Verband Schweizerischer Kantonalbanken
Union des Banques Cantonales Suisses
Unione delle Banche Cantonali Svizzere

Secretariat of the Basel Committee on
Banking Supervision
Bank for International Settlements
4002 Basel

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HPH/NG

Consultative Documents of December 2009

Dear Sirs

The Association of Swiss Cantonal Banks (ASCB) welcomes the opportunity to provide comments on the Consultative Documents *Strengthening the resilience of the banking sector* and *International framework for liquidity risk measurement, standards and monitoring* issued for comment by the Basel Committee on Banking Supervision on December 17, 2009.

The financial crisis has shown that not all banks operate their businesses as carefully as do the various cantonal banks with their local based business model. As a consequence to this financial crisis a broad discussion about necessary improvements of the regulatory frame work is in course. The cantonal banks agree as well on the necessity of a robust and well-functioning financial system as well on the important role liquidity is playing in this context.

In our view, the consultative documents are too strongly geared to the organizational form of a joint stock company, neglecting the fact that worldwide many banks – as the majority of the cantonal banks in Switzerland – have another legal form. It has to be kept in mind that the last financial crisis proved again the importance of a good mix of business models and organizational forms of the different banks being active in the financial markets.
Switzerland – one of the most important financial center with two of the worldwide biggest banks – hasn't been hit as heavily by the consequences of the financial crisis as other countries or as it would have been possible. This is due to the fact that an important part of the Swiss banking sector has a local based and locally oriented business model – most of these banks with a legal/organizational form other than the joint stock company.
All these banks and namely all cantonal banks performed very well all through the turmoils of the financial crisis and thus were an important factor of stability and an esteemed source of liquidity to local industry, commerce and trade as well as to other (stressed) banks.

Considering these facts, that
- the cantonal banks were not in the least at the origin of the last financial crisis
- the cantonal banks were not affected in a direct way by the consequences of the black out of the subprime markets
- the cantonal banks – due to their business and organizational model different to the ones of the big banks active on a multinational level – were a source of stability and liquidity

we consider the proposed provision for liquidity to be very demanding. If in the future all banks will be forced to maintain such a high level of liquidity, which represents a massive increase especially for regional banks active in the retail sector, substantial costs will occur, entailing a rise in the cost of retail

business and therefore higher costs to the whole economy. These costs are for regional banks – for the reasons mentioned above – not justified by the expected benefits.

It is essential that the impact of the regulatory changes be verified carefully with the results of QIS. In particular cumulative effects with other regulatory changes and the impact on the real economy must be taken into account.
We therefore strongly apply for a differentiation in the future regulatory framework.

Key Topics of Concern

1. Definition of Tier 1 Capital

The cantonal banks, for most of them the legal form has been that of independent, public-law institutions of their respective cantons for well over 100 years, have always had a so-called Dotationskapital (endowment capital) or Grundkapital (initial capital) representing the core of their equity. The cantonal banks are legally obligated to pay interest or the equivalent at cost to the cantons for the Dotationskapital or Grundkapital.

In addition to the Dotationskapital or Grundkapital, cantonal banks can raise Partizipationskapital (non-voting capital) in the market, and a dividend may be distributed.

For cantonal banks with the legal form of an independent public-law institution of a canton, both the Dotationskapital or Grundkapital and the Partizipationskapital (in addition to the retained earnings) represent the core of the bank's equity and are subordinated to all other capital.

Unfortunately, in particular classification criteria no. 5 to 7 of the consultative paper do not sufficiently take into account the legal form of independent public-law institutions and the realities linked to it, nor that the canton as the owner of the Dotationskapital or Grundkapital receives interest payments or a compensation at cost based on the amount of capital and the ongoing interest rates.

In terms of subordination, additional Partizipationskapital is treated the same way as Dotations-/Grundkapital. A possible dividend, however, does not follow the same rules as Dotationskapital or Grundkapital. We strongly feel that greater attention should be paid to the circumstances of non-joint stock companies, especially public-law institutions. Legal experts' reports confirm that Dotations-/Grundkapital are neither alienable nor callable or redeemable and thus fulfill the requirements concerning equity.

2. Definition of Liquid Assets

The buffer of liquid assets is narrowly defined with a high reliance on government and other public debtors in the bond category. The proposed standard may have a significant impact on the global bond markets as the investment grade level would de facto be raised from BBB to (at least) A–. This could create a de facto segmentation in the securities markets putting corporate debt at a systematic disadvantage vis-à-vis public debt.

The narrowly defined pool of liquid assets counteracts the objective of a broadly diversified bank securities portfolio. In countries with comparatively low volumes of public debt, such as Switzerland, especially cantonal and regional banks would find it difficult to create a sufficiently large pool of liquid assets. The alternative for such banks would either be to revert to holding large amounts of pure cash or to buying foreign public debt, both of which are undesirable outcomes. The suggested segmentation of the securities market would also affect the repo markets and the ability to implement a monetary policy, whereby repo markets vary in size between jurisdictions. The Swiss National Bank's GC Basket, for example, accepts bonds from (foreign) financial institutions as eligible for repo transactions since non-banks account for such a small share of the volume. We therefore propose to widen the definition of permitted securities to include, for instance, the Swiss National Bank’s GC Basket.

3. Structural characteristic of the net stable funding ratio

Given the currently proposed scheme for calculating the net stable funding ratio, classical retail banks may exhibit a structural funding gap of about 20%. This is so because mortgages and loans, one side of their core business, would for the most part require a 100% funding whilst deposits, the other side of their core business, would be accounted for at 70 to 85% only. Coupled with the above mentioned restrictions on creating the pool of liquid assets this would drive a wedge into retail banks' balance sheets that could not be easily resolved. This would limit the banks' ability to grant loans and negatively impact economic growth. We recommend evaluating these considerations within the framework of QIS since the classic retail banks should be allowed to maintain their successful business concepts without incurring large costs.

We thank you very much for the opportunity to present our views and would be pleased if you could take account of the concerns of traditional retail banks.

Yours sincerely,

Association of Swiss Cantonal Banks (ASCB)

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