MOODY'S RATINGS

CREDIT OPINION
3 July 2024

Update

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RATINGS

St.Galler Kantonalbank AG

Domicile	St.Gallen, Switzerland
Long Term CRR	Aa2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Aa2
Type	Senior Unsecured - Dom Curr
Outlook	Stable
Long Term Deposit	Not Assigned

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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St.Galler Kantonalbank AG

Update after rating affirmation

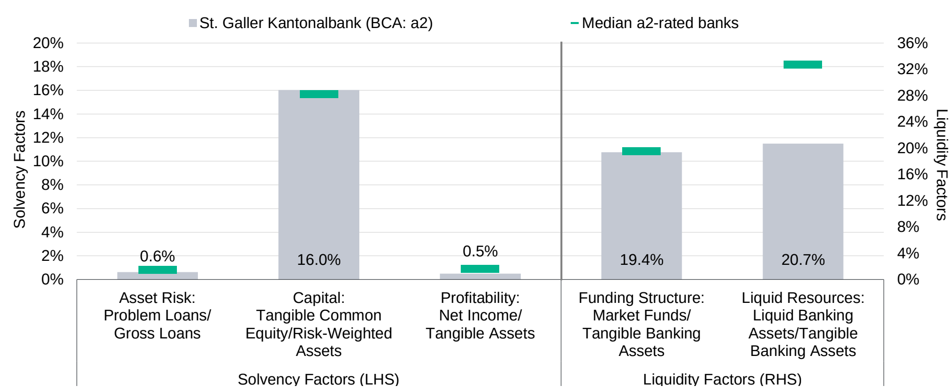
Summary

St.Galler Kantonalbank AG's (SGKB) Aa1 backed deposit ratings and Aa2 backed senior unsecured ratings reflect its a2 BCA, one notch of rating uplift from affiliate support because of the majority ownership by the Canton of St. Gallen and the bank's important role in the region as well as the application of our Advanced Loss Given Failure (LGF) analysis to its liabilities, resulting in three notches of rating uplift for SGKB's backed deposit ratings and no ratings uplift for its backed senior unsecured debt ratings.

For the backed senior unsecured debt ratings, the guarantee provided by the Canton of St. Gallen for non-subordinated liabilities provides two notches of ratings uplift, but none to the backed deposit ratings, given the already high starting point. We do not incorporate further rating uplift from sovereign government support in SGKB's deposit ratings due to the bank's small domestic market share and relatively low importance to the Swiss banking system.

SGKB's a2 BCA reflects the bank's solid capitalisation and its balanced liquidity and funding profiles benefitting from low funding costs and continued market access even in a more stressed environment owing to the canton's guarantee. The BCA also takes account of SGKB's sound asset quality, despite significant geographical concentrations and the bank's good profitability.

Exhibit 1
Rating Scorecard SGKB - Key financial ratios



Source: Moody's Ratings

Credit strengths

» The Canton of St.Gallen fully guarantees all of the bank's senior liabilities

» The bank's solid capital ratios, albeit recently declining, provide a strong buffer against downside risks

» Market funding reliance is balanced by the deficiency guarantee of the canton

Credit challenges

» Geographically concentrated loan book

» Significant exposure to residential real estate

Outlook

» The stable outlook on the backed long-term deposit and backed long-term senior unsecured debt ratings reflects our expectation that the financial profile of SGKB, including its liability structure, will remain broadly unchanged. We further do not expect any change in the guarantee framework the canton provides to SGKB.

Factors that could lead to an upgrade

» SGKB's long-term ratings could be upgraded if the bank's standalone creditworthiness improves significantly, resulting from a combination of materially reduced concentration risks, significantly higher profitability, and an improved combined liquidity profile.

» The bank's backed CRR and the backed senior unsecured debt rating could also be upgraded if the creditworthiness of the Canton of St. Gallen improves. The bank's backed CRR could also benefit from higher rating uplift from our Advanced LGF analysis following issuance of additional senior unsecured or subordinated debt instruments.

Factors that could lead to a downgrade

» The bank's ratings could be downgraded following a downgrade of the bank's BCA or a material deterioration of the canton's creditworthiness. The bank's backed long-term ratings could also be downgraded as result of an adverse change in the bank's liability structure, potentially leading to a lower rating uplift as a result of our Advanced LGF analysis.

» The bank's BCA could be downgraded if its capital buffers decline; its asset risk deteriorates leading to meaningfully and sustainably higher problem loans; or its profitability deteriorates to levels well below the average of the past three years. Furthermore, a declining liquidity buffer in conjunction with higher market funding dependence could lead to a BCA downgrade.

»

Key indicators

Exhibit 2
St.Galler Kantonalbank AG (Consolidated Financials) [1]

	12-23[2]	12-22[2]	12-21[2]	12-20[2]	12-19[2]	CAGR/Avg.[3]
Total Assets (CHF Billion)	41.3	40.8	39.6	38.5	35.9	3.6[4]
Total Assets (USD Billion)	49.1	44.1	43.3	43.6	37.1	7.3[4]
Tangible Common Equity (CHF Billion)	2.9	2.8	2.7	2.6	2.6	2.3[4]
Tangible Common Equity (USD Billion)	3.4	3.0	2.9	2.9	2.7	6.0[4]
Problem Loans / Gross Loans (%)	0.4	0.6	0.9	1.1	1.1	0.8[5]
Tangible Common Equity / Risk Weighted Assets (%)	16.0	16.3	16.6	16.6	17.5	16.6[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	4.8	6.2	9.0	11.8	10.9	8.5[5]
Net Interest Margin (%)	0.9	0.8	0.8	0.8	0.9	0.8[5]
PPI / Average RWA (%)	1.6	1.3	1.4	1.3	1.3	1.4[6]
Net Income / Tangible Assets (%)	0.6	0.5	0.5	0.4	0.5	0.5[5]
Cost / Income Ratio (%)	53.1	58.3	57.3	59.2	59.9	57.5[5]
Market Funds / Tangible Banking Assets (%)	19.4	20.9	21.7	23.0	22.3	21.4[5]
Liquid Banking Assets / Tangible Banking Assets (%)	20.7	24.0	25.9	25.3	22.7	23.7[5]
Gross Loans / Due to Customers (%)	116.0	113.1	111.0	115.5	119.5	115.0[5]

[-] Further to the publication of our revised methodology in July 2021, only ratios from annual 2020 onwards included in this report reflect the change in analytical treatment of the "high-trigger" Additional Tier 1 instruments. [1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; LOCAL GAAP. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Ratings and company filings

Profile

SGKB is a Swiss cantonal bank that operates mainly in the Canton of St.Gallen and Appenzell-Ausserrhoden, providing savings and credit services, as well as wealth management solutions to individuals and small and medium-sized businesses. The bank was founded in 1868 as a government-owned credit institution to promote regional economic development. As of 31 December 2023, the bank operated through a network of 40 banking outlets (including two German offices in Frankfurt and Munich) and employed 1,155 full-time equivalent employees. The Canton of St.Gallen is the largest shareholder of the bank, with a 51% stake. By law, the canton is required to hold at least 51% of the bank's shares, which have been listed on the SIX Swiss Exchange since 2001. For more information, please see our Swiss Banking System Profile.

Weighted Macro Profile of Strong (+)

SGKB is focused on the Swiss market and its Weighted Macro Profile is therefore Strong (+), in line with the Macro Profile of Switzerland.

Detailed credit considerations

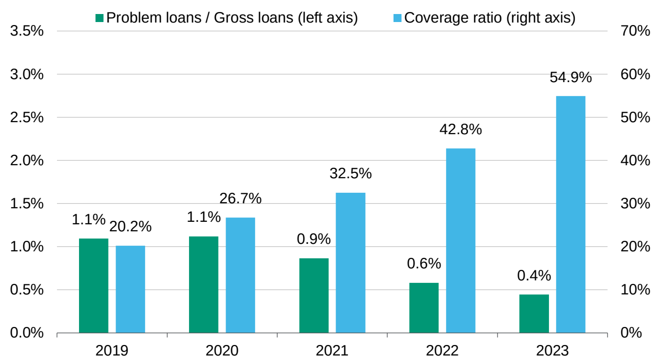
Narrow geographical focus and sector concentrations in real estate are key drivers for asset risk

We assign an a2 Asset Risk score, three notches below the aa2 initial score. The adjustment reflects the bank's narrow geographical footprint and sector concentrations, although the loan book is dominated by low risk residential mortgages.

SGKB's asset quality is strong and reflects stringent underwriting standards. In addition, its coverage ratio of 54.9% as of December 2023 provides a sufficient buffer to cover potential losses from its very small portfolio of non-performing loans, that are largely secured by mortgages. The bank's exposure to regional larger corporates as well as small and medium-sized enterprises provides a fair degree of diversification, while not impacting the overall level of non-performing loans negatively, thanks to SGKB's good risk management.

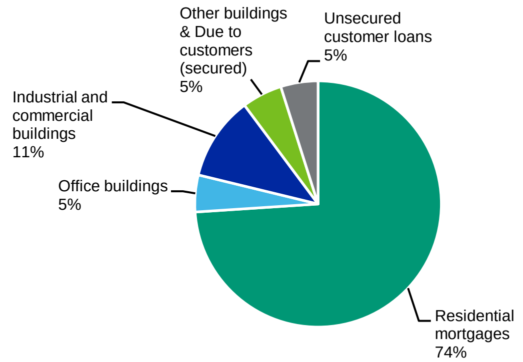
SGKB's residential and commercial mortgage loan book (CHF29.8 billion as of 31 December 2023), which is concentrated in the Canton of St.Gallen and Appenzell-Ausserrhoden, grew by 13.0% from year-end 2021 to 2023, above market average. The above-average expansion of SGKB's mortgage book in recent years has increased the bank's susceptibility to potential shocks from the domestic real estate markets. However, we believe the bank would be well positioned to absorb any potential weakening of the Swiss housing market as its mortgage loan book is highly granular, with only a small proportion exhibiting a loan-to-value ratio above 60%.

Exhibit 3
SGKB's problem loan ratio and coverage ratio improved in recent years



The problem loan ratio is in accordance with our definition.
Source: Moody's Ratings and company filings

Exhibit 4
SGKB's loan book largely consists of residential mortgages
Total loan book: CHF32.2 billion as of year-end 2023



Source: Moody's Ratings and company filings

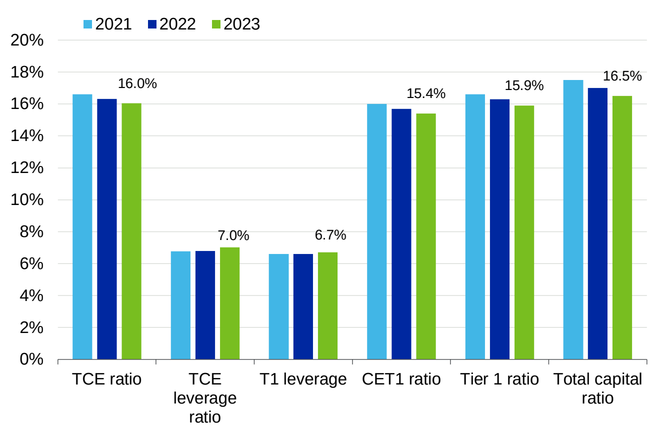
Solid capital ratios provide strong investor protection

We assign a aa3 Capital score, one notch below the aa2 initial score. Our evaluation reflects the bank's tangible common equity (TCE) ratio of 16.0% as of 31 December 2023, as well as solid leverage ratios and our expectations that the capital ratios for the bank will remain stable in 2024.

SGKB's capital ratios provide a strong, albeit recently declining, buffer against the bank's regulatory requirements[1] set by the Swiss Financial Market Supervisory Authority (FINMA). Growth in loans (+5.7% year-over-year) and risk weighted assets (RWA, +6.6%) outpaced capital accumulation via retained earnings (the bank's TCE grew 4.8%), leading to a further slight decline in capital ratios in 2023. During 2023, SGKB benefitted from growth opportunities arising from the situation around Credit Suisse AG.

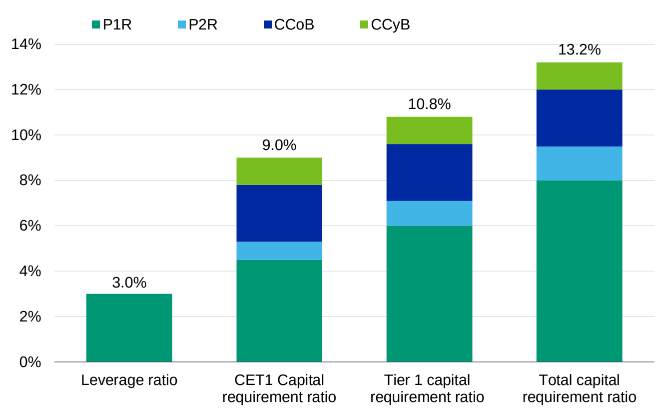
Similar to the bank's risk-based capital ratios, SGKB's leverage ratios deteriorated marginally in 2023, however remained solid, a situation that we do not expect to change.

Exhibit 5
SGKB well exceeds its regulatory capital requirements



TCE = Tangible Common Equity (Moody's calculation); CET1 = Common Equity Tier 1
Source: Moody's Ratings and company filings

Exhibit 6
SGKB's regulatory capital requirements as of 31 December 2023



P1R = Pillar 1 requirement; P2R = Pillar 2 requirement; CCoB = Capital conservation buffer requirement; CCyB = Countercyclical capital buffer requirement
Source: Moody's Ratings and company filings

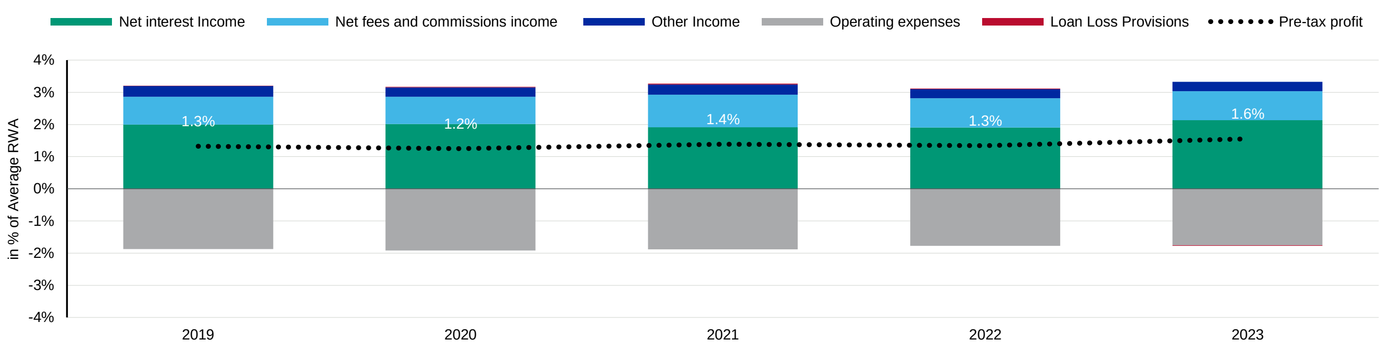
Improved profitability supported by higher rates, good loan demand and an increase in assets under management

We assign a baa3 Profitability score, one notch below the initial score, reflecting the bank's 0.5% average net income to tangible assets ratio during the 2020 to 2023 period. While the return on assets has improved to 0.6% in 2023, we expect that in 2024 and potentially beyond, SGKB's return on assets will soften somewhat, largely owing to deposit repricing leading to higher funding costs, a gradual increase in loan loss provisions and a declining positive effect on earnings from the SNB carry trade[2].

In 2023, SGKB recorded a substantial growth in Moody's-adjusted net income, driven by substantially higher net interest income. The more favorable interest-rate environment as well as an uptick in loan growth supported revenue generation. Further, a rebound of net fee and commission income, owing to an influx of net new money and new client acquisitions increased the revenue base. Despite certain cost pressures, driven by second round inflation effects and IT investments, and supported by limited loan loss provisions, the bank's pretax profit rose by almost 25% to CHF273 million. The positive trend is also reflected in SGKB's improved cost-income ratio of 53.1%, down from 58.3% in the previous year.

Exhibit 7

SGKB's revenue is driven by net interest income



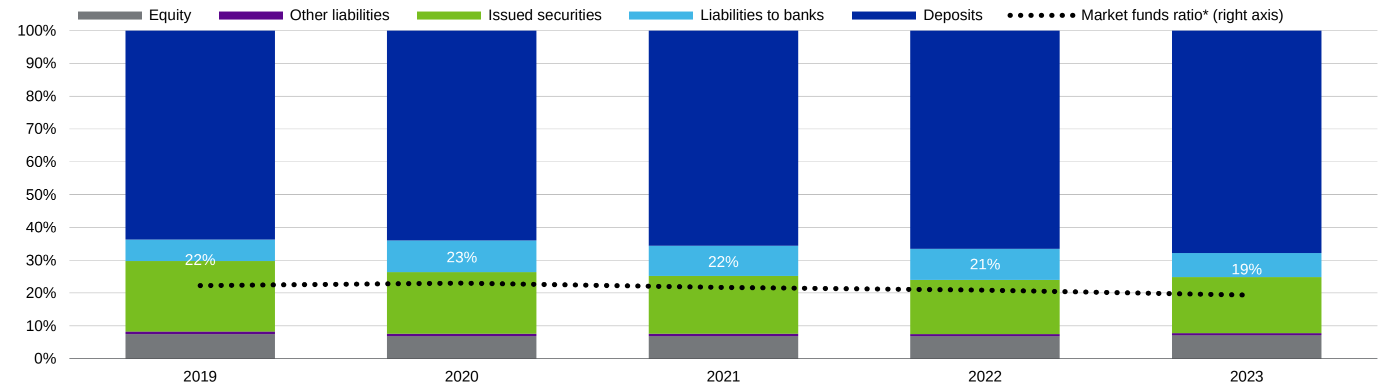
Source: Moody's Ratings and company filings

Excellent access to capital markets and strong deposit base

The a1 assigned Funding Structure score is positioned two notches above the a3 initial score. The score takes into account the guarantee provided by the Canton of St.Gallen on the bank's senior obligations, safeguarding the bank's access to more confidence-sensitive wholesale funding even under more adverse market conditions.

SGKB's main funding source is its customer deposit base, which amounted to CHF 27.8 billion as of 31 December 2023 (67% of total assets; including Kassenobligationen). The bank's largest market funding source is covered bonds, which amounted to CHF4.3 billion as of 31 December 2023, limiting potential interest-rate and refinancing risks for the bank owing to its better matched asset-liability profile. Additionally, market funding also comprised CHF3.0 billion of interbank liabilities and CHF2.7 billion of senior unsecured funding as of 31 December 2023. Further supporting funding stability, only 12% of the bank's covered bonds and 12% of its unsecured funding will mature before 2026.

Exhibit 8
SGKB's strong deposit franchise and long tenor of unsecured funding limits refinancing risks



*Market funds ratio = Market funds/tangible banking assets.
Source: Moody's Ratings and company filings

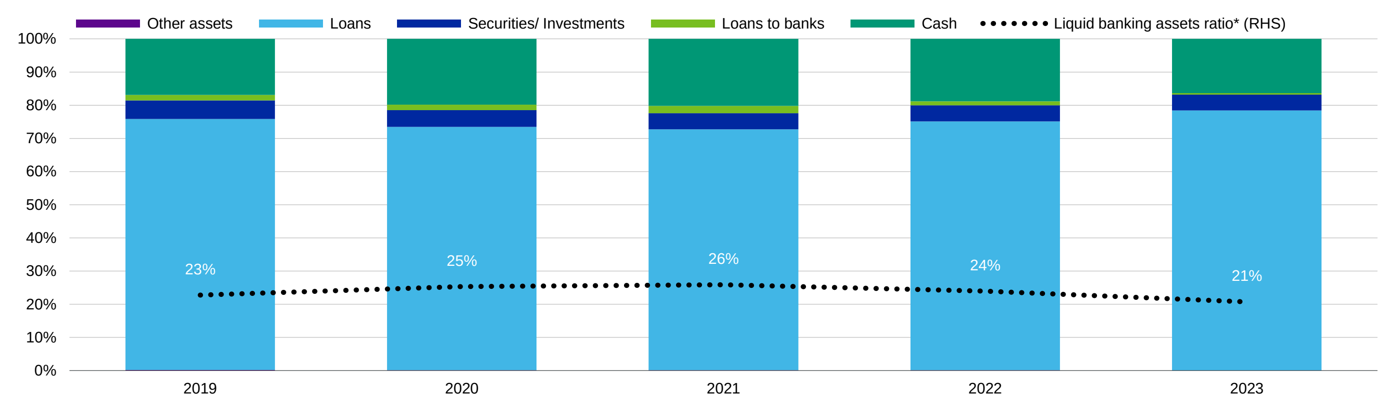
SGKB's liquid resources are sound, considering its moderate market funding reliance

We assign a baa1 Liquid Resources score, in line with the initial score, taking into account some limited asset encumbrance. With the SNB carry trade opportunity to fade out, bank's liquid resources are expected to decline in tandem with market funding dependence.

As a share of tangible banking assets, SGKB's liquid banking assets of 20.7% exceeded the bank's market funds of 19.4% as of 31 December 2023. Although some of its domestic peers still have stronger liquidity reserves compared with their market funding reliance, we do regard the bank's liquid resources as sound, also in light of the favourable term structure of SGKB's market funding and the canton's guarantee, both limiting refinancing risks.

As of 31 December 2023, SGKB's liquid banking assets were largely comprised of CHF6.7 billion of cash and central bank deposits and CHF1.6 billion of liquid investment securities. SGKB's Liquidity Coverage Ratio (LCR), stood at a solid 132.4% as of 31 December 2023, and the bank's Net Stable Funding Ratio (NSFR) was 127.6%.

Exhibit 9
SGKB's liquid resources are well balanced compared with its market funding profile

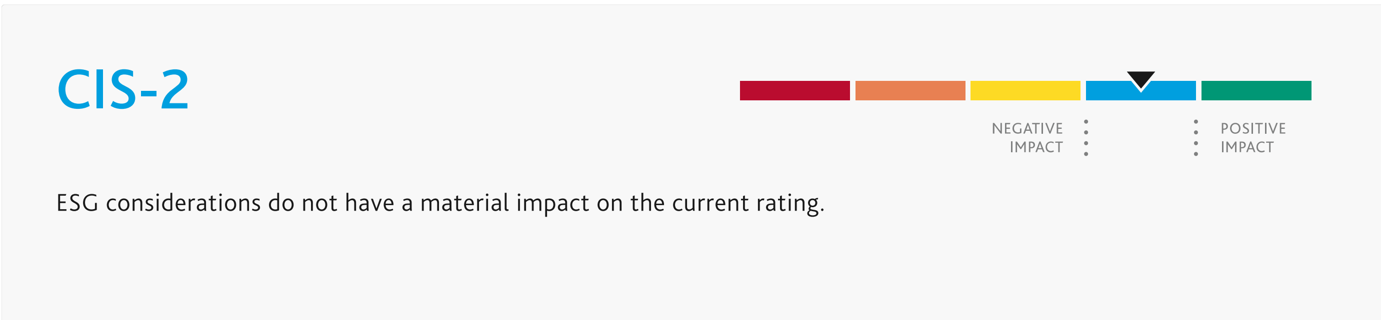


*Liquid banking assets ratio = Liquid banking assets/tangible banking assets.
Source: Moody's Ratings and company filings

ESG considerations

St.Galler Kantonalbank AG's ESG credit impact score is CIS-2

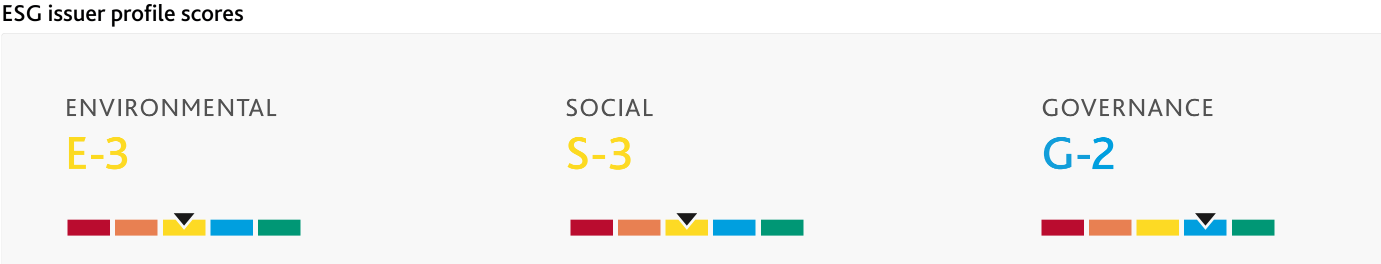
Exhibit 10
ESG credit impact score



Source: Moody's Ratings

SGKB's **CIS-2** indicates that ESG considerations do not have a material impact on the current rating.

Exhibit 11
ESG issuer profile scores



Source: Moody's Ratings

Environmental

SGKB faces moderate exposure to environmental risks primarily because of its loan portfolio exposure to carbon transition risks as a diversified regional banking group. Carbon transition risks relate mostly to its corporate loan book, which represents about a quarter of the bank's lending portfolio, with the remainder comprising residential real estate. In line with its peers, SGKB is facing mounting business risks and stakeholder pressure to meet broader carbon transition goals.

Social

SGKB faces moderate social risks related to customer relations and associated regulatory risks, litigation exposure, and high compliance standards. These risk exposures emerge primarily from its retail as well as its wealth and asset management operations and they are mitigated by the bank's developed policies and procedures. Furthermore, the bank's long track record of handling sensitive customer data as well as technology solutions and organizational measures to prevent data breaches and business disruption help to manage high cyber and personal data risks.

Governance

SGKB faces low governance risks, and its risk management, policies and procedures are in line with industry best practices and commensurate with its universal banking model. Also, even though the bank is 51% owned by the Canton of St.Gallen, seven of the nine members of its board of directors are considered independent.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Affiliate support

SGKB benefits from parental support from the Canton of St.Gallen. Parental support reduces the probability of default, as it would be available to stabilise a distressed bank and not just compensate for losses in resolution.

We consider a high level of support, reflecting that the Canton of St.Gallen owns 51% of the share capital of SGKB, which, combined with the bank's economic and social role as a cantonal bank in the region, provides an incentive for the canton to inject capital into SGKB prior to failure, in case of need. In this assessment, we also consider the deficiency guarantee, which is an incentive for the canton to inject capital prior to failure. Parental support provides one notch of rating uplift from the a2 BCA, leading to an a1 Adjusted BCA.

Loss Given Failure analysis

SGKB is subject to Swiss banking regulations, which we consider an operational resolution regime. We therefore apply our Advanced LGF analysis, which takes into consideration the risks faced by the different debt and deposit classes across the liability structure at failure. In our Advanced LGF analysis, we assign a 100% probability to deposits being preferred to senior unsecured debt, thereby reflecting depositor preference by law in Switzerland, otherwise we apply our standard assumptions.

For deposits, our LGF analysis indicates an extremely low loss given failure, leading to three notches ratings uplift from the a1 Adjusted BCA. For senior unsecured debt, our LGF analysis indicates a moderate loss given failure, leading to no uplift from the a1 Adjusted BCA.

Government support

We assess SGKB as government-backed by its regional authority, the Canton of St.Gallen, since it provides an explicit deficiency guarantee for all of the bank's unsubordinated obligations.

However, since we expect that the Canton of St.Gallen will provide some support to SGKB prior to failure, and given the uplift provided by our Advanced LGF analysis for the bank's senior obligations, SGKB's backed deposit ratings, its backed CRR and its backed Counterparty Risk Assessments do not benefit from further (regional) government support. The bank's Aa2 backed senior unsecured debt rating, however, incorporates two notches of (regional) government support uplift because of the deficiency guarantee. Since SGKB's subordinated Tier 2 instruments are not covered by the deficiency guarantee, they do not benefit from any uplift.

Further, we do not incorporate rating uplift from sovereign government support for SGKB's senior ratings due to the bank's small domestic market share and low importance to the Swiss banking system.

Methodology and scorecard

Methodology

The principal methodology we used in rating SGKB was our Banks Methodology, published in March 2024.

About Moody's Bank Scorecard

Our Bank Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 12

Scorecard St. Galler Kantonalbank

Macro Factors		
Weighted Macro Profile	**Strong +**	**100%**

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.6%	aa2	↔	a2		
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	16.0%	aa2	↔	aa3		
Profitability						
Net Income / Tangible Assets	0.5%	baa2	↔	baa3		
Combined Solvency Score		aa3		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	19.4%	a3	↔	a1		
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	20.7%	baa1	↔	baa1		
Combined Liquidity Score		a3		a2		
Financial Profile				a2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - Range				a1 - a3		
Assigned BCA				a2		
Affiliate Support notching				-		
Adjusted BCA				a1		

Balance Sheet	**in-scope (CHF Million)**	**% in-scope**	**at-failure (CHF Million)**	**% at-failure**
Other liabilities	9,356	22.6%	12,180	29.5%
Deposits	27,683	67.0%	24,860	60.1%
Preferred deposits	20,486	49.6%	19,461	47.1%
Junior deposits	7,198	17.4%	5,398	13.1%
Dated subordinated bank debt	100	0.2%	100	0.2%
Preference shares (bank)	100	0.2%	100	0.2%
Equity	1,240	3.0%	1,240	3.0%
Total Tangible Banking Assets	41,336	100.0%	41,336	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	10.4%	10.4%	10.4%	10.4%	2	2	2	2	0	aa2
Counterparty Risk Assessment	10.4%	10.4%	10.4%	10.4%	3	3	3	3	0	aa1 (cr)
Deposits	23.5%	10.4%	23.5%	10.4%	3	3	3	3	0	aa1
Senior unsecured bank debt	10.4%	3.5%	10.4%	3.5%	0	0	0	0	0	a1
Dated subordinated bank debt	3.5%	3.2%	3.5%	3.2%	-1	-1	-1	-1	0	a2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	2	0	aa2	-	Aa2	Aa2
Counterparty Risk Assessment	3	0	aa1 (cr)	-	Aa1(cr)	
Deposits	3	0	aa1	-	Aa1	Aa1
Senior unsecured bank debt	0	0	a1	-	Aa2	Aa2
Dated subordinated bank debt	-1	0	a2	-	A2	A2

Source: Moody's Ratings

Ratings

Exhibit 13

Category	Moody's Rating
ST.GALLER KANTONALBANK AG	
Outlook	Stable
Bkd Bank Deposits	Aa1/P-1
Bkd Counterparty Risk Rating	Aa2/P-1
Baseline Credit Assessment	a2
Adjusted Baseline Credit Assessment	a1
Bkd Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Bkd Senior Unsecured -Dom Curr	Aa2
Subordinate -Dom Curr	A2
Pref. Stock Non-cumulative -Dom Curr	Baa1 (hyb)

Source: Moody's Ratings

Endnotes

1 SGKB is classified as a Category 3 banking institution by FINMA. As such, it has to hold Common Equity Tier 1 of at least 9.0% of risk-weighted assets.

2 Swiss banks could hold sight deposits at 0% interest at the SNB in past years, which have been refinanced by market funding sources at negative rates in order to generate carry income. With the increase in interest rates starting in 2022, this carry trade opportunity declined but not disappeared because the SNB continued to remunerate banks' sight deposits at rates that remained above market funding rates. Starting 1 December 2023, the SNP no longer remunerates sight deposits up to the level of the minimum reserve requirement (minus cash holdings), and that the amount of sight deposits above that level that is remunerated at the SNB policy rate was lowered to 25 times the minimum reserve requirement from 28 times previously. Any sight deposits beyond that is remunerated at the SNB policy rate minus a discount of 0.5 percentage points. Hence, the carry trade opportunity has declined significantly for all Swiss banks.

REPORT NUMBER 1405339

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454