SFBC and large banks agree to set higher capital adequacy targets and introduce a leverage ratio

The Swiss Federal Banking Commission (SFBC) has agreed with Credit Suisse and UBS to raise current capital adequacy requirements and introduce additional elements to the regime. The new capital adequacy ratios were defined and communicated by the SFBC to the two banks with a formal decree on 20 November 2008. They must be complied with by the year 2013 subject to the profits earned in future periods.

Bern, 4 December 2008 – Losses of unheard of proportions have been sustained in the trading of risky instruments since the onset of the financial crisis in summer 2007. Even the so-called “Swiss Finish” – an extra buffer of 20% for Swiss banks over the minimum requirements of Basel II and deemed a conservative measure by international standards – proved inadequate in the recent turbulence. Not even the additional increase set by the SFBC to the two large Swiss banks at the end of August 2007 was enough.

The SFBC has developed the new capital adequacy regime in close collaboration with the Swiss National Bank. It will make Switzerland’s two large banks more resilient, thereby strengthening the whole financial system. The higher capital adequacy requirements and the introduction of a leverage ratio will equip the banks to better face future crises. The increased capital buffers will not prevent crises, but they will improve the banks’ ability to absorb any losses they sustain. This safety measure is an absolute necessity for Switzerland given that its two large banks are the central pillar of its financial system and, hence, the entire economy. No changes are planned for Switzerland’s other banks, who already voluntarily maintain capital levels reaching on average almost double of the required minimum.

The SFBC recognises that the financial markets are going through a very tough time. As a result, UBS and Credit Suisse have until 2013 to incrementally incorporate the new capital adequacy requirements. If the situation on the financial markets or the banks’ earnings make it impossible to meet the target levels by 2013, this deadline may be extended.

There are two complementary instruments at the heart of the new capital adequacy regime: the increase in risk-weighted capital requirements and the introduction of a
leverage ratio, i.e. a nominal cap on debt levels regardless of the risk involved. Both instruments were described in the Swiss Federal Government’s report on the package of measures to strengthen the Swiss financial system, presented on 5 November 2008.

**Flexible increase in capital target ratios**

The new capital adequacy target ratio for UBS and Credit Suisse will be in a range between 50% and 100% above the international minimum requirements (Pillar I) of Basel II. This flexibility is possible because the additional capital adequacy requirement under Pillar 2 (supervisory review process) of Basel II is being applied. This room for manoeuvre is necessary for the measures to develop their stabilising influence and, at the same time, exert a counter-cyclical effect. In good periods the banks must increase their capital up to a target level of 200% (100% Pillar 1, 100% Pillar 2). These buffers will then be available to the banks during crises up to an intervention level of 150%.

**Introduction of the leverage ratio as an additional instrument**

UBS and Credit Suisse will have to comply with a leverage ratio in addition to their risk-based capital adequacy requirement. The new non risk-weighted, nominal parameter will cap the sum of assets financed by debt. The leverage ratio defines the proportion of core capital to total assets and it will be set for both banks at a minimum of 3% at group level and at 4% for the individual institutions. The expected target leverage ratio in good periods is above the minimum level, thus countering the cycle. As both banks’ domestic lending activities are important for the Swiss economy, this segment is exempted from the leverage ratio.

“A ground-breaking step for Switzerland”

SFBC Director Daniel Zuberbühler commented: “I am very satisfied that we have been able to agree on a forward-looking and, under the current conditions, ambitious capital regime with both banks. This shows that Switzerland has been quick to learn the lessons of the ongoing financial crisis. International standards will go in the same direction: substantial increases in capital adequacy levels for global banks and supplementing the risk based capital framework with a simple metric such as the leverage ratio to compensate for the problematic elements of some model approaches.”