Swiss Banking Sector 2023
Balance Sheets Remain Robust

S&P Global Ratings

September 2023

This report does not constitute a rating action
Key takeaways

• The balance of risks has shifted from economic to industry risk for banks operating in Switzerland.

• Swiss banks continue to be the highest rated globally, with mostly stable outlooks, demonstrating remarkable resilience in times of stress. We have taken several rating actions on UBS and Credit Suisse over recent months.

• Credit losses continue to be very low and manageable for Swiss banks. At the same time, rising interest rates have led to a deceleration in house price rises, lowering the risk of economic imbalances.

• Credit Suisse's failure exposed the limitations of systemic regulation and the regulators' supervisory toolkits. We expect parliament to scrutinize the supervisory toolkit of Swiss financial regulator FINMA in the upcoming months.

• In the first half of 2023, rising interest rates and sound cost discipline enabled Swiss banks to post their highest profits in a decade, which compares well with peers.
BICRA Overview: Switzerland

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Key Rating Drivers

**Strengths**
- Very wealthy, competitive, and stress-resilient economy and robust government finances.
- Sound asset quality with high share of collateralized lending
- High share of stable funding sources including customer deposits and equity.

**Weaknesses**
- High gross leverage in the household sector, with incentives from the Swiss tax regime.
- Limitations of regulation and the financial regulator’s supervisory toolkit.
- Wealth management industry’s sensitivity to loss in confidence and risks related to money laundering and financial crime.

We revised our assessment of economic risk to '1' from '2' (with '1' denoting the lowest risk and '10' the highest), and our assessment of industry risk to '3' from '2'. We view both trends as stable. As a result, we have maintained Switzerland in BICRA group '2', reflecting our view that although the 'a-' anchor remains unchanged, the balance of risks has shifted for banks operating mainly in Switzerland (see "Select Swiss Banks Affirmed After Review Of Banking Sector; BICRA Group Remains '2'", published July 24, 2023).
Swiss banks are among the highest rated globally
Mostly stable outlooks; recent rating actions on UBS and Credit Suisse

Recent rating actions:

- In September 2023, we affirmed our ‘A-/A-2’ long- and short-term issuer credit ratings on UBS Group AG, with a negative outlook, and our ‘A+/A-1’ ratings on UBS AG, with a stable outlook. We upgraded Credit Suisse’s European and U.S. operating entities to ‘A+/A-1’ and assigned the ratings a stable outlook, as we now see them as core to the UBS group. The recent revision of our BICRA for Switzerland did not result in rating changes for Swiss banks (see "Credit Suisse Entities Upgraded To ‘A+’ On Improved Support Prospects; Ratings On UBS Entities Affirmed", published Sept. 7, 2023).

- In April 2023, we raised our long-term issuer credit rating on Raiffeisen to ‘AA-’ from ‘A+’ and the short-term issuer credit rating to ‘A-1+’ from ‘A-1’ on its resolution effectiveness and higher buffer of additional loss-absorbing capacity (see "Raiffeisen Schweiz Genossenschaft Upgraded To ‘AA-/A-1+’ On Effective Resolution Strategy; Outlook Stable", published April 4, 2023).

- In March 2023, we assigned our ‘BBB/A-2’ long- and short-term issuer credit ratings to Compagnie Bancaire Helvétique S.A. The outlook is stable (see "Compagnie Bancaire Helvétique S.A. Assigned ‘BBB/A-2’ Ratings; Outlook Stable", published March 30, 2023).

S&P Global Ratings
Real prices moderate after strong growth
But affordability metrics are 39% above the long-term average

Real estate prices

Affordability metrics increased further, now about 30% above the long-term average

UBS is a dominant national player in a fragmented market
Smaller cantonal banks enjoy significant market shares on a regional scale

*UBS Group AG includes Credit Suisse Group AG since June 12, 2023. UBS Group AG has total assets of CHF1,502.1 million, so we cap the x-axis at 500 for scale purposes. Data as of June 2023; data as of December 2022 for Bank J. Safra Sarasin. CHF--Swiss franc. D-SIB--Domestic systemically important banks. G-SIB--Global systemically important banks.
We expect capitalization to remain very strong in a global comparison
As Swiss banks profit from sound earnings retention

S&P Global Ratings' risk-adjusted capital ratio before diversification (total adjusted capital/S&P Global Ratings risk-weighted assets)

We expect Swiss banks' asset quality to continue outperforming peers'
With the lowest aggregated losses in the peer group

Domestic credit losses as a percentage of total loans

a--Actual. f--Forecast. For Austria, Canada, Germany, and Singapore the ratio is total credit losses, not just domestic. Source: S&P Global Ratings.
Adequate returns on sound cost discipline

Swiss banks post similar returns despite significantly higher capitalization than peers¹

Data as of June 2023 except UBS due to inflated returns following Credit Suisse events. Source: S&P Global Ratings.
Swiss banks post highest profits in a decade

Net interest margins stabilize on lower levels as interest rates resume

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Average growth in customer loans

Average NIM (right scale)

Median NIM (right scale)

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Swiss banks generally enjoy high liquidity
But some depend more on wholesale funding

Cantonal banks have large, but uneven, asset management investments

Net interest income dependency remains high despite increased efforts

Assets under management and noninterest income/operating revenue

Source: S&P Global Ratings data; Glarner Kantonalbank data not available.

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Hybrid capital instruments after the Credit Suisse failure

Prices are recovering but future legislation might subdue investor sentiment

• Under the Credit Suisse outcome, Additional Tier 1 (AT1) instruments were written down permanently to zero even though common equity shares were not. The AT1 documentation, combined with the authorities’ legislative powers, made this possible. Swiss AT1 instruments are seeing prices recover as the Credit-Suisse-related turbulence subsides, also demonstrated by recent issuances (see "European Bank AT1 Hybrids In A Post-Credit Suisse World", published March 21, 2023).

• Following the introduction of the Federal Council’s new regulation, FINMA will be authorized to write down AT1 instruments thanks to the liquidity backstop. As institutions will need to be solvent to access the backstop, a write-down might occur before the instrument’s regulatory capital ratio-based trigger event (see "Swiss Public Liquidity Backstop For Banks Comes With Strings Attached", published July 17, 2023, and "Swiss Public Liquidity Backstop Has Limited Implications For Hybrid Ratings", published Sept. 18, 2023).

Price comparison of individually rated Swiss hybrid instruments

Credit Suisse's failure exposed regulatory limitations
A larger UBS will test FINMA's ability to supervise SIBs

Key expectations

We expect FINMA to enforce the Swiss too-big-to-fail regulation on UBS, creating an equitable approach and mitigating potential moral hazard. Following the merger with Credit Suisse, UBS' balance sheet will likely represent about 200% of Switzerland's GDP.

Following the outcome of the parliamentary and expert commission, we believe further legislative changes could ensue, for example related to capital ordinance, FINMA's early intervention powers, the Swiss National Bank's (SNB)'s role as lender of last resort, and resolution.

- In Switzerland's two-tier banking system, we believe that the supervision of non-systemically important institutions has been generally effective.

- While general regulation in Switzerland remains strong, we now regard the Swiss institutional framework as comparable with global peers including Germany, Austria, the U.S., and New Zealand (see "Banking Industry Country Risk Assessment: Switzerland", published Aug. 18, 2023).

- Money laundering and the threat of sanctions for private banks' wealthy customers remain tail risks for the Swiss banking sector, especially for smaller private banks that are accommodating former wealth management clients from Credit Suisse.

UBS Group AG total assets to Switzerland's GDP

Sources: Swiss Bundesamt für Statistik, S&P Global Ratings.
Cantonal banks are expanding faster than cantons

We continue to monitor potential shortfalls in support as banks turn to growth

Total cantonal bank assets to Cantons' GDP

Key Expectations For Swiss Banks In 2023/2024

**Switzerland will continue to weather the muted global macroeconomic environment**

Energy supply and price shocks remain limited downside risks. We expect the Swiss economy to remain in positive territory, based on our projection of real GDP growth slowing to 0.8% in 2023 from 2.2% in 2022.

**Rising interest rates and the deceleration in house price rises are manageable**

We forecast minimal growth in 2023, no growth in nominal house prices in 2024, followed by 1.5% in 2025, and 2.0% in 2026, compared with above 6.0% between 2020 and 2022. We do not expect the SNB to implement any more significant interest rate hikes as inflation has moderated. In contrast, the central bank might lower interest rates again in 2024.

**Credit losses continue to be low thanks to collateralized lending**

Swiss banks’ loan portfolios are dominated by collateralized residential mortgage loans and loans to small and midsize enterprises that are often collateralized by real estate. We consider the underwriting standard to be prudent overall.

**FINMA’s supervisory toolkit will be under parliamentary scrutiny**

We believe further legislative changes could ensue related to capital ordinance, FINMA’s early intervention powers, the SNB’s role as lender of last resort, and resolution.

**Record profits for most banks with only moderate margin pressure**

Exceptional profit stability stems from domestically focused banks, including cantonal banks, which enjoy a strong local franchise and a clear focus on basic and low-risk banking products.
Key Contacts

Anna Lozmann
Director, Lead Analyst
+ 49 69 3399 9166
anna.lozmann@spglobal.com

Francois Moneger
Director
+ 33 14 420 6688
francois.moneger@spglobal.com

Cihan Duran
Associate Director
+ 49 69 3399 9177
cihan.duran@spglobal.com

Clement Collard
Associate Director
+ 33 14 420 7213
clement.collard@spglobal.com

Mathieu Plait
Associate Director
+ 33 14 420 7364
mathieu.plait@spglobal.com

Lukas Freund
Associate Director
+ 49 69 3399 9139
lukas.freund@spglobal.com

Harm Semder
Director
+ 49 69 3399 9158
harm.semder@spglobal.com

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Related Research

- Swiss Public Liquidity Backstop Has Limited Implications For Hybrid Ratings, Sept. 18, 2023
- Banking Industry Country Risk Assessment: Switzerland, Aug. 18, 2023
- Select Swiss Banks Affirmed After Review Of Banking Sector; BICRA Group Remains '2', July 24, 2023
- Swiss Public Liquidity Backstop For Banks Comes With Strings Attached, Report Says, July 17, 2023
- How The Composition Of Swiss Banks' Gone-Concern Buffers Affects Our Rating Metrics, April 4, 2023
- European Bank AT1 Hybrids In A Post-Credit Suisse World, March 21, 2023
- Credit FAQ: Asia-Pacific AT1 Hybrids Investors: Understanding The Credit Suisse Fallout, March 24, 2023
- Swiss Regulator’s Statement On Credit Suisse AT1 Confirms Impact Of Documentation And Legislative Powers, March 23, 2023
- Economic Research: European Housing Markets: Sustained Correction Ahead, July 20, 2023
- Economic Outlook Eurozone Q3 2023: Short-Term Pain, Medium-Term Gain, June 26, 2023
- Research Update: Credit Suisse Entities Upgraded To 'A+' On Improved Support Prospects; Ratings On UBS Entities Affirmed, Sept. 7, 2023
- Research Update: Raiffeisen Schweiz Genossenschaft Upgraded To 'AA-/A-1+' On Effective Resolution Strategy; Outlook Stable, April 4, 2023
- Research Update: Compagnie Bancaire Helvetique S.A. Assigned 'BBB/A-2' Ratings; Outlook Stable, March 30, 2023
- Research Update: Zuger Kantonalbank Assigned 'AA+/A-1+' Ratings; Outlook Stable, Nov. 8, 2022