FACT SHEET STATUS: 21 OCTOBER 2015

New "too big to fail" capital requirements for global systemically important banks in Switzerland

Switzerland is taking a lead internationally by introducing more stringent capital requirements. It is also taking further steps to strengthen its current "too big to fail" regime and hence the resilience of its systemically important banks.

At the height of the financial crisis in 2007 and 2008, state intervention was needed in many countries to rescue large interconnected financial institutions. Institutions of this kind provide services that are essential to the economy. Their collapse would have far-reaching negative consequences for the stability of the financial markets and the real economy. Consequently, these institutions are classified as "too big to fail" (TBTF). The implicit state guarantees lead to unjustified market distortion.

Review of the Swiss approach

In order to minimise the need for the state to implicitly guarantee systemically important financial institutions and hence the potential cost to Swiss taxpayers, Switzerland introduced TBTF regulations in 2012. In the intervening period, other countries with important financial centres have also done so. As provided for in the Banking Act, the Federal Council has now reviewed the Swiss TBTF regime in the light of international developments. In a February 2015 report, the Council acknowledged that the basic design of the measures was appropriate. Nevertheless, it saw the need for enhancements, particularly with regard to capital requirements and the implementation of emergency plans.

The world's first binding rules on total loss-absorbing capacity

Regulatory capital is intended to help financial institutions absorb unexpected losses. Systemically important banks should have enough capital to cover losses from current operating activities (going concern requirements). If an institution gets into severe financial difficulties, it may be unable to continue its normal business activities. The institution must then be either restructured or resolved in an orderly way. Regardless of the specific scenario, the systemically important functions performed by an institution must be preserved in all events and at all times. In order to ensure that this is the case, additional loss-absorbing capital must be available (gone concern requirements). These funds are required for restructuring or orderly resolution. They are provided by bank creditors who subscribe to special capital instruments designed to absorb losses in the circumstances described above. Where necessary, these instruments can be converted into equity capital or written down. Taken together, going concern and gone concern requirements make up the total loss-absorbing capacity (TLAC). The details of a global minimum TLAC standard are currently being discussed by the Financial Stability Board. Switzerland has decided to set a TLAC of 10% of total exposure for its global systemically important banks, assuming a leading role in defining this new requirement for loss-absorbing capital.

Switzerland among the countries with the most stringent capital requirements

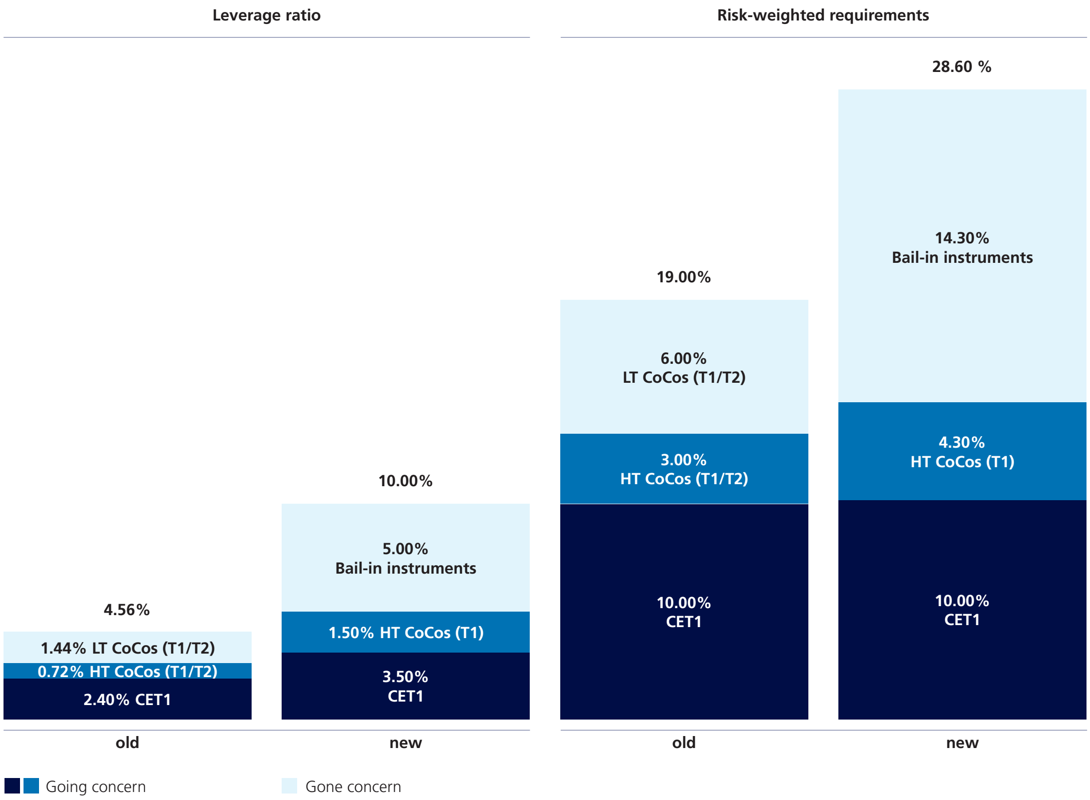
In 2012, Switzerland had already defined capital requirements for systemically important banks. Following the definition of these requirements in Switzerland, other countries with important financial centres also implemented standards, some of which now go beyond the Swiss regulations. According to both the Federal Council and the Brunetti expert group, Switzerland should be among the countries with the most stringent capital requirements for global systemically important banks, not least because these institutions form such a vital part of the Swiss economy. This means that the requirements, particularly as regards the leverage ratio, need to be increased.

The minimum capital requirements are defined in terms of both leverage ratio and risk-weighted assets (RWA). The leverage ratio acts as a safety net by ensuring that all positions, irrespective of their modelled risk, are underpinned by a minimum amount of capital.

The new capital requirements take account of other standards internationally, as well as historic loss data, the risk profile of the largest banks, and their significance for the Swiss economy.

Going concern: Systemically important banks are assigned to categories, depending on their total exposure and market share (bucketing approach),

Capital requirements



and it is this category which determines the requirements a bank has to meet. Based on current calculations, the global systemically important banks have to meet a leverage ratio requirement of 5%.

This required leverage ratio of 5% of total exposure will consist of a minimum requirement of 3% plus a 2% buffer. Total exposure reflects a bank's on- and off-balance sheet positions. The parallel capital requirement relating to risk-weighted assets is set at 14.3%, consisting of a minimum requirement of 8% and a 6.3% buffer. If a buffer is utilised, the bank must take steps to re-establish it. The minimum requirements match the quantitative targets set out in the Basel III rules.

Gone concern: The gone concern requirements essentially equal the going concern requirements. This is the approach taken by the Financial Stability Board for the global TLAC minimum standard. The unweighted requirements will therefore be set at 5% and the risk-weighted requirements at 14.3%. Since the gone concern component is earmarked for resolution, measures which improve an institution's global capability in this area can be rewarded by means of discounts. These can amount to a maximum of two percentage points for the unweighted ratio.

The newly recalibrated system leads to a total loss-absorbing capital (including bail-in instruments) of 10% of total exposure and a total loss-absorbing capacity of 28.6% (including all buffers, except the countercyclical buffer) for global systemically important banks. The increased capital requirements will be phased in linearly until the end of 2019.

Changes to capital quality

As well as minimum quantitative capital requirements, the quality of the capital instruments required has also been raised.

Going concern: For the leverage ratio, at least 3.5% must now be held in the form of Common Equity Tier 1 capital (CET1). This represents an increase of just under 50% compared with the previous regime (2.4%). The remaining requirements must be met using high trigger CoCos of Tier 1 quality. The risk-weighted requirements can be met using a maximum of 4.3% high trigger CoCos of Tier 1 quality. The difference (i.e. at least 10%) must be met using Common Equity Tier 1 capital (CET1).

Gone concern: The gone concern requirements must be met using instruments which satisfy minimum bail-in quality standards. They can be used, if necessary, to cover losses and enable a restructuring or orderly resolution.

Depending on the type of capital involved, instruments which have already been issued under the current TBTF regime will be grandfathered until they expire or are callable.

Switzerland takes a leading role

In making these changes, Switzerland is taking a leading role internationally. This is justified because, compared with other countries, Switzerland's systemically important banks are so large in comparison to its gross domestic product. Switzerland is the first country to define binding requirements for total loss-absorbing capacity.

Finalisation of emergency plans by 2019

As well as defining more stringent capital requirements, the Federal Council has addressed another important element of the TBTF problem by deciding that emergency plans for the Swiss business must be executable by the end of 2019. Preparations must be made to ensure the continuance of systemically important functions in Switzerland. The largest banks have already taken important steps in this direction by modifying their group structures so that they can be more easily restructured or resolved in the event of a crisis. Both banks now have group holding companies and, by the middle of 2016, are expected to have established separate legal entities in which the Swiss systemically important functions will be located. They have also announced their intention to found separate service companies.

Top-down bail-in in the event of a crisis

Organisational and financial unbundling before a potential crisis is a prerequisite for the successful recovery or resolution of systemically important financial groups. FINMA's preferred strategy for the recovery and resolution of systemically important financial groups envisages a resolution which is managed centrally by FINMA and driven from the holding level within a group (single point of entry approach). In this scenario, the creditors of the holding company bear some of the losses (through a bail-in), thereby enabling the financial group as a whole to be refinanced. This requires close cooperation and coordination with the relevant foreign resolution authorities. If, in a particular scenario, a bail-in strategy of this kind proves infeasible, the institution would undergo an orderly restructuring and the systemically important functions would be preserved.