

**Rating Action: Moody's affirms Berner Kantonalbank's Aa1 deposit and A1 senior unsecured debt ratings**

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Global Credit Research - 14 Mar 2018

**Outlook remains stable**

Frankfurt am Main, March 14, 2018 -- Moody's Investors Service has today affirmed Berner Kantonalbank AG's (BEKB) Aa1/P-1 deposit and A1 senior unsecured debt ratings. Moody's also affirmed the bank's a1 Baseline Credit Assessment (BCA), its a1 Adjusted BCA and its Aa3(cr)/P-1(cr) Counterparty Risk Assessments (CR Assessments). The outlook on the long-term ratings remains stable.

Please refer to the end of this press release for a list of all affected ratings.

**RATINGS RATIONALE**

**AFFIRMATION OF BASELINE CREDIT ASSESSMENT**

The affirmation of BEKB's a1 BCA and Adjusted BCA reflects the bank's strong and stable capitalisation, its low asset risk profile and conservative risk provisioning strategy, as expressed by a general practice of early recognition of impaired assets and extensive provisioning for these, and very sound liquidity metrics in the context of limited market funding reliance.

BEKB continues to benefit from strong and high-quality capital both in absolute terms and relative to its risk-weighted assets. With regulatory common equity tier 1 ratios consistently close to 20%, its core capital provides material buffers to regulatory requirements as reflected in its dividend policy that limits payouts in case those buffers fall below twice the regulatory requirement levels.

BEKB's loan portfolio is very granular, mainly exposed to residential real estate in the Canton of Berne area, and highly collateralized. While the bank's reported (and improved) NPL ratio remains higher than best-in-class peers, the rating agency views positively BEKB's early recognition of past due loans in combination with a high level of cash provisioning of close to 140% (including general risk provisions), the latter also limiting any negative pressure on the bank's future profits in an adverse economic scenario.

Moody's assessment also incorporates the relatively low profitability of BEKB -- albeit not unusual for a Swiss regional bank - and the strain on Swiss banks' earnings as a result of the persistently low interest rate environment, and its expectation of stable profitability going forward, despite the yield environment.

**AFFIRMATION OF DEPOSIT, SENIOR UNSECURED RATINGS AND COUNTERPARTY RISK ASSESSMENT**

The affirmation of BEKB's ratings and its CR Assessments reflects the affirmation of its BCA and unchanged results from Moody's Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of losses faced by different liability classes in resolution. For deposits, the analysis results in a very low loss-given-failure and two notches of rating uplift and takes into account a flexible resolution framework in Switzerland, which only excludes privileged deposits and covered bonds explicitly from bail-in, a cash-rich corporate sector and the bank's deposit structure. For BEKB's senior unsecured liabilities, the LGF analysis results in a high loss-given-failure and a positioning one notch below the BCA, prior to government support.

The ratings also reflect the assumption of a high probability of BEKB receiving (local) government support, which provides a one-notch rating uplift to the bank's ratings. The high probability of government support takes into account the majority ownership of the bank by the Canton of Berne and the bank's strong market position in the region.

**OUTLOOK**

The outlook on BEKB's Aa1 deposit rating and A1 senior unsecured rating is stable, reflecting Moody's expectation that BEKB's management sustains its cautious, risk-adverse strategy with material buffers to

regulatory requirements. The stable outlook is also based on a share of the Canton of Berne in the bank not lower than current and a largely stable funding structure, which results in unchanged rating uplift from Moody's LGF analysis.

#### WHAT COULD CHANGE THE RATING UP/DOWN

BEKB's ratings could be upgraded if (1) stronger credit fundamentals justify an upgrade of the BCA, and/or (2) the volume of senior unsecured debt or further subordinated instruments increases, which could lead to additional rating uplift (as assessed in Moody's Advanced LGF analysis), provided that Moody's government support assumptions remain unchanged. The government support assumptions take into account the Canton of Berne's longstanding majority ownership of the bank, although without an explicit statutory guarantee, as well as the canton's creditworthiness.

Upward pressure could be exerted on BEKB's BCA if the bank manages to materially and sustainably increase its profitability and significantly improves its liquid resources from current levels while sustaining the bank's conservative asset risk profile and its strong capitalisation.

BEKB's ratings could be downgraded if (1) the BCA would come under pressure, (2) the credit profile of the Canton of Berne deteriorates, or (3) the likelihood of the canton's stake (currently at 51.5%) falling below the 50.1% threshold were to increase. BEKB's deposit rating could be downgraded if the structure of the deposit composition changes to a higher share of privileged retail deposits, which could lead to a lower rating uplift as the share of deposits available for bail-in declines, as assessed in Moody's Advanced LGF analysis.

Downward pressure on BEKB's BCA could arise as a result of (1) a weakening of the bank's currently sound liquidity profile, either through lower liquid reserves relative to a growing balance sheet or relatively higher market funding reliability; (2) a deterioration in the Swiss Macro Profile; (3) a deterioration in the bank's asset quality, especially if this deterioration is because of a marked slowdown in the domestic real-estate market and impacts capitalization negatively; and/or (4) a prolonged weakening of the bank's recurring earnings.

#### LIST OF AFFECTED RATINGS

Issuer: Berner Kantonalbank AG

..Affirmations:

....Long-term Counterparty Risk Assessment, affirmed Aa3(cr)

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Long-term Bank Deposits, affirmed Aa1 Stable

....Short-term Bank Deposits, affirmed P-1

....Senior Unsecured, affirmed A1 Stable

....Adjusted Baseline Credit Assessment, affirmed a1

....Baseline Credit Assessment, affirmed a1

..Outlook Action:

....Outlook remains Stable

#### PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in September 2017. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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