Schwanengasse 12
P.O.Box
CH-3001 Berne
Phone +41 31 322 69 11
Fax +41 31 322 69 26
info@ebk.admin.ch
www.sfbc.admin.ch

Eidgenössische Bankenkommission
Commission fédérale des banques
Commissione federale delle banche
Swiss Federal Banking Commission

Media Conference, 27 April 2006

Attorney Daniel Zuberbühler
Director of the Swiss Federal Banking Commission

Basel II Switzerland: a precision landing

Since 1998 the SFBC Annual Report has contained information on the revision of the Basel Committee on Banking Supervision's Capital Accord (Basel II). The focus has gradually shifted from the international level, where the minimum standard was worked out carefully over a long period of time, to the level of national implementation. The SFBC Annual Report 2005 is therefore primarily devoted to the implementation of Basel II in Switzerland, while not losing sight of the ongoing work of the Basel Committee.[1] At both levels Basel II represents a massive regulatory project that ties up enormous resources on the part of both banks and supervisors, but that should – at least as far as the texts of the regulations and calibration are concerned – be concluded in 2006. However, the focus at each level is different (Slide 1): in Switzerland, the vast majority of small and medium-sized institutions will primarily rely on the basic, standardised approaches for Basel II. At the international level, however, in most cases work is still ongoing to fine-tune the advanced, institution-specific internal approaches (IRB and AMA) that the two globally active major Swiss banks will also apply from the start of 2008 onwards. The Swiss provisions for these sophisticated approaches refer to the rules drawn up by the Basel Committee, meaning that our involvement in this regard is focused on our active role within that Committee and its numerous technical working groups as well as the intensive and protracted approval process for the applicant banks.

This address is aimed at informing you on the current state of the implementation of Basel II in Switzerland. However, I cannot provide you with any additional information on the results of the Quantitative Impact Study 5 (QIS5). This international study about the impact of Basel II has been conducted by the Basel Committee in the fourth quarter of 2005 – at the same time, as a matter of fact, as the national study in Switzerland (QIS-CH). The data collected from a large sample of banks, belonging to member countries of the Basel Committee as well as from banks outside the G10, is currently being analysed in depth and will be evaluated by the Basel Committee at the end of May with a view to possible recalibration.

[1] SFBC Annual Report 2005: national implementation p. 15ff.; Basel Committee p. 97ff. (German) or p. 11 ss and p. 97 ss (French)

It has been agreed that national supervisory authorities will not even publish country-specific findings until the full results of QIS5 are made available by the Basel Committee. However, they will communicate them informally to the institutions concerned. This decision has to be respected in the interest of ensuring a coherent opinion-forming process, even though it would be helpful from a domestic policy point of view to go ahead now and highlight the trends at the two major Swiss banks that took part in QIS5.

Results of the Swiss consultation process

In the fourth quarter of 2005 the Banking Commission consulted with the private sector and the official bodies on the draft text of the ordinances and circulars together with a detailed explanatory report on the implementation of Basel II. The drafts essentially met with approval, including those circles which had originally feared that Basel II would threaten SME lending. As the subject matter is highly technical, criticisms from the most directly affected group – the banking associations – focused primarily on specialised technical issues and practical proposals for simplifications designed to facilitate cost-effective implementation without any significant deviations from the universally accepted objectives. These criticisms have since been addressed through a constructive dialogue within in the national working group responsible for the consultative drafts, and mutually resolved.

However, the banking associations' approval in principle of the concept for the Swiss implementation of Basel II was subject to a caveat. Understandably, they requested that the calibration of capital adequacy requirements based on the quantitative impact study be carried out correctly, transparently and in full consultation with all parties involved, in the national working group and in accordance with the objectives formulated. Since the Swiss quantitative impact study was carried out at the same time as the consultation on the various regulatory texts mentioned above, the banks were unable to submit a definitive opinion on the risk weights and multipliers proposed. At the end of the day, the point is how much capital is required under the new rules for the entire banking system and for individual institutions, but also how this compares to existing laws or – where relevant – to those applicable to foreign competitors, who the winners and losers are, whether the incentive structure is correct, and what changes can be expected in the future.

Results of the national study (QIS-CH) into the quantitative impact of Basel II in Switzerland

We published[2] the data collected from 77 institutions on 11 April 2006 together with our comments. I can therefore restrict myself here to a summary of the most important findings:

[2] http://www.ebk.admin.ch/d/dossiers/pdf/Analysebericht_d.pdf (German) or http://www.ebk.admin.ch/f/dossiers/pdf/Analysebericht_f.pdf (French)

- The purpose of the national study was to assess, whether the quantitative goal of maintaining the overall capital requirements in the banking system (excluding the large banks) could be achieved with the proposed risk weights and rules for the Swiss implementation of Basel II. The assessment was conducted via computations based on a representative sample of institutions. These computations however restricted themselves to the simple, standardised approaches for credit and operational risks, which were compared with the currently applicable capital adequacy requirements under the Swiss version of Basel I.

- The starting point and first benchmark of the comparison with current law was the Swiss standardised approach for credit risks, enriched with the new elements of Basel II, and the newly introduced requirements for operational risks, which were adopted unchanged from Basel II (Basel II SA-CH). The result is that we achieved an accurate precision landing, as evidenced from the graphical representation of the relative change between Basel I and Basel II SA-CH (Slide 2). The overall capital requirements in the system constituted of the 77 institutions amalgamated (via a weighted average) to form a single, “representative” bank falls by just 2.34%. This value would increase, but by a small amount only had the institutions made full use of all the reduction options offered by the new rules. Given these results we are happily spared the trials of a recalibration exercise, that could have brought up highly sensitive political issues, especially if as a consequence certain risk weights (e.g. for residential mortgages) had had to be increased.

- The redistribution effect of the new Basel II rules is very balanced: almost half of the institutions need to hold less capital, while the other half have higher requirements. The relative change is unevenly distributed, however. As is to be expected, the cantonal, regional and Raiffeisen banks, active in traditional lending business i.e. primarily with residential mortgages and retail loans (including small-scale corporate loans), tend to have a lower capital requirement than before. Conversely, the new requirements for operational risks lead to a relatively sharp increase in capital requirements, particularly for those institutions that focus primarily on asset management, investment advisory or trading services. However, these are generally the same banks that currently have very large capital surpluses. This is due to the fact that they are exposed to relatively few credit and market risks and were therefore only marginally affected by the rules, which until now have only targeted these risk categories. Therefore the relief granted by the new rules in terms of credit risks cannot compensate for the increase necessitated by requirements for operational risks. These banks evidence a reduction in their high capital surplus. In no cases, however, does the new regime result in a capital deficit (Slide 3).

- The second aim of QIS-CH was to determine the size of the multipliers required to bring the international standardised approach for credit risks (SA-BIS) offered as an alternative (and now, following the consultation process, available without restrictive conditions to all institutions) up to the same level as the Swiss standardised approach (SA-CH). This approach, also known as Basel II pure, is the most conform and accurate possible implementation of the standardised approach from the Basel II rules or the EU Directive, with no specifically Swiss add-ons, discounts or simplifications. The comparative study of the two approaches showed that while the Swiss

standardised approach leads on average to higher capital requirements, these are however smaller than what had been assumed while setting the multipliers proposed in the consultation package. The multipliers were therefore reduced accordingly and are being accepted by the banks (Slide 4).

No cost analysis, but no prejudice for future regulatory projects

In the explanatory notes to the consultation package and in the Annual Report 2005, the Banking Commission announced that it planned to carry out an analysis of the costs of implementing Basel II in the first quarter of 2006 in cooperation with the Swiss Bankers Association. Unlike QIS-CH, which looked at the impact of Basel II on capital adequacy requirements, the aim of this analysis was to estimate the costs of preparing for and changing over to Basel II in the banks as well as its subsequent day-to-day application. After we had prepared the corresponding survey and discussed it in the national working group, the heads of the Bankers Association and the Banking Commission agreed at the beginning of April not to carry out the Basel II cost analysis after all. Meaningful cost estimates are difficult to draw up and involve a great deal of time and effort on the part of all those involved. The timing was felt to be unfavourable first because the implementation load on banks is heavy enough, and second because the work on the rules is already so advanced that major changes appear hardly possible given the tight schedule. On the other hand, a reliable cost analysis could not have been carried out at an earlier stage when the rules to be applied had not yet been fully fine-tuned. Hence there is a considerable risk of coming up with a cost estimate either too early or too late.

Both parties agree as well, however, that the decision not to proceed with the analysis in the Basel II case should not prejudice quantitative cost/benefit analyses for subsequent regulatory projects. Principle 2 of the Guidelines for Financial Market Regulation[3] published by the Federal Department of Finance in September 2005, which the Banking Commission played a major role in formulating and to which we are fully committed expressly requires the regulatory authorities to estimate as accurately as possible the impact and costs of regulation for those affected and weigh these against the expected benefit. We will therefore develop the methodology for such analyses in conjunction with the Bankers Association and select a suitable regulatory project. Basel II was perhaps too great a challenge as an initial test subject. However, the basic concept of weighing up costs and benefits and above all differentiating according to varying needs was applied in full at every stage of the regulation process for the Swiss implementation of Basel II.[4]

Conclusion

We have reached the home straight for the Swiss implementation of Basel II. Agreement has been reached with the banking associations affected on all key issues. The

---

[3] http://www.efd.admin.ch/dokumentation/grundlagenpapiere/00818/index.html?lang=en

[4] cf. Daniel Zuberbühler, Basel II – Swiss cuisine with something for all tastes, SFBC media conference on 19 April 2005, http://www.ebk.admin.ch/e/publik/refer/pdf/050419_Referat_Z_e.pdf

national working group is taking care of the final, detailed adjustments and is also examining the deferred consultative proposal for a Banking Commission circular on concentration risk and on capital requirements for guarantees and credit derivatives.[5] At the end of June 2006 the Banking Commission will deliver the ordinances proposals to the Federal Department of Finance for submission to the Federal Council and complete its own five circulars. Provided the Federal Council approves the ordinances in the autumn, Basel II can enter into force in Switzerland for the simpler approaches on 1 January 2007. In accordance with EU law, the application deadline has been generously set to the beiginning of 2008. Under the guidelines issued by the Basel Committee and the EU, the advanced approaches for Basel II (Advanced Internal Ratings Based Approach for credit risks and Advanced Measurement Approaches for operational risks) will be available from 1 January 2008.

While it would be unwise to count our chickens before they're hatched, we are nevertheless confident that the highly complex Basel II regulatory project will be successfully completed by the end of this year. The national working group headed by Daniel Sigrist, Head of the Banking Commission's Risk Management Group, already merits particular praise; it has conducted its discussions in an open and constructive spirit, and both sides have put in an immense amount of work. One final example of the close cooperation between regulators and those subject to regulation in the Swiss financial sector is that the national working group is to remain in existence even after Basel II comes into force in order to jointly address the questions of interpretation that will inevitably arise in the months and years following implementation.

[5] http://www.ebk.admin.ch/d/regulier/konsultationen/060306_01_d.pdf (German) or http://www.ebk.ch/f/regulier/konsultationen/060306_01_f.pdf (French)