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Large banks: new capital adequacy treatment of holdings in subsidiaries, and update on recovery and resolution planning

The Swiss Financial Market Supervisory Authority FINMA is changing the way in which holdings in subsidiaries are treated when calculating capital adequacy requirements for Switzerland's two large banks, Credit Suisse and UBS. The changes will take effect retroactively as of 1 July 2017. FINMA is also providing information on the rebates granted to the two large banks in recognition of implemented measures to improve their global resolvability. Given their progress so far, FINMA sees the rebates as justified and has granted approximately one-third of the maximum rebate to both banks.

FINMA is changing the way in which holdings in subsidiaries are treated in examining compliance with regulatory capital adequacy requirements by the parent companies of Switzerland's two large banks. The reasons for this change were set forth in the Federal Council report on systemically important banks in June 2017. The new procedure improves the transparency of the parent companies' capital structures, simplifies calculations and enhances comparability with regulations in other key jurisdictions.

New system announced

Under the current system, the book value of the parent companies' holdings in subsidiaries must be deducted in full from core equity capital. To prevent Credit Suisse and UBS from considerably overshooting their capital adequacy requirements at consolidated level, FINMA has granted them relief measures under the Capital Adequacy Ordinance. Specifically, an individually determined proportion of holdings has been risk-weighted at 200% as opposed to holdings being fully deducted (see press release of 7 May 2014).

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Risk weightings for holdings in subsidiaries fixed

The full deduction of holdings from core equity is a stringent measure by international standards and makes significant relief measures essential. FINMA is therefore abolishing deductions from capital altogether as well as the accompanying relief measures allowed for the two large banks. In their place, a risk weighting is now applied with weights increasing up to 250% for all Swiss-based holdings and 400% for all foreign-based holdings by the end of the transition period. Both large banks have to regularly disclose the total book value of their Swiss and foreign holdings in the interests of total transparency. The new system, to be brought in on the basis of individual FINMA decrees, will apply to the two large banks retroactively as of 1 July 2017 and to their parent companies' capital ratios only, i.e. excluding consolidated ratios. It is planned that the new risk weightings will also apply to all other banks as of 1 January 2019. The process to make the required changes to the Capital Adequacy Ordinance has been initiated.

CS and UBS granted rebates on gone-concern component

FINMA is also announcing the rebates determined individually for the two large banks on the additionally required loss-absorbing funds (gone-concern component). These will apply as of 1 January 2018. Swiss "too big to fail" (TBTF) legislation provides for an incentive system in addition to the maintenance of systemically important functions under the Swiss emergency plan. Under this system, Credit Suisse and UBS may be granted rebates if they improve their overall recoverability and resolvability. FINMA assesses their eligibility for these rebates every year, taking account of measures that have been fully implemented. In view of the measures implemented up to the end of 2016, it sees the rebates as justified and has granted approximately one-third of the maximum rebate to both banks. This view takes account of the modular group structures set up by both banks and their rapid structuring of loss-absorbing debt in the form of bail-in bonds. Both institutions are at present working to implement further improvements that could lead to a reassessment of their rebates in the future.

Crisis resistance of systemically important functions improved

Credit Suisse and UBS have year after year improved their crisis resistance by drawing up detailed recovery and resolution plans and implementing corresponding measures. Both banks, for example, now have a non-operating holding company as their group parent and have transferred Swiss-based systemically important functions to separate subsidiaries. This has laid the foundations for them to submit a feasible Swiss emergency plan to FINMA by the legally prescribed deadline of 2019. However, further steps must be taken before then. In particular, the financial and operational dependencies that persist within the groups must be reduced. In addition, both institutions have drawn up FINMA-approved plans to take stabilising action in the event of an unrealised threat of destabilisation (recovery plans).