



**Unofficial translation of the  
Swiss Federal Banking Commission's  
„Rundschreiben der Eidg. Bankenkommission:  
Risikoverteilung“**

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# **Swiss Federal Banking Commission Circular: Risk diversification of 29 September 2006**

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<b>I. Object</b>	<b>Rz</b>
This Circular clarifies Art. 83–123 of the Capital Adequacy Ordinance (CAO). It regulates procedures for taking account of credit derivatives in the trading book and bank book and short-term interbank positions with regard to risk diversification. It shall not apply for the purpose of determining capital requirements.	<b>1</b>
<b>II. Credit derivatives</b>	
<b>A. Allowance by the security recipient</b>	
Credit default swaps and total return swaps: positions hedged by credit default swaps or total return swaps <sup>1</sup> may be deducted from the borrower's total position in respect of the reference instrument. In any event, the credit equivalent as defined in Art. 42 CAO for the corresponding credit default swap or total return swap shall also be taken into account as a component of each protection provider's total position.	<b>2</b>
Credit linked notes: claims hedged by credit linked notes <sup>2</sup> may be deducted from the borrower's total position in respect of the reference instrument. The protection provider's total position is not changed by credit linked notes.	<b>3</b>
First-to-default swaps: given the non-specific hedge effect, the total positions of borrowers may not be reduced by positions hedged by first-to-default swaps. However, a credit equivalent for the first-to-default swap is to be taken into account as a component of the total position of the particular protection provider.	<b>4</b>
Second-to-default swaps and n <sup>th</sup> -to-default swaps: likewise in the case of second-to-default swaps and n <sup>th</sup> -to-default swaps, no total positions of borrowers may be reduced by positions hedged by these contracts. A credit equivalent for the second-to-default swap and the n <sup>th</sup> -to-default swap respectively is to be taken into account as a component of the total position for the particular protection provider.	<b>5</b>
<b>B. Allowance by the security provider</b>	
Credit default swaps and total return swaps: hedge commitments made via credit default swaps or total return swaps shall be added to the borrower's total position in respect of the reference instrument. In addition, a credit equivalent for the credit default swap or the total return swap is also to be taken into account as a component of the total position of the protection recipient concerned. In the case of a credit default swap, this shall be no more than the sum of the outstanding premium payments that have not been discounted.	<b>6</b>
Credit linked notes: hedging commitments entered into in the form of credit linked notes shall be added to the borrower's total position in respect of the reference instrument. In addition to this, the claim in respect of the debt instrument issued by the protection purchaser is to be added to the protection recipient's total position.	<b>7</b>
First-to-default swaps: all hedging commitments entered into in the form of first-to-default swaps shall be added to the borrower's total position in respect of the claims in question. In addition, a credit equivalent shall be taken into account as a component of the total position of that particular protection	<b>8</b>

<sup>1</sup> Hedges shall be recognised providing they meet the criteria set out in Rz 204–216 and 220–231 of EBK RS 06/1 "Kreditrisiken".

<sup>2</sup> See footnote 1

recipient. However, this shall be no more than the sum of the outstanding premium payments that have not been discounted.

Second-to-default swaps: as a general rule, second-to-default swaps shall be taken into account in the same way as first-to-default swaps (cf. Rz 8). However, until the default of the first position in the basket the smallest position in the basket in risk-weighted terms need not be added to the borrower's total position in respect of the claim. As regards taking the credit equivalent into account, the provisions set out in Rz 8 shall apply. 9

$n^{\text{th}}$ -to-default swaps: these are taken into account as per the process set out in Rz 8 and 9. The  $n$  minus one smallest positions in the basket in risk-weighted terms need not be added to the total position of their issuer. Each time one of the positions in the basket defaults, the variable  $n$  decreases by one. For example, following the default of one of the positions in the basket, a fifth-to-default swap becomes a fourth-to-default swap. As regards taking the credit equivalent into account, the provisions set out in Rz 8 shall apply. 10

### III. Short-term interbank positions

#### A. Purpose

In order to facilitate processing transactions in interbank business, for risk diversification purposes the supervisory authority imposes a lower risk weighting rate for short-term positions to certain banks. The conditions under which banks shall be entitled to apply such preferential weightings are set out below. 11

#### B. Risk-weighting of short-term interbank positions

Contrary to Art. 106 (1) CAO and Art. 115 (2) CAO and in application of Art. 103 (2)(g) CAO, the risk-weighting percentage for sight and overnight positions to banks rated 1 or 2 in accordance with Art. 49 (2)(4) CAO in conjunction with Art. 55 (1) CAO, and to cantonal banks whose non-subordinated liabilities are all guaranteed by the canton, shall be 8%. 12

The preferential weighting under Rz 12 shall apply only to positions in respect of the parent company or, as applicable, to the foreign parent bank or the cantonal bank whose non-subordinated liabilities are all guaranteed by the canton. It shall not be applicable to other companies (banks or non-banks) belonging to the same group. The weightings applicable to these shall be the usual ones set out in Art. 106 (1) CAO and/or Art. 115 (2) CAO. 13

UBS AG and Credit Suisse Group and their affiliated group banks shall not be permitted to take advantage of the preferential ratings specified in Rz 12. 14

Bank subsidiaries shall not be entitled to apply the preferential weightings specified in Rz 12 to positions to their parent company in Switzerland or abroad. Likewise, bank subsidiaries of cantonal banks whose non-subordinated liabilities are all guaranteed by the canton shall not be entitled to apply the preferential weightings specified in Rz 12 to positions to the parent cantonal bank. However, where the conditions for intra-group counterparties stipulated in Art. 89 (1) CAO are fulfilled, the positions to the banks in question shall be excluded from the upper limit. 15

In the case of banks using the Swiss approach as defined in Art. 93 (1) CAO with capital adequacy for credit risks amounting to less than CHF 20 million, the preferential weightings set out in Rz 12 shall apply to positions with a residual term to maturity of up to three months. 16

By way of exception to Art. 106 (1) CAO and Art. 115 (2) CAO and in application of Art. 103 (2)(g) CAO, the risk weighting for banks belonging to the RBA group in respect of positions to the RBA central bank with a residual term to maturity of up to one year shall be 8%. 17

Banks belonging to the RBA group that simultaneously satisfy the conditions stipulated in Rz 16 shall not be entitled to take advantage of the preferential weightings set out in Rz 16 or those set out in Rz 17. 18

Two or more members of a group shall also form a group of related counterparties and hence constitute a single risk position (Art. 100 (1)&(2) CAO). The RBA central bank and the other companies belonging to the RBA group shall likewise form a single risk position. 19

Positions assigned an 8% weighting shall continue to be included in the risk position of the group in question in accordance with Art. 104 (1) CAO and/or Art. 113 CAO and reported in accordance with Art. 90 (1)&(2) CAO and Art. 92 CAO. The total risk position shall not exceed 25% of the eligible capital. 20

### **C. Procedure if a preferential weighting condition no longer applies**

If a counterparty no longer satisfies the criteria set out in Rz 12 positions to it shall be assigned the normal weightings specified in Art. 106 (1) CAO and Art. 115 (2) CAO. Banks as defined in Rz 16 shall be entitled to assign an 8% weighting to positions to such a counterparty with a residual term to maturity of up to three months for a further transitional period lasting three months. 21

Banks which no longer fulfil the condition stipulated in Rz 16 shall be entitled to assign an 8% weighting to positions specified in Rz 12 with a residual term to maturity of up to three months for a further transitional period lasting three months. 22

Banks as defined in Rz 18 which take advantage of the preferential weightings in accordance with Rz 12 but which no longer fulfil the conditions stipulated in Rz 16 shall be entitled to assign an 8% weighting to positions with a residual term to maturity of up to three months for a further transitional period lasting three months. 23

During the period specified in Rz 21, 22 and 23, new positions to the counterparty concerned shall only be entered into if the total risk position once positions have been weighted in accordance with Art. 106 (1) CAO resp. Art. 115 (2) CAO does not exceed the upper limit of 25% of eligible capital. 24

### **IV. Transitional provisions**

The provisions of this Circular shall be applicable from such time as the new risk diversification rules (Art. 83–123 and/or Art. 125 CAO) enter into force. Until then the rules set out in SFBC Circular 00/1 “Short-term interbank claims” shall continue to apply. 25

Where the upper limit specified in Art. 86 CAO is exceeded as a result of the modified provisions under Rz 12, 16 and 17, the position shall be brought back below the upper limit within at most one year.

### **V. Entry into force**

EBK RS 00/1 “Short-term interbank claims” shall be revoked with effect from 31 December 2007. 26

Date of entry into force: 1 January 2007 27

**Legal Basis:** Art. 85 CAO