Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

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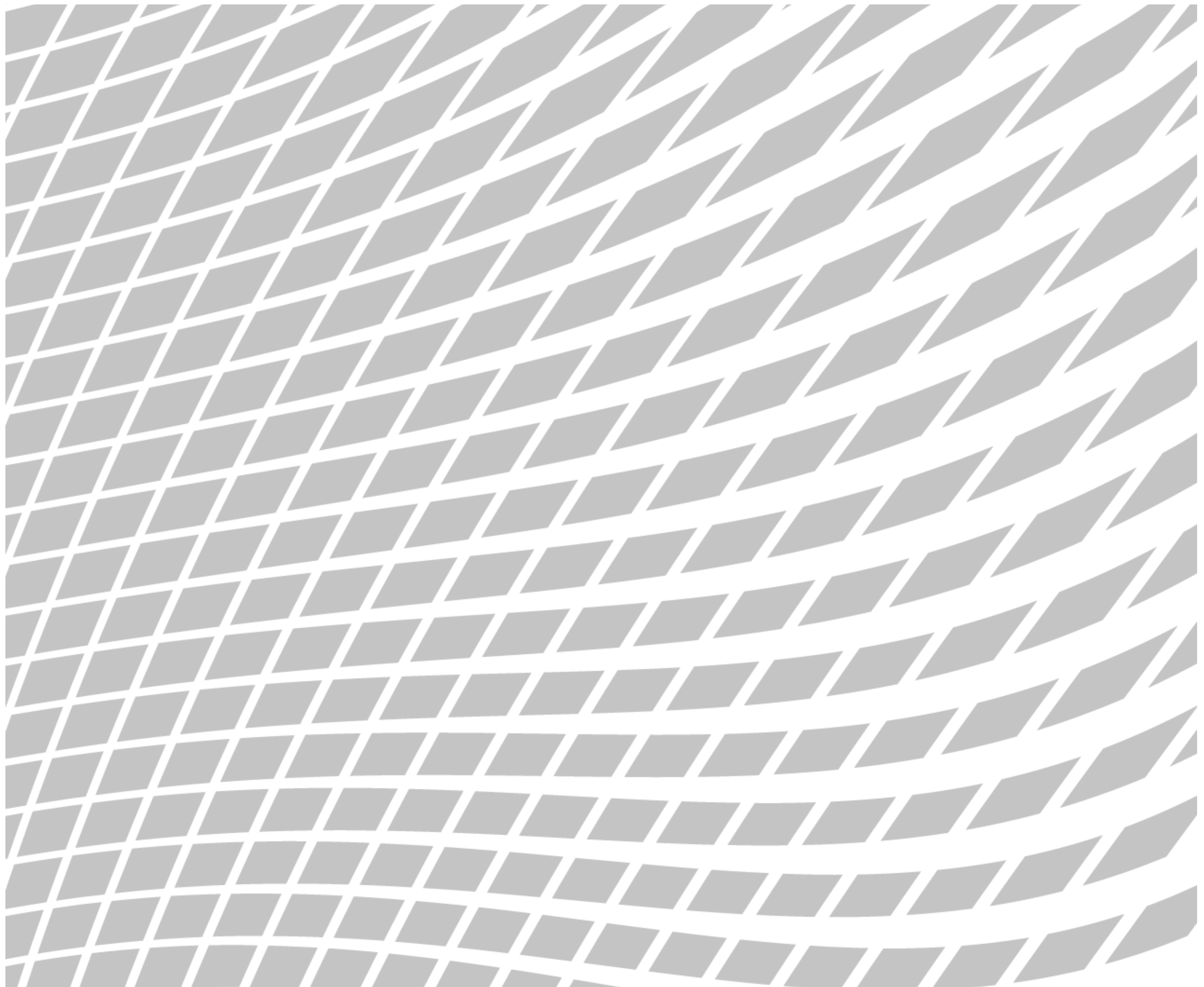
New Basel III rules on capital adequacy and revision of various FINMA circulars

Key points



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Switzerland intends to implement the capital adequacy rules of the international Basel III framework for all banks. To this end, FINMA is launching a consultation on the new circular governing eligible equity capital and on the amendments to the circulars governing market and credit risks, disclosure and risk diversification. Simultaneously, the Federal Department of Finance FDF will be carrying out a consultation on the relevant amendment to the Capital Adequacy Ordinance. Both consultations end on 16 January 2012.

After the 2008/2009 financial crisis there was a general consensus at national and international level that the banking sector needs stricter capital adequacy requirements. Under the leadership of the Group of Central Bank Governors and Heads of Supervision (GHOS) and the Basel Committee on Banking Supervision (BCBS), the new Basel III regulatory framework was drawn up during the course of the past three years, requiring banks to hold significantly more equity capital of a better quality (loss absorption capacity).

Against this international backdrop, provisions in Switzerland for stocking up banks with equity capital are to be revised. The Swiss Financial Market Supervisory Authority FINMA intends to adopt the international Basel III standards and complement them with transparent capital buffers which are specific to the situation in Switzerland. To this end, this package will replace the implemented Basel II standards applicable at national level, including their additions, discounts and other special rules (Swiss finish). This change in regulation, which was prepared by a national workgroup in collaboration with all the associations representing the institutions concerned, essentially brings the following advantages:

- More clarity: Many additions, discounts and special rules, which had been included in the Swiss finish since its introduction at the end of the 1980s when Basel I was implemented at national level, are to be replaced by the clearer and straightforward international provisions.
- Overall higher capital requirements: Besides complying with the minimum capital requirements and the capital buffer under Basel III, it is explicitly set down in the FINMA regulations that the banks must also hold additional capital, the amount of which is based on risk parameters (balance sheet total, managed assets, privileged deposits and minimum required capital – see FINMA Circular 11/2). The prudential basic philosophy that the Swiss capital adequacy regulations are to go beyond the international minimum standards is therefore maintained and strengthened further.
- More transparency: The higher capital requirements at Swiss institutions will no longer be defined externally in a selective and intransparent manner in the minimum requirements (former Pillar 1), but will be reported transparently in the category for additional equity capital.
- Better comparability: It will be possible to compare the capital ratios at Swiss institutions directly with the international standards applicable, which means that it will be no longer necessary to justify compliance with the Basel minimum standards vis-à-vis international supervisory committees in order to legitimise the Swiss special solution.
- Greater accuracy: The new provisions target the right institutions. The banks will be allocated to five supervisory categories according to their size and risk impact. The higher the category to which the bank is allocated, the greater are its additional capital requirements.
- Better risk control: Since the risk diversification rules for all institutions are to be adjusted to the international norms, the cluster risks of individual institutions will in future be less underestimated.

Swiss implementation of the new capital requirements comprises the minimum requirements determined under the international regulatory framework, the capital buffer and the anticyclical buffer (the so-called 'Basel pure'), i.e. the international minimum standards, as well as additional capital requirements which FINMA prescribes depending on the size of the bank (Swiss additions).

The new provisions should enter rapidly **into force, i.e. on 1 January 2013**, respecting the transitional deadlines of the international regulatory framework. The over 300 banks in Switzerland are affected differently depending on their current capital resources and their diverging business models. The greatest impact will be on the two big banks for which the 'too big to fail' package prescribes more stringent rules. In other words, big institutions will in future be expected to hold considerably more equity capital than under the Basel minimum standards; medium-sized banks will on average require somewhat more equity capital, while smaller banks will not or will only be marginally affected, or in some cases may even be released from this requirement. Most Swiss institutions already hold sufficient high-quality equity capital to comply with the implementation in Switzerland of the new international capital adequacy requirements.

Estimates show that the **switching costs** for the institutions are at a manageable level when set against total IT costs and the importance of the new regulations: small and medium-sized banks are expecting these costs to be in the general order of CHF 300,000, while big institutions must reckon with a low one-digit million mark if they have not already adjusted their systems to the new regime.

FINMA has estimated that the **economic repercussions** are also small. By adjusting the minimum capital requirements to international standards, it may be the case that additional costs arise in certain sectors of the credit industry (in particular, agricultural and commercial buildings). On the basis of macro-economic analyses however, it is not expected that the new rules will result in a general credit squeeze in Switzerland. The model calculations made by the Macroeconomic Assessment Group (MAG) for the Basel Committee on Banking Supervision predict a maximum GDP decline of less than 0.2% after four and a half years. The values for Switzerland are likely to be lower: although the country has a very high level of borrowing per capita by international standards, the vast majority of this is attributable to mortgage financing. The volume of loans directly relevant to growth (e.g. for SMEs) is considerably lower in Switzerland than in most other countries.

Not all the elements of the international Basel III framework will be implemented in this proposed revision of the Capital Adequacy Ordinance (CAO) and of the relevant FINMA implementing provisions. The introduction of an unweighted leverage ratio and new minimum standards for liquidity risks are still subject to preventive observation periods to identify any undesired effects that may arise. Starting next year, the relevant draft revisions will follow for Swiss banks.