

FINMA Circular 19/xx “Risk diversification – banks”

Key points

7 April 2017

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1. The Federal Council is revising the Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Dealers (CAO; SR 952.03). In parallel, FINMA is carrying out a complete revision of its Circular 2008/23 “Risk diversification – banks”. This work is being done in response to the evolution of the Basel Committee on Banking Supervision’s international standards (Basel III) following the financial crisis. The partial revision of the CAO and the complete revision of FINMA Circular 08/23 are specifically intended to transpose the Basel III standards on risk diversification into Swiss supervisory law. Both are scheduled to enter into force on 1 January 2019. The Federal Department of Finance (FDF) launched a consultation on the draft of the partially revised CAO on 7 April 2017. It will run until 14 July 2017. FINMA is holding a consultation on the draft of the completely revised Circular 08/23 in parallel with this.
2. The Basel III rules represent an international framework agreement and contain capital adequacy requirements for banks as before, but new risk diversification requirements have now also been included. They place maximum limits on credit risks vis-à-vis individual counterparties in order to prevent excessive concentrations.
3. The new Basel III risk diversification rules bring changes relative to the current regime in a number of key areas:
 - They limit large credit exposures by using Tier 1 capital as the basis for measurement rather than total eligible capital.
 - In principle, large credit exposures exceeding 25% of a bank’s Tier 1 capital are no longer permitted under the new rules. This also applies to interbank exposures, the only exception being intraday exposures.
 - In the case of larger residential real estate loans, the limit applies to the entire loan amount. Up to half of the market value of the property was previously not covered by the limit.
 - Swiss Pfandbriefe are now given a preferential weighting of 20%, compared with 0% previously (or 25% under the regime expiring in 2018).

4. A first initial impact study involving 20 institutions showed that these changes could have a material impact on certain individual institutions. A second impact study will be carried out during the consultation period to draw up a definitive assessment.
5. For smaller institutions, the intention is for the new risk diversification rules to be implemented in a proportionate manner if this is judged necessary and reasonable in view of the second impact study's findings. Specifically, the planned rules allow smaller institutions (i.e. banks and securities dealers in categories 4 and 5 under Article 2 para. 2 of the Banking Ordinance) to enter into interbank positions with non-systemically important banks up to a yet to be determined limit above 25% of their Tier 1 capital as specified in Article 116 of the current CAO.
6. Swiss Pfandbriefe may only be issued by two institutions, the Central Mortgage Bond Institution of Swiss Cantonal Banks and the Mortgage Bond Bank of Swiss Mortgage Lenders. This small number of issuers makes it impossible for supervised institutions to diversify risks. FINMA favours a look-through approach. Instead of allocating Pfandbriefe exposures to the relevant issuing institution, this option entails allocating Swiss Pfandbriefe exposures to these institutions' member banks.