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 2011/2
Capital buffer and capital planning – banks

Capital buffer and capital planning in the banking sector

Reference:	FINMA Circ. 11/2 “Capital buffer and capital planning – banks”
Date:	30 March 2011
Entry into force:	1 July 2011
Last amendment:	1 January 2013 [Modifications are indicated by an asterisk (*) and are listed at the end of the document.]
Legal framework:	FINMASA Art. 7 para. 1 let. b BA Art. 4 paras. 1, 2 and 3 CAO Art. 45
Appendix:	Categorisation of institutions

Addressees

BankA			ISA			SESTA	FMIA						CISA									AMLA			Other	
Banks	Financial groups and congl.	Other intermediaries	Insurers	Insurance groups and congl.	Intermediaries	Securities dealers	Trading venue	Central counterparties	Central securities depositories	Trade repositories	Payment systems	Participants	Fund management companies	SICAVs	Limited partnerships for CISs	SICAFs	Custodian banks	Asset manager CISs	Distributors	Representatives of foreign CISs	Other intermediaries	SROs	DSFIs	SRO-supervised institutions	Audit firms	Rating agencies
X	X					X																				

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I. Objective and purpose

In addition to minimum capital requirements for credit, market and operational risks in Article 42 (Pillar 1), the Capital Adequacy Ordinance (CAO; SR 952.03) provides for banks to hold a capital buffer in accordance with Article 43 and additional capital in accordance with Article 45 to allow for any risks not covered by the minimum capital requirements and to ensure that the minimum capital requirements are met even in adverse circumstances (Pillar 2). 1

As regards determining each institution's specific capital adequacy requirements, the Basel Capital Accord 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 any risks not covered or insufficiently covered are taken into consideration by the minimum requirements under Pillar 1. This ensures compliance with the minimum requirements, even in adverse circumstances, so that the institution's business activities can be continued in an orderly fashion (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 45 CAO (additional capital) 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.[1] 9

[1] SIBs (Systemically Important Banks) will in future have to hold a higher share of risk-bearing capital over and above the minimum requirements under Pillars 1 and 2 (Basel Committee on Banking Supervision: Global systemically important banks: assessment methodology and the additional loss absorbency requirement – rules text, November 2011). Switzerland's two large banking groups are classed as SIBs. Article 8 para. 3 of the

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III. Overall capital buffers 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 43 CAO in addition to the minimum capital under Article 42 CAO. 11

A. Abrogated

Abrogated 12*

Abrogated 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, therefore, FINMA divides individual institutions and financial groups into five categories based on their total assets, assets under management, privileged deposits and required own funds.[2] 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 at the end of the calendar year with effect from the next fiscal year. 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 capital buffers 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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revised BA gives the Swiss National Bank the power to declare other institutions systematically important for Switzerland.

[2] 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 (Heading 5 CAO).

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	Capital ratio[3] 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. Quality of capital to meet the capital adequacy target

The table below shows the quality of capital to be held in each category to meet the capital adequacy target. The share of capital exceeding the overall capital ratio of 8% in accordance with Article 42 CAO is regarded as part of the capital buffer.

20a*

20b*

	CET1 (Art. 21 ff. CAO)	AT1 (Art. 27 ff. CAO) or better	T2 (Art. 30 ff. CAO) or better
Category 2	8.7%-9.2%	2.1%-2.2%	2.8%-3.0%
Category 3	7.8%	1.8%	2.4%
Category 4	7.4%	1.6%	2.2%
Category 5	7%	1.5%	2%

FINMA may determine the requirements for the quality of the additional capital in the captial buffer on a case-by-case basis, taking account of each institution's categorisation and individual risk situation.

20c*

E. Failure to comply with the capital buffer target

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.

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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

[3] The capital ratio results from the ratio between eligible capital and risk-weighted positions in accordance with Article 42 para. 2 CAO.

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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 intensifies its supervision and contacts the institution to clarify the causes. 24

If the institution is generally capable of making a profit or borrowing capital on standard terms via the capital market, it is then requested to take the necessary measures to restore the capital ratio to the capital adequacy target as quickly as possible. 25

If the institution is temporarily not capable of making a profit, be it for institution-specific reasons or due to a crisis in the international or Swiss financial sector, it is to show FINMA that it is taking suitable measures to restore the capital ratio to the capital adequacy target and indicate when this can be expected. In this case, FINMA may grant a longer deadline for restoring the target level, taking account of the institution's circumstances and the situation in the financial sector. 26

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

If FINMA deems the measures taken by an institution to be inadequate, it will introduce supervisory measures depending on the extent to which the institution's capital falls below the capital adequacy target. 27

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. 28

If the intervention threshold is breached, FINMA may, in addition to the measures listed in margin no. 28, order the institution to reduce its risk-weighted assets, sell specific assets or withdraw from specific areas of business. 29

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. 30

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. 31

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 32

necessary.

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. 33

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, which is to be documented in writing, at both consolidated and individual institution levels in line with their individual circumstances. 34

In assessing whether their capital is appropriate, institutions must take into account the economic cycle. 35

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 an economic downturn and their revenues falling sharply. The underlying assumptions for the capital planning must be documented in a transparent and comprehensible manner. 36

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"). 37

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. 38

Forward-looking capital planning must be closely tied to overall planning, particularly the institution's income targets and budget process. 39

Capital planning must provide a reliable forecast of available capital on the basis of business planning and budgeting, future profits, dividend policy and corporate actions foreseen by the executive management. 40

Capital planning must be based on realistic assumptions with regard to business performance. 41

C. Governance and process

The executive management is responsible for determining capital planning and the capital planning process. 42

The board of directors must approve the capital planning at least once a year. 43

D. Review procedure

Audit firms comment on the adequacy of the capital planning, indicating the extent of the audit they conducted. They are also to set out their key assumptions. Audit firms must pass comment on institutions' capital planning in their regulatory audit reports. 44

FINMA analyses and reviews institutions' capital planning in line with their categorisation. 45

VI. Entry into force

This Circular enters into force on 1 July 2011. 46

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. 47

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. 48

The institutions have to prepare their capital planning in accordance with margin nos. 34–43 starting for the fiscal years 2012–2014 by 31 March 2012. 49

Abrogated 50

Appendix

Categorisation of institutions

	Criteria (in CHF billions)		
Category 1[4]	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

At least three of the criteria listed above must be fulfilled for categorisation.

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

List of modifications

This Circular has been modified as follows:

These modifications were adopted on 5 July 2012 and will enter into force on 1 January 2013.

newly inserted margin no.	20a – 20c
abrogated margin no.	12 – 13 and 50

Moreover, references to the Capital Adequacy Ordinance (CAO; SR 952.03) have been adapted according to the version which will enter into force on 1 January 2013.

This modification will enter into force on 1 January 2013.

modified margin no.	5