S&P Global Ratings

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Research Update:

Luzerner Kantonalbank Outlook Revised To Positive On The Canton's Improved Fiscal Performance; Ratings Affirmed

May 24, 2022

Overview

- In our view, Luzerner Kantonalbank's (LUKB's) credit quality benefits from the bank being a government-related entity with an extremely high likelihood of receiving support from its majority owner and guarantor, the Canton of Lucerne.
- The canton's financial performance has improved, indicating a stronger ability to support LUKB if needed.
- We therefore revised the outlook on LUKB to positive from stable, and affirmed our 'AA/A-1+' issuer credit ratings. We also affirmed all issue ratings on the cantonal bank's debt.
- The positive outlook indicates LUKB's importance to the canton and the latter's improved ability to provide support, if needed, over the next 12-24 months.

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Rating Action

On May 24, 2022, S&P Global Ratings revised its outlook on Luzerner Kantonalbank to positive from stable. We affirmed our 'AA/A-1+' long- and short-term issuer credit ratings on LUKB, as well as our issue ratings on the bank's senior unsecured and hybrid debt.

Rationale

The outlook revision indicates the Canton of Lucerne's improved ability to support LUKB, if needed. Due to higher tax revenue, increased profit distribution from the Swiss National Bank, and subsidies, the canton's fiscal performance has strengthened, offsetting increased expenditures. We assume that the canton's enduring stronger fiscal performance suggests that it is better placed to support LUKB in times of stress.

We expect LUKB to maintain its integral link and very important role for Lucerne. We consider LUKB to be a government-related entity (GRE). LUKB has an important role in contributing to the development of the canton's economy and an integral link to the canton, including benefitting from a guarantee. In the event of financial stress at LUKB, we believe there is an extremely high likelihood that the canton would provide sufficient and timely support to the bank, since a default could severely damage the canton's reputation.

LUKB's capitalization will continue to be a rating strength, and we expect the bank will show above-average growth rates. In our view, the canton's planned capital increase of Swiss franc (CHF) 500 million in 2023 will support the bank's growth. We expect the bank to expand further outside its home canton, focusing mainly on residential mortgage lending. In addition, the bank has been increasingly involved in short-term mortgage financing as well as structured products, leading to above-average growth figures compared with cantonal bank peers.

Outlook

Our positive outlook on LUKB indicates an improved ability of its owner, the Canton of Lucerne, to support the bank in times of stress. We expect that, over the coming two years, LUKB will continue to benefit from an extremely high likelihood of support from Lucerne.

Upside scenario

We could consider an upgrade of LUKB over the next two years if Lucerne's creditworthiness were to improve materially, strengthening its ability to support the bank.

A positive rating action stemming solely from the improvement of LUKB's stand-alone credit profile (SACP) is remote over the next two years. This is because we do not expect LUKB to significantly adjust its comparatively concentrated business model.

Downside scenario

We would consider revising our outlook on LUKB to stable if Lucerne's financial prospects were to wane, indicating a weaker ability to provide support. We could lower our issuer credit rating if LUKB's ties with the canton weakened or if there were changes to the canton's state guarantee, which we deem unlikely for the time being.

The sensitivity of the rating on LUKB to a potential downward revision of the SACP remains very limited. However, if we concluded that the bank's risk appetite had become less prudent than peers' over our outlook horizon, or if our risk-adjusted capital ratio for the bank became increasingly dependent on the issuance of hybrid instruments, we could revise down the SACP and consequently lower our issue ratings on LUKB's subordinated debt.

Ratings Score Snapshot

Luzerner Kantonalbank Ratings Score Snapshot

	To	From
Issuer Credit Rating	AA/Positive/A-1+	AA/Stable/A-1+

Luzerner Kantonalbank Ratings Score Snapshot (cont.)

	To	From
SACP	a+	a+
Anchor	a-	a-
Business Position	Adequate (0)	Adequate (0)
Capital and Earnings	Very strong (2)	Very strong (2)
Risk Position	Adequate (0)	Adequate (0)
Funding and	Adequate and	Adequate and
Liquidity	Adequate (0)	Adequate (0)
Support	(+2)	(+2)
ALAC Support	0	0
GRE Support	(+2)	(+2)
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

ESG credit indicators: E-2, S-2, G-2

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: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed		
Luzerner Kantonalbank		
Senior Unsecured	AA	
Subordinated	A-	
Junior Subordinated	BBB	
Ratings Affirmed; Outlook Action		
	To	**From**
Luzerner Kantonalbank		
Issuer Credit Rating	AA/Positive/A-1+	AA/Stable/A-1+