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Zuercher Kantonalbank

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Zuercher Kantonalbank

SACP	aa-

\+

Support	+3

\+

Additional Factors	0

Anchor	a-	
Business Position	Strong	+1
Capital and Earnings	Very Strong	+2
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Strong	

ALAC Support	0
GRE Support	+3
Group Support	0
Sovereign Support	0

Issuer Credit Rating
AAA/Stable/A-1+

Major Rating Factors

Strengths:	Weaknesses:
• Close ties with the financially strong Canton of Zurich, facilitated by full ownership and a statutory guarantee. • A strong domestic franchise in the Zurich area, complemented by a sound countrywide presence in corporate lending, private banking, and asset management. • A sound financial profile characterized by superior capitalization and relatively stable earnings.	• Some concentration risk due to a focus on real estate lending in its home region. • Weaker cost efficiency than many cantonal bank peers.

Outlook: Stable

S&P Global Ratings' stable outlook on Zuercher Kantonalbank (ZKB) mirrors that on its owner and guarantor, the Canton of Zurich (AAA/Stable/--), reflecting our expectation that ZKB will continue to benefit from its status as a government-related entity (GRE) with an extremely high likelihood of receiving cantonal support over the next two years if needed. The stable outlook also reflects our view that Swiss domestic markets will remain resilient against risks stemming from the COVID-19 pandemic.

However, if the bank's stand-alone creditworthiness weakens significantly and unexpectedly as a result of higher-than-anticipated cyclical risk and capital depletion, as reflected by our risk-adjusted capital (RAC) ratio falling below 15%, we might consider a downgrade.

A downgrade could result from competitive pressure on ZKB's businesses position from a margin squeeze in asset management activities, as well as in its in core lending business due to the entrance of new digital players, particularly if the trend toward platform banking further accelerates. An improvement in ZKB's stand-alone credit profile (SACP) that would support its subordinated debt remains a remote scenario at this stage, given the our already very high assessment of its SACP.

Rationale

We expect ZKB will remain among the highest-rated banks globally because of its superior stand-alone creditworthiness, combined with an extremely high likelihood of material extraordinary government support in the case of need. We note ZKB's solid local franchise and Swiss business diversification, which mitigates some concentration risk due to its tilt toward real estate lending in its home region. We also consider ZKB's conservative risk profile and robust balance sheet, supported by a history of prudent risk management and cautious lending standards, and customer loyalty instilled by cantonal ownership and the guarantee.

However, we expect potential pressure on profitability in the long term due to the ultra-low-rate environment, and, like for most peers, worsening operating conditions nearer term due to the COVID-19 pandemic. We believe, however, that prudent risk governance combined with a relatively robust Swiss economy, with domestic real estate markets showing particular resilience, ZKB's annuity-like revenue characteristics, and diversification from recurring asset management income will continue to support ZKB's superior capitalization, which is a key credit strength. This is indicated by our projected RAC ratio of 17.5%-18.0% over the coming 24 months. We also consider the bank's highly collateralized mortgage portfolio, which partly offsets our concerns regarding regional concentrations. ZKB's funding and liquidity profile is characterized by its sound management of ample customer deposits and wholesale funding, which we expect will remain stable given customer confidence is reinforced by the cantonal guarantee.

We expect ZKB will continue to benefit from its strong ties to its full owner the Canton of Zurich, which provides a cantonal guarantee on unsubordinated obligations. At the same time, ZKB is deeply rooted in the local economy, with a retail market share of about 50%. We believe a default by ZKB would have a significant impact on the regional economy. We consider ZKB to be a GRE with an extremely high likelihood of receiving extraordinary government support in times of stress. This provides three notches uplift to ZKB's SACP to arrive at the 'AAA' issuer credit rating.

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

Our criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor stand-alone credit profile (SACP), the starting point in assigning an issuer credit rating (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 expect Switzerland's economy will contract materially in 2020 due to the COVID-19 pandemic, but will fully recover over the coming two years. Under this scenario, we think the Swiss banking sector will remain resilient, supported by the country's diversified and competitive economy, very high household income levels, and a proven stress-resilient corporate sector.

We think Swiss authorities' material support measures for domestic firms and households should cushion the pandemic's short-term effect on Swiss banks' loan books. Additionally, we view positively banks' prudent loan underwriting standards and high collateralization of the residential mortgage loans, which dominate most banks customer portfolios. Considering these factors, we expect only a limited increase in credit losses, from historical low levels. We also expect affordability risk in the housing market might slightly reduce over the coming years as price growth in the owner-occupied segment is likely to remain muted in the wake of the pandemic. However, we note that a particular, ongoing risk is the investment property segment (estimated 30% of the market), where we already observed signs of a price correction before the COVID-19 pandemic.

Our view of industry risk in Switzerland encompasses the stability of the domestic banking sector and our expectation that damage from the COVID-19 pandemic will remain contained. We view positively the limited presence of foreign players, the banks' high capitalization levels in an international comparison, and their low reliance on capital markets for funding. In our view, the Swiss regulator's initiatives remain more stringent than those in other European banking sectors. We expect that banks' net interest margins will further decline gradually in a permanent low interest-rate environment, as higher-yield assets mature and retail deposit rates remain floored at zero. However, we expect that repricing of lending products, additional fee income from investment advisory-related activities, and ongoing cost management can offset some of the pressure. We consider risk for Swiss banks from tech disruption as limited as of today, given the population's preference for cash payments, the small size of the market with high barriers of entry, and technologically well-equipped banks.

Table 1

Zuercher Kantonalbank--Key Figures

	--Year ended Dec. 31--				
(Mil. CHF)	**June-2020**	**2019**	**2018**	**2017**	**2016**
Adjusted assets	179,416.0	166,931.0	169,266.0	163,689.0	157,817.0
Customer loans (gross)	97,152.0	93,502.0	90,039.0	87,227.0	85,096.0
Adjusted common equity	12,208.0	11,701.0	11,343.0	10,665.0	10,266.0
Operating revenues	1,322.0	2,410.0	2,334.0	2,350.0	2,341.0
Noninterest expenses	778.0	1,445.0	1,434.0	1,438.0	1,515.0

Table 1

Zuercher Kantonalbank--Key Figures (cont.)

	--Year ended Dec. 31--				
(Mil. CHF)	**June-2020**	**2019**	**2018**	**2017**	**2016**
Core earnings	525.2	954.0	1,077.9	894.1	799.2

CHF--Swiss franc.

Business position: Solid operational stability owing to diverse business profile and strong franchise

We expect ZKB's business profile will remain a strength based on its diverse business activities and our expectation of relatively sustainable revenue generation against the backdrop of the currently difficult economic cycle. We believe that benefits steaming from diversification of revenue streams by business type, high financial wealth, and resilience of the local customer base offset the risks steaming from the bank's geographic concentration in the wider Zurich area.

We expect ZKB will defend its market position as the largest cantonal bank and fourth-largest bank in Switzerland (with total assets of Swiss franc [CHF] 179.5 billion [about €168.6 billion] on June 30, 2020) and an estimated market share of about 7%-10% in customer deposits and customer lending. While we consider concentration in the wider Zurich area a rating constrain, we view positively the bank's long-standing presence in its home region, one of Switzerland's economically strongest regions, with a leading market share of about 50% in retail banking. Compared with other Swiss cantonal bank peers, this concentration is offset by diversification of business activities conducted on a national scale, including corporate lending to small and midsize enterprises and large corporations, as well as private banking. Furthermore, ZKB provides services for other cantonal banks as an originator of syndicated loans and a participant in the market for traded structured investment products.

In 2015, ZKB took over Swisscanto, an asset management company previously collectively owned by the country's cantonal banks. Swisscanto complemented ZKB's product offering and strengthened its business profile and earnings capacity. The combined asset management activities created the country's third-largest investment fund manager. While we regard this takeover generally as a good strategic fit for ZKB, Swisscanto also brought certain challenges. We observe general margin pressure on active fund managers in a low-yield environment, as well as increasing competition and regulation around product suitability and pricing transparency, which also required an update of ZKB's pricing model and the introduction of new service schemes.

Compared with most commercial banks in Europe, ZKB has demonstrated sound profitability, particularly during the most recent financial crises. We expect its solid revenue to benefit from a strong annuity characteristic, with only about 15% coming from trading or market sensitive income. This is underpinned by the bank's stable and long-standing customer base, which we expect it to maintain, supported by its public ownership and the guarantee from the canton.

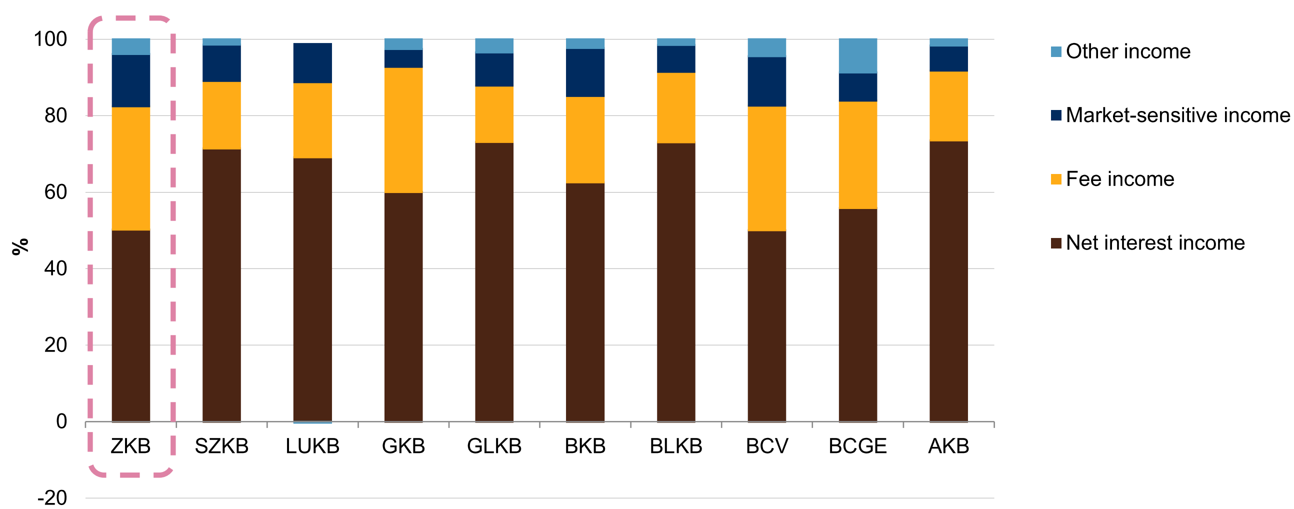
We expect interest income, mainly from deposit-taking and lending activities, will continue to account for more than 50% of ZKB's total revenue (see chart 1), which is supported by 2.1% growth in interest income in first-half 2020 on a year on year basis. Revenue from fee and commission accounts for 33% of revenue compared with 25%-30% before the Swisscanto acquisition. We expect ZKB will defend its fee share by active pricing management such as introduction of new service schemes in asset management, compensating for the anticipated loss of revenue from the elimination of kick-back fees for fund distributors in Switzerland, and increasing competition. We also see potential risk to fee generation in asset management following the expiration of earn-out payments after 2018, but have to date not observed any material impact. ZKB had incentivized former co-owner cantonal banks to further distribute Swisscanto products by deferred earn-out payments as a further element of the acquisition price for Swisscanto. However, a number of cantonal banks already replaced Swisscanto products with self-produced funding vehicles.

We believe the bank's financial targets remain focused on long-term value for its owner the Canton of Zurich, and that the bank will continue to benefit from the strong support of its owner, as demonstrated by an amended cantonal bank law that came into effect on Jan. 1, 2015, and included an increase of the canton's endowment capital facility for ZKB by CHF1.075 billion to CHF3 billion. ZKB drew CHF500 million on this facility on June 30, 2015, leaving a residual facility of CHF575 million. We do not include this capital in our assessment or expect ZKB to utilize the residual capital buffer in the next few years. However, we note the availability of such funds if ever needed.

We see the risk that new fintech competitors could disrupt ZKB's business model in future as relatively low, given its loyal and conservative client base, which is likely to continue to favor a relationship-based bank over pure digital banks. This will give ZKB time to further gradually adjust its product offering and digital customer interaction.

Chart 1

ZKB Benefits From A High Share Of Stable Fee Income Thanks To Its Asset Management Operations
Operating revenues breakdown



Data relates to FY-2019. AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. GLKB--Glarner Kantonalbank. GKB--Graubuendner Kantonalbank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zuercher Kantonalbank. Source: S&P Global Ratings.

Table 2

Zuercher Kantonalbank--Business Position

		--Year ended Dec. 31--			
(Mil. CHF)	**June-2020**	**2019**	**2018**	**2017**	**2016**
Loan market share in country of domicile	N/A	7.6	7.5	7.6	7.6
Deposit market share in country of domicile	N/A	9.3	9.8	9.5	9.9
Total revenues from business line (currency in millions)	1,347.0	2,414.0	2,437.0	2,358.0	2,358.0
Return on average common equity	8.7	7.0	6.8	7.1	6.5

CHF--Swiss franc. N/A--Not applicable.

Capital and earnings: To remain a key rating strength

We expect ZKB will preserve its superior capitalization, reflected in our projected RAC ratio of 17.5%-18.0% in the coming 12-24 months, after 18.4% at year-end 2019. Such robust RAC ratios place ZKB among the highest capitalized banks globally, and in the middle range of rated Swiss cantonal banks that are highly capitalized in a global comparison (see chart 2).

Our RAC projection incorporates moderate loan growth, in line with the Swiss market, that partly offsets pressure on net interest margins from the negative interest rate environment and the difficult economic cycle in Switzerland. We also expect ZKB will maintain its dividend distributions to the canton at about 50% of core earnings and to pay compensation to the canton for the cantonal guarantee of CHF20 million-CHF 25 million annually. ZKB paid out a CHF150 million special dividend in 2020 relating to the banks' 150th anniversary.

Additionally, the quality of ZKB's capital and earnings supports our capital assessment. The bank continues to deliver stable earnings, despite the ongoing challenges from the COVID-19 pandemic, the strong Swiss franc, and the negative interest rate environment in its core market. In June 2017, the bank replaced an additional Tier 1 capital instrument with a similar instrument with notional of CHF750 million that can be called the first time in 2023. However, we forecast that the share of hybrid capital instruments within total adjusted capital will remain relatively low and hover between 5% and 7%.

The bank's cost efficiency ratio has improved to about 59% June 2020 compared with about 62% over recent years, mainly driven by cost-measures and positive synergy effects following the Swisscanto integration. This remains slightly weaker than those of its main cantonal bank peers, which are typically at 50%-60% (see chart 3). It is also weaker compared with peers in the Nordics, but in line with or better than many Western European banks. We expect the cost-to-income ratio will remain on a slightly positive trend over the coming years, but consider that the gap to domestic peers is unlikely to disappear entirely, due to bank's broader and nationwide set of more diverse operations and higher staff compensation levels in Zurich.

Table 3

Zuercher Kantonalbank--Capital And Earnings

		--Year ended Dec. 31--			
(Mil. CHF)	**June-2020**	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	17.5	18.9	19.0	17.6	16.4
S&P Global Ratings' RAC ratio before diversification	N/A	18.4	18.0	17.9	20.3

Table 3

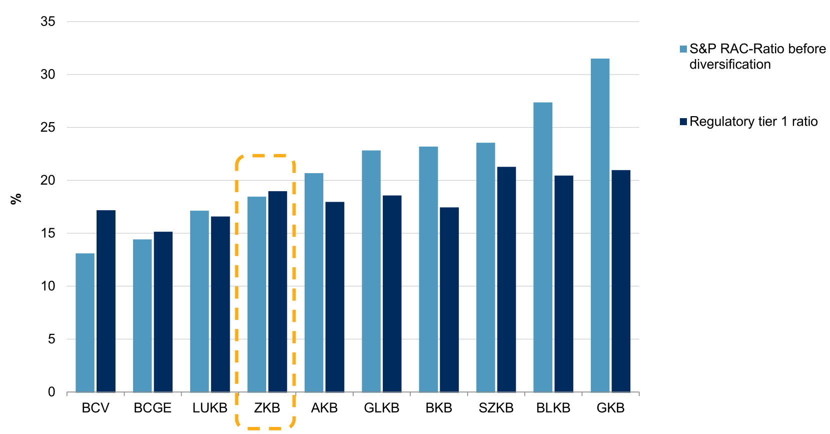
Zuercher Kantonalbank--Capital And Earnings (cont.)

		--Year ended Dec. 31--			
(Mil. CHF)	**June-2020**	**2019**	**2018**	**2017**	**2016**
S&P Global Ratings' RAC ratio after diversification	N/A	16.1	16.0	15.7	18.7
Adjusted common equity/total adjusted capital	94.2	94.0	93.9	93.4	94.6
Net interest income/operating revenues	47.4	50.2	52.4	51.5	51.3
Fee income/operating revenues	30.6	32.2	33.2	32.8	31.1
Market-sensitive income/operating revenues	20.8	13.7	12.6	14.6	16.7
Cost to income ratio	58.9	60.0	61.4	61.2	64.7
Preprovision operating income/average assets	0.6	0.6	0.5	0.6	0.5
Core earnings/average managed assets	0.6	0.6	0.6	0.6	0.5

CHF--Swiss franc. N/A--Not applicable. RAC--Risk adjusted capital.

Chart 2

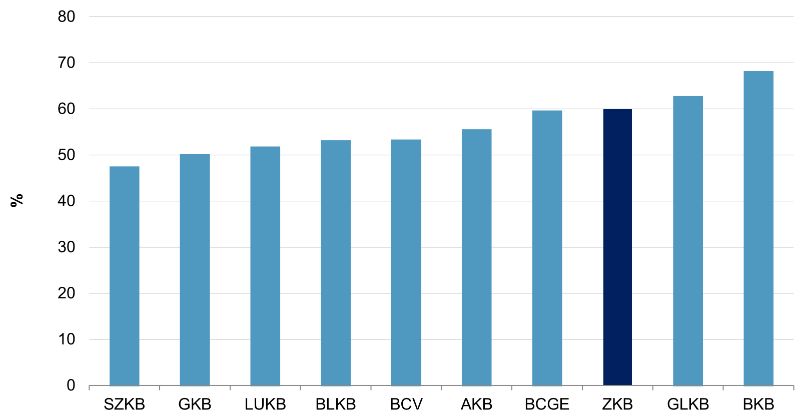
ZKB's Capitalization Is Very Strong In A Global Comparison, But Only Average Among Cantonal Banks



Ratios as of Dec 2019. RAC--Risk adjusted capital. AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. GLKB--Glarner Kantonalbank. GKB--Graubuendner Kantonalbank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zuercher Kantonalbank. Source: S&P Global Ratings.

Chart 3

ZKB's Cost Efficiency Is Weaker Than Cantonal Cank Peers'
Cost-to-income ratio



Cost-to-income ratio is defined as noninterest expense as % of operating revenues. Data relates to FY-2019. AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. GLKB--Glarner Kantonalbank. GKB--Graubuendner Kantonalbank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zuercher Kantonalbank. Data relates to FY-2019. Cost-to-income ratio is defined as noninterest expense as % of operating revenues. Source: S&P Global Ratings.

Table 4

Zuercher Kantonalbank--Risk-Adjusted Capital Framework Data

(Mil. CHF)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global RWA	Average S&P Global RW (%)
Credit risk					
Government & central banks	40,686.3	1,641.5	4.0	243.0	0.6
Of which regional governments and local authorities	2,202.8	1,186.8	53.9	78.7	3.6
Institutions and CCPs	16,924.0	4,500.3	26.6	4,591.8	27.1
Corporate	47,405.5	27,142.0	57.3	30,756.9	64.9
Retail	67,728.0	18,246.2	26.9	17,091.7	25.2
Of which mortgage	64,081.3	15,301.5	23.9	14,859.3	23.2
Securitization§	0.0	0.0	0.0	0.0	0.0
Other assets†	653.7	653.7	100.0	646.7	98.9
Total credit risk	173,397.5	52,183.7	30.1	53,330.1	30.8
Credit valuation adjustment					
Total credit valuation adjustment	--	2,842.9	--	0.0	--
Market Risk					
Equity in the banking book	492.2	1,969.4	400.1	3,701.1	752.0
Trading book market risk	--	3,614.3	--	5,701.8	--
Total market risk	--	5,583.7	--	9,402.9	--

Table 4

Zuercher Kantonalbank--Risk-Adjusted Capital Framework Data (cont.)

Operational risk					
Total operational risk	--	4,372.2	--	4,985.3	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification	--	64,982.5	--	67,718.3	100.0
Total diversification/ concentration adjustments	--	--	--	9,504.8	14.0
RWA after diversification	--	64,982.5	--	77,223.1	114.0
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		12,260.7	18.9	12,446.0	18.4
Capital ratio after adjustments‡		12,260.7	18.9	12,446.0	16.1

*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 2019, S&P Global Ratings.

Risk position: Prudent management mitigates concentration in residential and commercial real estate amid the pandemic.

We expect ZKB's risk position will remain a neutral rating factor. Our base case assumes that Swiss domestic markets will remain resilient against the impact of the COVID-19 pandemic, and that ZKB's risk position reflects benefits from the bank's low-risk, highly collateralized, and granular residential mortgage portfolio and generally sound asset quality. ZKB's business model continues to concentrate on lower-risk retail lending, collateralized mortgage loans, lending to SMEs, and corporate lending. Loans collateralized by residential real estate account for about 75% of ZKB's loan book but only about 42% of its total assets. This remains lower than for other cantonal banks due to ZKB's broader business range including a higher share of trading securities (5% of total assets).

We also believe ZKB will continue to prudently manage its real estate market exposures by what we regard as conservative underwriting standards, sound risk management, high granularity, and high levels of collateralization. This should enable the bank to remain relatively resilient despite difficult pandemic-related credit conditions and should keep its loan loss record relatively favorable. In line with its cantonal bank peers, new loan loss provisions on customer loans have been very low in recent years due to favorable economic environment and rising house prices.

We expect that loan book growth will be moderates, averaging 3% for the period 2020-2023, also because management is emphasizing risk-adjusted margins rather than pure volume growth, particularly in light of difficult operating conditions during the 2020 recession. Nevertheless, in our view, the cumulative build-up in house prices in recent years and ZKB's significant exposure to residential real estate leaves the bank vulnerable to a heightened risk of correction and higher credit losses than in recent years.

We generally view commercial lending as riskier than residential real estate loan business, particularly in an recessionary environment. ZKB's loans collateralized by commercial real estate, collateralized by other means, or unsecured account for about 23% of customer lending, which is higher than that of many cantonal bank peers. Although ZKB typically grants syndicated loans without collateral, we expect the bank will maintain stringent monitoring, even of high quality large exposures.

ZKB's securities portfolio amounted to CHF16.7 billion as of June 30, 2020. We regard the asset quality of the nontrading securities portfolio (worth CHF5 billion) as sound. The portfolio focuses on Swiss covered bonds, as well as sovereign and public sector obligors in Switzerland and Germany, and on European supranational institutions.

Most of the bank's trading revenue is client initiated, and slightly more volatile than its interest and fee business. ZKB also engages in proprietary trading operations but mainly acts as a market maker in fixed income and foreign exchange products. Although these operations are limited, they increase the volatility of the bank's earnings. However we believe that the bank will maintain a low risk appetite and that its risk management tools will allow it to closely monitor these activities.

Table 5

Zuercher Kantonalbank--Risk Position

	--Year ended Dec. 31--				
(Mil. CHF)	**June-2020**	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	7.8	3.8	3.2	2.5	4.3
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	14.0	12.4	13.9	8.7
Total managed assets/adjusted common equity (x)	14.7	14.3	14.9	15.4	15.4
New loan loss provisions/average customer loans	0.0	0.0	(0.2)	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	N/A	0.1	0.1	0.2	0.2
Loan loss reserves/gross nonperforming assets	N/A	253.1	251.2	221.6	243.8

CHF--Swiss franc. N/A--Not applicable. RWA--Risk weighted assets.

Funding and liquidity: Favorable funding profile benefits from solid franchise and cantonal guarantee

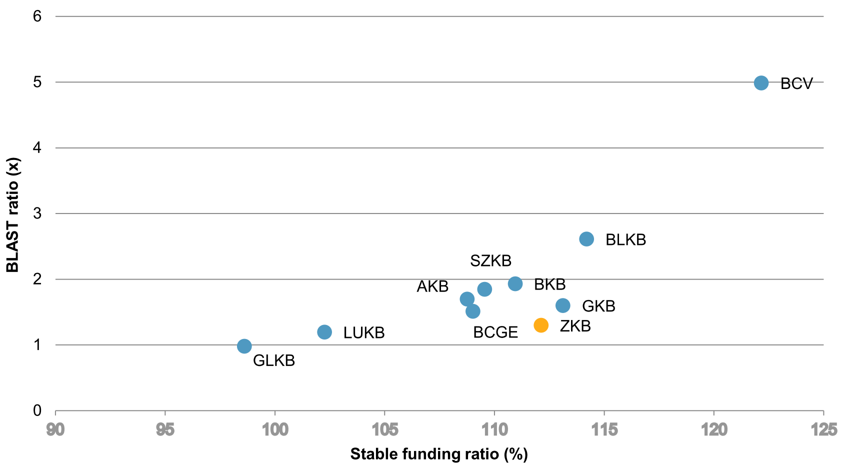
We expect ZKB's funding profile will remain comfortably in line with that of Swiss peers and other banking systems with the same favourable industry risks. At the same time we expect ZKB's liquidity management and position will remain a strength, which reflecting the bank's ability to withstand an extended period of market or idiosyncratic stress.

In our view, ZKB continues to benefit substantially from the cantonal guarantee that reinforces customer confidence and implicitly supports a widespread and loyal depositor base. The bank's loan-to-deposit ratio, by our measures, was 110.4% as of June 2020, and is likely to stagnate, not taking into account the bank's large equity position. This is also reflected by our stable funding ratio of 107% as on June 2020, which is in line with that of many domestic peers. At the same time, ZKB's exposure to confidence-sensitive wholesale funding is larger than for other cantonal banks. Interbank funding and capital market funding via secured and unsecured instruments account for about 45% of the bank's total funding. However, we expect the bank's wholesale funding sources will remain stable or even benefit from a flight to quality in more challenging economic conditions thanks to the bank's cantonal guarantee.

Our assessment of ZKB's liquidity as strong reflects the bank's favorable liquidity position, which, in our view, would allow it to endure more than 12 months with no access to market funding. This is demonstrated by the bank's strong liquidity ratio (broad liquid assets to short-term wholesale funding) of about 1.2x for first-half 2020. The ratio remains low compared with peers that have a strong assessment (see chart 4). However, we expect ZKB to maintain elevated liquidity and, owing to its close ties with the Canton of Zurich and loyalty of its customer base, it will remain less sensitive than other commercial banks in a more challenging operating environment. As such, our ratio-based liquidity analyses are reinforced by above qualitative arguments.

Chart 4

ZKB Remains In A Comfortable Funding And Liquidity Position
Funding and liquidity profile.



BLAST ratio is calculated as broad liquid assets divided by short-term wholesale funding. Ratios as of Dec. 2019. AKB--Aargauische Kantonalbank. BCGE--Banque Cantonale de Geneve. BCV--Banque Cantonale Vaudoise. BLKB--Basellandschaftliche Kantonalbank. BKB--Basler Kantonalbank. GLKB--Glarner Kantonalbank. GKB--Graubuendner Kantonalbank. LUKB--Luzerner Kantonalbank. SZKB--Schwyzer Kantonalbank. ZKB--Zuercher Kantonalbank. Source: S&P Global Ratings.

Table 6

Zuercher Kantonalbank--Funding And Liquidity					
	--Year ended Dec. 31--				
(Mil. CHF)	**June-2020**	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	54.0	56.1	55.2	54.5	56.5
Customer loans (net)/customer deposits	110.5	109.6	104.9	106.8	104.8
Long-term funding ratio	69.1	70.9	69.6	68.9	71.6
Stable funding ratio	107.1	112.1	115.8	112.0	109.7
Short-term wholesale funding/funding base	33.4	31.6	32.9	33.6	30.6
Broad liquid assets/short-term wholesale funding (x)	1.2	1.3	1.3	1.3	1.3
Net broad liquid assets/short-term customer deposits	12.6	17.0	20.4	17.1	14.9
Short-term wholesale funding/total wholesale funding	71.9	71.3	72.7	73.0	69.8
Narrow liquid assets/3-month wholesale funding (x)	1.4	1.4	1.4	1.4	3.4

CHF--Swiss franc.

Support: Three notches of uplift due to extremely high likelihood of extraordinary support from the Canton of Zurich

We expect ZKB will remain a GRE with an extremely high likelihood that the Canton of Zurich would provide timely and sufficient extraordinary support in the event of financial distress. We base this on our view of the bank's integral link with, and very important role for the canton. ZKB benefits from its existing cantonal guarantee on the bank's unsubordinated obligations, which is stipulated by law, as well as its ownership structure and its importance for Zurich's regional economy. We think that any default by ZKB would have a significant impact on the regional economy. Because of this, we add a three-notch uplift to ZKB's 'aa-' SACP to derive the long-term rating.

We expect the existing cantonal guarantees will remain in place in the medium term. Beyond our outlook horizon, we see a potential risk that future agreements between Switzerland and the EU regarding preferential market access for Switzerland might include the removal of the remaining guarantees for all cantonal banks.

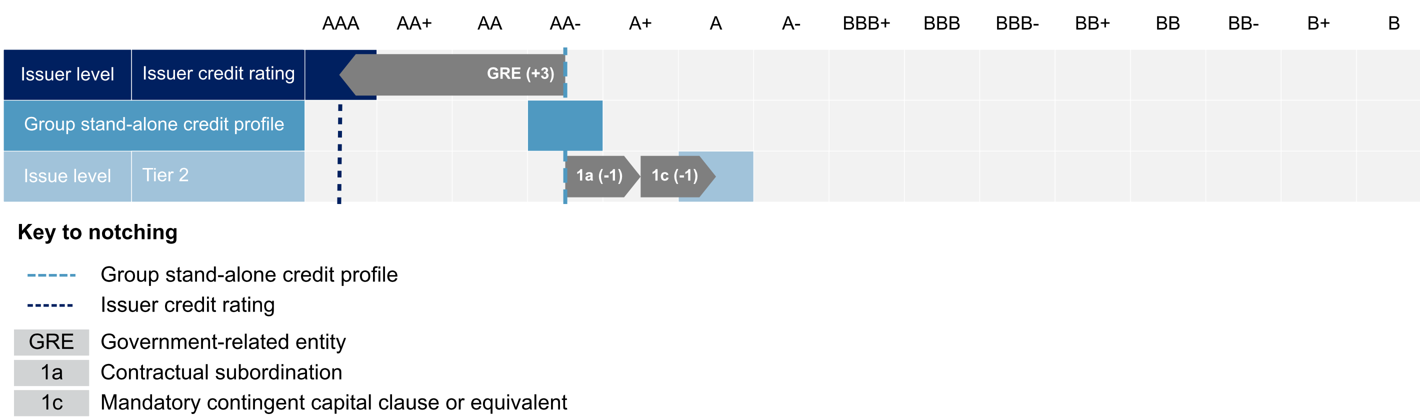
Environmental, social, and governance

ESG factors have a neutral impact in our assessment of ZKB's credit worthiness. Social and environmental credit factors are in line with those of peers in the banking industry, while the bank's governance standards are comparable with the practice in its home country.

Hybrid issue ratings

We notch down our ratings on ZKB's two Tier 2 subordinated bond instruments from the bank's 'aa-' SACP because, as we understand, they do not benefit from the guarantee provided by the Canton of Zurich (see chart 5). For these instruments, we deduct one notch for the instruments' subordination and one notch for their contingent capital clause to arrive at an 'A' issue rating. We do not apply additional notching for the mandatory write-down trigger at a 5% regulatory common equity Tier 1 ratio of ZKB, because it is set at a level that we consider to be a nonviability trigger.

Zuercher Kantonalbank: Notching



Note: The number-letter labels in the table above are in reference to the notching steps we apply to hybrid capital instruments, as detailed in table 3 of our "Hybrid Capital: Methodology And Assumptions" criteria, published on July 1, 2019.

Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 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
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- 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

Related Research

- COVID-19: Swiss Banking Sector To Remain Resilient, June 17, 2020
- Research Update: Canton of Zurich 'AAA' Ratings Affirmed; Outlook Stable, May 22, 2020
- Banking Industry Country Risk Assessment: Switzerland, Nov. 20, 2019

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 10, 2020)*		
Zuercher Kantonalbank		
Issuer Credit Rating		AAA/Stable/A-1+
Subordinated		A
Issuer Credit Ratings History		
24-Aug-2018	*Foreign Currency*	AAA/Stable/A-1+
03-Jul-2012		AAA/Negative/A-1+
20-Jan-1998		AAA/Stable/A-1+
24-Aug-2018	*Local Currency*	AAA/Stable/A-1+
03-Jul-2012		AAA/Negative/A-1+
20-Jan-1998		AAA/Stable/A-1+
Sovereign Rating		
Switzerland		AAA/Stable/A-1+
Related Entities		
Zurich (Canton of)		
Issuer Credit Rating		AAA/Stable/--
Senior Unsecured		AAA

*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.