Circular 2011/2
Capital buffer and capital planning – banks

Capital buffer and capital planning in the banking sector

Reference:	FINMA Circ. 11/2 “Capital buffer and capital planning – banks”
Date:	30 March 2011
Entry into force:	1 July 2011
Last amendment:	31 October 2019 [Modifications are indicated by an asterisk (*) and are listed at the end of the document.]
Legal framework:	FINMASA Art. 7 para. 1 let. b BA Art. 4 paras. 1, 2 and 3 CAO Art. 2, 43, 44, 44*a*, 45, 131*a*, 131*b*
Appendix:	Determining risk-weighted assets for the extended countercyclical buffer (Art. 44a and 131a CAO)

Addressees

BankA			ISA			SESTA	FMIA						CISA									AMLA			Other	
Banks	Financial groups and congl.	Other intermediaries	Insurers	Insurance groups and congl.	Intermediaries	Securities dealers	Trading venue	Central counterparties	Central securities depositories	Trade repositories	Payment systems	Participants	Fund management companies	SICAVs	Limited partnerships for CISs	SICAFs	Custodian banks	Asset manager CISs	Distributors	Representatives of foreign CISs	Other intermediaries	SROs	DSFIs	SRO-supervised institutions	Audit firms	Rating agencies
X	X					X																				

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I. Objective and purpose

In addition to minimum capital requirements primarily for credit, market and operational risks in Article 42 (Pillar 1), the Capital Adequacy Ordinance (CAO; SR 952.03) also provides for banks to hold a buffer (i.e. a capital buffer in accordance with Article 43 CAO, plus the countercyclical buffer in accordance with Article 44 CAO, plus the extended countercyclical buffer in accordance with Article 44*a* and 131*a* CAO) and, in individual cases, additional capital in accordance with Article 45 and 131*b* CAO, to take account of any risks not covered by the minimum capital requirements and to ensure that the minimum capital requirements are met even in adverse circumstances (Pillar 2). 1*

As regards determining each institution's specific capital adequacy requirements, the Basel Capital Accord requires institutions to employ suitable processes to identify, measure and aggregate all the types of risk that are relevant to them and underpin them with (economic) capital. 2

In principle, an adequate buffer under Pillar 2 must be structured such that any risks not covered or insufficiently covered by the minimum requirements under Pillar 1 are taken into consideration. This ensures compliance with the minimum requirements, even in adverse circumstances, so that the institution's business activities can be continued in an orderly fashion (going-concern principle). 3*

The buffer requirements under Articles 43–44*a* and 130, 131*a* and 131*b* CAO are also intended to contribute to the avoidance of procyclical behaviour on the part of institutions and to an increase in overall financial stability. 4*

This Circular fleshes out FINMA's supervisory practices concerning Articles 43–45 CAO (buffer and additional capital) and contains further details on the countercyclical buffers as defined by Articles 44 and 44*a* CAO as well as the guidelines on implementing further requirements under Pillar 2, in particular relating to the internal capital planning process. 5*

FINMA's supervisory practices concerning other aspects of Pillar 2 are already specified in FINMA Circulars 19/2 "Interest-rate risks – banks", 17/1 "Corporate governance – banks" and 10/1 "Remuneration schemes" (risk-based remuneration: margin nos. 30–38). 6*

II. Scope of application

This Circular applies to banks under Article 1 of the Banking Act (BA; SR 952.0), securities dealers under Article 2 let. d and Article 10 of the Stock Exchange Act (SESTA; SR 954.1), and financial groups and financial conglomerates under Article 3*c* paras. 1 and 2 BA. 7

For financial groups, these capital adequacy requirements apply both at consolidated level and at the level of the individual institution. FINMA has the power to grant exemptions to the requirements at the individual institution level. 8

Institutions under Articles 47a–47e CAO can confine themselves to the simplified leverage ratio as far as the fundamental capital planning requirements (margin nos. 34–37) and the content of capital planning (margin nos. 38–41) are concerned. 8.1*

Section III of this Circular does not apply to the systemically important banks. 9*

III. Categorisation, capital buffers and capital adequacy target

Abrogated 10*-11*

A. Abrogated

Abrogated 12*-13*

B. Categorisation and capital buffers

Abrogated 14*

FINMA reviews the allocation of institutions and financial groups to one of the categories set out in Article 2 para. 2 of the Banking Ordinance (SR 952.02) at the end of the calendar year on the basis of their supervisory reporting[1] and capital statement with effect from the next fiscal year. 15*

If an individual institution and the financial group to which it belongs do not fall into the same category, both are subject to the higher capital buffer. This rule covers cases where the individual institution has the role of a parent company. It does not apply to other banks and securities dealers in the group. The capital adequacy target is determined by the institution's individual categorisation. Institutions that are part of a holding structure or contractual group must at least fulfil the capital adequacy requirements corresponding to their categorisation, while the capital buffer determined on a consolidated basis must be met at financial group level. However, FINMA reserves the right to require particular institutions within a group to meet a higher capital ratio if their role in the group is similar to that of a parent company. 16*

If moving an institution into a different category results in a higher capital buffer, FINMA will grant a specific transitional deadline for that institution. 17*

C. Abrogated

Abrogated 18*-20*

D. Capital adequacy target

For non-systemically important banks the capital adequacy target is equal to the overall capital ratio in accordance with annex 8 CAO plus the countercyclical buffer requirements (Article 44 and 44*a* CAO) plus any supplementary capital requirements under Article 45 CAO. Depending on the quality of capital, the capital adequacy target comprises targets for CET1, AT1, Tier 1 and Tier 2 capital. 20.1*

[1] A group holding company with or without a banking licence does not need to report privileged deposits at its banking subsidiaries at consolidated level. The privileged deposits of consolidated banking subsidiaries are therefore added when categorising financial groups.

If an institution's overall capital ratio falls below its capital adequacy target by more than the amount set out below or its CET1 ratio falls below its CET1 target by more than the amount set out below, this will trigger the measures stipulated in margin nos. 24–29: 20.2*

20.3*

Category	Intervention triggered if overall capital ratio/CET1 capital ratio falls below capital adequacy target/CET1 target by more than
1 and 2 (non-systemically important)	1.2 percentage points
3	1 percentage point
4	0.7 percentage points
5	0 percentage points

E. Abrogated

a. Conscious failure to comply with the capital adequacy target

In principle, it is permissible for an institution to fail knowingly to comply with the capital adequacy target on a temporary basis, for example in the case of a merger or acquisition. 21

In such cases, the institution must inform FINMA in advance that it will fail to comply, stating its reasons as well as how and when compliance with the capital adequacy target will be restored. 22

If circumstances such as mergers or acquisitions result in an institution changing category, FINMA may grant a specific transitional deadline for that institution. 23

b. Unintended failure to comply with the capital adequacy target / breach of the intervention threshold

If FINMA sees an institution's overall capital ratio or CET1 ratio falling below the capital adequacy target, it intensifies its supervision and contacts the institution to clarify the causes. 24*

If the institution is generally capable of making a profit or borrowing capital on standard terms via the capital market, it is then requested to take the necessary measures to restore the capital ratio to the capital adequacy target as quickly as possible. 25

If the institution is temporarily not capable of making a profit, be it for institution-specific reasons or due to a crisis in the international or Swiss financial sector, it is to show FINMA that it is taking suitable measures to restore the capital ratio to the capital adequacy target and indicate when this can be expected. In this case, FINMA may grant a longer deadline for restoring the target level, taking account of the institution's circumstances and the situation in the financial sector. 26

c. Supervisory measures in response to an unintended failure to comply with the capital adequacy target / breach of the intervention threshold

If FINMA deems the measures taken by an institution to be inadequate, it will introduce supervisory measures depending on the extent to which the institution's capital falls below the capital adequacy target. 27

If an institution's capital falls below the target level, FINMA may order it to reduce or refrain entirely from dividend payments, share buybacks and discretionary remuneration components or to carry out a capital increase. 28

If the intervention threshold is breached, FINMA may, in addition to the measures listed in margin no. 28, order the institution to reduce its risk-weighted assets, sell specific assets or withdraw from specific areas of business. 29

IV. Stricter requirements for specific cases

FINMA will take measures if it deems that the capital buffers in accordance with Articles 43–44*a*, 130 and 131*a* CAO do not adequately cover an institution's risk profile or that the institution's risk management is insufficient in view of its risk profile. These measures will remain in place as long as the increased risk situation persists. 30*

In particular, FINMA will consider stricter requirements on a case-by-case basis where there are significant risk concentrations (in terms of areas of activity, counterparties or loans in specific economic sectors, regions or currencies etc.), where the institution is exposed to refinancing or liquidity risks or for financial groups with complex and intransparent structures. 31

If it subjects an individual institution to stricter capital adequacy requirements, FINMA will give reasons for its decision to the institution concerned and issue a ruling where necessary. 32

Institutions will be given reasonable advance warning if FINMA intends to impose institution-specific capital adequacy requirements and will have the opportunity to adjust their risk profile such that FINMA can dispense with the intended measures. 33

V. Capital planning

A. Fundamental capital planning requirements

Regardless of the buffers in accordance with Articles 43–44*a*, 130 and 131*a* CAO, FINMA expects supervised institutions and groups to operate adequate capital planning, which is to be documented in writing, at both consolidated and individual institution levels in line with their individual circumstances. 34*

In assessing whether their capital is adequate, institutions must take into account the economic cycle. 35

They must show in their capital planning that they are in a position to meet their capital adequacy requirements in future (over a three-year horizon), even in the event of an economic 36 downturn and their revenues falling sharply. The underlying assumptions for the capital planning must be documented in a transparent and comprehensible manner.

FINMA takes account of the supervised institutions' various business models and risk profiles by ensuring that capital planning requirements are aligned with each institution's size as well as the nature and complexity of its operations ("proportionate approach"). 37

FINMA will conduct an extended capital planning dialogue with certain institutions on a case-by-case basis, particularly those that pose a systemic risk. In the course of this dialogue institutions must present plans on how they would mitigate adverse developments under stressed conditions. FINMA may lay down particular requirements for these institutions. 37.1*

B. Content of capital planning

Analysing an institution's current and future capital adequacy requirements in relation to its strategic targets is integral to the institution's overall planning efforts. 38

Forward-looking capital planning must be closely tied to overall planning, particularly the institution's income targets and budget process. 39

Capital planning must provide a reliable forecast of available capital on the basis of business planning and budgeting, future profits, dividend policy and corporate actions foreseen by the executive management. 40

Capital planning must be based on realistic assumptions with regard to business performance. 41

C. Governance and process

The executive management is responsible for determining capital planning and the capital planning process. 42

The board of directors must approve the capital planning at least once a year. 43*

D. Review procedure

Audit firms comment on the adequacy of the capital planning, indicating the extent of the audit they conducted. They are also to set out their key assumptions. Audit firms must pass comment on institutions' capital planning in their regulatory audit reports. 44

FINMA analyses and reviews institutions' capital planning in line with their categorisation. 45

VI. Countercyclical buffers (Articles 44, 44*a* and 131*a* CAO)

The risk-weighted assets for the (sectoral) countercyclical buffer under Article 44 CAO are determined in accordance with annex 7 CAO; on the determination of the risk-weighted assets for the extended countercyclical buffer (Article 44*a* and 131*a* CAO) see the Appendix. 46*

VII. Transitional provisions

Abrogated 47*-50*

Appendix

Determining risk-weighted assets for the extended countercyclical buffer (Art. 44*a* and 131*a* CAO)

The discussion of the extended countercyclical buffer in this annex draws on the following documents published by the Basel Committee on Banking Supervision: 1

- "Basel III: A global regulatory framework for more resilient banks and banking systems" of December 2010, revised in June 2011 ("B3");
- "International Convergence of Capital Measurement and Capital Standards, A Revised Framework, Comprehensive Version" of June 2006 ("B2");
- "Frequently asked questions on the Basel III Countercyclical Capital Buffer" of October 2015 ("FAQ").

References to these documents in the text are given in square brackets using the abbreviations B2, B3 and FAQ.

I. Definition of "foreign exposure"

The term "foreign exposure" in Article 44*a* para. 1 CAO refers to the level of foreign claims on an ultimate risk basis, i.e. based on the jurisdiction where the guarantor of the exposure resides as per the definitions in the international banking statistics of the Bank for International Settlements (BIS).[2] 2

Foreign claims are claims by a Swiss bank on counterparties outside Switzerland. 3

Foreign claims comprise all credit exposures, i.e. to the public sector, banks and the non-bank private sector (as defined in the BIS international banking statistics), but excluding exposures such as derivative contracts, guarantees and loan commitments. 4

The lower limit of CHF 25 billion for the total foreign exposure set out in Article 44*a* CAO relates to the bank's highest level of consolidation including branches and subsidiaries in Switzerland and abroad. 5

II. Computation of the weighted average extended countercyclical buffer in accordance with Art. 44a paras. 2–4 CAO

[B3§144] The weighted average of the extended countercyclical buffer, which can be a maximum of 2.5%, is computed as follows: 6

$$\sum_j X_j \frac{RWA_j^{AZP}}{RWA^{AZP}}$$

where:

j represents the jth member state of the Basel Committee on Banking Supervision (including Switzerland);

$\boldsymbol{X_j}$ is the level of the countercyclical buffer applying in member state j;

[2] https://www.bis.org/statistics/bankstatsguide.htm

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RWA_j^{AZP} are the weighted exposures to the non-bank private sector in member state j for credit and market risk in accordance with Art. 42 para. 2 let. a, c and f CAO;

RWA^{AZP} is the total weighted exposure to the non-bank private sector in all jurisdictions (including Switzerland) for credit and market risk in accordance with Art. 42 (2) a, c and f CAO.

The weighted exposures in accordance with Art. 42 para. 2 let. b, d and e CAO are not included in the extended countercyclical buffer.

[FAQ 3.1] For the purposes of the countercyclical buffer, the expression "private non-banking sector" refers to the definition given in the consolidated banking statistics published by the BIS. Credit risks covered by equity capital towards the public sector and towards banks, as defined in the consolidated banking statistics published by the BIS, are expressly excluded. 7

[FAQ 3.1] The expression "credit and market risk" relates to all credit risks (including counterparty credit risks) that are to be covered by equity capital and the corresponding risk-weighted minimum capital requirements in the trading book for the specific risk, the incremental risk charge and securitisations. 8

Positions which are secured by banks or by the public sector, be this through an explicit guarantee or through collateral or credit derivatives, must be taken into account. Alternatively, they can also be taken into account in accordance with the rules of the competent supervisory authorities in the respective member state. 9

Further information on X_j, the amount of the countercyclical capital buffer in the member state j: 10

- [FAQ 2.5, 5.1] The BIS will maintain a register of all decisions of national authorities on the level of the countercyclical buffer (http://www.bis.org/bcbs/ccyb/index.htm). The buffer levels listed in this register are used to compute the weighted average buffer. 11
- [FAQ 2.4] If a national authority sets its countercyclical buffer at over 2.5% of risk-weighted exposures, FINMA may recognise this buffer level at its discretion. If FINMA does not recognise the buffer in excess of 2.5%, a bank must apply an extended countercyclical buffer of 2.5% to credit exposures located in this country. 12
- [B3§141, FAQ 6.1] If a national authority raises the countercyclical buffer or sets it above zero for the first time, a bank must apply this buffer with effect from twelve months from the date on which the national authority announces the new level of the countercyclical buffer, irrespective of whether the authority requires the banks incorporated in this state to apply the change in the buffer earlier. 13
- [FAQ 6.2] If a national authority lowers the countercyclical buffer requirement, the lower level may be used from the date stipulated by the national authority. 14

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III. Computation of capital requirement for the extended countercyclical buffer (Art. 44a para. 2 and 131a CAO)

[B3§143] The risk-weighted assets under the extended countercyclical buffer, which determines the capital charge, is computed by multiplying the weighted average buffer requirement by the bank's total risk-weighted assets: 15

$$RWA^{gesamt}\left(\sum_j X_j \frac{RWA_j^{AZP}}{RWA^{AZP}}\right)$$

where:

$\boldsymbol{RWA^{gesamt}}$ represents the bank's total risk-weighted assets under Art. 42 para. 2 CAO (subject to the floor as stipulated in FINMA Circular 17/7 "Credit risk – banks", margin no. 476 and FINMA Circular 08/21 "Operational risk – banks", margin no. 116).

Further information on the location of a credit exposure

[FAQ 3.1, 3.2] A bank should where possible determine the geographic location of a non-bank private sector credit exposure or credit risk according to where the ultimate risk lies, i.e. the jurisdiction of the guarantor, not the the jurisdiction in which the exposure was booked. 16

[FAQ 3.2] The jurisdiction of the immediate obligor and ultimate obligor are determined for the purposes of computing the countercyclical buffer on the basis of the definitions of the BIS international banking statistics. 17

[FAQ Annex] The procedure for identifying the location of the ultimate obligor is as follows: 18

19

	Jurisdiction of ultimate obligor of credit exposure
Borrower located in jurisdiction A	
No guarantor[3]	A
Guarantor located in jurisdiction A	A
Borrower located in jurisdiction A	
Guarantor located in jurisdiction B	B
Borrower is a branch of a parent company domiciled in jurisdiction B	B
The borrower is domiciled in jurisdiction A and the guarantors are spread across several countries or the guarantee/collateral cannot be assigned exclusively to any one jurisdiction.	The most reasonable operating solution for the bank or the policy of the BIS international banking statistics, if one exists

[3] The guarantor may be the provider of the collateral or guarantee or the protection seller in a credit derivative.

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For derivative exposures with collateral: if the counterparty is located in country A and the collateral in country B	The most reasonable operating solution for the bank or the policy of the BIS international banking statistics, if one exists
Repo transaction with a counterparty in jurisdiction A (irrespective of geographical location of the collateral risk)	A
Securities lending and borrowing transactions and Lombard loans with a counterparty in jurisdiction A	The most reasonable operating solution for the bank or the policy of the BIS international banking statistics, if one exists
Securitisation exposures	Based on the country of residence of the debtors of the underlying exposures ("look through" approach) If the debtors of the underlying exposures cannot be assigned to any one country, the bank will choose the most reasonable operating solution for the bank or use the policy of the BIS consolidated banking statistics, if one exists
Specialised lending as defined by [B2§219–220] ("look through" approach)	
e.g. project finance: borrower in jurisdiction A with project located in jurisdiction B	B
Specialised lending in general	Jurisdiction in which the profits from the lending are generated
Collective investment vehicle located in jurisdiction A	
The bank holds debt instruments issued by such an investment vehicle	Jurisdiction in which the investment vehicle (or its parent company/guarantor) is domiciled
The bank holds shares or units in such an investment vehicle	Allocated proportionately to the jurisdictions of the ultimate risk exposures in which the investment vehicle is invested ("look through" approach).
Trading book exposures from jurisdiction A	A
[FAQ 4.3] If the capital charge is determined on a portfolio basis and the portfolio comprises trading book exposures from different countries (provisional treatment until the Basel Committee on	The risk-weighted equivalents of the minimum capital requirements for the trading book are allocated to the constituent countries of the portfolio by computing the proportion of the

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Banking Supervision publishes a definitive solution).	portfolio's total exposure at default (EAD) that is due to the EAD from counterparties in each country. If a country accounts for a negative proportion of the portfolio's total EAD (e.g. owing to short positions), a minimum allocation of 0 applies.

The jurisdiction of the immediate counterparty should only be used if the jurisdiction of the ultimate risk is impossible to determine on a reasonable effort basis. 20

IV. Further issues

[FAQ 2.6] If authorities in member states of the Basel Committee on Banking Supervision implement sectoral buffer requirements limited to specific credit exposures or other macroprudential measures, these need not be taken into account in determining the weighted average of the extended countercyclical buffer. 21

[FAQ 2.1] Reciprocity is only mandatory for Basel Committee member jurisdictions. If non-member jurisdictions implement a countercyclical capital buffer, this need not be taken into account. 22

List of modifications

This Circular has been modified as follows:

These modifications were adopted on 5 July 2012 and will enter into force on 1 January 2013.

newly inserted margin nos.	20a – 20c
abrogated margin nos.	12 – 13 and 50

Moreover, references to the Capital Adequacy Ordinance (CAO; SR 952.03) have been adapted according to the version which will enter into force on 1 January 2013.

This modification will enter into force on 1 January 2013.

modified margin no.	5

These modifications were adopted on 20 June 2018 and will enter into force on 1 January 2019.

newly inserted margin nos.	20.1, 20.2, 20.3, 37.1
modified margin nos.	1, 3, 4, 5, 6, 9, 15, 16, 17, 24, 30, 34, 43, 46
abrogated margin nos.	10, 11, 14, 18, 19, 20, 20a, 20b, 20c, 47, 48, 49
other modifications	change in title before margin nos. 10, 14, 20.1, 46 abrogation of title before margin nos. 18, 21

This modification was adopted on 31 October 2019 and will enter into force on 1 January 2020.

newly inserted margin no.	8.1

The appendix to this Circular has been modified as follows:

These modifications were adopted on 20 June 2018 and will enter into force on 1 January 2019.

abrogated	appendix on the categorisation of institutions
new	appendix on determining risk-weighted assets for the extended countercyclical buffer (Art. 44*a* and 131*a* CAO)