

Rating Action: Moody's assigns Aa2 rating to Zuercher Kantonalbank's Tier 2 subordinated debt

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Frankfurt am Main, April 04, 2022 -- Moody's Investors Service (Moody's) has today assigned a Aa2 foreign currency subordinated debt rating to the proposed new Euro-denominated Tier 2 capital-eligible debt of Zuercher Kantonalbank (ZKB). The subordinated debt instrument carries a point of non-viability (PONV) loss absorption feature and has a six-year maturity with a one-off issuer call date after five years.

The rating is subject to the receipt of final documentation, the terms and conditions of which are not expected to change in any material way from the draft documents that Moody's has reviewed.

All other ratings and rating assessments as well as corresponding outlooks of ZKB are unaffected by today's rating action.

RATINGS RATIONALE

ASSIGNMENT OF Aa2 SUBORDINATED DEBT RATING

The Aa2 rating assigned to the proposed subordinated debt instrument reflects ZKB's aa1 Adjusted Baseline Credit Assessment (BCA), which incorporates a three-notch affiliate support uplift from the bank's a1 BCA because of a maintenance guarantee from the bank's sole owner, the Canton of Zurich. The maintenance guarantee requires the canton to inject capital into ZKB, in case of need, until the canton defaults itself. The Aa2 rating further incorporates the results of Moody's Advanced Loss Given Failure (LGF) analysis, yielding a one-notch downward adjustment from the bank's Adjusted BCA, as well as Moody's assumption of a low probability of sovereign government support for loss-absorbing instruments, resulting in no rating uplift.

Given the proposed volume of subordinated debt and limited loss protection from subordination in the form of residual equity and Additional Tier 1 (AT1) instruments, the rating agency's Advanced LGF analysis indicates a high loss given failure for ZKB's proposed subordinated debt instrument, resulting in a one-notch downward adjustment from the bank's aa1 Adjusted BCA to reflect the expected loss severity of these instruments at the bank's PONV.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING

An upgrade of ZKB's subordinated debt rating could be driven by an upgrade of the bank's BCA, which could result from a combination of materially reduced concentration risks, significantly higher profitability, and an outsized shift in funding towards granular deposits. The instrument's rating could also be upgraded because of an improved result from Moody's Advanced LGF analysis, in particular if caused by meaningful issuance of instruments subordinated to the proposed Tier 2 instrument, thereby leading to lower loss given failure for the bank's subordinated debt.

A downgrade of ZKB's subordinated debt rating could be prompted by a downgrade of the bank's BCA, which could be driven by increased asset risk combined with a lower buffer from its capital ratios and depressed profitability. Furthermore, a deteriorating liquidity profile could exert downward pressure on the bank's BCA. A downgrade of the subordinated debt rating could also result from a deterioration of the canton's creditworthiness or if the guarantee framework the canton provides to ZKB were altered.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Banks Methodology published in July 2021 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1269625. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections

Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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The rating has been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

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