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

Circular 2011/xx: “Capital buffer and capital planning in the banking sector”

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Date:	
Entry into force:	1 July 2011
Last amendment:	
Legal framework:	FINMASA Art. 7 para. 1 let. b BA Art. 4 paras. 1, 2 and 3 CAO Art. 34
Appendix 1:	Categorisation of institutions

Addressees

BA			ISA			SESTA		CISA									AMLA			Other	
Banks	Financial groups and congl.	Other intermediaries	Insurers	Insurance groups and congl.	Insurance intermediaries	Stock exch. and participants	Securities dealers	Fund mgmt companies	SICAVs	Limited partnerships for CISs	SICAFs	Custodian banks	Asset managers CISs	Distributors	Reps. of foreign CISs	Other intermediaries	SROs	DSFIs	SRO-supervised institutions	Audit firms	Rating agencies
X	X						X														

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I. Objective

In addition to minimum capital requirements for credit, market and operational risks in Article 33 (Pillar 1), the Capital Adequacy Ordinance (CAO; SR 952.03) provides in Article 34 for banks to hold additional capital to allow for any risks not covered by the minimum requirements and to ensure that the minimum requirements are met even in adverse circumstances (Pillar 2). 1

As regards determining each institution's specific capital adequacy requirements, the Basel II Capital Accord[1] 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 capital buffer under Pillar 2 must be structured such that it covers all of the institution's on-balance-sheet and off-balance-sheet risks and such that the institution's business activities can be continued in an orderly fashion, even in a stress scenario (going-concern principle). 3

The Pillar 2 requirements 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 Article 34 CAO (additional capital requirements) and contains guidelines on implementing further requirements under Pillar 2, in particular relating to internal capital planning processes. 5

FINMA's supervisory practices concerning other aspects of Pillar 2 are already specified in FINMA Circulars 08/6 "Interest-rate risk – banks", 08/24 "Supervision and internal control – banks" (risk control: margin nos. 113-126) 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 3c 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 institutions. FINMA has the power to grant exemptions to the requirements at the individual institution level. 8

The large banking groups are not covered by this Circular[2]. 9

[1] International Convergence of Capital Measurement and Capital Standards – A Revised Framework, Comprehensive Version, Basel Committee on Banking Supervision, June 2006

[2] SIFIs (Systemically Important Financial Institutions) will in future have to hold a higher share of risk-bearing capital over and above the minimum requirements under Pillars 1 and 2. Switzerland's two large banking groups are classed as SIFIs. The legislative efforts currently underway in connection with the "too big to fail" issue will empower the Swiss National Bank to declare other institutions systematically important.

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III. Overall capital adequacy requirements under Pillar 2

FINMA sets capital adequacy targets for supervised institutions. 10

To meet these targets, institutions must hold an overall capital buffer under Article 34 CAO in addition to the minimum requirements under Article 33 CAO. 11

A. Quality of additional capital

As regards the composition and eligibility of the additional capital (Art. 34 CAO), the CAO's requirements for the minimum capital required under Pillar 1 (Art 16 ff. CAO) apply[3]. 12

FINMA may impose quality requirements for the capital buffer in individual cases, taking account of the categorisation and specific risk situation of the institution concerned (see section IV. below). 13

B. Categorisation

In a risk-based supervisory approach, categorisation is a useful tool when it comes to applying a standard supervisory yardstick to institutions with comparable risk profiles. As regards setting overall capital adequacy requirements under Pillar 2, FINMA divides individual institutions and financial groups therefore into five categories based on their total assets, assets under management, privileged deposits and required own funds[4]. The suitability of the chosen categorisation criteria is to be checked periodically. 14

The table in the Appendix lists the ranges used to determine which category an institution falls into. The institution must meet at least three of the criteria listed to qualify for a given category. FINMA reviews the category allocations of institutions and financial groups annually. 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 adequacy target. 16

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

C. Limits for additional capital requirements in line with categorisation

The capital adequacy requirements under Pillar 2 are set in a degressive manner depending on the institution's size and complexity. 18

The limits for each category are shown in the table below. 19

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[3] Following the incorporation of the Basel III reforms – A global regulatory framework for more resilient banks and banking systems, December 2010 (http://www.bis.org/publ/bcbs189.pdf) from the Basel Committee on Banking Supervision – into the CAO, the requirements in terms of the quality of capital, in particular the share of Tier 1 capital to be held, will increase.

[4] Category 1 is omitted from the overview given here (margin no. 20) because this Circular does not cover the large banking groups, which are instead subject to separate capital adequacy requirements that take account of their circumstances.

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	Capital ratio[5] determining capital adequacy target	Capital ratio below which immediate and extensive action is taken under supervisory law (intervention threshold)
Category 2	13.6-14.4%	11.5%
Category 3	12%	11%
Category 4	11.2%	10.5%
Category 5	10.5%	10.5%

D. Failure to comply with capital adequacy requirements

a. Intended 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 capital ratio falling below the target level, it will demand that the target level be restored and intensify its supervision of that institution. 24

If the institution is generally capable to make a profit or borrow capital on standard terms via the capital market, FINMA will take suitable measures to ensure that the capital ratio is restored to the target level as quickly as possible. 25

If the institution is temporarily not capableto make a profit, be it for institution-specific reasons or due to a crisis in the Swiss financial sector, FINMA will take suitable measures to ensure that the capital ratio is restored to the target level. In this case, taking account of the institution's circumstances and the situation in the financial sector, FINMA may extend the deadline for restoring the target level. 26

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

[5] Total capital in relation to risk-weighted assets

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. 27

If the intervention threshold is breached, FINMA may, in addition to the measures listed in margin no. 27, order the institution to reduce its risk-weighted assets, sell specific assets or withdraw from specific areas of business. 28

IV. Stricter requirements for specific cases

FINMA will take measures if it deems that the capital adequacy target in accordance with section III.C above does 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. 29

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. 30

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. 31

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. 32

V. Capital planning

A. Fundamental capital planning requirements

Regardless of the overall capital buffer in accordance with margin no. 11, FINMA expects supervised institutions and groups to operate adequate capital planning at both consolidated and individual institution levels in line with their individual circumstances. 33

In assessing whether their capital is appropriate, institutions must take into account the economic cycle. 34

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 their revenues falling sharply. 35

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”). 36

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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. 37

Forward-looking capital planning should be closely tied to overall planning, particularly the institution's income targets and budget process. 38

Capital planning should provide a reliable forecast of available capital on the basis of future profits, dividend policy and corporate actions planned by the executive management. 39

Capital planning should be based on realistic assumptions with regard to business performance. 40

C. Governance and process

The executive management is responsible for capital planning and the capital planning process. 41

The board of directors must approve the capital planning at least once a year. 42

D. Review procedure

Audit firms must pass comment on institutions' capital planning in their supervisory audit reports. 43

FINMA analyses and reviews institutions' capital planning in line with their categorisation. 44

VI. Entry into force

This Circular enters into force on 1 July 2011. 45

VII. Transitional provisions

Institutions whose capital does not meet the corresponding target level given in this Circular on 1 July 2011 must comply with the target level by 31 December 2016 at the latest. 46

If an institution or financial group submits a justified request, FINMA may grant a longer transitional deadline for the capital adequacy target to be achieved. 47

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	Criteria (in CHF billions)		
Category 1[6]	Total assets	≥	250
	Assets under management	≥	1,000
	Privileged deposits	≥	30
	Required equity	≥	20
Category 2	Total assets	≥	100
	Assets under management	≥	500
	Privileged deposits	≥	20
	Required equity	≥	2
Category 3	Total assets	≥	15
	Assets under management	≥	20
	Privileged deposits	≥	0.5
	Required equity	≥	0.25
Category 4	Total assets	≥	1
	Assets under management	≥	2
	Privileged deposits	≥	0.1
	Required equity	≥	0.05
Category 5	Total assets	<	1
	Assets under management	<	2
	Privileged deposits	<	0.1
	Required equity	<	0.05

[6] Only the large banking groups, which are excluded from the scope of this Circular, fulfil the criteria for Category 1.