



Rating_Action: Moody's assigns Aa2 rating to Zuercher Kantonalbank's inaugural bail-in bond

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Frankfurt am Main, April 03, 2023 -- Moody's Investors Service (Moody's) has today assigned a Aa2 domestic currency junior senior unsecured rating to the proposed new CHF-denominated bail-in bond of Zuercher Kantonalbank (ZKB). The bail-in bond, which has a five-year maturity with a one-off issuer call date after four years, can be partially or fully written down in a bail-in scenario before ZKB's equity is fully written off. In such an unlikely event, the bondholders will receive a recovery certificate as compensation that can make them whole again over a maximum ten-year period if ZKB generates sufficient profits following its recapitalisation.

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 JUNIOR SENIOR UNSECURED RATING

The Aa2 rating assigned to the proposed bail-in bond 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, taking into account the proposed volume of bail-in bonds and limited loss protection from subordination in the form of residual equity, Additional Tier 1 (AT1) and Tier 2 instruments. This indicates a high loss given failure for ZKB's proposed bail-in bond, resulting in a one-notch downward adjustment from the bank's aa1 Adjusted BCA. In addition, the Aa2 rating incorporates Moody's assumption of a low probability of sovereign government support for loss-absorbing instruments, resulting in no related rating uplift.

In the course of resolution proceedings enacted by the Swiss regulator FINMA, the proposed bail-in bonds can be partially or fully written down before ZKB's equity is fully written off, thereby ensuring that the Canton of Zurich remains the sole owner of the bank and ZKB remains a public law institution. Hence, the holders of the bail-in bonds explicitly waive their no-creditor-worse-off (NCWO) rights when purchasing the instrument. To compensate for the bail-in bonds being written down rather than converting into equity, the bondholders will receive a recovery certificate after the instrument is written down, which can make them whole again over a maximum ten-year period if ZKB generates sufficient profits following its recapitalisation.

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

An upgrade of ZKB's junior senior unsecured 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 AT1 or Tier 2 instruments subordinated to the proposed bail-in bond, thereby leading to a lower loss given failure for the bank's junior senior unsecured debt class.

A downgrade of ZKB's junior senior unsecured 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 junior senior unsecured rating could also result from a deterioration of the canton's creditworthiness or if the guarantee framework the canton provides to ZKB changes.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/api/rmc-documents/71997>. Alternatively, please see the Rating Methodologies page on <https://ratings.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 on <https://ratings.moodys.com/rating-definitions>.

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Goetz Thurm
Vice President - Senior Analyst
Financial Institutions Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Michael Rohr
Senior Vice President
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main, 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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