resilient, Jun. 17, 2020
- Potential Revision To Glarus' Cantonal Bank Law Could Lead To Downgrade Of Swiss-Based Glarner Kantonalbank, Jun. 12, 2020
- Tech Disruption In Retail Banking: Swiss Banks Are In No Rush To Become Digital Frontrunners, Feb. 13, 2020
- Banking Industry Country Risk Assessment: Switzerland, Nov. 20, 2019
- Swiss Cantonal Banks: Ratings As High As The Alps, Jan. 31, 2019

## Ratings List

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](http://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](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](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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