Basel Committee
on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel III regulations – Switzerland

June 2013

BANK FOR INTERNATIONAL SETTLEMENTS

Note that this report refers to the RCAP grades prior to October 2025. The grade 'materially non-compliant (MNC)', ie one notch above the lowest grade, has since been renamed to 'partially non-compliant (PNC)' for greater clarity

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Glossary

AFS	Available for Sale
AMA	Advanced Measurement Approaches
AT	Additional Tier 1 Capital
BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles for Effective Banking Supervision
BIS	Bank for International Settlements
CAR	Capital Adequacy Ratio
CCF	Credit Conversion Factor
CET1	Common Equity Tier 1 Capital
CHF	Swiss Francs
EL	Expected Loss
FINMA	Swiss Financial Market Supervisory Authority
G-SIB	Global Systemically Important Banks
IA	International Approach (of Swiss rules)
IRB	Internal Ratings-based Approach (for credit risk)
IMA	Internal Models Approach (for market risk)
IRC	Incremental Risk Charge
LGD	Loss Given Default
PD	Probability of default
PONV	Point of non-viability
RCAP	Regulatory Consistency Assessment Programme
RWA	Risk-weighted Assets
SIG	Supervision and Implementation Group
SME	Small and Medium-sized Enterprises
SSA	Swiss Standardised Approach
STA	Standardised Approach
TBTF	Too big to fail
UL	Unexpected Loss
VaR	Value at Risk

Preface

This report presents the findings of the Basel Committee's RCAP Assessment Team for Switzerland, covering the capital standards under the Basel framework. The team was led by Mr Stephen Bland of the Bank of England (Prudential Regulation Authority) and consisted of five experts conversant with different areas of the Basel capital standard. The assessment work was coordinated by the BCBS Secretariat.[1]

The Swiss RCAP assessment comprised three phases: (i) self-assessment (December 2012 to January 2013), (ii) an on- and off-site assessment phase (February to April 2013), and (iii) a post assessment review phase (April to May 2013). The assessment phase included a visit to Switzerland from 8 to 12 April 2013. During the on-site visit, the RCAP Assessment Team held discussions with officials of the Swiss Financial Market Supervisory Authority (FINMA), a former senior FINMA official, senior officials from a representative set of Swiss banks including the two Global Systemically Important Banks (G-SIBs), and major audit firms.[2] These discussions provided the RCAP Assessment Team with the industry perspective on implementation of the Swiss Basel III capital standards.

The assessment is based on information made available to the RCAP team by FINMA. It relates to published Swiss Basel III regulatory requirements which are in force since 1 January 2013 and updates of Swiss rules as of 13 May 2013. The assessment took into account capital regulation reforms undertaken while the RCAP process was underway. The assessment has suggested some areas for follow-up work on capital standards in Switzerland that could be taken up during the next assessment round under the RCAP. Switzerland's compliance with other Basel III standards on liquidity, leverage, and global systemically important banks (G-SIBs) will be assessed once they are adopted and come on stream as per the globally agreed Basel III time line.

The RCAP Assessment Team sincerely thanks the staff of FINMA for the professional and efficient cooperation extended to the team throughout the assessment process.

1 Full details of the Assessment Team, and those involved in the review of this report is given in Annex 1.

2 FINMA broadly uses a two-tier system of supervision and capital monitoring. FINMA-approved audit firms carry out regulatory audits under FINMA's oversight. For the two G-SIBs and other larger banks, FINMA performs own supervisory reviews.

Executive summary

This report assesses Switzerland's capital regulatory regime and its consistency with the international minimum standards established by the Basel Committee. The assessment identifies domestic regulations and provisions that are inconsistent with the Basel framework. It assesses the current and potential impact of these deviations on the capital ratios and highlights aspects of the Swiss capital regime that could have a negative impact on financial stability or lead to inconsistencies in the implementation of capital requirements.

The adoption of Basel III-based capital rules in Switzerland was completed during 2012.[3] The Swiss implementation of Basel capital standards is characterised by a principle-based approach to regulation and supervision as well as a long-standing tradition of remaining "super-equivalent"[4] to Basel requirements.

Switzerland has implemented its Basel capital framework with an intention that it conforms closely to the Basel standard. This is known as the "International approach" (IA). The RCAP found the IA closely aligned with Basel III standards and was therefore assessed as "Compliant". The overall assessment was based both on a comprehensive analysis of materiality, use of expert judgement and technical clarifications provided by FINMA and the 13 banks covered in the RCAP.

Despite overall compliance, some Basel requirements relating to definition of capital, Credit Risk-IRB, and disclosure were assessed to be only "Largely Compliant". The team has recognised in its assessment that FINMA has initiated a process of formal rectification. The "Swiss Standardised Approach" (SSA), which will cease by end-2018 and will be used by only one of the 13 RCAP sample banks from 2014 onwards, was found to be "Materially Non-Compliant".[5]

As a result of this assessment, FINMA has taken action to strengthen 20 elements of its Basel capital requirements under the IA. These notifications were made public and adopted on 10 May 2013 (Annex 6).[6] The pertinent primary and secondary legislation will be updated during 2013–14, and will replace the 10 May "draft rules" based on tertiary legislation (as with any legislative process, amendments to the primary and secondary legislation require some time, so that completion will not be feasible during the RCAP assessment period). FINMA has agreed to keep the Basel Committee informed as the legislative process is completed during 2013–14. The rectified issues will be followed up during the subsequent RCAP assessments for Switzerland (Annex 8).

[3] See also the Report to G20 Finance Ministers and Central Bank Governors on monitoring implementation of Basel III regulatory reform, April 2013, www.bis.org/publ/bcbs249.pdf.

[4] While this traditional feature of Switzerland was taken note of in terms of documentation, super-equivalence was not taken into account in evaluating the materiality of deviations or in exercising expert judgement (ie, in terms of grading) in accordance with the RCAP assessment methodology.

[5] The SSA has a number of super-equivalent elements but they were not recognised for the assessment grading.

[6] See FINMA, "Basel III: Letzte Änderung vom 10. Mai 2013", www.finma.ch/d/faq/beaufsichtigte/Seiten/basel-III.aspx (German version) or „Bâle III : dernière modification : 10 mai 2013", http://www.finma.ch/f/faq/beaufsichtigte/pages/basel-iii.aspx (French version) or „Basilea III: aggiornato al 10 maggio 2013", http://www.finma.ch/i/faq/beaufsichtigte/pagine/basel-iii.aspx (Italian version). The assessment team has been provided with an English translation of the publication.

Response from Switzerland

Switzerland has traditionally adopted an approach to banking regulation combining higher prudential standards (in particular capital requirements) than the international norms, with a principle-based approach in other areas leading to a lower overall density of regulation. Through super-equivalence to the new international capital standards, this traditionally more stringent capital adequacy regime has been maintained. It is now fully transparent, setting minimum capital thresholds differentiated by categories of banks, depending on their size and importance. Only for the smallest banks does the threshold equal the 10.5% capital requirement of the Basel Accord (8% minimum requirement plus 2.5% capital conservation buffer). For all other banks the thresholds are higher, amounting to 12% for medium-sized banks and ranging up to about 19% for the globally systemically-relevant Swiss banks.

FINMA welcomes and very much supports the introduction of the regulatory consistency assessment programme (RCAP) as an instrument to foster consistency and thereby strengthen the credibility of the Basel Accord. In Switzerland, the RCAP process helped to validate our efforts to faithfully implement the Basel Accord. In particular, the process was very useful in identifying elements where national interpretations were not exactly in line with the Basel Accord.

FINMA has rectified 20 deviations or potential misinterpretations identified by its own self-assessment and by the Assessment Team. These changes have been communicated publicly on May 10, 2013. Work is in progress to incorporate them into secondary and primary legislation during 2013-2014. This covers in particular the definition of capital and the treatment of equity exposure under the IRB (see Annex 6 for details), but excludes those changes that are naturally covered by tertiary legislation. FINMA will notify the Basel Committee of the final regulations and will discuss those during the next round of RCAP assessments for Switzerland.

Overall, we agree with the findings of the RCAP Level 2 assessment, which we perceived as a tough, but fair process. We thank the RCAP Assessment Team very much for its detailed review of our Basel III implementation and highly appreciate the team’s expertise and professionalism.

1. Assessment context and main findings

1.1 Context

Status of implementation

Switzerland has put in place its national Basel III capital framework (the IA) in a timely manner applicable to all categories of domestic banks (Annexes 2 and 4). The main regulation for the Swiss capital standards is the Capital Adequacy Ordinance (CAO), implementing Basel II from 1 January 2007, Basel 2.5 from 1 January 2011, and Basel III from 1 January 2013. Currently the IA runs in parallel with the SSA but the latter will cease to exist after 2018 (the SSA is a legacy of the past, going back to regulations existing pre-Basel I). The vast majority of internationally active banks (as defined in Section 1.2 for the purpose of the Swiss RCAP) have moved or will move to the IA by end-2014.[7] Details of domestic capital regulations implementing the IA are listed in Annex 2.[8]

Implementation context

Structure of the banking system and financial soundness

The Swiss financial system is dominated by 322 banks which hold about 87% of the systems' assets, amounting to more than 700% of GDP. 98 banks are internationally active in one way or another (Annex 9, Table 5) with two of these classified as G-SIBs accounting for 64% of the banking sector in terms of total assets. Besides the two G-SIBs, there are four other broad types of banks, namely a number of domestic and foreign private banks focusing on asset management, savings banks operating in the Swiss regions ("Cantons"), a cooperative bank group, and other specialised banks focusing on retail banking.

Capital levels in the banking system have been substantially higher than Basel minimum levels throughout the last decade.[9] They are close to 18% for total capital and about 15% for Tier 1 and Common Equity Tier 1 (CET1) (Annex 9). There was a downward trend in capital ratios at the time of the onset of the financial crisis in 2007–08, which primarily affected the two Swiss G-SIBs (one of which required public support), but capital levels have increased substantially in recent years reflecting decisive action by FINMA and the banks.[10] The dominant risk type is credit risk, accounting for more than 60% of RWAs. This is followed by operational risk (16%), market risk (14%), and non-counterparty related risk (10%) (ie "other assets").

Historically, the Swiss requirements for the computation of RWAs (ie, the SSA before the IA come into place by 2013) have been more conservative than those required by the Basel capital standards (see Annex 9 Figure 2 for details). This aspect of Swiss capital regulations was however not made publicly explicit. With the implementation of Basel III capital standards, it was decided to align the pre-Basel III Swiss rules (based on the SSA) with international Basel rules by introducing the IA. In terms

[7] Future RCAPs assessment teams will verify that the transition has proceeded as envisaged. It should also be noted that 78 other internationally active banks (ie all other internationally active banks not included in the RCAP sample) are currently using the SSA. They constitute about 27% of banking system assets. Of these, 78 banks, more than 40 will move to the IA by end-2013, and the rest by end-2014.

[8] See also Annex 9 for an overview of banks' use of eligible approaches for credit, market and operational risks.

[9] This statement is not based on any attempt to compare capital levels adjusted for any potential gaps in regulations or differences in regulatory approaches.

[10] The crisis has prompted the establishment of too-big-to-fail (TBTF) regulatory measures aimed at increasing the capital levels of the two G-SIBs. This includes requiring additional Tier 1 and Tier 2 capital (such as contingent capital). The two G-SIBs have also been re-defining their business models. Domestic banks are also seeking to adjust to structural shifts and the evolving global economic environment. Some signs of possible systemic risk were identified in the mortgage sector and these have been addressed by recent regulatory initiatives, through a countercyclical buffer for lending secured by residential properties.

of the broader regulatory and supervisory approach, the super-equivalence of the Swiss capital regime (ie the "Swiss finish") is continued via the higher minimum capital thresholds defined under Pillar 2, which range between 10.5% and 14.4% for most banks and go well beyond this range for the two G-SIBs (currently at about 19%).

Basel standards

Among all Swiss banks, six banks have implemented an internal ratings-based approach for credit risk (IRB), five have implemented internal models approach for market risk, and two banks have adopted an advanced measurement approach for operational risk (AMA). This compares to 267 banks using the Standardised Approach for credit risk[11] (STA), 88 for market risk, and 274 that use the Standardised Approach or Basic Indicator Approach for operational risk (Annex 9).[12] Swiss rules require banks using the IRB approach to do so for at least 90% of their assets.[13]

Banks that apply the SSA can choose when they move from the SSA to the IA during a transition period that extends until end-2018. Of the 13 RCAP banks, eight banks use the STA to credit risk. Of these, six applied the SSA at year-end 2012, but all except one of these envisage moving to the IA by end 2014. The other five RCAP banks use the IRB. About half of the remaining[14] internationally active banks (about 80) will be off the SSA by end-2014 (Annex 9, Figure 1).

Legal system and mode of supervision

Swiss law is based on the continental European tradition of civil law. FINMA's regulatory approach has been a principle-based one and is reflected in the Swiss capital rules: (i) rules in several areas remain less specified than the Basel standards; and (ii) while a substantial part of Swiss Basel rules are established in primary legislation, a large part are also contained in secondary legislation and the remainder in tertiary legislation (Annex 4, Table 4). Both these elements provide FINMA with sizeable discretion in specifying the technical requirements (Annex 4 provides the hierarchy and specificities of various legal and regulatory instruments used in Switzerland).

Supervision by FINMA has traditionally been characterised by a two tier system, ie, substantial reliance on external auditors who perform an official supervisory function and are thereby part of the formal supervisory system, in addition to the supervisory role of FINMA.[15] FINMA uses a risk-based approach to supervision, focussing its efforts on the larger banks.

[11] These banks either use the SSA or the IA STA rules.

[12] The difference to the more than 300 banks in Switzerland is made up by branches and a large share of institutions eligible to use the de minimis approach to market risk, ie the banks (ie some 200 banks) not using either an internal model or the STA for market risk use the de minimis approach.

[13] As discussed below, there is an exception to this rule in the context of the TBTF regime.

[14] Ie banks that are not part of the RCAP sample.

[15] As mentioned earlier, another defining principle of Swiss supervision and regulation has been super-equivalence vis-à-vis Basel standards, which remains out of scope for the RCAP assessment. Such an approach has been driven by several factors: (i) a large banking system relative to GDP with two GSIBs (financial stability considerations); (ii) market discipline by stakeholders, especially in the area of private wealth management, a core business line of the Swiss banks; and (iii) a capital cushion mirroring the principle-based approach.

1.2 Scope of the assessment

Scope

The objective of the assessment was to evaluate the extent to which domestic regulations in Switzerland are consistent with the capital standards under the Basel framework in both letter and spirit. This was examined across two dimensions, and the identified gaps were subject to a materiality assessment.

- a comparison of domestic regulations with the capital standards under the Basel framework to identify if all the required provisions of these standards have been adopted (*completeness* of Swiss capital regulation); and
- independent of the form of the capital requirements whether there are any differences in substance between the domestic regulations and the capital standards under the Basel framework (*consistency* of the Swiss capital regulations).

In carrying out the above, the RCAP Assessment Team considered all binding documents that effectively implement the Basel framework in Switzerland as of 13 May 2013, the cut-off date for the assessment (Annex 4).[16]

Bank coverage

The assessment was based on data submitted for 13 sample banks. Three of the banks are foreign subsidiaries of groups based in other jurisdictions and two of the 11 are not internationally active, but included to ensure representativeness. The selection of the RCAP sample banks was based on three criteria:

- All internationally active banks (defined for the purposes of the RCAP as banks having branches or subsidiaries outside Switzerland)
    - o banks for which less than 20% of their assets are foreign were excluded (except for those banks that are considered large and/or qualify so as to have a representative sample);
- All banks with considerable size and business activity based on the domestic definition (FINMA categories 1–3), including relevant banks with purely domestic business, to establish a representative sample.[17]
    - o small banks with RWA of less than CHF 10 billion were excluded (0.4% of banking sector assets);
- At least one bank for each of the supervisory approaches used in Switzerland (for credit risk, market risk and operational risk) was covered, and the vast majority of banks with advanced approaches (ie IRB).[18]

[16] For the broader context of the assessment, the report has drawn on other Basel work streams (QIS/CMG reports), and the published versions of financial stability assessments and Swiss compliance with the Basel Core Principles.

[17] See, eg FINMA Circular 2011/2, "Capital buffer and capital planning – banks", www.finma.ch/e/regulierung/Documents/finma-rs-2011-2-e.pdf, for a definition of the categories, which are meant to cluster banks in terms of size and complexity.

[18] As shown in Table 5 in Annex 9 there are six IRB banks in Switzerland. All of them but one (very) small IRB bank were included in the sample.

Enforceability of rules[19]

The assessment considered primary (the law and ordinance) and secondary (circular) legislation as binding and therefore eligible for the assessment.[20] In terms of tertiary rules (ie FAQ/guideline-type rules), the team noted that such rules were only used for technical clarifications, and reflect the legal tradition in Switzerland. As such, these rules were considered effective[21] and therefore eligible for the assessment. However, such rules would not be considered acceptable as the primary basis for implementing a specific provision of the Basel standards.

As a corollary of the former, the assessment also took into account tertiary legislation published on 10 May 2013 (see Annex 6) used to rectify the deviations identified by the RCAP. The assessment team was satisfied that these public commitments given by FINMA to transpose these rectifications into primary and secondary legislation in 2013-14 (unless tertiary legislation is the natural legal instrument)[22] were sufficiently "effective" to be taken into account. FINMA's response is a strong commitment to finalise the rectification as envisaged. Future Swiss RCAPs would clearly need to check that this happened as envisaged, thereby putting conditionality on the assigned grades.

Data

The data used for the assessment of materiality of quantifiable deviations from the Basel standards were based on bank-by-bank figures provided by FINMA (either directly or through collection from the banks) on the 13 banks in the RCAP sample. This formed the basis for evaluating the impact on capital ratios, risk-weighted assets (for Pillar 1 elements), and exposures (for gaps covered by less comprehensive analysis).[23]

For the non-quantifiable deviations, the assessment team relied upon FINMA's self-assessment, qualitative information provided by FINMA, and technical discussions with FINMA staff and the banking industry.

1.3 Assessment grading and methodology

As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale, both at the level of each of the 15 key components of the Basel capital framework and overall assessment of compliance by a jurisdiction: compliant, largely compliant, materially non-compliant and non-compliant.[24] A regulatory framework is considered:

[19] As foreseen by the RCAP process "all binding documents that effectively implement Basel III" are taken into account (www.bis.org/publ/bcbs216.htm).

[20] Primary and secondary legislation, as defined for this assessment, constitutes formal legislation. Please note that in previous RCAPs these legal forms were both referred to as primary legislation.

[21] In order to reach this conclusion, the RCAP team assessed the instrument against a number of enforceability criteria, as also used for previous RCAP assessments. Specifically, the assessment team noted that tertiary regulation implementing Swiss Basel rules is (i) publicly available, (ii) clearly understood as being effective by auditors and banks (evident based on empirical evidence); and (iii) used mainly for "sufficiently" technical matters.

[22] This only applies to one of the 20 changes.

[23] As for other QIS studies the impact of each gap was estimated by a hypothetical replacement of FINMA rules with actual Basel standards. The calculations were performed by the 13 RCAP sample banks in a three-week period in March 2013.

[24] This four-grade scale is consistent with the approach used for assessing countries' compliance with the Basel Committee's Core Principles for Effective Banking Supervision. The actual definition of the four grades has been adjusted to take into account the different nature of the two exercises. In addition, components of Basel III that are not relevant to an individual jurisdiction may be assessed as "not applicable"(N/A).

- *Compliant* with the Basel framework if all minimum provisions of the international framework have been satisfied and if no material differences have been identified that would give rise to prudential concerns or provide a competitive advantage to internationally active banks;
- *Largely compliant* with the Basel framework if only minor provisions of the international framework have not been satisfied and if only differences that have a limited impact on financial stability or the international level playing field have been identified;
- *Materially non-compliant* with the Basel framework if key provisions of the Basel framework have not been satisfied or if differences that could materially impact financial stability or the international level playing field have been identified; and
- *Non-compliant* with the Basel framework if the regulation has not been adopted or if differences that could severely impact financial stability or the international level playing field have been identified.

Materiality of the deviations was assessed in terms of their current, or, where applicable, the future impact on the capital ratios of banks, thereby affecting the level playing field among international banks and/or raising financial stability concerns. Wherever relevant and feasible, an attempt was made to quantify the impact of deviations based on data collected from all of the 13 Swiss banks.

For the *quantifiable gaps*, the RCAP assessment team, together with FINMA attempted to quantify the impact, both in terms of current materiality and potential future materiality.[25] The *non-quantifiable gaps* were discussed with FINMA and the assessment was based on observed good practices in other jurisdictions and expert judgement.

It was also taken into account that, as a general principle, the burden of proof lies with the assessed jurisdiction to show that a finding is not material or not potentially material.

Further information on the materiality assessment is given in Annex 10.

1.4 Main findings

Overall

The assessment revealed that the capital rules in Switzerland based on the IA are closely aligned with Basel capital standards. But, there were some material deviations related to the definition of capital and credit risk which have since been rectified.

The IA rules were found to be "Compliant" (C) in 11 out of 14 graded[26] components of the Basel framework, and "Largely Compliant" (LC) in three areas (see Table 1 below).

The SSA, however, was assessed to be "Materially Non-Compliant" (MNC), based on one component classified as "Non-Compliant" (NC), two as MNC, two as LC and six as C.[27] It should be noted that by strictly not taking account of super-equivalent approaches in RCAPs has a substantial negative impact on the SSA's assessment.

[25] As such, due consideration was given to the number of banks having the relevant exposure, the size of exposures impacted, the range of impact and possibility of any rise in the relative proportion of the impacted exposures in the balance sheets of banks in the foreseeable future.

[26] The Swiss rules for the G-SIB buffer will be subject to follow up RCAP analysis once the final Basel standards are established.

[27] The grades for the SSA are the same as for the IA, except for the STA to credit risk, market risk and counterparty credit risk and the advanced approaches to credit risk, market risk and operational risk are not eligible to those banks, which leads to a total number of 11 components to be assessed.

Summary assessment grading | Table 1

Key components of the Basel framework	Grade for the IA[28]
Overall Grade	C[29,30]
Scope of application	C
Transitional arrangements	C
Pillar 1: Minimum capital requirements	
Definition of capital	LC
Capital buffers (conservation and countercyclical)	C
Credit Risk: Standardised Approach	C[31]
Credit risk: Internal Ratings-based approach	LC
Credit risk: securitisation framework	C
Counterparty credit risk rules	C[32]
Market risk: standardised measurement method	C[33]
Market risk: Internal Models Approach	C
Operational risk: Basic Indicator Approach and the Standardised Approach	C
Operational risk: Advanced Measurement Approaches	C
G-SIB additional loss absorbency requirements	N/A
Pillar 2: Supervisory Review Process	
Legal and regulatory framework for the Supervisory Review Process and for taking supervisory actions	C
Pillar 3: Market Discipline	
Disclosure requirements	LC

Compliance assessment scale (See section 1.2 for more information on the definition of the grades): C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant). (N/A) To be assessed after the Committee concludes the final Basel standards.

As the assessment progressed, FINMA used the RCAP process to rectify 20 of the identified issues in the IA through corrections of FINMA requirements (Annex 6). These amendments addressed deviations in the areas of capital, credit risk, and market risk. The assessment team considers the changes to IA rules that were communicated in public on 10 May 2013 via tertiary regulatory instruments as a rectification of the gaps.[34] The pertinent primary and secondary formal legislation will

28 The corresponding grades for the SSA are given in footnotes. See description of grades below.

29 This grade was assigned despite the Swiss regulations being assessed as only largely compliant in three areas, notably the definition of capital and Credit Risk/IRB. It was a balanced judgement, in which the deciding factor was FINMA’s commitment to immediately addressing issues through corrections of FINMA rules via the public issuance of tertiary legislation, and revisions to formal regulation in due course.

30 The grading for the SSA is MNC. Note that super-equivalence was not taken into account.

31 NC for the SSA. Note that super-equivalence was not taken into account.

32 MNC for the SSA. Note that super-equivalence was not taken into account.

33 MNC for the SSA. Note that super-equivalence was not taken into account.

34 See FINMA, “Basel III: Letzte Änderung vom 10. Mai 2013“, www.finma.ch/d/faq/beaufsichtigte/Seiten/basel-III.aspx (German version) or „Bâle III : dernière modification : 10 mai 2013“, http://www.finma.ch/f/faq/beaufsichtigte/pages/basel-iii.aspx (French version) or „Basilea III: aggiornato al 10 maggio 2013“, http://www.finma.ch/i/faq/beaufsichtigte/pagine/basel-iii.aspx (Italian version). The assessment team has been provided with an English translation of the publication.

be updated during 2013–14 replacing the current publication of tertiary legislation (unless it is the natural legal instrument). Given the common use of tertiary rules by FINMA and its use as a credible regulatory instrument by banks, auditors and other relevant stakeholders, the assessment team considers the changes of the rules as a binding commitment of FINMA to align its framework with Basel standards.

As part of the RCAP, discussions were held with senior representatives of select Swiss banks. The objective was to get their perspectives on the implementation of the Basel capital standards in Switzerland. The views exchanged were constructive and the overall industry view was positive about FINMA regulations, and its approach to regulation and supervision (principle-based, super-equivalence), and Basel III implementation.

Main findings by component

The main findings of the RCAP Assessment Team relate to the definition of capital and credit risk (IRB and SSA), and, to a lesser degree, counterparty credit risk (SSA only), market risk, Pillar 2 and Pillar 3. The summary below includes findings where deviations have been rectified by FINMA during the RCAP process:

- Capital: The assessment identified some broad issues relating to the capital rules in Switzerland, some of which have subsequently been rectified, including the definition of Common Equity Tier 1. The materiality assessment for the quantifiable gaps (recognition of stock surplus and minority interest) suggest that they are not material for now. The first consolidated capital reporting of all banks to FINMA based on Basel III rules is due in August 2013 (based on end June 2013 data). Hence, a definitive quantitative assessment will have to be subject to follow-up RCAP analysis, and on-going monitoring so that the issues do not become material at a later stage. The component is graded “Largely Compliant” based on the rectification of deviations by FINMA and supervisory action by FINMA (in line with its principle-based approach) to warrant that the remaining deviations will not become material at a later stage. Without rectification by FINMA, the assessment result for the capital component would have been “Materially non-compliant”:
    - The Swiss rules deviate from Basel standards in terms of the CET1 definition and application in some areas. The Swiss definition of CET1 uses a principle-based approach to cater to all the kinds of corporate legal forms applicable in Switzerland. However, not all criteria foreseen under Basel III standards[35] are fully met and it is not specifically stated that the criteria for joint stock companies must be met solely by common shares. Hence, the CAO and the Circular 13/1 leave some potential for the use of other instruments than “common shares” to qualify as CET1, especially for the issuance of participation rights (“Partizipationsscheine”), as long as they fulfill, in FINMA’s view, the relevant 14 CET1 criteria.
    - Currently, however, no capital instruments other than common shares are used as CET1 by Swiss joint stock companies. More importantly, FINMA has rectified the deviation by a public statement that for listed joint stock companies only common shares will be recognised as a CET1 capital instrument, which will be reflected in revised primary legislation in due course.

[35] These criteria are set out from paragraph 53 of BCBS, *Basel III: A global regulatory framework for more resilient banks and banking systems*, revised version, June 2011) www.bis.org/publ/bcbs189.htm.

- The Swiss rules modified some of the 14 criteria for application to cooperative, private and publicly owned banks. These modifications are meant to accommodate governing laws for these banks. This is consistent with the Basel Committee's general stipulation that application of the CET1 criteria can take into account the specific constitution and legal structure of non joint stock companies. However, the Basel framework is very specific in stating that "the application of the criteria should preserve the quality of the instruments by requiring that they are deemed fully equivalent to common shares in terms of their capital quality as regards loss absorption *and do not possess features which could cause the condition of the bank to be weakened as a going concern during periods of market stress*".[36]

- In this regard, the RCAP team considered the Swiss modification to allow such banks to issue instruments re-deemable at the option of the holder and include them as CET1 as a deviation from Basel standards. The deviation could undermine confidence in a bank and put it under (additional) stress if an institution that has historically met all requests for repayment of a capital instrument were to delay or limit repayment in the future. At the same time, the Swiss rules foresee as a safeguard that the minimum capital requirements with regard to Art. 41 CAO must continue to be fulfilled before any repayment. Additionally, banks must involve FINMA ahead of any action which might lead to changes of their statutes and/or in the relevant public register. Moreover, the Swiss rules allow preferred dividend payments to be accepted for some types of banks, which is a deviation from Basel standards.

- Stock surplus to be paid on share capital recognised in different tiers could be recognised in CET1 regardless of its origin (Margin 17 Circular 13/1) provided that it qualifies as disclosed reserves. Even if FINMA would not allow classification of a surplus paid on a Tier 2 instrument as CET1, the Swiss rules would nevertheless allow for that. The issue is also relevant in the area of additional Tier 1 capital (AT1). The experience with some hybrid Tier 1 capital instruments in the past, which were labelled "preference shares", for example, and the use of the respective surplus to pay coupons in non-profitable times led to a decision by the Basel Committee to recognise only a paid surplus in the corresponding tier, but not in CET1.

- Under Basel standards, the treatment of minority interests or any third party investments in other regulatory capital instruments of consolidated subsidiaries limits the amount that can be recognised as capital at the group level. The CAO foresees a more generous treatment of minority interest for inclusion in the parent bank's capital as it allows recognition of all capital requirements listed in Art. 41 CAO (the minimum requirements, the conservation buffer, the countercyclical buffer and additional requirements, such as for Pillar 2 and the systemic risk buffer) when calculating the amount of minority interest to be recognised in the consolidated capital.[37] This deviation will likely result in a persistent potential deviation vis-à-vis Basel standards, especially in a situation where the countercyclical capital buffer is also activated. The materiality would depend on the overall size of the buffers (Pillar 2, the countercyclical and systemic risk) applicable to the pertinent consolidated subsidiary.

[36] Footnote 12 in BCBS, Basel III: A global regulatory framework for more resilient banks and banking systems, revised version, June 2011.

[37] The current business model of the vast majority of Swiss banks does not make use of third-party CET1 investments in the capital of its subsidiaries. Third-party investments in other regulatory capital instruments (AT1 or T2) of consolidated subsidiaries are also expected to be insignificant, to await confirmation based on 2013 mid-year reports.

- The Basel framework foresees a broad definition of "indirect holdings" to avoid double gearing. Prior to rectification of the deviation (Annex 6), the CAO left some room for a narrower definition of "indirect holdings", which could result in banks avoiding certain deductions of its exposures to the capital of another financial institution.

- Credit Risk, IRB: in terms of the *IRB approach* for credit risk, the Basel framework has been faithfully implemented through the IA, in which most of the Basel III standards are directly cross-referred to. However, the RCAP team identified seven deviations, in relation to three broad issues, namely equity exposures, the IRB roll-out, and the treatment of defaulted assets.

  - Prior to rectification by FINMA (Annex 6), the treatment of equity exposures under Swiss IRB rules exhibited deviations in terms of parameters and/or floors as well as the treatment of equity exposure more generally, which turned out to be material both on an "average" system-wide basis as well as for one of the IRB banks. The deviation resulted from a historic desire to align with the Basel II EU implementation in terms of reporting and RWA computation. FINMA has taken immediate supervisory steps with the bank most affected.

  - In respect of the roll-out, the Swiss IRB requires a minimum IRB coverage of 90% of credit risk exposure but stipulates that, in principle, this minimum coverage level of 90% should also be met after the implementation of the IRB. In addition, FINMA allows the two G-SIBs to apply the standardised approach to unencumbered assets held solely for Swiss TBTF liquidity purposes. Taken together, this may allow a permanent partial exemption from IRB requirements. That said, the exemption for TBTF banks would be mainly for high-quality liquid assets, while roll-out provisions in the Basel standard were more concerned about partial use for lower-quality assets. Overall, the estimated impact of a less than 100% IRB rollout was low, but leaves room for potential materiality.

  - Regarding defaulted positions (whatever the asset class), the Swiss IRB applies a shortcut standardised methodology for the estimation of the unexpected loss (UL) for these assets, which substitutes for the fully-fledged Advanced IRB methodology required by Basel III to estimate LGD for such defaulted assets. In addition, the Swiss IRB approach allows specific provisions and partial write-offs to be used as the best estimate of the expected loss on defaulted positions, subject to the approval by FINMA, instead of requiring banks to construct their best estimate of this expected loss based on current economic circumstances and facility status of the assets. FINMA stressed that current economic circumstances and facility status are taken into account in establishing specific provisions. Short of an ultimate quantitative assessment of the impact , and in the absence of convincing evidence that the Swiss method is unlikely to be less conservative than Basel III, especially under specific circumstances (eg downturn conditions), the assessment team considers the gap to be potentially material.

- Credit Risk, STA: in terms of the IA STA, there were no deviations of substance from the international standards. In terms of the SSA, which will be abolished subject to a transition period, the following material gaps were identified: (i) treatment of commercial real estate exposures; (ii) the use of life insurance contracts as eligible collateral for Lombard lending; and (iii) the minimum conditions for the use of a zero haircut for repo-style transactions.

- Counterparty credit risk: in terms of the IA there were no deviations of substance from the Basel standards. In terms of the SSA the Swiss rules deviate in terms of the computation of potential future exposure under the Current Exposure Method and have a spill-over effect in terms of the calculation of the CVA requirements. The materiality assessment indicates that the impact is material.

- Market Risk: for *internal models*, the deviations mainly include a few non-quantifiable gaps, to be rectified by revised IA rules, related to the processes of quantifying stressed Value at Risk (VaR), the inclusion of sovereign exposure in the Incremental Risk Charge (IRC), and the revocation of model approval due to backtesting. There is no evidence that FINMA has allowed to make use of these deviations (which could be material) in the past before aligning the Swiss rules to Basel standards during the assessment process. For *standardised models*, the potential ability to treat unrated Nth-to-default credit derivatives in the same ways as other securitisations represented a deviation, which FINMA has also rectified. Finally, with respect to the SSA, a deviation exists for interest rate-specific risk whereby charges for a long and short credit position of the same issuer can be offset.
- Operational Risk: there were no rule based deviations of substance from international standards.
- Pillar 2 requirements are compliant with Basel standards. However, the team noted, that at least in the past FINMA seems to have a made an implicit trade-off between super-equivalence of capital requirements and supervisory measures to address specific risks.
- Pillar 3 requirements are compliant with Basel standards for large banks, although the first reports under the Basel III requirements have yet to be issued. On size grounds, however, 237 banks out of 322 banks are partially exempted from Pillar 3 requirements including foreign banks where the parent is subject to full disclosure requirements and some small banks with some international presence through subsidiaries and/or branches.

Materiality analysis

As shown in Table 2, the RCAP team identified a total of 63 gaps for the IA. Out of about 50 gaps considered quantifiable, 30 were subject to quantitative impact analysis ("RCAP QIS" based on bank level data or quantitative analysis by FINMA) and 14 were found to be material or potentially material accordingly (Annex 10, Table 7). Around 20 deviations were non-quantifiable, and were handled based on expert judgement, while the remaining 15 gaps were very minor and did not warrant impact analysis.

Table 7 in Annex 10 lists the number of findings by materiality level for each component of the capital standards assessed (not material, potentially material, and material). The impact analysis revealed one material issue for IA, which has been rectified, and five for the SSA (which were not rectified), in addition to a number of potentially material issues.

Overview of the number of deviations and their materiality — Table 2

Number of "negative" deviations		
	Material[38]	Total
Number of deviations identified by the Assessment Team	IA: 14 SSA: 5	63
Rectified by amendments to Swiss rules	IA: 4 SSA: 0	20 0
Final number of findings	IA: 10 SSA: 5	50 23

[38] Number of material and potentially material issues (see Table 7 in Annex 10).

The not readily quantifiable (as they are mainly subject to potential materiality) and non-quantifiable issues are not considered material at present, but some could, in principle, potentially become (more) so as banks develop their business models in response to the Basel III regime. As foreseen by the RCAP methodology, the team balanced these areas together with the more quantifiable areas in reaching its overall judgement.

Two issues identified by the team, related to foreign exchange rates and capital (Annex 7) were not considered for grading and will have to be discussed by the Basel Committee for further guidance. Together with issues identified as relevant for follow up assessments (Annex 8), these issues will be evaluated at a later stage.

2. Detailed assessment findings

The component-by-component details of the assessment of Switzerland's compliance with the capital standards under the Basel framework are detailed in this part of the report.

2.1 Scope of application

Section grade	Compliant (C)
Summary	Four deviations were identified by the RCAP Team, none of which is material, and one of the four issues only applies to the SSA (ie there are three non-material issues for the IA). The *introduction section* is fully compliant. The *Scope of application* section is compliant except for the three (SSA: four) non material issues noted below.
Overview of findings by Basel paragraph:	
Basel paragraph no	Paragraphs 20-23: Introduction
Reference in the domestic regulation	CAO art. 7-13 (respectively art. 6-11 in the old CAO valid until the end of 2012)
Findings	FINMA can exclude a subgroup from the (sub-) consolidation requirement if a) all sub-group entities are active in Switzerland; and b) if the whole group is subject to an appropriate consolidation by FINMA or another supervisory entity.
Materiality	Not material
Basel paragraph no	Paragraphs 25-27: Introduction
Reference in the domestic regulation	CAO art. 21 and FINMA Circular 13/1 (respectively art. 22 in the old CAO) CAO art. 9 (respectively art. 8 in the old CAO)
Findings	Art. 22 of old CAO states that minority interests "may" be recognised. The Swiss policy is to examine on a case-by-case basis the inclusion of minority interests in the regulatory capital. A non-consolidation is possible if the concerned financial entity is held for less than one year or if it is not material.
Materiality	Not material
Basel paragraph no	Paragraph 42 : General provisions
Reference in the domestic regulation	CAO art. 137 (respectively art. 62 in the old CAO)
Findings	SSA General provisions up to 1.25% of risk weighted assets are not included in Tier 2 capital due to some banks' inability to determine the amount of provisions booked per single asset. Therefore a simplified method has been implemented where 75% of total provisions are deducted from the risk-weighted positions to cover positions that require capital.
Materiality	SSA: Not material; IA: Not material
Basel paragraph no	Paragraph 43 to the extent not modified by the Basel III package: IRB EL deductions
Reference in the domestic regulation	CAO art. 30 & 32e and FINMA Circular 13/1, margin no. 98 (respectively articles 31 and 26 in the old CAO)
Findings	A formal error to the new 1250% risk weight for certain equity exposures treated via deduction under the PDG/LGD approach under Basel II, which will be corrected. However, currently no IRB bank uses the PD/LGD approach to equity.
Materiality	Not material

2.2 Transitional arrangements

Section grade	Compliant (C)
Summary	Two non-material issues were identified by the RCAP Team.
Overview of findings by Basel paragraph:	
Basel paragraph no	Paragraphs 45-49 as amended by the revised framework:[39] Transitional arrangements
Reference in the domestic regulation	CAO art. 47 and FINMA Circular 08/19 margin no. 381.1 FINMA Circular 08/21
Findings	No transitional arrangements/capital floor is imposed for banks applying the Advanced Measurement Approach (AMA) for operational risk. Currently all banks applying AMA for operational risks also apply the IRB approach for credit risk which imposes a capital floor. This is a technical error which will be corrected by the next revision of Circular 08/21.
Materiality	This is currently a non-material issue as banks applying AMA for operational risk also apply the IRB approach for credit risk which imposes a capital floor, and unlikely to become material in the future (ie will remain non-material).
Basel paragraph no	Paragraphs 49(i)-49(xviii): The constituents of capital
Reference in the domestic regulation	N/A Superseded by the Basel III package
Findings	On para. 49 (iv): Although FINMA stated that the paragraphs were superseded by the Basel III package and therefore putting a N/A in the self-assessment, the CAO and FINMA Circular 13/1 still provide rules and allow for recognition of hidden reserves; see margins nos. 99-101 in Circular 13/1. However, such recognition is only allowed at a solo level and is only applicable to non-listed banks, which means in practice they could potentially be used even by an internationally active bank in the form of a non-joint stock company as long as it is not obliged to set up consolidated accounts for regulatory purposes. See also findings in the following section on Basel III Capital, Definition of Capital, and comment on para. 57 (Tier 2 capital).
Materiality	Not material

2.3 Pillar 1: Minimum capital requirements

2.3.1 Definition of capital

Section grade	Largely Compliant (LC)
Summary	1. The Swiss definition of CET1 uses a principle based approach to be able to cover all kinds of corporate legal forms that banks can be licensed under. Nevertheless, not all criteria mentioned in the Basel III rules standards[40] are fully met and it is not specifically pointed out that these criteria for listed joint stock companies must be met solely by common shares. 2. The Swiss rules modified some of the 14 criteria especially for application to cooperative, private and publicly owned banks. FINMA explains that the modifications are necessary to accommodate governing laws for

[39] The Basel Committee agreed at its 8-9 July 2009 meeting to keep in place the Basel I capital floors beyond the end of 2009. See press release of 13 July 2009.

[40] These criteria are set out from paragraph 53 of Basel III: A global regulatory framework for more resilient banks and banking systems (revised version June 2011), which is available at www.bis.org/publ/bcbs189.htm.

	these banks. 3. Stock surplus to be paid on share capital recognised in different tiers can nevertheless be recognised in CET1 regardless of the origin (Margin 17 Circular 1/13) subject to the evaluation that is qualifies as disclosed reserves. 4. The Basel framework's treatment of minority interests or third party investments in other regulatory capital instruments of consolidated subsidiaries limits the amount that can be recognised in capital at the group level. The CAO proposes a more generous treatment of minority interests for inclusion in the parent's capital as it allows incorporation of all capital requirements listed in Art. 41 CAO. 5. Basel has adopted a broad definition of "indirect holdings" to minimise the issue of double gearing. The CAO could be understood as giving a more narrow definition of "indirect holding", thereby opening up the potential for a bank to avoid certain deductions of its exposures to the capital of another financial institution.
Overview of findings by Basel paragraph:	
Basel paragraph no	52- 53: Common Equity Tier 1
Reference in the domestic regulation	Art. 20-26 CAO; FINMA Circular 13/1 margins. nos. 11-29 and 43-60
Findings	Basel stipulates that internationally active joint stock companies must meet the 14 criteria for CET1 instruments solely with common shares. The Swiss rules require instruments to satisfy the 14 criteria to qualify as CET1 capital in general terms but currently make no explicit reference to the "common shares only" requirement. Art. 22 CAO and margins no. 11-13 Circular 13/1 allow for recognising more than one instrument in CET1. FINMA argues that they consider the relevant rules to be (still) in line with the Basel III standards as they require the 14 criteria including the loss absorption requirement to be met. The flexibility provided by the Swiss rules is primarily aimed to be used by banks in the legal form of non-joint stock companies, as their ability to raise sufficient CET1 capital is limited. The assessment team considers this as a deviation from a key provision of the Basel III standards. Currently, no joint stock company makes use of the flexibility provided by the Swiss rules nor do relevant banks intend to do so, which was confirmed by their representatives at meetings during the on-site visit. After further discussions with FINMA, a commitment was reached to make the Swiss rules more compliant with regard to the internationally active listed joint-stock companies through publishing a relevant FAQ (see Annex 6). In due course, FINMA will present a proposal to the Swiss Federal Council to change the CAO stating the "common shares only requirement". Margin no. 21 of Circular 13/1 raises a general concern. There might be a potential conflict regarding the application of the paid-up criterion in Criterion 11 and if an effective availability of own capital can still be seen as warranted. The issue could become relevant when granting a loan against collateral that knowingly consists of own capital instruments, as it can be the case with the business of Lombard lending. The recognition of unrealised gains on available-for-sale (AFS) assets seems to be more prudent than under Basel III, where such gains can flow unlimited through other comprehensive income (OCI) into CET1. The treatment of unrealised gains is currently discussed in light of the amendments proposed by the IASB on IFRS 9 and might lead to amendments of the relevant Basel III standards respectively. The Swiss rules perpetuate for the time being the standard introduced in 2004 by the Basel Committee regarding the implementation of the so called prudential filters by deducting such unrealised gains from CET1 and recognising 45% of this positive difference in Tier 2 capital. However, the Basel III standards do not envisage such a treatment to continue and there is no recognition for such positive item in the relevant Basel III standards on T2 capital (the list provided in para. 57 is conclusive).

	Nevertheless, FINMA regards this as in line with international practices.
Materiality	Potentially material (partially rectified, see Annex 6)
Basel paragraph no	53, footnote 12: Application of Common Equity Tier 1 criteria to non-joint stock companies
Reference in the domestic regulation	Art. 20-26 CAO; FINMA Circular 13/1 margins. nos. 43-60
Findings	Under Swiss rules the 14 CET1 criteria were modified for public sector owned banks, cooperative banks and classic private banks with unlimited responsibility for individuals. FINMA explains that it needs some flexibility in application of footnote 12 to account for non-joint-stock companies. For the relevant companies' criterion 3 on perpetuity and criteria 5/6/7 regarding distributions is not fully in line with Basel III standards. The assessment team had some difficulty recognising that the modification would allow such banks to issue instruments redeemable at the option of the holder in order to include them as CET1. It is concerned that if an institution has historically met all requests for repayment of a capital instrument, it would be very difficult for the institution itself to delay or limit repayment without undermining confidence in the institution and putting it under additional stress. On the other hand, the Swiss rules foresee as a safeguard that the sum of the capital requirements with regard to Art. 41 CAO be fulfilled. Seen as more important for the assurance of the criterion on permanence was the notification by FINMA to the assessment team that banks with regard to Article 3 para. 3 of the Swiss Banking Act always have to involve FINMA ahead of any action which might lead to changes of the statutes and subsequently in the relevant public register. Preferred payments are accepted for partnerships as a compensation to be paid for their unlimited liability. Likewise, a limitation on dividends to holders of cooperative shares is acceptable unless this leads to an obligation for the bank to pay a dividend. With regard to publicly owned banks' "interest" payments, FINMA takes the view that the classification as interest is more of a formal deviation, but not a material one. However, as some of such investments are refinanced by corresponding public bonds issuances, there could be pressure on a bank to always pay out corresponding amounts to enable them to pay the interest on such bonds.
Materiality	Potentially material (due to preferential payments allowed)
Basel paragraph no	56: Additional Tier 1 capital
Reference in the domestic regulation	Art. 27 CAO, margin no. 17 Circular 13/1
Findings	According to margin no. 17 Circular 13/1 paid stock surplus for shares recognised in AT 1 can be recognised in CET1. FINMA argues that a de-recognition would be contrary to the Swiss legal setup and contrary to Basel rules since the conclusion in the Circular is based on the precondition that stock surplus meets disclosed reserves in terms of quality. From a purely legal point of view as well as under accounting rules the same is true for most European countries. Nevertheless, the Basel III standards require banks to distinguish between different classes of capital and the relevant premia paid. This issue was discussed at great length and depth in Basel before the decisions were taken in December 2010. The need to distinguish between the different classes of capital was based on the experience that (i) the hierarchy for loss allocation could not be conducted in a straightforward way; and (ii) instead of conserving capital resources in times of stress, coupons on AT1 instruments were paid out of such premia even in case of insufficient profits. Unlike FINMA, the assessment team does not consider this issue merely to be one of formal compliance, but identifies potential materiality, despite the fact that no such AT1 and 2 instruments were in use by now. Finally, FINMA sees no conflict with investors' rights regarding the potential disturbances of the loss

	hierarchy, as warranted by the Basel III standards, which could also create reputational risks for the banks.
Materiality	Potentially material.
Basel paragraph no	57: Tier 2 capital
Reference in the domestic regulation	Art. 30 para. 4 (c) CAO; margins nos. 99-101 Circular 13/1
Findings	Such reserves were allowed under Basel I and II (no. 49 iv to vi), but are not accepted any longer under Basel III, not least due to the lack of transparency ("hidden reserves"). However, in Switzerland such recognition is only allowed on a solo level and is only applicable to non-listed banks, which means that such reserves could only potentially be used by an internationally active bank in the form of a non-joint stock company as long as it is not obliged to set up consolidated accounts for regulatory purposes. Currently, there is no such bank in the sample. Swiss rules continue to allow a more prudent treatment by recognising 45% of the positive difference from certain unrealised gains on AfS assets in T2 capital introduced in 2004 when adopting the rules on Prudential Filters. However, the Basel III standards do not envisage such a treatment to continue and there is no recognition for such positive item in para. 57 (the list provided in para. 57 is conclusive). Nevertheless, FINMA regards this as in line with international practices. This is an issue which will need BCBS review.
Materiality	Not material
Basel paragraph no	59: Tier 2 capital
Reference in the domestic regulation	Art. 20 and 30 CAO; margin 17 Circular 13/1
Findings	The issue raised for the share premium under CET1 and AT1 is also relevant in this respect, even if considered rather theoretical from a Swiss perspective. From a formal standpoint, however, it is required by the relevant Basel III standards to distinguish between share premia paid for instruments in different tiers (see above).
Materiality	Not material
Basel paragraph no	62- 65: Minority interest
Reference in the domestic regulation	Art. 21 para. 2, 27 para. 6 and 30 para. 3 CAO
Finding	The Basel adjustments for minority interest are based on the minimum capital requirements plus the capital conservation buffer only. Margin no. 37 allows, in addition to the above elements, recognition of all other elements mentioned in Art. 41 CAO, which comprise the countercyclical buffer and any additional own funds requirements regarding to Art. 45 CAO (Pillar 2 requirements) to be taken into account when calculating the amount of minority interest to be recognised in consolidated capital. This has the effect of increasing the amount of minority interest recognised in the parent bank's capital. FINMA argues that its approach is conservative as only regulated subsidiaries are included. The data provided by FINMA indicates that minority interest constitutes, by now, a non-material portion of CET1: based on the RCAP QIS, one bank is affected, but the impact is currently not material. Data on AT1 and T2 are not yet available, though, as the first Pillar 3 reporting based on Basel III rules is to be supplied by the banks in August 2013 based on data of the second quarter of 2013.
Materiality	Potentially material
Basel paragraph no	69-70: Deferred tax assets
Reference in the domestic	NA

regulation	
Findings	The current clarification regarding the treatment of certain Deferred tax liabilities (DTLs) as required by rule no. 69. Margin 107 is not considered sufficient by the team. Specifically, not all DTLs are allowed to be netted against DTAs. The DTLs which are to be netted against the deduction of goodwill, intangibles and defined benefit pension assets must be allocated on a pro rata basis between DTAs subject to the threshold deduction treatment and DTAs that are to be deducted in full. FINMA confirmed they would provide clarification through publishing a FAQ.
Materiality	Not material, rectified subject to additional clarification (see Annex 6)
Basel paragraph no	75: Own credit risk
Reference in the domestic regulation	Art. 31 para. 3 CAO in conjunction with margin no. 147 Circular 13/1
Findings	The update issued by the Basel Committee as of July 2012 has not yet been adopted, because it was issued shortly after the Swiss Federal Council's approval of the CAO on 1st June 2012, but FINMA confirmed that clarification will be addressed via an FAQ.
Materiality	Not material, but rectified (see Annex 6)
Basel paragraph no	78: Investments in own shares – covers also such in own AT 1 and T 2 instruments
Reference in the domestic regulation	Art. 32 (h) in conjunction with Art. 52 para.3 CAO
Findings	Although the self-assessment did not refer to the relevant rules for the treatment of own AT1 and T2 capital instruments, the Swiss rules provide such (Art. 34 CAO and margin no. 117 Circular 13/1). However, Art. 52 para. 1 CAO does not explicitly address the deduction of any potential future holdings as a result of contractual obligations to purchase own shares as required by para. 78. FINMA confirmed to provide clarification through a FAQ.
Materiality	Not material, but rectified (see Annex 6)
Basel paragraph no	80-83: Investments in the financial sector (unconsolidated, < 10%)
Reference in the domestic regulation	Art. 36 and 37, as well as Art. 33
Findings	It should be clarified at the level of the Ordinance, preferably in Art. 36, that the relevant investments always cover direct, indirect and synthetic holdings in regulatory capital instruments and that banks should look through holding of index securities to determine their underlying holdings of capital. FINMA agreed and confirmed it would clarify the inconsistencies as soon as possible. Furthermore, neither CAO nor the Circular provide a sound definition of what is meant by "indirect holding". Both rule sets only refer to regulatory capital instruments, which is too narrow for the purpose of avoiding double counting of regulatory capital. It should be clarified that it does comply with the Basel rules text and the relevant FAQ 15 according to which an indirect holding arises when a bank invests in an unconsolidated intermediate entity to gain an exposure to the capital of another financial institution. By restricting the definition to holdings of capital instruments, the rules would not capture exposures to financial sector entities gained through other forms of investments in the unconsolidated intermediate entity. This could be, for example, by way of granting a loan to a third party, which again invests in a regulatory capital instrument of a financial entity. Such an investment should also be covered by the rules to warrant that double counting of regulatory capital is avoided. FINMA confirmed to issue an FAQ to reflect the intention behind the Basel III standards. This issue could be subject to Level 3 type analysis of actual practice in the future.

Materiality	Not material, but rectified (see Annex 6)
Basel paragraph no	84-86: Significant unconsolidated Investments in the financial sector
Reference in the domestic regulation	Art. 38 CAO
Findings	As mentioned before, a sound definition of "indirect holdings" is missing.
Materiality	Not material (see before), rectified (Annex 6)
Basel paragraph no	90: Former deductions from capital
Reference in the domestic regulation	Several sources in Bank Law, CAO and Circular 08/19
Findings	Swiss rules comply with Basel standards, except for point b) for certain equity exposures under the PD/LGD approach, which could still be deducted as foreseen under Basel II rules. However, FINMA has rectified this deviation (Annex 6; see also relevant comment on paras. 340-358 in section 2.3.4). It should also be noted that currently no IRB bank uses the PD/LGD approach (Annex 9, Table 6).
Materiality	Not material, rectified (Annex 6)
Basel paragraph no	91-93: Disclosure requirements
Reference in the domestic regulation	Circular 08/22 and relevant tables annexed to the Circular
Findings	Due to different interpretation of Basel III standards, the templates are drafted following the Swiss understanding and might need to be redrafted to be fully in line with the Basel III requirements, for example share premia in AT1 and T2, pro rata allocation of certain DTLs.
Materiality	Not material
Basel paragraph no	94 (f)-(g): Existing capital instruments
Reference in the domestic regulation	Art. 140, 141 CAO regarding lit. (g) n/a regarding lit. (f)
Findings	Regarding lit. (g), there are no rules foreseen for the treatment of existing instruments with call and step-up features. FINMA expressed commitment to follow Basel III but has chosen a pragmatic way and will react if necessary on a bank by bank basis after receiving the first reports or the first full disclosure on capital based on the new rules in August 2013.
Materiality	Not material

2.3.2 Capital buffers (conservation and countercyclical)

Section grade	Compliant (C)
Summary	The adoption of the buffer requirements is twofold, as there are detailed rules set out in Circular 11/2 for the Swiss category 2 to category 5 banks, whereas the two G-SIBs are covered by the CAO. The rules are closely aligned with Basel standards, but although FINMA has far-reaching powers and discretion in this area, the restrictions foreseen by the Basel III rules on dividend payments, share buybacks and discretionary bonus payments do not apply "automatically" as the detailed quartile system was not taken over into Swiss rules. Furthermore, the Basel standards on the countercyclical buffer (ie, the issue on reciprocal application) are not yet finalised (their application will start in 2016), while Switzerland has already implement some kind of countercyclical buffer rules, which were already used by the Swiss Federal Council in February 2013 to activate a sector-specific countercyclical capital buffer for lending secured by residential properties.

Overview of findings by Basel paragraph:	
Basel paragraph no	129: Definition
Reference in the domestic regulation	Art. 43 and 45 CAO and margins nos. 10-29 Circular 11/2
Findings	The Circular 11/2 is not relevant for the so called "Großbanken" (big banks), which are described in the relevant footnote as Systemically Important Banks. For such banks Art. 129 CAO is relevant, which requires them to hold a permanent buffer of 8.5% (at least 5.5% must be in CET1 capital). It seems as if the requirements for the conservation buffer are part of this additional buffer, but this is not sufficiently clear based on FINMA rules. However, clarification is provided through the "Kommentar zur Totalrevision der Eigenmittelanforderungen (ERV)" published in June 2012 by the Swiss Confederation and the Confederation's Financial Department.
Materiality	Not material
Basel paragraph no	130-131: Distribution constraints
Reference in the domestic regulation	Circular 11/2, margin nos. 20, 24-29
Findings	In general, FINMA has the power to restrict dividend payments, share buybacks and discretionary bonus payments. However, these restrictions do not apply automatically. Rather, FINMA only "may order" (margin no. 28) after seeing an institution's capital ratio falling below the target level (margin no. 24 – which could, in principle, be rather late given the discretion in applying the rules) and thereby seeks to compensate for the lack of binding rules with higher intervention levels (albeit with wide discretion in ordering restrictions). The principle that "immediate and extensive action is taken under supervisory law" appears only in the headline of the box belonging to margin no. 20 but is not spelled out more concretely in the margins, suggesting that the principle would not always be applied most decisively. Yet, Art. 43 CAO seems to suggest that the buffer will always have to be respected and therefore separate binding restrictions on dividend payments are not necessary. The uncertainty results from the fact that para. 3 only deals with the setting of an individual grace period for restoring the capital buffer in the case of a shortfall, while it is silent on any distribution restriction. The corresponding rules for the Systemically Important Banks in Art. 129 paras. 3 and 4 CAO seem to be stricter, as they require immediate restoring of the buffer once the banks are (again) able to generate profit. Furthermore, Basel III standards are based on CET1 based ratios only, whereas FINMA Circular is based on eligible capital and splits up the requirement in margin no. 20a* into the three tiers with CET1 ratios for banks in categories 2-4 higher than required by para. 131.
Materiality	Not material
Basel paragraph no	132 (a) and 132 (b): Definition of distribution and earnings
Reference in the domestic regulation	General reference to the comments made on rule 129.
Findings	Partially compliant. 132 (a) is transposed via margin no. 28. 132 (b) is not transposed as there is no binding rule definitely restricting banks from making positive net distributions.
Materiality	Not material, see above
Basel paragraph no	133-135: Transitional arrangements
Reference in the domestic regulation	Margin no. 47 Circular 11/2
Findings	The capital conservation buffer requirements are based on margin no. 47, and expected to be fulfilled by end of 2016. Given the capital buffers of Swiss banks including the Pillar 2 add-on, today's minimum capital levels are stricter than Basel

	III rules. With the transitional steps provided for in para. 133 (reflected in Art. 144 CAO) for the time from 2016 to 2018 the Basel III conservation buffer will replace and consume part of the pillar 2 excess capital requirements of Swiss banks, while the countercyclical buffer will be added on top of the Swiss minimum level. Art. 146 CAO provides the rules for the capital conservation buffer to be adopted by the systemically important banks. Para. 135 regarding the division of the capital conservation buffer requirements into quartiles were not transposed into Swiss rules for both regimes.
Materiality	Not material (with regard to the missing quartile system)
Basel paragraph no	142-145: Bank specific countercyclical buffer
Reference in the domestic regulation	Art. 44 and 45 CAO
Findings	Art. 44 CAO only deals with the national countercyclical buffer requirements (rule 139-140). Also for the systemically important banks there is only a reference in Art. 132 CAO to Art. 44 CAO, but no further requirements are foreseen. FINMA explains that due to the effective start in 2016 and constitutional legal constraints, the relevant rules for a global application of the countercyclical buffer requirements have not yet been specified.
Materiality	Not material (internationally applicable rules outstanding)
Basel paragraph no	146-148: Extension of the CCB
Reference in the domestic regulation	Art. 44 and 45 CAO
Findings	As the system of quartiles for the conservation buffer in rule 131 is not adopted, the same holds true for the extension to the capital conservation buffer (CCB). It is up to FINMA to set the relevant restrictions, but no binding rule is provided by the Circular or the CAO.
Materiality	Not material
Basel paragraph no	150: Transitional arrangements
Reference in the domestic regulation	Art. 44 and 45 CAO
Findings	Currently, there seem to be no transitional rules for the implementation of the Basel III countercyclical capital buffer. Existing transitional rules only refer to the capital conservation buffer (Art. 144 CAO) and the systemic buffer (Art. 146 CAO), and no other reference is made. Due to the outstanding layout of internationally applicable rules FINMA refers as a safeguard to a general Pillar II rule (Art. 45 para. 1 CAO) to be able to set up relevant buffers if needed. See also “Kommentar zur Totalrevision der Eigenmittelanforderungen (ERV)” published in June 2012 by the Swiss Confederation and the Confederation’s Financial Department, section 5.4, pages 39-40.
Materiality	Not material (internationally applicable rules outstanding)

2.3.3 Credit risk: Standardised Approach

Section grade	IA: Compliant (C) SSA: Non-Compliant (NC)
Summary	For the IA 11 non-material deviations were identified by the RCAP team, and six thereof rectified by FINMA. For the SSA 13 deviations were identified by the RCAP team with 3 assessed as material. None of the material issues was rectified.

	General No sovereign floor is imposed that would ensure that no claim on an unrated bank will receive a risk weight lower than that applied to the claims on the sovereign of incorporation. Due to the size of the retail portfolio of the small banks in Switzerland, FINMA implemented a granularity threshold of 1% instead of 0.2%. The credit conversion factor (CCF) applied to convert off-balance sheet exposures to credit exposure equivalents is not that explicitly set out as was done in the Basel Accord. For Lombard lending, certain life insurance contracts can be recognised as eligible financial collateral. Furthermore, under the SSA, based on specific requirements a flat risk weighting of 50% can be used. A zero haircut can be applied for repos and repo-like transactions where the repurchase agreement is denominated in Swiss Franc if among others these are concluded and settled via the Swiss Value Chain. Certain qualitative requirements for credit risk mitigation are not explicitly specified in the FINMA circular. SSA only In determining the risk weight percentage for short term bank and securities firms and the CCF of off-balance sheet exposures, the residual maturity is used instead of the original maturity. Based on the particularities of the Swiss real estate market, specific commercial real estate loans and agricultural loans will receive a preferential risk weight. Weaker conditions are set for the use of a zero haircut for repos and repo-like transactions.
Overview of findings by Basel paragraph:	
Basel paragraph no	Paragraphs 53-56: Claims on sovereigns
Reference in the domestic regulation	IA CAO art. 66 para. 1, 67, appendix 2 FINMA Circular 08/19 margin no. 4.1-4.2 FINMA concordance tables for rating classes SSA Appendix 2 of the old CAO
Findings	For banks not making use of external ratings, claims to the Swiss Sovereign have a fixed risk weight of 0% irrespective of the exposure being denominated and funded in Swiss Franc. This issue has been corrected by the issuance of a FAQ (see Annex 6).
Materiality	Not material, rectified (Annex 6)
Basel paragraph no	Paragraphs 60 – 64: Claims on banks Paragraph 65: Claims on securities firms Amendment 2 of Treatment of trade finance under the Basel capital framework [41]
Reference in the domestic regulation	IA CAO art. 66 para.1, CAO art 68, appendix 2 FINMA concordance tables for rating classes SSA Appendix 2 of the old CAO

[41] Treatment of trade finance under the Basel capital framework, October 2011.

Findings	No sovereign floor is imposed that would ensure that no claim on an unrated bank will receive a risk weight lower than that applied to the claims on the sovereign of incorporation. Furthermore, due to no sovereign floor imposed, amendment 2 of the Treatment of Trade Finance under the Basel Capital Framework is implemented in an indirect manner. This issue has been corrected by the issuance of a FAQ (see Annex 6). The RCAP QIS indicated that this issue is not material. For Swiss mortgage bonds ("Pfandbrief") a fixed risk weight of 20% under the IA and 25% under the Swiss approach is applied. Currently only two institutions are permitted to issue such bonds. The institutions are themselves liable for the bonds issued. They only have claims on Swiss banks, collateralised by the pledge of mortgages the banks have given. Both institutions are well rated (both are rated Aaa by Moody's), and the risk weight of 20% is accordingly consistent with both Basel II paragraph 66 (for corporate exposure) and Basel II paragraph 63 (for bank exposure). Also these institutions are governed by a special law and they are placed under the supervision of FINMA and are subject to capital requirements. A fixed risk weight of 20% is applied for deposit liabilities to the holders of the deposit protection fund. The RW of 20% is motivated by the fact that individual deposits are only insured up to a value of CHF 100,000. Also deposits up to CHF 100,000 are prior ranking to other deposits and claims. SSA The risk weight for short-term claims to banks is based on the residual maturity of the claim instead of the original maturity as required. While this issue appear material, it is mitigated by a required risk weight of 25% instead of 20%.
Materiality	SSA: This is a non-material issue as the use of the 25% risk weight results in the SSA being super equivalent. For the other gaps identified, the team assessed the impact to be non-material. One of the issues was rectified (Annex 6).
Basel paragraph no	Paragraphs 69 – 71: Claims included in the regulatory retail portfolios
Reference in the domestic regulation	IA CAO appendix 3 SSA Appendix 4 of the old CAO
Findings	No specific reference is made to the product criterion for claims to be included in the regulatory retail portfolio Subject to BCBS review (Annex 7) Low value of individual exposures is currently set at CHF 1.5 million = EUR 1.25 million with the current exchange rate. However with the implemented Basel II, CHF 1.5 million was equivalent to EUR 1 million. To prevent any volatility in the domestic market it is considered impractical to adjust the threshold on a periodic basis. This issue is a general one subject to BCBS review (see Annex 7and below) With the implementation of Basel II, the granularity criterion was set at 1% instead of 0.2% of the overall retail portfolio based on a national QIS. The RCAP QIS indicated that under the 0.2% criterion only one RCAP bank is affected and that the impact is non-material.
Materiality	Not material (based on RCAP QIS)
Basel paragraph no	Paragraphs 72 – 73: Claims secured by residential property
Reference in the domestic regulation	IA CAO art. 72 para. 1, appendix 3 SSA Appendix 4 of the old CAO
Findings	SSA Agricultural properties have a special status, between the residential and the commercial treatment. For the portion which is considered well collateralised (LTV below 66.6%), a risk weight of 50% is assigned. Whereas, for the part considered less secured (LTV above 2/3), a risk weight of 75% is assigned. This

	approach is based on the fact that usually the residential property of the farmer constitutes a very significant part of the value financed by credit.
Materiality	Not material
Basel paragraph no	Paragraph 74: Claims secured by commercial real estate
Reference in the domestic regulation	IA CAO art. 72, appendix 3 SSA Appendix 4 of the old CAO
Findings	SSA Specific commercial real estate will receive a risk weight below 100% based on the particularities of the Swiss real estate market: (a) Commercial and multipurpose real estate (LTV tranche up to 50% max.): 75% risk weight (b) Industrial real estate (LTV tranche up to of 33% max.): 75% risk weight.
Materiality	SSA: The impact of the gap is assessed to be material based on the RCAP QIS.
Basel paragraph no	Paragraphs 82 – 89: Off-balance sheet items
Reference in the domestic regulation	IA CAO art. 54, art 76 and appendix 1 SSA Appendix 1 of the old CAO
Findings	IA Whether a guarantee is used to cover doubtful receivables or not a CCF of 50% will be applied, whereas the Basel minimum requirements require a CCF of 100% for direct credit substitutes. FINMA indicated that paragraphs 82 to 89 will be more explicitly set out in a FAQ. SSA CCFs are based on the residual maturity of the contingent liability instead of the original maturity. Furthermore, under the SSA building contractors' guarantees for construction projects in Switzerland are assigned a preferential CCF of 25% instead of 50%.
Materiality	IA: The impact of gap is assessed to be non-material based on the RCAP QIS and rectified (Annex 6). SSA: The impact of the gap is assessed to be non-material based on the RCAP QIS.
Basel paragraph no	Paragraphs 92-108 as amended by the revised framework[42] The mapping process; Multiple assessments; issuer versus issues assessment; Domestic currency and foreign currency assessments; Short-term/long-term assessments; Level of application of the assessment; Unsolicited ratings
Reference in the domestic regulation	IA FINMA Circular 08/19 margin nos. 4-15, 103 CAO appendix 2 FINMA concordance tables (table of Basel II para 103) SSA FINMA Circular 08/19 margin nos. 4-15 and 103 old CAO, appendix 2 FINMA concordance tables
Findings	The following requirements are not explicitly implemented in the FINMA circular:

[42] Paragraph 94, 99 and 108 amended by Basel III (Paragraphs 118 and 121)

	1. Para 95 – Specific requirement for public disclosure pertaining to ECAIs used for risk weighting assets. 2. Para 105 – treatment of short-term claims when there is no specific short term claim assessment and when short-term assessments map into a more favourable risk weight. This was rectified via FAQ (Annex 6). SSA As specified under the findings of para 60 to 64, short term claims to banks are based on residual maturity instead of original maturity.
Materiality	SSA: This is a non-material issue as the use of the 25% risk weight results in the SSA being super equivalent. The requirements, which were not explicitly implemented in the FINMA circular, are assessed to be non-material issues, and were rectified (Annex 6).
Basel paragraph no	Paragraphs 109–118 as amended by revised framework:[43] Overarching issues
Reference in the domestic regulation	CAO art. 61 and 74-75 FINMA Circular 08/19 margin nos. 103, 104, 115.1, 116 and 202-203 FINMA Circular 08/22 margin no. 41
Findings	Although not explicitly stated in the circular, the qualitative requirements of paragraph 115 are nevertheless expected to be fulfilled and, where material, it is subject to the yearly supervision process. FINMA Circular 11/2 indicates that a generic Pillar 2 add-on is in place which is dependent on the "size" of the bank. The Pillar 2 cushion is intended to pragmatically cover residual risks. Furthermore, it was indicated that thought will be given to whether the requirements of paragraph 115 should be more explicitly stated in the FINMA circular For Lombard lending and SFTs in the banking book, both the simple and comprehensive approach (in parallel) are permitted. Essentially none of the 13 banks in the RCAP sample uses these approaches in parallel.
Materiality	On a qualitative basis, the assessment team judges this issue to be non-material. Note is taken of FINMA's supervisory interaction where residual risk is identified to be material.
Basel paragraph no	Paragraphs 119–144: Overview of credit risk mitigation techniques - Collateralised transactions; On-balance sheet netting; Guarantees and credit derivatives; Maturity mismatch; Miscellaneous
Reference in the domestic regulation	CAO art. 61-62 FINMA Circular 08/19 margin nos. 102, 106-112, 116-117 and 136-143
Findings	Minimum standards that should be met before capital relief will be granted in respect of any form of collateral are not explicitly stated. This is however expected to be fulfilled and, where material, this is subject to the yearly supervision process. Furthermore, the external auditors confirmed that process-oriented audits will cover many aspects of the credit risk mitigation techniques as specified in paragraphs 199 to 144.
Materiality	On a qualitative basis, the assessment team judges this issue to be non-material. Note is taken of the work performed by the external auditors.
Basel paragraph no	Paragraphs 145 – 146 as amended by revised framework[44]: Collateral - Eligible financial collateral Paragraphs 147 – 155 as amended by revised framework:[45] Collateral - The comprehensive approach; Calculation of capital requirement; Own estimates for haircuts

[43] Paragraph 115 (i) added by Basel III (Paragraph (110)

[44] New paragraph 145(i) inserted by Basel III (Paragraph 111)

Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 118-123,133-135 and 154-162
Findings	Certain life insurance contracts (with specific supervisory haircuts) are recognised as eligible financial collateral for Lombard lending, as the Basel pure approach does not well address the particularities of the Swiss Lombard lending business.
Materiality	For the banks under SSA, the impact of the gap is assessed to be material based on the RCAP QIS.
Basel paragraph no	Paragraphs 166 – 172 as amended by revised framework[46:] Collateral - The comprehensive approach; Adjustment for different holding periods and non-daily mark-to-market or remargining; Conditions for zero H
Reference in the domestic regulation	IA FINMA Circular 08/19 margin nos.163-165 and 172-198 SSA Old CAO art. 61 para. 2 FINMA Circular 08/19 margin nos.163-165 and 172-198
Findings	The life insurance contracts are exempt from the daily revaluation requirement and an annual revaluation requirement is imposed. A zero haircut can be applied for repos and repo-like transactions where the repurchase agreement is denominated in Swiss Franc including any securities from the private sector and collateral that is denominated in a different currency than the exposure. Furthermore, a zero haircut for the repurchase agreement is denominated in Swiss Franc is also available for banks applying the VAR method. Preferential treatment to CHF repo transactions applies only if – among other requirements - these are concluded and settled via the Swiss Value Chain and secured by collateral that is eligible with the Swiss National Bank (SNB). Due to the twice a day margin transfers and the high standards in risk reduction, these transactions are subject to zero haircut. The SNB uses the same system and standards (ie zero haircuts) to conduct its open market operations. SSA Weaker conditions are set for the use of a zero haircut for repo-style transactions as these requirements were already in place when Basel II was introduced.
Materiality	SSA: The impact of the gap is assessed to be material based on the RCAP QIS. The impact of the other gaps identified is assessed to be non-material.
Basel paragraph no	Paragraphs 182 – 187: Collateral - the simple approach
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 127-132 and 200-201
Findings	Cash deposits, fiduciary deposits, medium-term notes and unrestricted life policies with a surrender value may be exempted from the requirement of at least 6 monthly market valuations. For transactions collateralised with gold, a 0% risk weight can also be applied if the exposure and the collateral are in the same currency. This was rectified via FAQ (Annex 6). SSA Under the SSA, Banks applying the simple approach for collateral may assign a 50% flat risk weight for Lombard loans. This flat rate can only be used if the Lombard loan is: Secured by a diversified portfolio composed of standard moveable assets traded on a regulated stock exchange or representative market, cash deposits, fiduciary deposits or unrestricted life policies with a surrender value; and

[45] Paragraph 151 and table revised by Basel III (Paragraph 111)

[46] Paragraph 167 amended by Basel III (Paragraph 103)

	Marked to market at least once a week or on a daily basis in exceptional market conditions
Materiality	SSA: Impact of the gap is assessed to be non-material. The impact of the other gaps identified is assessed to be non-material. One of the issues was rectified (Annex 6).
Basel paragraph no	Paragraphs 189 - 201 as amended by the revised framework[47]: Guarantees and credit derivatives
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 217 – 218, 202-243
Findings	The following paragraphs have not been included in the circular and was corrected via FAQ - Paragraph 197 on materiality thresholds on payments of credit protection - Paragraph 199 on tranched cover.
Materiality	Not material, rectified (Annex 6)

2.3.4 Credit risk: Internal Ratings-based Approach

Section Grading	Largely Compliant (LC)
Summary	Seven deviations were identified by the RCAP Team, one of which was material, but has been rectified by FINMA during the assessment process. The Basel II IRB approach has been implemented in Switzerland in a faithful way, through the IA. Accordingly, most of Basel II standards are directly referred to as applicable for IRB banks, which leaves scope only for a limited number of deviations. The main departures from Basel II relate to: • the treatment of equity exposures (one deviation, rectified) • the treatment of defaulted assets (five deviations) • the roll-out treatment (one deviation) *The treatment of equity exposures* According to the IA, equity exposures are broken down into three categories, namely private equity positions forming part of a sufficiently diversified portfolio, positions in equity shares traded on a recognised exchange, and all other equity positions. These equity positions are then subjected to either a market-based approach or an internal models approach. The market-based approach is further subdivided into a PD/LGD approach and a simplified risk-weighting method. However • the simplified risk-weighting method allows for risk-weights that are lower than those set out in [Para 344] of Basel II; • the internal models approach does not require the floors specified in [Para 347], but alternative floors; • the PD/LGD approach relies on an LGD of 65% as far as private equity exposures forming part of a sufficiently diversified portfolio are concerned, instead of an LGD of 90% as required in [Para 350-2nd bullet point and Para 355] of Basel II; • the PD/LGD approach does not use the floors referred to in [Para 351 to Para 353] of Basel II. FINMA has issued tertiary legislation and thereby closed the gap. The bank most affected by the gap has been informed and supervisory steps have been taken.

[47] Paragraph 195 amended by Basel III (Paragraph120)

	The treatment of defaulted assets (whatever the asset class) According to the IA, the risk-weighting for defaulted positions (whatever the asset class), after deduction of specific write-downs and partial write-offs, must be 100% both under the A-IRB and F-IRB. This differs from [Paras 272, 328 to 330, 471] of Basel II, whereby the capital requirement for a defaulted asset under the A-IRB is the amount, if any, by which the LGD on a defaulted asset exceeds the bank's best estimate of expected loss on that asset.[48] This treatment also infringes [Paras 308 and 334] of Basel II, which stipulate that on and off-balance sheet exposures are measured gross of specific provisions or partial write-offs. In addition, specific provisions for defaulted positions and partial provisioning can be used as the best estimate of the expected loss on a position, provided FINMA agrees. This provision differs from the A-IRB provision in [Para 471] of Basel II, whereby for each defaulted asset, the bank must also construct its best estimate of the expected loss on that asset based on current economic circumstances and facility status. FINMA stressed that current economic circumstances and facility status are taken into account when establishing specific provisions. *The roll-out treatment* The IA, as far as roll-out is concerned, requires a minimum IRB coverage of approximately 90% of the capital required for credit risks, and stipulates that, in principle, this minimum coverage level of 90% should also be met after the implementation of the IRB. However, FINMA allows TBTF banks to apply standardised approach risk weights to unencumbered assets held solely for Swiss TBTF liquidity purposes. Altogether, the Swiss treatment of roll-out may boil down to allowing a permanent partial exemption from IRB requirements, a potentially material deviation.
Overview of findings by Basel paragraph:	
Basel paragraph no	Paragraphs 215-217: Categorisation of exposures
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 291-323
Findings	Under the IA, the allocation of exposures into asset classes is based on specific definitions, one of which (the one which applies to retail exposures) is not fully in line with that set out by Basel II. This impact is, however, not material, based on the data received. See *Paragraphs 231-233* below.
Materiality	The assessment team judges the finding as non-material (see Paragraphs 231-233 below).
Basel paragraph no	Paragraph 229: Definition of sovereign exposures
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 291 and 293
Findings	Sovereign exposures are defined in reference to [Para 229] of Basel II, including positions to those multilateral development banks listed in Appendix 1 of FINMA Circular 08/19. Although the listed MDBs currently comply with the criteria referred to in [Para 59] of Basel II, this may not be granted forever: a limitative list of MDBs is not bound to square with the criteria-based definition of MDBs, as set forth in Basel II.
Materiality	Based on qualitative considerations, the assessment team judges the finding as non-material.
Basel paragraph no	Paragraph 231: Definition of retail exposures
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 291, 295, 300-318
Findings	According to FINMA Circular 08/19 margin 301, owner-occupied real estate is to be understood as real estate which is occupied or let by the borrower, which may be viewed as consistent with [Para 231-2nd bullet point] of Basel II.

[48] For the F-IRB, there is no UL capital charge according to the Basel standards.

	However, notwithstanding margin 317, margin 303 stipulates that exposures to small business entities in the form of self-employed persons are eligible for retail treatment regardless of the exposure. This is not consistent with [Para 231-3rd bullet point] of Basel II. In addition, according to margins nos. 304-315, Lombard collateral loans are considered eligible for retail treatment, provided at least 95% of the bank's collateral loans (by number) qualify as retail positions on account of the amount and counterparty involved and these loans are subject to reliable risk management (reliance on processes, overcollateralisation and statistically-based haircutting, close monitoring of the value and quality of the underlying collateral, ability to realise collateral rapidly...). This eligibility of Lombard loans (some of which may be exposures to business entities with an amount of more than €1million) for retail treatment is not consistent with [Para 231-3rd bullet point] of Basel II. Margin 318 allows loans secured by commercial real estate to be treated as eligible for retail treatment, in the position sub-category “residential real estate”, which is not consistent with [Para 231-2nd bullet point] of Basel II. See below Paragraph 328.
Materiality	On the basis of the data received, these gaps have currently no material impact, neither in terms of risk-weighted assets nor in terms of Tier 1 capital ratios, for any of the few banks concerned. The assessment team considers these gaps as unlikely to be become material in the future and thus considers them non-material.
Basel paragraph no	Paragraph 244 – 269: Foundation and Advanced approaches; adoption of the IRB approach across asset classes; transition arrangements (Paras. 256 and 262(i) amended by Basel II)
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, in particular margin no. 2.2.2, 275, 288-290
Findings	Margin 288 states that a bank may introduce the IRB approach in any of the ways specified in [Para 257] of Basel II, provided the initial implementation of the IRB approach results in IRB calculations covering at least approximately 90% of the capital required for credit risks for all of the bank’s counterparty-related positions where the IRB approach is appropriate. However, it also stipulates that, in principle, this minimum coverage level of 90% should also be met after the implementation of the IRB. This latter provision is not consistent with the requirement of [257] of Basel II, whereby when a bank adopts an IRB approach for an asset class within a particular business unit (or in the case of retail exposures for an individual sub-class), it must apply the IRB approach to all exposures within that asset class (or sub-class) in that unit. In addition, FINMA allows TBTF banks to apply standardised approach risk weights to unencumbered assets held solely for Swiss TBTF liquidity purposes. This is not consistent with the requirements set out in [Paras 257 and 258] of Basel II.
Materiality	The data received show that the gap arising from a permanent satisfaction with a minimum 90% IRB coverage (“rollout gap”) has currently no material impact on the Tier 1 ratio for any of the few IRB banks concerned. The assessment team, however, considers that this rule may boil down to allowing a permanent partial exemption from IRB requirements, the materiality of which cannot be ruled out. This is all the more worth stressing given the allowance for a standardised treatment of unencumbered assets held solely for Swiss TBTF liquidity purposes (“TBTF liquidity gap”), even though this latter gap has currently no material impact either. Going forward, this finding could also become relevant for the two banks concerned, depending on the outcome of forthcoming international liquidity standards and assuming no consequent revisions of the capital adequacy treatment of unencumbered assets. Altogether, the assessment team considers the impact of these gaps (in respect of [Paras 257 and 258] of Basel II) as potentially material.
Basel paragraph no	Paragraphs 270–272 as amended by the revised framework: Formula for derivation of risk-weighted assets
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 324

Findings	FINMA Circular 08/19 margin 324 states that the risk-weighted asset amount for a defaulted position is 100% of EAD, after deduction of individual value adjustments (ie specific provisions) and partial write-offs, under both A-IRB and F-IRB. As a result, the capital requirement for such a defaulted exposure is equal to the product of 8% and the EAD, net of individual value adjustments and partial write-offs. Under the AIRB approach, this provision differs from [Para 272] of Basel II, whereby the risk-weighted asset amount for a defaulted exposure is the product of K, 12.5, and the EAD, with the capital requirement (K) for such a defaulted exposure being equal to the greater of zero and the difference between its LGD and the bank's best estimate of expected loss.
Materiality	Under the IA, the calculation of risk-weights relies on a standardised shortcut methodology aimed at assessing the UL in respect of defaulted assets, which substitutes for the fully-fledged IRB methodology required by [Para 471] of Basel II to estimate LGD for such defaulted assets. Accordingly, the Swiss rules differ, conceptually and practically, from the Basel II standard for the A-IRB. Short of a RCAP QIS quantification of the difference between the outcome of the Swiss method and that of Basel II, the assessment team has carried out a reverse stress testing exercise, jointly with FINMA, in order to estimate the range of "break-even" LGD for defaulted assets that would pinpoint a potentially material underestimation of capital requirements relative to Basel II. The results confirm that the range of such LGD for defaulted assets is not unlikely, particularly under specific circumstances (eg downturn conditions). Accordingly, the assessment team considers the gap to have a potentially material impact.
Basel paragraph no	Paragraphs 273 – 274: Firm-size adjustment for small- and medium sized entities (SME)
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, and in particular margin nos. 267, 325-326
Findings	The firm-size adjustment used for SMEs is transposed into the IA on the basis of a conversion factor of 1.5 (ie EUR 1 equals CHF 1.50), held constant ever since the first implementation of Basel II. This results in a CHF 75 million threshold, instead of a CHF 61 million threshold (approximately), if using the current €/CHF conversion rate. This implies that the firm-size adjustment for SMEs is used on a wider basis as permitted by [Para 273] of Basel II. In addition, margin 326 allows use of: • a simplified approach, whereby "sales may be allocated to segments of counterparties of similar size using a random sample basis"; • the "size of the company", if neither annual sales nor balance sheet total are meaningful size indicators. Neither such "simplified" approach, nor such "size" indicator are foreseen in [Para 274] of Basel II.
Materiality	The IA translated Basel II in a faithful manner at the time of initial implementation, on the basis on the 1.5 CHF/€ exchange rate, so that no gap is to be formally highlighted (see Annex 7). Nonetheless, the revaluation of the CHF/€ exchange rate since then has given rise to a discrepancy between the actual thresholds used for determining the firm-size adjustments for SMEs under Swiss rules and those required by Basel II. The data received confirm that this discrepancy has a material impact on the risk-weighted assets of IRB banks. Hence, this is an issue that may deserve further attention, subject to BCBS rulings, but which remains out-of-scope for the present assessment. The other simplified approaches are judged not material.
Basel paragraph no	Paragraph 308–317: Exposure at default (EAD)
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 339-340
Findings	Margin 266 explicitly refers to the relevant paragraphs of Basel II. Margins 339 and 340 provide clarifications, which are fully consistent with [Para 309] and [Para 310] of Basel II.

	However, the above-mentioned margin 324 states that the risk-weighted asset amount for a defaulted position is 100% of EAD, after deduction of individual value adjustments (ie specific provisions) and partial write-offs, both under the A-IRB and F-IRB. This is not consistent with [Para 338] of Basel II, which requires on- and off-balance sheet exposures to be measured gross of specific provisions or partial write-offs (see above paragraphs 270-272).
Materiality	Potentially material (see above Para 270-272).
Basel paragraph no	Paragraph 327 – 330: Risk-weighted assets for retail exposures
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 318, 351, 352
Findings	As a result of margins nos. 318 and 351, loans secured by commercial real estate are risk-weighted as "residential real estate exposures", which is not consistent with [Para 328] of Basel II. Moreover, according to margin 352, defaulted retail positions, after deduction of specific write-downs and partial write-offs, are risk-weighted at 100%, which is not consistent with [Paras 328 to 330] of Basel II, whereby the capital requirement (K) for a defaulted exposure is equal to the greater of zero and the difference between its LGD and the bank's best estimate of expected loss.
Materiality	Based on the data received, the assessment team considers the impact of the deviation as unlikely to be material. This judgement is mainly based on the consideration that the risk-weights used for residential real estate exposures are lower than those set forth for commercial real estate exposures (as part of other retail exposures under Basel II) only for the very best-rated obligors, which do not constitute a material portion of the banks' exposures. The gap related to the treatment of defaulted retail exposures is deemed to have a potentially material impact (see above paragraphs 270-272).
Basel paragraph no	Paragraph 331 – 338: Risk components
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266
Findings	As mentioned above (paragraphs 327-330), according to Circular 08/19 margin 352, the risk weighting for defaulted retail positions under both A-IRB and F-IRB is 100 % of the EAD, after deduction of individual value adjustments (ie specific provisions) and partial write-offs, which is not compliant with [Para 334] of Basel II, according to which "both on and off-balance sheet retail exposures are measured gross of specific provisions or partial write-offs".
Materiality	Potentially material (see above Paras 270-272).
Basel paragraph no	Paragraphs 340 – 358: Risk weighted assets for equity exposures
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 319-323, 353-370
Findings	Equity exposures are broken down into three categories, namely private equity positions forming part of a sufficiently diversified portfolio, positions in equity shares traded on a recognised exchange, and all other equity positions. These equity positions are then subjected to either a market-based approach or an internal models approach. The market-based approach is further subdivided into a PD/LGD approach and a simplified risk-weighting method. The choice between these approaches is left at the discretion of the bank, provided it meets the relevant minimum requirement, which is consistent with [Para 342) of Basel II. However, • according to margins 357-358, FINMA's simplified risk-weighting method allows for risk-weights (ie a risk-weight of 190% for private equity exposures forming part of a sufficiently diversified portfolio, 290% for exchange traded equity exposures and 370% for all other equity exposures) that are lower than those set out in [Para 344] of Basel II (ie a 300% risk-weight to exchange traded equity exposures and a 400% risk weight to all other equity holdings). However, the calculation of an EL (0.8% of EAD) is also required for such equity

	exposures; • according to margin 360, for the calculation of regulatory capital under the internal modelling approach, FINMA does not require the floors specified in [Para 347], ie a 200% risk weight for publicly traded equity holdings and a 300% risk weight for all other equity holdings, to be applied, but instead requires alternative floors, which are defined as the sum of the related minimum risk weightings under the PD/LGD approach and 12.5 times the relevant EL value. This treatment is not consistent with [Para 347] of Basel II; • according to margin 362, for the calculation of regulatory capital under the PD/LGD approach, FINMA applies an LGD of 65% as far as private equity exposures forming part of a sufficiently diversified portfolio are concerned, instead of an LGD of 90% as required in [Para 350-2nd bullet point and Para 355] of Basel II; • according to margin 363, for the calculation of regulatory capital under the PD/LGD approach, FINMA does not apply the floors referred to in [Para 351 to Para 353] of Basel II. Short of any clarification in Circular 08/19, [Para 354] of Basel II seems still to be applicable, so that the banks are left with an option to apply a risk-weight (up to 1250 %) or a deduction to their equity exposures treated under the PD/LGD approach. This alternative is not consistent with [Para 90] of Basel II, which prescribes a 1250% risk-weighting as a substitute for deduction from capital. The impact of this finding is however judged to be non-material. According to margin 370, the risk-weighting for defaulted equity shares is 100%, after deduction of individual value adjustments and partial write-offs, which results in the exclusion of such shares from the IRB treatment and is accordingly not consistent with [Para 358] of Basel II.
Materiality	FINMA has rectified the gap and will align the IA fully to the Basel standards (Annex 6). Moreover, no bank currently applies the PD/LGD approach. At the same time, QIS data suggests that the gaps related to the other other deviations currently have a material impact on the Tier 1 ratio of one IRB bank as well as of all IRB banks on an average system-wide basis.
Basel paragraph no	Paragraphs 452 – 460: Definition of default; re-aging; treatment of overdrafts; definition of loss for all asset classes
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 382-388
Findings	Margin 382 states that the duration of late payment for the purpose of defining default should always be 90 days, regardless of the type of borrower. Margins 383 to 386 provide an alternative definition of default for Lombard (collateral) loans, whereby such a loan may be considered in default, if: • the realisable market value of the available collateral falls below the level of the Lombard loan, and • as a result, the position shows a cover shortfall, and • there is no indication or it is unlikely, that the counterparty can meet its credit obligations, or agreed measures have failed to rectify the cover shortfall. This alternative definition of default is not mandatory, but left to the banks' discretion. As a result of this alternative definition of default, a Lombard loan is likely to be considered in default somewhat earlier or more often than according to the definition of [Para 452 – 1st bullet point] of Basel II. However, the above-mentioned 3rd bullet point (which is one the three cumulative conditions of the alternative definition) does not differ significantly from the 1st bullet point of [Para 452] of Basel II, so that there is no scope for material differences between the two definitions of default. Besides, this alternative definition does not make any reference to [Para 452 – 2nd bullet point], but the latter is anyway irrelevant for such Lombard loans. So, there is

	no scope, either, for any material difference with the Basel II definition.
Materiality	Not material
Basel paragraph no	Paragraphs 468 – 473: Requirements specific to own-LGD estimates
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 324, 352, 370, 390
Findings	Margin 266 explicitly refers to the relevant paragraphs of Basel II. However: • firstly, the risk weighting for defaulted positions (whatever the asset class), after deduction of specific write-downs and partial write-offs, must be 100% both under A-IRB and F-IRB. This differs from [Para 471] of Basel II, whereby the capital requirement for a defaulted asset under the A-IRB is the amount, if any, by which the LGD on a defaulted asset exceeds the bank's best estimate of expected loss on that asset and should be set by the bank on a risk-sensitive basis in accordance with [Para 272 and Paras 328 to 330] (see above Paras 270-272 and 328-330). • secondly, specific provisions for defaulted positions and partial provisioning can be used as the best estimate of the expected loss on a position, provided the FINMA agrees. This provision differs from the provision in [Para 471] of Basel II, whereby for each defaulted asset, the bank must also construct its best estimate of the expected loss on that asset based on current economic circumstances and facility status. In particular, the best estimate of the expected loss has to be calculated on the basis of PD and LGD according to Basel II rules, so that the latter should take into account a definition of (economic) loss that is consistent with [Para 460] of Basel II, which differs from the (accounting) loss that is inherent in the definition of specific provisions.
Materiality	Short of an explicit quantification of the related impact through the RCAP QIS, the assessment team considers the gap to be potentially material (see also Paras 270-272).

2.3.5 Securitisation framework

Section Grading	Compliant (C)
Summary	No findings

2.3.6 Counterparty credit risk rules

Section Grading	IA: Compliant (C) SSA: Materially non-compliant (MNC)
Summary	In terms of CCP requirements, FINMA has given Swiss banks exemption from the capital requirement for clearing the member-to-client leg of an exchange traded derivatives transaction conducted under a bilateral agreement until 31 December 2015. This does, however, not apply if such exposures are material. The calculation of the potential future exposure under the SSA deviates from the Basel minimum requirements. This will consequently also have an impact on the calculation of CVA for the banks applying the SSA.
Overview of findings by Basel paragraph:	

Basel paragraph no	Paragraphs 3-9 as amended by revised framework[49]: Scope of application
Reference in the domestic regulation	CAO art. 56 FINMA Circular 08/19 margin nos. 408.10-408.11 and 410
Findings	Swiss banks were given exemption from Annex 4 paragraph 6(ii) until 31 December 2015. This means that both client banks and clearing member banks can capitalise the client-to-clearing member leg of exchange traded derivatives according to the traditional method (the so-called "Börsenmethode") and don't have to include this leg in the CVA capital charge. New requirement to treat exchange traded derivatives in the same way as OTC derivatives implies material system changes and would have been impossible for most banks to achieve this within the short notice (the relevant Basel paper was published only in July 2012). Therefore, banks are given more time to adapt their systems. • This temporary deviation will disappear on 1 January 2016 • OTC derivatives, including centrally cleared OTC derivatives are not concerned by this deviation. • The two systemically important banks are not making use of this deviation. • Exposures to CCPs are not concerned (only mutual exposures between clearing members and clients).
Materiality	Based on the temporary exemption , the impact of the gap is assessed to be non-material
Basel paragraph no	**Paragraphs 91-96: Current Exposure Method**
Reference in the domestic regulation	CAO art. 49 para. 1 and para. 2 let. c, art. 53 para. 1 and art. 56-57 IA FINMA Circular 08/19 margin nos. 16-63 (excluding those that have been deleted). SSA Old FINMA Circular 08/19 margin nos. 16-48.
Findings	Credit derivatives with reference to certain instruments have specific add-on factors Typo in terms of equity derivatives with maturity greater than 5 years which will be corrected via FAQ and subsequently updated in the circular SSA Under certain cases no add-on factors will be required as the Swiss believe that applying the same add-ons to both margined and un-margined trades is a major deficiency of the Basel CEM. When calculating the credit equivalent, it is possible to net up to the full amount of the add-on against negative replacement value of a given contract as it was seen as being risk sensitive (which is also acknowledged in the current fundamental review). However, it is not allowed to net between add-on factors. Calculation of mark-to-market is specified for each instrument. In the case of options, an appropriate delta weighting should be used as this was seen as being more risk sensitive.
Materiality	SSA: Impact of the gap is assessed to be material based on the national QIS results conducted in Switzerland The impact of the other gaps identified is assessed to be non-material
Basel paragraph no	**Paragraphs 104-105 added by revised framework:[50] Standardised CVA risk capital charge**
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 397-407 CAO art. 64 para. 5

[49] Additional Paragraph added after Paragraph 9 by Basel III (Paragraph 99). Para. 6(i) (ii) replaced by Basel III (CCP rules).

[50] Paragraphs 104-105 added by Basel III (Paragraph 99)

Findings	FINMA circular 08/19 introduces an alternative simplified version of the CVA charge for those banks that otherwise would have to calculate the standardised CVA charge and for which the CVA charge is immaterial. Deviations from the Basel text, but consistent with the Basel FAQ For counterparties that have no netting agreement or more than one netting set, the circular applies different aggregation rules than prescribed in the Basel text. In the Basel version, the total EAD (summed across netting sets) is multiplied by the notional weighted average maturity and discounted according to the average maturity. In the Swiss version, each netting set EAD is multiplied with its maturity and discounted according to its maturity which is consistent with the Basel FAQ 2a.2.[51] • Deviations from Basel version for more than one hedge position on the same credit index. In the Basel version, the total notional is multiplied by, and discounted through the notional weighted average maturity. In the Swiss version, each notional is multiplied by, and discounted through its own maturity which is consistent with the Basel FAQ 2a.3.[52] • Where no external rating exists and the bank has no supervisory approval to use internal ratings or where banks choose not to rely on any (external or internal) ratings, a weight of 1% can be applied with the exception for the weight applicable to the Swiss confederation, the SNB, the European central bank and the European Union, which is compatible with the weight for the rating category AAA-AA. The weight of 1% is consistent with a (yet unpublished) Basel FAQ. SSA Due to deviation from the current exposure method for banks applying the SSA, the calculation of the CVA charge will be impacted.
Materiality	SSA: Impact of the gap is assessed to be material based on material impact of the deviation from the current exposure method. The impact of the other gaps identified was assessed to be non-material.

[51] Publication BCBS 237 ("Basel III counterparty credit risk and exposures to central counterparties - Frequently asked questions").

[52] Publication BCBS 237 ("Basel III counterparty credit risk and exposures to central counterparties - Frequently asked questions").

2.3.7 Market risk: The Standardised Measurement Method

<table>
<tr><td>Section Grading</td><td>IA: Compliant (C)
SSA. Largely compliant (LC)</td></tr>
<tr><td>Summary</td><td>FINMA has two approaches for market risk capital rules:

The IA is a framework closely aligned to Basel 2.5 that is applied to many, including its largest, internationally active banks. The IA also includes the model-based approach (see 2.3.8 below).
SSA is a modification of Basel 2.5 (phased out in 2018) applied to smaller, primarily domestic banks. Some options available under the IA are not available to banks under the SSA, such as all model-based approaches or the commodities maturity ladder treatment under the standardised approach. Other variations outlined in the following table depict areas super-equivalence (conservative) and non-material deviations (more lenient) with Basel 2.5.

<table>
<tr><th>Conservative</th><th>Lenient</th></tr>
<tr><td>10% interest rate specific risk charge and FX charge (as opposed to 8%)</td><td>Offsetting of longs and shorts from the same issuer is allowed for the purposes of determining net interest rate specific risk exposure (as opposed to “same issue”)</td></tr>
<tr><td>20% charge on net commodity position under the simplified approach (as opposed to 15%)</td><td>Banks are allowed to apply for the inclusion of open equity stakes in hedge funds in trading book - Subject to holding additional equity for these positions</td></tr>
</table>
FINMA conducted some domestic QIS analysis to find out whether banks under the SSA would face greater capital charges if under the IA STA. FINMA’s suggested limited impact overall, but materiality for specific banks.
Other marginal issues of note (predominately related to standardised) are itemised below.</td></tr>
<tr><td colspan="2">Overview of findings by Basel paragraph:</td></tr>
<tr><td>Basel paragraph no</td><td>VI. Market Risk (Paragraphs 683(i) to 718)Paragraph 683(i)-689(iv), revised framework[53] as amended by the revised framework (Scope of the Computation of RWAs for Trading Book Assets)</td></tr>
<tr><td>Reference in the domestic regulation</td><td>FINMA Circular 08/20 margin nos. 1–30
FINMA Circular 08/20 margin nos. 94.11–94.15</td></tr>
<tr><td>Findings</td><td>FINMA is compliant with these preliminary paragraphs on scope and coverage of capital charges.
The only open item is the treatment of equity stakes in hedge funds, which are not permitted to be in trading book. Under the old Circular, Margin no. 31 says “If a bank nonetheless wishes to calculate capital adequacy requirements for shares in hedge funds according to the rules of the trading book, it can submit an application to FINMA explaining how the criteria for treatment according to these rules are fulfilled.” This, however, is accompanied with a requirement to hold more equity with the amount determined based on a FINMA-prescribed stress test. FINMA confirmed that there is no longer any bank on the SSA with open equity stakes in hedge funds.
This Margin No. 31 has been repealed under the new Circular.
Margin Nos. 94.11–94.15 are exact renditions of Basel rules on correlation trading</td></tr>
</table>

[53] New paragraph 689(iv) introduced by Basel II.5

	portfolio compositions.
Materiality	Not material for IA (Annex 6)/ Not material for the SSA
Basel paragraph no	Paragraphs 708(ii)- 708(iii): Definition of capital
Basel paragraph no	Paragraphs 708(ii)- 708(iii): Definition of capital
Reference in the domestic regulation	No reference is given.
Findings	Instead, FINMA states "replaced by Basel III rules". There is no information suggesting retention of Tier 3 capital against market risk in the Swiss rules. In the past, FINMA has never been confronted with a request to recognise Tier 3 capital in a bank. As a consequence the new CAO, in compliance with Basel III, does not envisage any transitional rules and starting January 1, 2013, former tier 1 would not qualify as regulatory capital any longer.
Materiality	Not material
Basel paragraph no	3. Interest rate risk (Paragraphs 709(i) to 718(viii)) Paragraphs 709(i) - 709(ii) as amended by the revised framework40: Definitions
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 63–92 FINMA Circular 08/20 margin no. 94.16 FINMA Circular 08/20 margin no. 94.2
Findings	Paragraphs 63-92 loosely describe the scope of capture for interest rate risk. There is no clear guidance as to what to do for non-convertible preference shares, pass-through MBS (footnote 145). Convertible debt that might behave like equities or rates products is cited in MN-157. Whereas margin no. 94.16 defines how to deal with the correlation trading portfolio (CTP) as specified in the latter half of para. 709(i) and margin no. 94.2 the interim treatment for the non-CTP as revised in Basel 2.5 para. 709(ii)
Materiality	Appears non-material based on RCAP QIS Data
Basel paragraph no	Paragraphs 709(iii): Definition of Specific risk
Reference in the domestic regulation	IA FINMA Circular 08/20 margin no. 93 SSA FINMA Circular 08/20 (old) margin no. 93
Findings	Under the SSA a bank can net any position from the same issuer prior to determining a charge. The new rules do not allow this. Namely only identical long and short positions in the exact same issue can be offset prior to capital determination. A national QIS shows that this deviation is material for specific banks. Note that specific risk capital charges for the SSA is 10% versus 8% under Basel II.
Materiality	Not material for IA/potentially material for SSA.
Basel paragraph no	Paragraph 710 to 711(ii): Issuer Risk ("qualifying category")
Reference in the domestic regulation	FINMA Circular 08/20 margin no. 94.
Findings	Margin no. 94* replicates the table in para. 710 and refers to Art. 4 lit. e CAO. to articulate what "qualified" is. It provides a definition and categories that align with the rating classes. Yet, Circular 08-20 does not outline how these map into ratings standards akin to external rating agencies Another Table of Correspondence provided by FINMA confirms a mapping consistent with Basel II. Art. 4 lit. e CAO. replicates para. 711(i).
Materiality	Not material
Basel paragraph no	Paragraphs 712 to 712 (ii), as amended by revised framework41: Non qualifying issuers, securitisation
Reference in the domestic regulation	CAO art. 4 let. g paras. 3-4 FINMA Circular 08/20 margin no. 94

Findings	CAO art. 4 let. g replicates para. 711(i) but para. 712 and para. 712(i) contain information similar to the table in para. 710. The rest of this BCBS passage (para. 712(ii)) offers some supervisory discretion. FINMA does not appear to adopt these discretionary items.
Materiality	Not material
Basel paragraph no	Paragraphs 712(iii) to 712 (viii), as amended by revised framework 42: Specific risk rules for positions covered under the securitisation framework
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 94.1–94.10 FINMA Circular 08/20 margin no. 227
Findings	Margin nos. 94.1-10 and 227 replicate broadly the standardised specific risk treatment for all securitisation types. Margin no. 227 instructs banks to calculate specific risk for n-th-to-default-credit-derivatives along the same lines as other securitisations. Yet, uncited margin nos. 212* to 213 replicate the treatment consistent with para. 718 (a-b)) for n-th-to-default credit derivatives. Para. 718 (c) clearly states that rated positions can apply the securitisation treatment but is silent on whether unrated n-th-to-default credit derivatives can be treated similarly. This suggests the proper application should be para. 718 (a-b) as written in margin. No. 212*-213. The issue at play is if an unrated n-th-to-default credit derivative can apply all options available to other securitisations, it can bypass the ratings based approach described in margin nos. 94.1-5 (which suggests a deduction) and consider alternatives including the supervisory formula approach or the concentration ratio approaches as described in margin nos. 94.6-10. This could possibly result in a capital charge lower than that described in margin nos. 212*- 213 (para. 718 (a-b)) FINMA has decided to issue an FAQ advising that unrated n-th-to-default credit derivatives cannot apply margin nos. 94.6-10 and thus would have to deduct if using the methodologies in margin nos. 94.1-5. Such an outcome would be at least as severe as applying margin nos. 212*-213.
Materiality	Rectified (Annex 6)
Basel paragraph no	Paragraphs 713 to 718 as amended by the revised framework43: Positions hedged by credit derivatives
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 214–227.1
Findings	Citation discrepancy. FINMA did not describe its treatment for para. 718, which is intertwined with its treatment of securitisations, as described in the previous section. The rest of the citations replicate the offsetting treatments for positions hedged by credit derivatives (pars. 713- 717). One exception is the stipulation in para. 714 and para. 715 that in order to be eligible for offsetting the instruments must move in opposite directions. This is not explicitly stated in FINMA's rules. FINMA agreed that there is a lack of a definition of price movement in Circular 08/20 but considered the definition in para. 715 (replicated in margin no. 224) to adequately describe what was meant by "moving in opposite directions".
Materiality	Not material
Basel paragraph no	Paragraphs 718(i) - 718(viii): General market risk
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 98–115
Findings	FINMA applies both the maturity method and the duration method as options and replicates the relevant text in pars. 718(i)-(viii).
Materiality	Not material
Basel paragraph no	Paragraphs 718(ix) – 718(xviii): Interest rate derivatives
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 71-92

Findings	Margin nos. 89-92 does not explicitly state that the positions must be in the same currency. However, that is implicit given it is an instruction for the maturity ladder and duration methods and this passage says "allocated to corresponding maturity band" or "relevant time band".
Materiality	Not material
Basel paragraph no	4. Equity position risk (Paragraphs 718(xix)to 718(xxix)) Paragraphs 718(xix) - 718(xxii) as amended by the revised framework44: Definitions and methods
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 126-130
Findings	Covers pars.718 (xix)-(xxviii). The treatment of equity derivatives in par. 718(xxix) is covered by margin no. 122.
Materiality	Not material
Basel paragraph no	Paragraphs 718(xxiii) - 718(xxix): Calculation of positions and capital charges
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 120-125
Findings	This citation passage covers para. 718 (xxiii), suggesting that specific risk is 8% of the net position per issue (ie FINMA does not allow carve outs of index positions from specific risk). Hence, an 8% charge is applied to the net position for each individual constituent security. FINMA claims that the the Swiss rule is super-equivalent because a more lenient treatment of indices and arbitrage positions according to pars. 718 (xxv) – 718 (xxviii) is not available. This means it does not impose a 2% specific risk charge for index positions but, instead, applies an 8% charge to each position (as is only required for single positions).
Materiality	Not material
Basel paragraph no	5. Foreign exchange risk (Paragraphs 718(xxx) to 718 (xLii) Paragraphs 718(xxx)- 718(xxxi): Definitions
Reference in the domestic regulation	FINMA Circular 08/20 margin no 131
Findings	These passages are definitional and cite the need to capture gold as an FX risk. (replicated in margin no. 131). Also margin no. 130 lays replicates the capital calculation procedure described in to par. 718(xxxi).
Materiality	Not material
Basel paragraph no	Paragraphs 718(xxxii)- 718(xxxix): Exposure in a single currency
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 132 – 142
Findings	Appears to cover all the relevant components. Margin nos. 32-40 cover items deducted from eligible capital that do not give rise to an FX charge (ie. They're structural positions). That is consistent with par. 718 (xxxix).
Materiality	Not material
Basel paragraph no	Paragraphs 718(xL) – 718 (xLii): Portfolio of foreign currency positions and gold
Reference in the domestic regulation	IA FINMA Circular 08/20 margin nos. 143-144 SSA FINMA Circular 08/20 (old) margin nos. 143-144
Findings	Under the SSA, FINMA applies a 10% charge versus 8% under its IA. This is super-equivalent to BCBS's 8%.
Materiality	Not material
Basel paragraph no	6. Commodities risk (Paragraphs 718(xLiii)- 718(Lv))

	Paragraphs 718(xLiii)- 718(xLvii): Definitions
Reference in the domestic regulation	IA FINMA Circular 08/20 margin nos. 145-152 SSA FINMA Circular 08/20 (old) margin nos. 143-152
Findings	Under the SSA, only the simplified approach is available to banks (no maturity ladder approach), but a 20% charge on the net position (as opposed to 15% under para. 718 (Liv)) is applied. According to FINMA big traders are encouraged towards internal models and evidence suggests that only banks with immaterial RWA contributions from commodity risk apply the simplified approach. Under the IA both the simplified and maturity ladder approaches are available and the capital charges are identical to the international Basel standards framework.
Materiality	Not material under IA/Not material under SSA.
Basel paragraph no	Paragraphs 718(XLviii): Models
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 147-149
Findings	This passage says you can always choose models but just make sure the following risks are incorporated. This is somewhat redundant given the internal models requirements later.
Materiality	Not material
Basel paragraph no	Paragraphs 718(xLix) - 718(Liii): Maturity Ladder approach
Reference in the domestic regulation	IA FINMA Circular 08/20 margin nos. 155.1–155.3 SSA Not available
Findings	Under the SSA, the maturity ladder approach is not available. FINMA considers that not offering the maturity ladder approach is not considered an issue or material difference. The maturity ladder approach is available under the IA.
Materiality	Not material
Basel paragraph no	Paragraphs 718(Liv) to 718(Lv): Simplified approach
Reference in the domestic regulation	IA FINMA Circular 08/20 margin no. 156 SSA FINMA Circular 08/20 (old) margin no. 156
Findings	Under the SSA there is a 20% capital charge on net commodity positions as opposed to 15% in para. 718 (Liv). The IA is consistent with the Basel II standards.
Materiality	Not material
Basel paragraph no	7. Treatment of options Paragraphs 718(Lvi)- 718-(Lvii): Definitions
Reference in the domestic regulation	FINMA Circular 08/20 margin no. 161
Findings	While banks buying options solely can choose the simplified approach, banks with written options can choose a mixture of the scenario based approach and the delta-plus approach for various options. The FINMA rules are not clear on this but Basel standards say you can only choose one.
Materiality	Not material

2.3.8 Market risk: Internal Models Approach

Section Grading	Compliant (C)
Summary	The IA is largely in line with Basel standards for internal models. Areas initially identified as non-compliant are generally related to BCBS interpretive issues that were released after the publication of Circular 08/20. These discrepancies include: • banks must include all sovereign exposures in IRC and • banks must not use any observational weighting scheme for the computation of stress VaR. Both of these issues could be material if not implemented. FINMA confirmed that it does apply these interpretive issues and has updated its FAQs to codify its compliance. The only other potentially material consideration is the treatment of banks that are in the yellow and red zone for back testing exception breaches. FINMA has not articulated what constitutes a breach of model integrity and hence a removal of internal modelling and reversion back to a standardised treatment. FINMA closed this deviation based on an FAQ where it reserves the right to revoke its permission to use model-based approaches to calculate capital adequacy.
Overview of findings by Basel paragraph(s):	
Basel paragraph no	8. Market Risk – The Internal Models Approach (Paragraphs 718(Lxx) to Paragraph 718 (XCix) Paragraphs 718(Lxx) to 718(Lxxv) as amended by revised framework45: General criteria and qualitative standards
Reference in the domestic regulation	FINMA Circular 08/20 margin no 228, nos. 231-244, nos. 265-283, 298-361
Findings	Para. 718(lxxiv) (i) lays out the items that internal auditors should address including: • The adequacy of the documentation of the risk management system and process; • The organisation of the risk control unit; • The integration of market risk measures into daily risk management; • The approval process for risk pricing models and valuation systems used by front and back-office personnel; • The validation of any significant change in the risk measurement process; • The scope of market risks captured by the risk measurement model; • The integrity of the management information system; • The accuracy and completeness of position data; • The verification of the consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources; • The accuracy and appropriateness of volatility and correlation assumptions; • The accuracy of valuation and risk transformation calculations; • The verification of the model's accuracy through frequent back-testing as described in para. 718(Lxxiv) (b) above and in the accompanying document: Supervisory framework for the use of back testing in conjunction with the internal models approach to market risk capital requirements. The detailed duties of internal audit in this context are not specified in Swiss rules although margin no. 360 cites Art. 18 Para. 2 BA and Art. 19 FINMA-AO; yet, these references seem to refer to coordination between internal and external audit. FINMA says "internal audit verifies the risk monitoring system as a whole (trading and control systems) regularly at least once a year. The investigations cover the activities of both the trading and risk monitoring departments." Since the section in circular 08/20 does not say anything about assessing the appropriateness of volatility and correlation assumptions or accuracy of valuation,

	risk transformation calculators or position data, it is not clear if the blanket statement "as a whole" suffices.
Materiality	Not material
Basel paragraph no	Paragraph 718(Lxxvi) as amended by the revised framework46: Quantitative standards
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 291-296.2
Findings	Margin no. 296.1 covers stressed VaR but fails to mention that weightings of daily observations cannot be used as mentioned in the BCBS interpretive issues #1.8. This needs to be clarified since exponential weightings can dramatically alter stress VaR results. FINMA has rectified this issue.
Materiality	Rectified (Annex 6)
Basel paragraph no	Paragraphs 718(Lxxvii) - 718(Lxxxiv) as amended by revised framework47: Stress testing
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 336-351
Findings	There is no reference to para. 718 (Lxxxi) "supervisory scenarios requiring no simulations by the bank". There should be loss information during the reporting period that supervisors can compare to results in the bank's internal measurement system.
Materiality	Not material.
Basel paragraph no	Paragraph 718(Lxxxv): External validation
Reference in the domestic regulation	FINMA Circular 08/20 margin no. 360 FINMA Circular 13/3 margin no. 6 and attachment 1 and 2
Findings	Para. 718 (lxxxv) says external auditors/supervisors must validate internal models' accuracy through steps: (a) Verifying that the internal validation processes described in para. 718(Lxxiv) (i) are operating in a satisfactory manner; (b) Ensuring that the formulae used in the calculation process as well as for the pricing of options and other complex instruments are validated by a qualified unit, which in all cases should be independent from the trading area; (c) Checking that the structure of internal models is adequate with respect to the bank's activities and geographical coverage; (d) Checking the results of the banks' back-testing of its internal measurement system (ie comparing value-at-risk estimates with actual profits and losses) to ensure that the model provides a reliable measure of potential losses over time. This means that banks should make the results as well as the underlying inputs to their value-at-risk calculations available to their supervisory authorities and/or external auditors on request; (e) Making sure that data flows and processes associated with the risk measurement system are transparent and accessible. In particular, it is necessary that auditors or supervisory authorities are in a position to have easy access, whenever they judge it necessary and under appropriate procedures, to the models' specifications and parameters. Meanwhile margin no. 360 says: "The investigations of internal and external auditors must also be strictly coordinated in the field of risk management and risk monitoring (Art. 18 Para. 2 BA; Art. 19 FINMA-AO)." Margin nos. 362-365 explains that external auditors must be "notified without delay if: • significant changes are made to the risk aggregation models (cf. Margin nos. 231-244), • the risk policy is changed (cf. margin nos. 231-244) • the period for the stressed VaR (cf. margin no. 296.1) is changed,

	• the number of exemptions from back testing exceeds four for the relevant observation period before 250 observations have been made (cf. margin nos. 320-335). The back testing procedure must be documented at least quarterly. The results must be reported to FINMA and the external auditors within 15 trading days of the end of each quarter” Although not cited by FINMA, margin no. 232 states that it will base its decision on whether to authorise the use of the model on the outcome of joint audits carried out with the bank’s external auditors under its overall control.
Materiality	Non-material documentation differences.
Basel paragraph no	Paragraph (Lxxxvi): Combination of internal models and the standardised methodology
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 261-264
Findings	The two sections roughly coincide in terms of treatment of commodities, partial use of standardised and finally the summation of standardised and internal models contributions to capital.
Materiality	Not material
Basel paragraph no	Paragraphs 718(Lxxxvii) – 718(XCviii) as amended by the revised framework48: Treatment of specific risk
Reference in the domestic regulation	FINMA Circular 08/20 margin nos.230.1-230.2, margin nos. 275-283, attachments 13 and 14
Findings	There is no mentioning of the inclusion of sovereigns in the Incremental risk charge (IRC), while BCBS interpretive issues 2.1.5 asked for inclusion of sovereigns in the IRC. FINMA has rectified this gap by stating that banks must include sovereign positions in the IRC.
Materiality	Rectified (Annex 6)
Basel paragraph no	Paragraph 718 (XCix) as amended by the revised framework49: Model validation standards
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 352, margin nos. 320-335
Findings	There is no clear mention of models being deemed unacceptable and possibly being turned off ("any shortcomings must be eradicated without delay, since otherwise the conditions for determining capital adequacy requirements according to the model-based approach will be deemed no longer to be fulfilled"). Meanwhile Annex 10A of Basel II para. 55 on VaR back testing says “in the case of severe problems with the basic integrity of the model, the supervisor should consider whether to disallow the use of the model for capital purposes altogether.” The deviation has been rectified.
Materiality	Rectified (Annex 6)
Basel paragraph no	Paragraph 718(cii): Systems and controls
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 33-35
Findings	The Swiss rules say "right up to senior management level" whereas 718 (cii) says "a main board executive director"
Materiality	Not material
Basel paragraph no	Paragraph 718(cviii)-718(cix): Valuation adjustments
Reference in the domestic regulation	FINMA Circular 08/20 margin no. 32-46
Findings	The two last sentences of para. 718. cviii have not been taken over in national regulation. Hence, FINMA does not require its banks, when using third-party valuations or marking to model, to consider whether making valuation adjustments are necessary. Nevertheless, Swiss rules foresee that third party valuations should be taken into account for less liquid positions, see FINMA Circular 08/20 margin no.

	47. The deviation has been rectified.
Materiality	Rectified (Annex 6)

2.3.9 Operational risk: Basic Indicator Approach and Standardised Approach

Section Grading	Compliant (C)
Summary	No deviations were identified by the RCAP Team.
Overview of findings by Basel paragraph:	
Basel paragraph no	B. The measurement methodologies (Paragraphs 645 to 659) Paragraphs 645 – 648: General
Reference in the domestic regulation	FINMA Circular 08/21 margin nos. 1, 48
Findings	Basel standards expect banks to progress beyond the BIA but FINMA does not provide encouragement to move along the spectrum of available approaches. Instead, all banks are expected to use either the BIA, SA or AMA for regulatory capital calculations. FINMA's rationale is that AMA is meant to be an option for large, international and complex banks only. FINMA considers the above differences with respect to "supervisory expectations for banks" as formal in nature and not as differences with respect to the Basel Accord. Note that FINMA also requires certain banks (cf. margin no. 19-22), which are using the BIA, to comply with the Basel Sound Practices for the Management and Supervision of Operational Risks.
Materiality	Not material
Basel paragraph no	Paragraphs 652 – 654: The Standardised Approach - Measurement methodology
Reference in the domestic regulation	FINMA Circular 08/21 margin nos. 23-27
Findings	FINMA has neither implemented the ASA (footnote 104– Basel) nor Paragraph 653. FINMA's rationale is that the former is not necessary and the latter is explanatory only. This is accurate; paragraph 653 merely explains the ingredients into the Standardised formula.
Materiality	Not material
Basel paragraph no	Paragraphs 660-663: The Standardised Approach- Qualifying criteria
Reference in the domestic regulation	FINMA Circular 08/21 margin nos. 29-44
Findings	Deviations include the qualifying criteria for the use of the Standardised Approach in paragraph 660 and paragraph 661, and the period of initial monitoring. In the former case, FINMA considered these criteria to be already covered in the "Sound Practices for the Management and Supervision of Operational Risk". For the latter, FINMA did not implement it but believes that factually it has the right without having to state it explicitly. There are some wording nuances, where in the end the BCBS is providing guidance to supervisors on the implementation of the STA. Aside from these citations the passage replicates the BCBS paragraphs and cites them accordingly.
Materiality	Not material

2.3.10 Operational risk: Advanced Measurement Approach

Section Grading	Compliant (C)
Summary	No deviations were identified by the RCAP Team.
Overview of findings by Basel paragraph:	
Basel paragraph no	C. Advanced Measurement Approach (655 to 679) Paragraphs 655–659 and 664–665: Advanced Measurement Approach (AMA)-General standards
Reference in the domestic regulation	FINMA Circular 08/21 margin nos. 45-47, 51-55, CAO para. 45
Findings	FINMA identified the following as missing: (a) Paragraph 656: the recognition of allocation mechanisms has not been explicitly implemented. The issue of capital allocation had already been addressed for each of the two then AMA candidate bank individually, based on an approval regulation in December 2007. The two Swiss banks approved for AMA do apply allocation mechanisms for internal purposes based on simple approaches applied at the division level. (b) Paragraph 657: recognition of diversification effects for international AMA banks approved abroad. This was not implemented, which is more conservative than the Basel II framework. (c) Paragraph 658: supervision of allocation mechanisms. The para. is similar to paragraph 656, so no need to explicitly implement was identified. (d) Paragraph 665: period of initial monitoring. FINMA believes this is general information only. FINMA is super-equivalent because they will not recognise diversification effects.
Materiality	Not material
Basel paragraph no	D. Advanced Measurement Approach (Quantitative standards) (Paragraphs 667 to 676) Paragraphs 667-668: AMA soundness standard
Reference in the domestic regulation	FINMA Circular 08/21 margin no. 70
Findings	Paragraph 668 has no explicit reference to flexibility in model development and review of evolving industry practices. FINMA explains it is considered as implicit. It was recognised from the beginning that AMA regulation, and in general operational risk quantification, was in its initial phase and such new discipline would evolve over time. A similar concept is covered also by Basel paragraph 667 which is reflected in FINMA Circular 08/21 margin no. 69. Otherwise it replicates the BCBS passage.
Materiality	Not material
Basel paragraph no	Paragraph 669: Detailed Criteria
Reference in the domestic regulation	FINMA Circular 08/21 margin nos. 71-75
Findings	FINMA did not include the requirement to “sufficient granularity” in paragraph 669c because the term “sufficient granularity” was deemed as problematic. Meanwhile the general notion was deemed to already be covered by other paragraphs (FINMA Circular 08/21 margin nos. 70, 73). FINMA did not explicitly write out paragraph 669 (d) “Risk measures for different operational risk estimates must be added for purposes of calculating the regulatory minimum capital requirement. However, the bank may be permitted to use internally determined correlations in operational risk losses across individual operational risk estimates, provided it can demonstrate to the satisfaction of the national supervisor that its systems for determining correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates (particularly in periods of stress). The bank must validate its correlation assumptions using appropriate quantitative and qualitative

	techniques." FINMA, instead, paraphrased it with "all explicit and implicit assumptions regarding dependencies across individual operational risk loss events and across used estimates must be plausible and verifiable." Follow up with FINMA on whether its approach is comprehensive in its coverage of correlation approvals confirmed that all key model assumptions (including the number of unit of measures and dependency assumptions) are subject to explicit FINMA approval, which also applies to any subsequent changes to assumptions.
Materiality	Not material
Basel paragraph no	Paragraphs 670 – 673: Internal data
Reference in the domestic regulation	FINMA Circular 08/21 margin nos. 76-85
Findings	FINMA is super-equivalent to the Basel II Framework. Circular 08/21 margin no. 85 explicitly excludes operational risk gains from AMA calculations.
Materiality	Not material
Basel paragraph no	Paragraph 675: Scenario analysis
Reference in the domestic regulation	FINMA Circular 08/21 margin nos. 89-91
Findings	FINMA rules are super-equivalent because there are additional requirements. Namely, Circular 08/21 margin no. 91 requires scenarios to be updated at least on an annual basis and immediately in case of material changes (no frequency is specified in paragraph 675). Instead FINMA says "Over time, such assessments need to be validated and re-assessed through comparison to actual loss experience to ensure their reasonableness."
Materiality	Not material
Basel paragraph no	Paragraph 676 : Business environment and internal control factors
Reference in the domestic regulation	FINMA Circular 08/21 margin nos. 92-97
Findings	Paragraph 679, third bullet (uncertainty of payment and coverage mismatches) is not included in Circular 08/21 but FINMA believes that it is sufficiently covered by margin nos. 98-107.
Materiality	Not material
Basel paragraph no	E. Partial use of AMA (Paragraphs 680 – 683)
Reference in the domestic regulation	FINMA Circular 08/21 margin nos. 108-114
Findings	FINMA rules are super-equivalent in that they don't allow permanent partial use.
Materiality	Not material

2.4 Pillar 2: Supervisory review process

Section Grading	Compliant (C)
Summary	Four key principles The four key principles of Pillar II have been implemented in close alignment with the Basel III standards. IRB As far as credit risk and securitisation are concerned, the Swiss rulebook does not explicitly incorporate some provisions of Basel II, dealing respectively with the

	residual risks associated with the use of credit risk mitigation techniques or securitisations that provide protection against first loss credit enhancements. Likewise, there is no mention that FINMA will take appropriate action where a bank's estimates of exposure or EAD under the Internal Model Method or alpha do not adequately reflect its exposure to CCR. IRRBB FINMA conducts tests of changes in economic value of equity based on +/- 100 bps parallel shocks to interest rate curves instead of the +/-200 bps standardised test as specified in para. 764. Their internal assessment has documented a linear relationship between the two shock/impact levels, which suggests that their technique is compliant with the Basel II Pillar 2 approach. Supplementary PII This is compliant.

Overview of findings by Basel paragraph:	
Basel paragraph no	Paragraphs 726-728 Principle 1: Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels
Reference in the domestic regulation	FINMA Circular 11/2 margin nos. 34-45 FINMA Circular 08/24 margin nos. 1-2, 9-12, 80-81, 85, 113-120, 121-125, 126 FINMA Circular 08/21 margin no. 52 FINMA "Board of Directors of Banks and Securities Dealers", FAQs 8/12, Q5
Findings	FINMA circular 11/2 refers to the expectations that a bank operates forward-looking capital planning, in a duly documented manner, taking account of the economic cycle, the bank's income target and budgeting process (including future profits, dividend policy, corporate actions...). Other circulars set out the requirements in respect of corporate governance, in particular with regard to the business strategy and risk policy. In particular, FINMA Circular 08/24 sets out requirements relating to the role of the board of directors and senior management. FAQ 08/12 clarifies the expectations in respect of the role of the board of directors.
Materiality	Not material
Basel paragraph no	Paragraphs 738(ii): VaR model stress tests
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 336-351
Findings	FINMA Circular 08/20 margin nos. 336-351 appropriately requires banks to supplement their VaR model with stress tests that incorporate those factor shocks listed in [Para 738(ii)] of Basel II with the exception of one-way markets. However, the latter are likely to be covered by "any other risks" not appropriately reflected in the VaR. In addition, procedures must ensure that results of the stress testing trigger the necessary measures and are reflected in the policies and limits defined by management and the body responsible for overall management, supervision and monitoring. This may be viewed as consistent with the requirement in [Para 738(ii)] that the calibration of stress tests be reconciled back to a clear statement setting out the premise upon which the bank's internal capital assessment is based (ie risk management strategy).
Materiality	Not material
Basel paragraph no	Paragraph 738(v): Combination of risk measurement approaches
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 261-264
Findings	FINMA requires banks which wish to use the internal models to have in principle a risk aggregation model which at least covers all categories of risk factors for general market risks. In addition, it subjects combination of the model based and the standardised approach to the condition that the same approach is used within the same category of risk factor. This is consistent with the [Para 738(v)] of Basel III

	requirement that banks demonstrate how they combine their risk measurement approaches.
Materiality	Not material
Basel paragraph no	Paragraph 741: Liquidity risk
Reference in the domestic regulation	Ordinance of Liquidity of Banks (AS 2012), Article 7 (link) FINMA Circular 13/6: Liquidity of Banks, margin no. 20 (link)
Findings	AS 2012 requires banks to have adequate processes for identifying, measuring, monitoring and controlling liquidity risk, which is consistent with [Para 741] of Basel III. FINMA Circular 13/6 requires the liquidity risk monitoring and management systems to include the measurement of incoming inflows and outflows as well as the available amount of high quality liquid assets, so that the bank can withstand any deterioration in its liquidity situation over a short term horizon. This requirement does go so far as to impose an evaluation of the bank's capital adequacy in view of its liquidity profile and liquidity of the market. But this link with capital adequacy referred to in [Para 741] is not a binding requirement ("should").
Materiality	Not material
Basel paragraph no	Paragraphs 753-755: Supervisory review of compliance with minimum standards
Reference in the domestic regulation	FINMA Circular 08/22 margin nos. 16-36, 37-47.4, 60-61
Findings	FINMA requires that the approaches used for calculating capital adequacy requirements be specified in the qualitative information disclosed, if material at the time of the annual accounts. The additional disclosure obligations required by Basel III are explicitly referred to as well. The compliance with such disclosure obligations is subject to the annual verification of the external auditors. These provisions are consistent with the requirements set out in [Para 753] of Basel II.
Materiality	Not material
Basel paragraph no	Paragraph 757-758
Reference in the domestic regulation	CAO art. 43-45, 124-136 FINMA Circular 11/02 margin nos. 34-45
Findings	Until full phase-in of Basel III rules in 2019, on top of the Basel III supplementary capital minimum requirements, FINMA requires banks to hold a general (system-wide) buffer in the form of CET1 (equal to 2.5 % of risk-weighted assets). In addition, the Swiss National Bank is able to ask the Federal Council to require banks to hold a countercyclical buffer in the form of CET1 (up to 2.5% of risk-weighted assets). Last, FINMA is able to require (bank-specific) supplementary capital in case the capital resulting from pillar 1 minimum requirements and above-mentioned buffer requests does not ensure sufficient capital adequacy in view of the bank's business, risk profile or management techniques used.
Materiality	Not material
Basel paragraph no	Paragraphs 759-760 Principle 4: Supervisors should seek to intervene at an early stage to prevent capital from falling below the minimum levels required to support the risk characteristics of a particular bank and should require rapid remedial action if capital is not maintained or restored.
Reference in the domestic regulation	CAO art. 42-45, 124-132 FINMA Circular 11/02 margin nos. 21-33
Findings	According to FINMA Circular 11/02 margins 24 to 26, if FINMA sees an institution's capital ratio falling below the target level (ie, the thresholds set by FINMA per categories 2 to 5 as defined in FINMA circular 11/2), it intensifies its supervision and contacts the institution to clarify the causes. According to FINMA Circular 11/02 margins 27 to 29, 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. 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. If the intervention threshold is breached, FINMA may, in addition to the above-mentioned measures, order the institution to reduce its risk-weighted assets, sell specific assets or withdraw from specific areas of business.
Materiality	Not material
Basel paragraph no	Paragraphs 763-764: Interest rate risk in the banking book
Reference in the domestic regulation	FINMA Circular 08/6 margin nos. 2, 5, 17, 25-27, 43, 46-47, 48-49 (link)
Findings	The citation does not mention measuring the change in economic value of equity from a 200bps parallel interest rate shock. However, it does suggest that banks should consider parallel shocks and estimate the change in EVE (margin 45) (called net present value perspective). This shock is measured in terms of net interest income (NII, referred to as "earnings perspective") after a 100bps IR shock instead, as an example (43). FINMA might want to consider running the standardised interest rate shock "outlier" test as specified in para. 764.
Materiality	Non-material
Basel paragraph no	Paragraph 765: Stress tests under the IRB approaches
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 279, 284
Findings	According to FINMA Circular 11/02 margins nos. 3, 36 and 37, FINMA is empowered to impose buffers in order to ensure the bank's compliance with minimum requirements, even in adverse circumstances. According to FINMA Circular 08/19 margin 284, the stress test results must be incorporated in the calculation of any such additional capital charges applicable under Pillar 2 [Para 765].
Materiality	Not material
Basel paragraph no	Paragraph 766: Definition of default
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 2-2.3, 266, 382-387
Findings	A specific definition of default is provided with regard to Lombard loans. See above *Paragraph 452*. Implementation and monitoring of the manner in which banks detect loans or positions at risk are reviewed during the bank's authorisation procedure.
Materiality	Not material
Basel paragraph no	Paragraphs 767-769: Residual risk
Reference in the domestic regulation	Paragraphs 767-769 not explicitly implemented in existing regulation
Findings	Although FINMA claims that the qualitative requirements of [Paras 767-769] are expected to be fulfilled and, where material, subjected to the supervision process, this is not explicitly stated in existing regulation, so that there is no requirement that: • banks have in place appropriate written CRM policies and procedures in order to control the residual risks they are exposed to; • banks regularly review the appropriateness, effectiveness and operation of these CRM policies and procedures; • banks consider whether, when calculating capital requirements, it is appropriate to give the full recognition of the value of the credit risk mitigant as permitted in Pillar 1 and demonstrate that their CRM management policies and procedures are appropriate to the level of capital benefit that they are recognising
Materiality	Based on qualitative considerations, the assessment team considers the finding to

	be non-material.
Basel paragraph no	Paragraphs 777(i)-777(xiii) as amended by the revised framework: Counterparty credit risk
Reference in the domestic regulation	FINMA Circular 08/19 margin no. 102 requires banks to fully apply the Basel II and Basel III text in relation to the EPE models. But it is not absolutely clear that also pillar 2 shall be covered by this.
Findings	As acknowledged by FINMA, it is not explicitly stated that pillar 2 requirements (especially those set out in [Para 777(xiii)] in respect of the supervisor's action) are covered by margin 102, which specifies that the provisions contained in the Basel II minimum standards and some aspects modified in Basel III apply with respect only to the EPE modelling method.
Materiality	Based on qualitative considerations, the assessment team considers the finding to be non-material.
Basel paragraph no	Paragraphs 778(iii)-778(iv) as amended by revised framework: Stress testing under the internal models approach; Specific risk modelling under the internal models approach
Reference in the domestic regulation	FINMA Circular 08/20 margin nos. 261-264, 336-351, Appendix 13
Findings	Even assuming that FINMA complies with the Basel III minimum requirements set out in paragraphs 718(Lxx) to 718(xciv) and those required by paragraph 718(Lxxiv)(g), taking into account the principles set forth in paragraphs 738(ii) and 738(iv) – see above –, none of the references provided (FINMA Circular 08/20 margin nos. 261-264, 336-351, Appendix 13) ensures that, in case there is a shortfall or FINMA is not satisfied with the premise upon which the bank's assessment of internal market risk capital adequacy is based, FINMA will take the appropriate measures (including requiring the bank to reduce its risk exposures and/or to hold an additional amount of capital, so that its overall capital resources at least cover the Pillar 1 requirements plus the result of a stress test acceptable to the supervisor). However, Circular 02/11 margin 30 empowers FINMA to take measures (including stricter capital adequacy requirements) if it deems that the bank's capital target does not adequately cover the bank's risk profile or that the bank's risk management is insufficient in view of its risk profile. This may be viewed as consistent with [Para 778(iii)] of Basel II . Likewise, even assuming that FINMA complies with the Basel II minimum requirements set out in paragraph 718(Lxxxix) for banks wishing to model the specific risk arising from their trading activities – see above –, none of the references provided ensures that, in case FINMA considers that limited liquidity or price transparency undermines the effectiveness of a bank's model to capture the specific risk, it will take appropriate measures (including requiring the exclusion of positions from the bank's specific risk model). However, Circular 02/11 margin 30 empowers FINMA to take measures (including stricter capital adequacy requirements) if it deems that the bank's capital target does not adequately cover the bank's risk profile or that the bank's risk management is insufficient in view of its risk profile. This may be viewed as consistent with [Para 778(iv)] of Basel III.
Materiality	Not material
Basel paragraph no	Paragraphs 790-794: Provision of implicit support
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 253-265
Findings	Margin 253 explicitly refers to the relevant paragraphs of Basel III. Margin 265 does not provide any further clarification regarding Paragraphs 790-794.
Materiality	Not material
Basel paragraph no	Paragraph 795: Residual risks
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 253-265
Findings	There is currently no specific provision stating that FINMA reviews the

	appropriateness of protection recognised against first loss credit enhancements, nor that FINMA takes appropriate action in case it would consider the approach to this protection recognised as not adequate.
Materiality	Based on qualitative considerations, the assessment team considers the finding to be non-material.
Basel paragraph no	Paragraphs 796-807: Call provisions; Early amortisation
Reference in the domestic regulation	FINMA Circular 08/19 margin nos. 253-265
Findings	According to margin 265, banks are *not* expected to disclose to the FINMA the rationale for their decision to exercise a call, nor the impact of having exercised the call on the bank's regulatory capital ratio prior to exercising a call (ie the national discretion of [Para 798] of Basel III is not used).
Materiality	Not material

2.5 Pillar 3: Market discipline

Section Grading	LC (Largely Compliant)
Summary	Pillar 3 requirements are largely compliant. For the large banks, the requirements are compliant, though the first actual Pillar 3 reports under the requirements are yet to be issued.[54] On size grounds, however, 237 banks out of 322 banks are partially exempted from Pillar 3 requirements, including some internationally active banks (para 809). Those banks are exempt from Table 4-6,, Disclosure requirements for credit risk, Table 7: Credit risk mitigation, Table 8: Counterparty Credit Risk, Tables 10-11: Standardised approach and Internal models approach (IMA),Table 12: Operational risk, Table 13: Equities: disclosure for banking book positions ,Table 14: Interest rate risk in the banking book (IRRBB). As regards Table 4: (b) FINMA does not require the average gross exposure; (f) the amount of impaired loans is not broken down by major industry or counterparty type; FINMA does not require the disclosure of specific and general allowances by major counterparty types, nor a breakdown into specific allowances and charge-offs; With regard to Table 8 FINMA did not introduce special requirements for qualitative disclosures for counterparty credit risks, as Table 8c requires. With regard to Table 13(a), there is no such qualitative requirement by FINMA.
Overview of findings by Basel paragraph:	
Basel paragraph no	Paragraph 809 as amended by the revised framework: Guiding principles
Reference in the domestic regulation	FINMA Circular 08/22
Findings	The banks applying the standardised approach are subject to “partial” disclosure (disclosure of available capital and capital needs) if their capital needs for credit risk do not exceed CHF 200 million (see margin nos. 8-14 of FINMA Circular 08/22). The paragraph also impacts the following paragraphs: Paragraphs 825-826 and Tables 4-6: Disclosure requirements for credit risk, Table 7 as amended by revised framework: Credit risk mitigation, Table 8: Counterparty Credit Risk, Tables 10-11 as amended by the revised framework: Standardised approach and

[54] All banks, including all internationally active banks, have a grace period of two months to implement the Basel III Pillar 3 requirements. Hence, the RCAP team is not able, at this stage, to ultimately assess compliance of Pillar 3 rules.

	Internal models approach (IMA),Table 12: Operational risk, Table 13: Equities: disclosure for banking book positions Table 14: Interest rate risk in the banking book (IRRBB)
Materiality	Potentially material
Basel paragraph no	Paragraphs 825-826 and Tables 4 -6: Disclosure requirements for credit risk
Reference in the domestic regulation	FINMA Circular 08/22, margin nos. 24-28 & appendix 1 & tables 3 7 and circular 08/2, margin nos. 106, 149, 150-153a, 169-173a, 177-181
Findings	Table 4: (b) FINMA does not require the average gross exposure to be published; (f) the amount of impaired loans is not broken down by major industry or counterparty type; The Swiss authorities do not require disclosure of specific and general allowances by counterparty type.
Materiality	Not material
Basel paragraph no	Table 8: Counterparty Credit Risk
Reference in the domestic regulation	FINMA Circular 08/22 and FINMA circular 08/02, margin nos. 193-197.
Findings	Concerning the difference: see partial disclosure exemption in the scope of appliance related to para. 809. Apart from that, the rules do no introduce special requirements for qualitative disclosures for counterparty credit risks: FINMA requires less detailed information than (c) foresees.
Materiality	Not material
Basel paragraph no	Table 13: Equities: disclosure for banking book positions
Reference in the domestic regulation	FINMA Circular 08/02, margin nos 154-158 and FINMA circular 08/22, table 1.
Findings	Table 13 (a) foresees qualitative disclosure with respect to equity risk including: (i) differentiation between holding on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons; (ii) discussion of important policies covering the valuation and accounting of equity holdings in the banking book. This includes accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation as well as significant changes in these practices. In the listed reference provided by FINMA, no such qualitative disclosure is required.
Materiality	Not material

Annexes

Annex 1: RCAP Assessment Team and Review Team

Team Leader:

Mr Stephen Bland	Prudential Regulation Authority, Bank of England

Team Members:

Mr Thierry Bayle	Autorité de Contrôle Prudentiel, Banque de France
Mr Greg Caldwell	Office of the Superintendent of Financial Institutions, Canada
Mr Matthias Gutmann	Deutsche Bundesbank
Ms Esté Nagel	Reserve Bank of South Africa
Ms Zhangjun Wu	China Banking Regulatory Commission

Supporting Members:

Mr Christian Schmieder	Basel Committee Secretariat

Review Team Members[55]

Mr Mitsutoshi Adachi	SIG member, Bank of Japan
Mr Stefan Blochwitz	SIG member, Deutsche Bundesbank
Mr Kim Leng Chua	SIG member, Monetary Authority of Singapore
Mr William Coen	Basel Committee Secretariat

[55] The Review Team is separate from the RCAP Assessment Team, and provides an additional level of quality assurance for the report's findings and conclusions. The RCAP Assessment Team has also benefitted from feedback from the RCAP Peer Review Board, and worked closely with the Head of Basel III Implementation at the Basel Committee Secretariat.

Annex 2: Implementation of the capital standards under the Basel framework as of end March 2013

Basel III Regulation	Date of issuance by BCBS	Date of issuance by Switzerland	Status
Basel II			Grade
Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version	June 2006	Issued 29 September 2006, in force from 1 January 2007	4
Basel 2.5			
Enhancements to the Basel Framework	July 2009	Issued 10 November 2010, in force from 1 January 2011	4
Guidelines for computing capital for incremental risk in the trading book	July 2009	Issued 10 November 2010, in force from 1 January 2011	4
Revisions to the Basel II market risk framework	July 2009	Issued 10 November 2010, in force from 1 January 2011	4
Basel III			
Basel III: A global regulatory framework for more resilient banks and banking systems –revised version	June 2011 (Consolidation of rules issued in December 2010 and January 2011)	1 June 2012, in force from 1 January 2013 Parallel approach for Standardised Approach (SSA), ceasing to exist by end 2018	4
Pillar 3 disclosure requirements for remuneration	July 2011	1 June 2012, in force from 1 January 2013	4
Treatment of trade finance under the Basel capital framework	October 2011	1 June 2012, in force from 1 January 2013	4
Composition of capital disclosure requirements	June 2012	6 December 2012, in force from 1 January 2013	4
Capital requirements for bank exposures to central counterparties	July 2012	30 October 2012, in force from 1 January 2013	4
Regulatory treatment of valuation adjustments to derivative liabilities	July 2012	10 May 2013 (FAQ)	4

Number and colour code: 1 = draft regulation not published; 2 = draft regulation published; 3 = final rule published; 4 = final rule in force (ie the due date for implementation is over). **For rules which are due for implementation as on 31 December 2012**

Green = implementation completed;

Yellow = implementation in process;

Red = no implementation.

Annex 3: List of capital standards under the Basel framework used for the assessment

(i) *International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Basel II)*, June 2006

(ii) *Enhancements to the Basel II framework*, July 2009

(iii) *Guidelines for computing capital for incremental risk in the trading book*, July 2009

(iv) "Basel Committee issues final elements of the reforms to raise the quality of regulatory capital" Basel Committee press release, 13 January 2011

(v) *Revisions to the Basel II market risk framework: Updated as of 31 December 2010*, February 2011

(vi) *Basel III: A global regulatory framework for more resilient banks and banking systems,* December 2010 (revised June 2011)

(vii) *Pillar 3 disclosure requirements for remuneration*, July 2011

(viii) *Treatment of trade finance under the Basel capital framework*, October 2011

(ix) *Interpretive issues with respect to the revisions to the market risk framework*, November 2011

(x) *Basel III definition of capital – Frequently asked questions*, December 2011

(xi) *Composition of capital disclosure requirements: Rules text*, June 2012

(xii) *Capital requirements for bank exposures to central counterparties*, July 2012

(xiii) *Regulatory treatment of valuation adjustments to derivative liabilities: final rule issued by the Basel Committee*, July 2012

(xiv) *Basel III counterparty credit risk – Frequently asked questions*, November 2011, July 2012, November 2012

Annex 4: Local regulations issued by FINMA implementing Basel capital standards

Overview of issuance dates of important Swiss capital rules

Table 3

Type and Descriptions	Time of issuance
Regulation	
Swiss Banking Act Swiss Federal Banking Ordinance	8 November 1934 17 May 1972
Capital Adequacy Ordinance (CAO) implementing Basel II	29 September 2006, in force since 1 January 2007
Amendment to CAO, implementing Basel 2.5	10 November 2010, in force since 1 January 2011
Fully revised version of CAO, implementing Basel III	1 June 2012, in force since 1 January 2013
Various FINMA circulars implementing Basel III	Second half of 2012

Hierarchy of Swiss legal and regulatory instruments

Table 4

Level of rules (in legal terms)	**Type**
Primary (1)	Legal instruments • Federal Acts (1.1) • Federal Council Ordinances (1.2) • FINMA ordinances (1.3)
Secondary (2)	FINMA circulars (2.1) Self-regulation (2.2)
Tertiary (3)	Legal administrative procedures (3.1): FINMA rulings Other administrative procedures (3.2) • FINMA notifications • FINMA newsletter • FAQs

Note: Definitions and descriptions are given below

Definition and description of Swiss legal instruments (Source: FINMA)

Legal instruments (primary legislation) (1)

A legal instrument is enacted by the responsible authority (eg Parliament, the Federal Council, a certain authority). Legislative powers to do so are issued in the Federal Constitution. The enactment of the law is then published in the Classified Compilation of Federal Legislation as prescribed in the provisions of the Publication Act (SR 170.512). Legal instruments are binding. It is not possible to appeal against a legal instrument per se.

Federal Acts (1.1)

In the hierarchical structure of legislation, federal acts are subordinate to the Constitution. Under Article 164 para. 1 Federal Constitution, all important legislative provisions must be passed as a federal act. This includes, for instance, severe restrictions on constitutional rights (eg economic freedom),[56] basic provisions on the rights and obligations of persons and on procedures followed by the federal authorities.

Examples: Financial Market Supervision Act, Banking Act.

Federal Council ordinances (1.2)

The Federal Council can pass legislative provisions in the form of an ordinance insofar as it is empowered to do so by the Constitution or an act. Ordinances are general abstract legal provisions which are subordinate to an act. By contrast with federal acts, they are passed through a simplified procedure.

Examples: Capital Adequacy Ordinance, Banking Ordinance, Liquidity Ordinance.

FINMA ordinances (1.3)

FINMA ordinances impose obligations or confer rights or responsibilities on supervised institutions in general and abstract terms with directly binding force. FINMA ordinances may only be issued based on a superordinate legal foundation (federal act or Federal Council ordinance).

Example: Banking Insolvency Ordinance

The transfer of law-making rights to groups and offices (also including organisations outside the Federal Administration such as FINMA) is only permissible if it is authorised by a federal act or a generally binding federal decision (cf. Art. 48 para. 2 RVOG). Even in such cases, a decision on whether delegation in this respect is justified must take the scope of the legal instruments into consideration.[57]

Circulars (secondary legislation) (2)

If so prescribed in financial market legislation (see above), FINMA regulates by means of ordinances and circulars that define and explain how financial market legislation should be applied.

FINMA Circulars (2.1)

The purpose of FINMA circulars is to enable the supervisory authority to implement legislative rules in a uniform and proper manner by specifying open, undefined legal norms and outlining generally abstract

[56] Sutter-Somm, Karin, St Gallen Commentary on Article 164 margin no. 10, Zurich 2002.

[57] Guidelines on legislation, Guidelines on the drafting of federal legislation, 2nd revised edition, margin no. 595.

requirements for exercising discretionary powers. Circulars do not need any explicit legal basis in the form of an act; their content, however, must be materially related to a superordinate enactment.

Circulars are binding for FINMA. Compliance with all FINMA Circulars (as well as Acts and Ordinances) applicable to banks are subject to the annual audit process and issues of non-compliance will be reported in the annual audit report, based an assessment of risk and materiality.

Circulars do not have the characteristics of Acts of Ordinance though. Accordingly, a supervised institution may appeal against a Circular in a concrete case if the institution considers the Circular not applicable for its particular circumstances.

Example: FINMA Circular 13/6 "Reporting requirements for short-term liquidity coverage ratio and qualitative requirements for liquidity risk management".

Self-regulation (2.2)

Self-regulation takes a variety of different forms. A distinction is made between voluntary or autonomous self-regulation, self-regulation that is recognised as a minimum standard and compulsory self-regulation based on a mandate from the legislator.

Compulsory self-regulation

Compulsory self-regulation is based on self-regulatory organisations receiving a mandate from the legislator to deal with a given topic through self-regulation. Regulatory mandates of this kind are contained in, for example, Article 37h of the Banking Act (deposit insurance), Article 4 para. 1 of the Stock Exchange Act (appropriate organisation), Article 4 para. 3 of the Collective Investment Schemes Ordinance (requirements for simplified documentation on structured products) and Article 25 of the Anti-Money Laundering Act (specification of due diligence obligations). Compulsory self-regulation can also be recognised by FINMA where the legislator has not already stipulated that state approval is required. Recognition increases the legitimacy, effectiveness and credibility of such norms, and contributes to self-regulation being perceived as an equal alternative to state regulation both in and outside Switzerland.

Self-regulation as a minimum standard

Under Article 7 para. 3 of the Financial Market Supervision Act, FINMA may, either at the request of a self-regulatory organisation or on its own initiative, recognise self-regulatory measures as a minimum standard (cf. FINMA Circular 08/10 "Self-regulation as a minimum standard"). Once recognised, such norms in principle no longer merely apply to members of the relevant self-regulatory organisation but must accordingly be observed as minimum standards by all other participants in the sector. Subsequent compliance with recognised minimum standards is enforced by FINMA or by the self-regulatory organisations. A list of currently recognised self-regulatory measures is included in the annex to FINMA Circular 08/10 "Self-regulation as a minimum standard".

Examples: minimum requirements for mortgage financing issued by the Swiss Bankers Association, 1 June 2012.

Autonomous self-regulation

Voluntary or autonomous self-regulation is based solely on private autonomy and is by definition established without any government involvement (eg codes of conduct issued by professional associations).

Tertiary legislation (3)

Legal administrative procedures (Tertiary legislation) (3.1)

Rulings are part of legal administrative procedures. Federal authorities that act to fulfil a public-law duty for the Confederation are empowered to issue a ruling. Rulings must set out reasons and instructions on the right of appeal; parties directly concerned are entitled to lodge an appeal with the Federal Administrative Court and, last stage, with the Federal Supreme Court.

FINMA rulings

Under Article 5 of the Federal Act on Administrative Procedure (APA; SR 172.021), rulings are decisions of the authorities in individual cases that have the establishment, withdrawal or amendment of a specific administrative law issue as their subject matter. It therefore does not constitute a general abstract legal instrument.

Other forms of administrative procedures (3.2)

Alongside legal administrative procedures (decrees or rulings), Swiss administrative law also permits other forms of administrative procedures. As an administrative authority, these principles also apply to FINMA.

Informal administrative procedures

If supervised institutions agree voluntarily to act as deemed appropriate, FINMA may, within its application of the legal framework, waive a formal and official order (ruling). Consultations and agreements (generally in writing) are then part of the informal and consensual administrative procedures undertaken in cooperative efforts between FINMA and the supervised institutions. If informal administrative procedures do not bring the desired results, FINMA can still at any time issue a ruling (3.1).

Example: FINMA notification about the IRB multiplier for residential property.

De facto or simple administrative procedures

De facto or simple administrative procedures include, for example, information, instructions, recommendations, warnings, official reports and other statements, and are of an informative nature. If such procedures do not bring the desired results, FINMA can still at any time issue a ruling (3.1).

FINMA newsletters about important and topical supervisory issues are directed at a specific audience. Since they express warnings, set out FINMA's expectations of the supervised institutions or remind them of certain duties, they are often of an appellative nature.

Example: FINMA newsletter about the short-term liquidity coverage ratio (LCR).

FAQs provide standard FINMA answers. FAQs are compiled in cases where there have been, or will be, numerous enquiries about regulatory rules. FAQs are not directly legally binding instruments, are not of a direct legislative nature and do not substantiate FINMA's practice. FAQs mainly aim at providing a better understanding of specific regulatory rules.

Examples: FAQs about Basel II or Basel III.

Annex 5: Details of the RCAP assessment process

A. Off-site evaluation

(i) Completion of a self-assessment questionnaire by FINMA

(ii) Evaluation of the self-assessment by the RCAP Team

(iii) Independent comparison and evaluation of the domestic regulations issued by FINMA with corresponding Basel III standards issued by BCBS

(iv) Identification of observations as a result of steps (ii) and (iii)

(v) Refinement of the list of observations based on clarifications provided by FINMA

(vi) Assessment of materiality of deviations for all quantifiable deviations based on data and non-quantifiable deviations based on expert judgement

(vii) Forwarding of the list of observations to FINMA

B. On-site assessment

(viii) Discussion of individual observations with FINMA

(ix) Meeting with Swiss banks, and regulatory auditors

(x) Assignment of component grades and overall grade

(xi) Discussion with FINMA and revision of findings to reflect additional information received

(xii) Submission of the detailed findings to FINMA with grades

(xiii) Receipt of comments on the detailed findings from FINMA

C. Review and finalisation of the RCAP report

(xiv) Review of comments by the RCAP Team, finalisation of the draft report and forwarding to FINMA for comments

(xv) Review of FINMA comments by the RCAP Team

(xvi) Review of the draft report by the RCAP Review Team

(xvii) Review of the draft report by the Peer Review Board

(xviii) Reporting of findings to SIG by the team leader

Annex 6: List of deviations rectified by amendments to Swiss rules during the assessment period[58]

Basel paragraphs	FINMA paragraph(s)	Brief description of the difference	Paragraph(s) and changes made in the amendment to pertinent rule(s)
BIII, Capital, 53, footnote 12	CAO Art. 20-26, Circular 13/1 margins nos. 43-60	The team identified a deviation in terms of the capital instruments allowed under Basel III as CET1 for internationally active banks structured as joint stock companies (see section 2.3.1)	Basel III Para 53 stresses that for internationally active banks structured as joint stock companies the CET1 criteria must be met solely with common shares. FINMA will present a proposal to the Swiss Federal Council to change the CAO and express: For banks/financial groups under its supervision structured as joint stock companies and listed on the Swiss Stock Exchange or an equivalently regulated market FINMA would not intend to recognise capital instruments other than common shares as CET1.
BIII, Capital, 69-70	NA	The team has identified a deviation for the permission of netting of deferred tax liabilities (DTLs) (see section 2.3.1)	The CAO lacks concise guidance how this issue referred to in Basel III Para 69 should be addressed. For clarification a new margin no. 107a will be added to FINMA-Circular 13/1 with the following content: The DTLs permitted to be netted against DTAs must exclude amounts which have been netted in the process of identifying the exact amount of an asset to be deducted, eg goodwill, intangibles and defined benefit pension assets. Such DTLs must be allocated on a pro rata basis between DTAs subject to the threshold deduction treatment and DTAs that are to be deducted in full. FINMA will issue a revised update of its initial clarifications (through FAQs) in due course and update secondary legislation accordingly.
BIII, Capital, 75	CAO, Art 31, para 3, in conjunction with Circular 13/1, margin no. 147	In July 2012, the BCBS published a revised treatment of accounting valuation adjustments arising from the bank's own credit risk with regard to derivative liabilities in Basel III, Para 75. This issue is currently not implemented in Swiss rules (see section 2.3.1).	Para 75 (http://www.bis.org/press/p120725b.htm) is currently not yet reflected in Swiss regulation. The rule will be implemented according to the Basel III transitional provisions for regulatory adjustments, as stated in article 142 Swiss CAO. That is, the deduction from Common Equity Tier 1 of all accounting valuation adjustments to derivative liabilities arising from the bank's own credit risk will be phased in, starting with 20% in 2014 and rising by 20% per year thereafter until full deduction occurs from 1 January 2018. Hence, there is no practical issue for 2013. An amendment of the CAO

[58] This summary was composed by the Assessment Team based on input provided by FINMA. See www.finma.ch/d/faq/beaufsichtigte/Seiten/basel-III.aspx (in German) and www.finma.ch/f/faq/beaufsichtigte/pages/basel-iii.aspx (in French). The assessment team has been provided with an English translation of the publication.

Basel paragraphs	FINMA paragraph(s)	Brief description of the difference	Paragraph(s) and changes made in the amendment to pertinent rule(s)
			may be necessary as the new rule applies to all banks and not only to those applying the fair value option. Temporarily a new instruction in margin no. 147 of FINMA-Circular 13/1 shall require: With regard to derivative liabilities, derecognise all accounting valuation adjustments arising from the bank's own credit risk. The offsetting between valuation adjustments arising from the bank's own credit risk and those arising from its counterparties' credit risk is not allowed.
BIII, Capital, 78	CAO Art 32 (h)	The Assessment team has identified a deviation in terms of how indirect holdings in capital instruments are captured (see section 2.3.1).	The deviation will be clarified in FINMA Circular 13/1 via a new margin no. 121a as follows: In accordance with Para 80, footnote 26 of Basel III and Basel FAQ 15 (to Para 78–89) indirect holdings are exposures or parts of exposures that, if a direct holding loses its value, will result in a loss to the (reporting) bank/financial group substantially equivalent to the loss in value of the direct holding, ie when the change in value of the indirect exposure is narrowly correlated with the change in value of the direct investment in a capital instrument, such exposure is to be captured as indirect holding.
BIII, Capital, 78	CAO Art 52	The team has identified a need for clarification for CAO article 52, which deals with "potential future holdings as a result of contractual obligations to purchase own shares" (see section 2.3.1).	By now, FINMA has not identified a contractual obligation to purchase own shares outside the explicit examples enumerated in the net position calculation in CAO article 52. But for the avoidance of doubt a new margin no. 117a will be added to the FINMA-Circular 13/1 with the following content: In the calculation of the net position in accordance with article 52 CAO as regards own capital instruments the bank has to determine whether there is any other form of a contractual obligation to purchase own capital instruments in addition to the explicit examples given in the CAO and – where applicable – the bank has to account for such instruments. Some further need for clarification has been identified and will be clarified in public by FINMA.
BIII, Capital, 80-83	CAO Art. 36/37, and Art. 33	The team has identified a need for clarification for the treatment of any kind of exposure to the financial sector to capture direct, indirect and synthetic holdings for the application of the threshold deductions (see section 2.3.1).	FINMA will clarify this issue by redrafting of margin no. 118 in FINMA Circular 13/1 or by insertion of a new margin no. 118a. Since CAO article 52 para. 2 explicitly mentions "indirect and synthetic" as an alternative to the direct holding of an exposure, which is the implicit starting position of the paragraph in the CAO, it may formally not be appropriate to repeat the enumeration of these 3 exposures in article 36 for fear of duplication. In article 38 para. 2 the omission of synthetic holding (while addressing

Basel paragraphs	FINMA paragraph(s)	Brief description of the difference	Paragraph(s) and changes made in the amendment to pertinent rule(s)
			“direct” and “indirect” explicitly) is an oversight to be rectified.
BII, Para 54	CAO Appendix 2	For Banks not making use of external ratings, claims to the Swiss Sovereign have a fixed risk weighted of 0% irrespective of the exposure being denominated and funded in Swiss Franc (see section 2.3.3).	FINMA Basel III FAQ, but it is also envisaged to update CAO appendix 2: [A claim from the] Swiss Confederation, Swiss National Bank, European Central Bank, European Union (...) is subject to a 0% risk weighting] *provided that the claim is denominated and refinanced in the national currency.*
Paragraphs 60 – 64	CAO Article 66 para 1	No sovereign floor is imposed that would ensure that no claim on an unrated bank will receive a risk weight lower than that applied to the claims on its sovereign of incorporation (see section 2.3.3).	The sovereign floor has not been implemented in Swiss regulation due to an oversight. Its implementation is foreseen by means of a new para. 3 in article 68 of the CAO: Article 68 Banks and Securities Dealers Claims against banks with no external rating (with the exception of short-term self-liquidating letters of credit in trade finance[59)] may not be given a risk weighting lower than that of claims against the sovereign state in which they are incorporated.
BII, Para 82 – 89	CAO Appendix 1	Paragraph 82 to 89 not that explicitly set out (see section 2.3.3).	FINMA Basel III FAQ foresees the following changes: CAO appendix 1, point 1.3 added *Short term self-liquidating letters of credit from commodity trades (eg documentary letters of credit secured by the delivery in question).* CAO appendix 1, point 5.1 added Transaction-specific contingent liabilities (eg performance and bid bonds, product guarantees and standby letters of credit related to specific trades) CAO appendix 1 point 5.2 added Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) CAO appendix 1, point 6.1 added Direct credit substitutes, eg general loan guarantees (including standby letters of credit serving as financial security for loans and securities) and acceptances (including endorsements that have the character of acceptances) Remarks added to CAO appendix 1:

[59] See BCBS 205, page 4 (www.bis.org/publ/bcbs205.pdf).

Basel paragraphs	FINMA paragraph(s)	Brief description of the difference	Paragraph(s) and changes made in the amendment to pertinent rule(s)
			1. Other contingent liabilities (under 6.2) include in particular • Repurchase transactions and sales claims with a recourse option and credit risk remaining with the bank • the lending and depositing of securities as collateral as well as repurchase and similar transactions involving securities (repos, reverse repos and securities lending) • forward sales, forward deposits and partially paid-up equity and other securities representing commitments that are certain to be taken up 2. If a commitment is made to provide an off-balance-sheet position, the bank can apply the lower of the two applicable credit conversion factors.
BII, Para 95	N/A	Paragraph 95 is not included in FINMA Circular 08/19 (see section 2.3.3).	FINMA Basel III FAQ foresees the following changes: Margin no 15.1 added Banks must disclose which rating agencies they use for risk-weighting their positions. The details of each recognised rating agency they select shall be broken down according to the type of claim, the risk weight assigned to each rating under the procedure permitted for this purpose and the total sum of risk weighted positions for each risk weighting.
BII, Para 105	N/A	Paragraph 105 not included in FINMA Circular 08/19 (see section 2.3.3).	FINMA Basel III FAQ foresees the following changes: FINMA Circular 08/19, Margin no 13.1 added • The basic treatment of short-term loans- as outlined in CAO Appendix 2 number 4.1 - applies to all claims against bank with an initial maturity of up to three months, provided no specific short-term rating exits • Where a short-term rating does exist and results in more advantageous (ie lower) or identical risk weightings than the basic treatment according to CAO Appendix 2 number 4.1, the short term rating should only be applied to the specific loan in question. Other short-term liabilities shall be subject to the basic treatment according to CAO Appendix 2 number 4.1 Where a specific short-term rating results in less advantageous (ie higher) risk weightings for a short term claim against a bank, the basic treatment of short term interbank loans according to CAO Appendix 2 number 4.1 may not apply. All unrated short-term loans are then given the same risk weighting, which corresponds to the specific short-term rating

Basel paragraphs	FINMA paragraph(s)	Brief description of the difference	Paragraph(s) and changes made in the amendment to pertinent rule(s)
BII, Para 185	FINMA Circular 08/19 margin 131	For collateralised transactions, a 0% risk weight can be applied to gold where the exposure and collateral are denominated in the same currency (see section 2.3.3).	FINMA Basel III FAQ foresees the following changes: FINMA Circular 08/19, Margin no 131 amended The words "or gold" are to be deleted from margin 131
BII, Para 197	N/A	Para 197 is not included in FINMA Circular 08/19 (see section 2.3.3).	FINMA Basel III FAQ foresees the following changes: FINMA Circular 08/19, Margin no 232.1 added Materiality limits for amounts below which no payment is made in the event of a loss constitute retained first-loss positions and must be risk weighted at 1250% by the bank obtaining the hedge protection
BII, Para 199	N/A	Para 199 is not included in FINMA Circular 08/19 (see section 2.3.3).	FINMA Basel III FAQ foresees the following changes: FINMA Circular 08/19, Margin no 232.2 added Where the bank transfers some of the risk of a loan to one or more protection providers in one or more tranches, retaining some of the risk itself, and the transferred and retained risks are not equal rank, the bank may recognise hedge protection for either the senior tranches (eg second loss tranche) or the subordinate tranches (eg first-loss tranche). In this case, the provisions of section XIV (securitisation transactions) apply.
BII, Para 340-358	FINMA Circular 08/19 margin nos. 353-370	Treatment of equity exposures under IRB: Why did the Swiss IRB equity implementation differ from Basel standards? (see section 2.3.4).	"This has historical reasons and was driven by the wish to have a consistent reporting framework and consistent RWA computation infrastructures for Swiss banks operating in the EU and for foreign subsidiaries of EU banking groups. Following the Basel pure implementation principle the rules for equity exposures under the IRB will be made fully consistent with the Basel standards, thereby replacing the currently implemented rules that follow the EU's implementation of Basel II. As usual this will be done by a reference to the Basel text. In this context it will also be clarified that under Basel III the capital charge for expected losses is to be based on a risk weighting (replacing the capital deduction treatment under Basel II)." Further, FINMA has contacted the bank most affected by this change ahead of disclosing the FAQ, to explicitly inform them about the change in regulation and to grant a meaningful transition period.
BII, Para. 712 (iii) to 712 (viii)	FINMA circular 08/20,margins 94.1-94.10 and margin 227	Margin 94.10 refers to deduction of capital, while Basel III foresees a capital charge of 100%. (see section 2.3.7).	The wording "it must deduct that position from capital" in margin no. 94.10 of FINMA-Circular 08/20 will be replaced with *"a capital charge of 100% applies"*. Margin no 227.1 of FINMA-Circular 08/20 will be amended as follows:

Basel paragraphs	FINMA paragraph(s)	Brief description of the difference	Paragraph(s) and changes made in the amendment to pertinent rule(s)
		Margin no. 227.1 of FINMA-Circular 08/20 cannot be applied for non-rated nth-to-default credit derivatives (see section 2.3.7).	For *rated* first-to-default, second-to-default and nth-to-default credit derivatives, the capital charge for specific risks needs to be calculated pursuant to *margin nos. 94.1 to 94.5. Non rated nth-to-default credit derivatives receive a capital charge of 100%.*
BII, Para 718 (Lxxvi)	FINMA Circular 08/20 margin nos. 291-296.2	The team has identified a deviation in terms of the weighting scheme to daily observations for the stressed VaR calculation (see section 2.3.7).	The following sentence will be added to the end of margin no. 296.1 of FINMA-Circular 08/20: *Different weightings for daily observations are not permitted when calculating the stressed VaR.*
BII, Para. 718 (Lxxxvii)	FINMA Circular 08/20 margin nos. 230.1-230.2, margin nos. 275-283, attachment 13 and 14	Government bonds are subject to the IRC (see section 2.3.7).	The following footnote is to be added to margin no. 283: *According to "Interpretative issues with respect to the revisions to the market risk framework, November 2011", issue 2.1.5, government bonds must also be included in the IRC.*
BII, Para 718 (cii)	FINMA Circular 08/20 margin nos. 352, 320-335	Clarification is needed as to whether FINMA can withdraw a model approval in case of more than 10 back testing exceptions (see section 2.3.7).	The following sentence is to be added to the end of margin no. 334 of FINMA-Circular 08/20: *In the event of serious problems in connection with the underlying integrity of the model, FINMA reserves the right to revoke its permission to calculate capital adequacy requirements using the model-based approach.*
BII, Para. 718(cviii)-718(cix)	FINMA Circular 08/20 margin nos. 32-46, 46	Margin no. 32 of FINMA-Circular 08/20 does not refer to pricing capacity of banks in periods of stress. Also, margin no. 32 does not refer to banks' capacity to valuate positions in times of market interruptions and illiquidity (see section 2.3.7). Clarification is needed as to whether banks have to use third party valuations when checking whether valuation adjustments are necessary, which is also relevant for model valuations (see section 2.3.7).	The following text is to be added to margin no. 32 of FINMA-Circular 08/20 (to account for this oversight): *The bank must possess sufficient capacity to ensure prudent and reliable valuations, even in periods of stress. A bank must have the capacity to employ alternative valuation methods if the input values and rates required for valuation are not available due to illiquidity or market interruptions.* The following text will be added to margin no. 46 of FINMA-Circular 08/20: *Third-party valuations should be used to assess whether valuation adjustments are necessary. This also applies to model valuations.*

Annex 7: Areas for further guidance from the Basel Committee

The following deviations were not considered for the assessment as guidance is required from the Basel Committee:

- FX issue
  - Basel II, Para 70: Low value of individual exposures due to FX issue
  - Para. 273-74: Definition of SMEs: FX rate issue
- Capital
  - CET1: Para 52/53: Margin no. 21 of Circular 13/1 raises a general concern. There might be a potential conflict regarding the application of the paid-up criterion in Criterion 11 and if an effective availability of own capital can still be seen as warranted when granting a loan against collateral that knowingly consists of own capital instruments, especially common shares, as it can be the case with the business of Lombard lending.
  - T2: Continued treatment to recognise certain unrealised gains on AfS assets only partially in T2 instead of fully recognising them in CET1[60], although para. 57 does not list such an item to be recognised.

[60] Resulting in a super-equivalent treatment.

Annex 8: List of issues for follow up RCAP assessments

The Assessment Team identified the issues listed below for follow-up assessments:

1. Related to Basel III implementation in Switzerland

   (a) All issues subject to rectification (Annex 6)

   (b) Transition of banks under the SSA to the IA

   (c) Assessment of potential materiality:

   (c1) Additional evidence would be required for the assessment of the impact of the treatment of defaulted assets under paras 272, 328 to 330, 471 of Basel II to come to a final judgement on the potential materiality of LGDs

   (c2) The materiality of a few issues considered potentially material for capital can be determined after the first consolidated capital reporting to FINMA (based on end June 2013 data) will be available by August 2013 (see section 2.3.1)

2. Issues subject to finalisation of international standards

   (a) Basel III capital rules (Para 142-145): Bank specific countercyclical buffer once implemented by BCBS

   (b) G-SIB additional loss absorbency requirements once implemented by BCBS

Annex 9: Key financial indicators of Swiss banking system

Overview of Swiss banking sector and implementation of Basel rules — Table 5

Size of banking sector	
Banking System Assets/Total financial system assets	87%
Total assets all banks (CHF, bn)	3,845
Total assets of internationally active banks (CHF, bn)	3,182
Total capital of internationally active banks (CHF, bn)	144
Number of banks	
Number of banks	322
Number of internationally active banks	98
Number of Global Systemically Important Banks (G-SIBs)	2
Capital standards under the Basel framework	
Number of banks required to implement Basel-equivalent standards	322
Use of different approaches by banks	See Table 6
Capital adequacy (internationally active banks, as per 31 December 2012)	
Total capital (CHF, bn)	144
Total Tier 1 capital (CHF, bn)	127
Total CET1 capital (CHF, bn)	121
Total risk-weighted assets (CHF, bn)	826
RWAs for credit risk (Per cent of total RWAs)	62%
RWAs for market risk (Per cent of total RWAs)	14%
RWAs for operational risk (Per cent of total RWAs)	16%
Total Bank Assets (CHF, bn)	3,182
Total off-balance sheet bank Assets (CHF, bn)	651
Capital Adequacy Ratio (weighted average)	17.4%
Tier 1 Ratio (weighted average)	15.3%
CET1 Ratio (weighted average)	14.6%

Source: FINMA, January 2013

Switzerland: Overview of Basel rule implementation in Switzerland

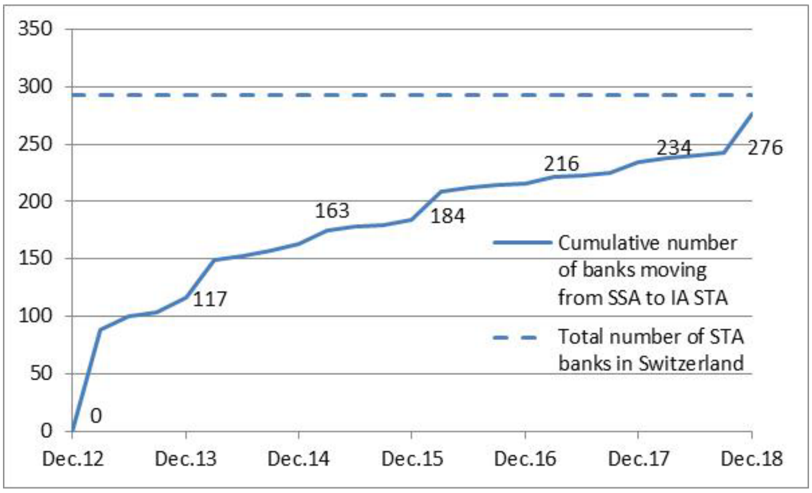
Table 6

Capital			First implemented in
PON	Contractual approach		2013
Pillar 1	SSA or IA	Internal Model approach	
Credit Risk[61]	SSA: 244; IA: 23	IRB: 6	2008
Equity risk in the banking book		Simplified risk weight method: 6 PD/LGD approach: 0	2008
Market Risk[62]	De Minimis: 176 SSA: 88; IA: 23	IMA: 5	1998
Operational Risk[63]	BIA: 252; STA: 22	AMA: 2	2008
Non-counterparty related risks	SSA: 244 ; IA: 29	Not applicable	
CCR	CEM SSA: 244; CEM IA: 25 SM: 0	IMM: 3	2008
CVA	SSA: 244; IA: 22	Advanced Method: 2	2013

Source: FINMA

Note: totals per line are not always the same due to missing data in some cases. The notion of IA as used throughout this report also covers the Internal Model Approach.

Figure 1: Expected transition of SSA banks to IA STA



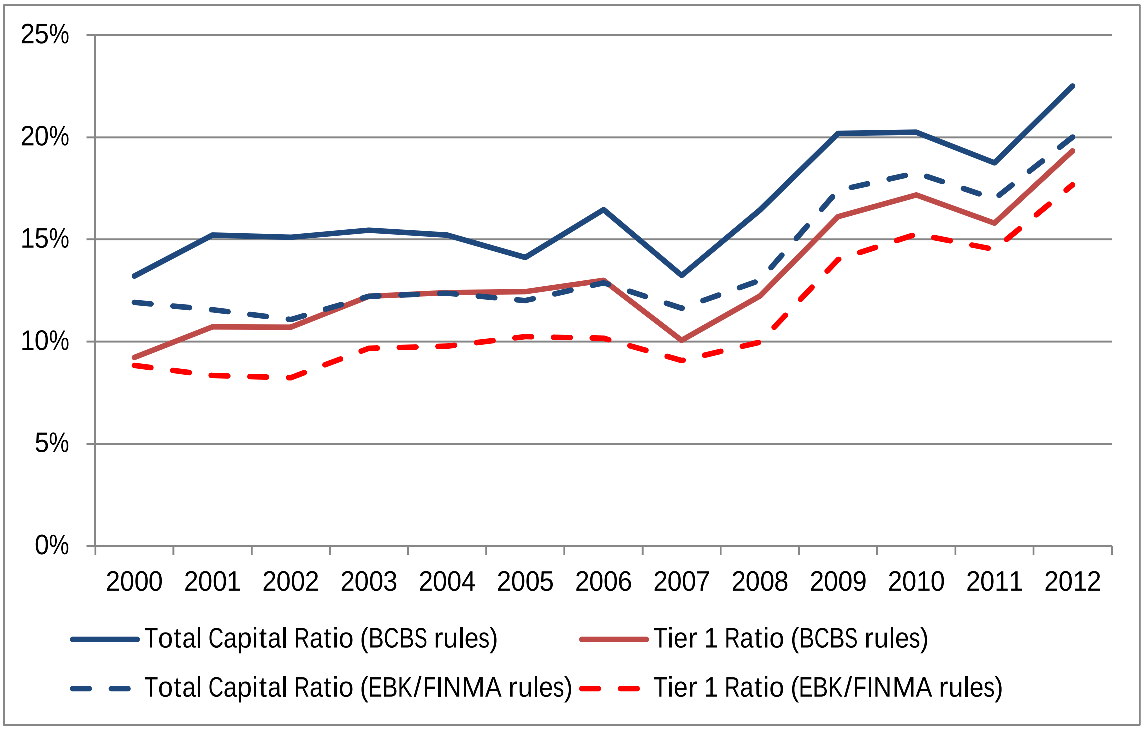
Source: FINMA, based on a survey

61 The difference to the 322 banks is made up mainly by branches and some special cases (incl. singular cases of missing data with respect to the approach used).

62 The difference to the 322 banks mentioned above is made up by branches and a large share of institutions eligible to use the de minimis approach to market risk, ie the banks (ie some 200 banks) not using either an internal model or the standardised approach for market risk use the de minimis approach and singular cases of missing data with respect to the approach used.

63 The difference to the 322 banks is made up mainly by branches and some special cases (incl. singular cases of missing data with respect to the approach used). The few missing data items do explain also why the totals of banks for credit vs market vs operational risk approaches differ slightly, eg 273 banks (credit risk) vs 276 banks (operational risk).

Figure 2: Evolution of capital ratios of the Swiss RCAP sample banks (weighted average)



Source: FINMA

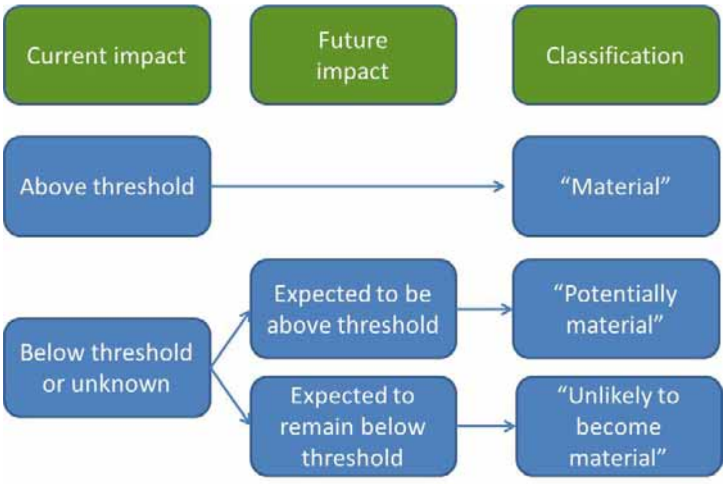
Note: the smaller gap at the start of the time series (ie in 2000) is due to missing data

Annex 10: Materiality assessment

The assessment of materiality distinguished between quantifiable and non-quantifiable gaps. For the Swiss RCAP, an attempt was made to quantify the impact of all quantifiable gaps for each bank affected by the gap. 16 gaps were assessed based on bank data, while 10 other gaps were quantified using data available to FINMA. In those cases where the computation of the impact was not straightforward, the computation erred on the conservative side. In the area of capital definition, there was no data to quantify most gaps – mainly as they are potential issues. Hence, the review team relied on expert judgement.

As shown below, an attempt was made to determine whether gaps are "material", considering both the current impact on potential materiality. In the latter case, the team distinguished between gaps that were considered "unlikely to become material" and potentially material gaps.

Figure 3: Classification of quantifiable gaps



The table below gives an overview of the number of gaps classified as non-material, material and potentially material by component.

Number of gaps by component Table 7

Component	Non-material	Material	Potentially Material
Scope of Application	IA: 3 SSA: 4	0	0
Transitional Arrangements	2	0	0
Definition of capital	(10)	0	(4)
Capital buffers	6	0	0
CR: Standardised Approach	IA: (11) SSA: 10	0 3	0 0
CR: IRB	4	(1)	6
Securitisation	0	0	0
Counterparty Credit Risk	IA: 3 SSA: 1	0 2	0 0
MR: Standardised Approach	IA: (3) SSA: (3)	0	0 0
MR: IMA	(4)	0	(2)
OR: SA/BIA	0	0	0
OR: AMA	0	0	0
Pillar 2	0	0	0
Pillar 3	3	0	1
Total	IA: (49) SA: (18)	IA: (1) SA: 5	IA: (13) SA: 0

Note: materiality is defined based on quantitative thresholds (for the quantifiable gaps) or expert judgement (for the non-quantifiable gaps). Numbers of parenthesis indicate that some of the gaps were rectified.

Cumulative impact of findings on banks' Tier 1 ratios Table 8

Component	Average impact (basis points)	Maximum impact (basis points)
IA STA	1	4
SSA	63	91
IA IRB	4	5

Note: The impact was normalised to 10%, ie for a tier 1 ratio of 15% and a computed impact of 15 basis points, the assigned impact would be 10 basis points. Rectified issues were removed.

Materiality of gaps for Credit Risk, IA STA

Table 9a

Component		Average impact on RWAs	Maximum impact on RWAs	Average impact on Tier 1 ratios (basis points)	Maximum impact on Tier 1 ratios (basis points)
Para 69f granularity		0.1%	0.1%	0.3 bps	0.3 bps
Para 160f Haircut		0.1%	0.1%	0.5 bps	0.6 bps

Note: The impact was normalised to 10%, ie for a tier 1 ratio of 15% and a computed impact of 15 basis points, the assigned impact would be 10 basis points. Rectified issues are not shown.

Materiality of gaps for Credit Risk, SSA

Table 9b

Component	Average impact on RWAs	Maximum impact on RWAs	Average impact on Tier 1 ratios (basis points)	Maximum impact on Tier 1 ratios (basis points)
Para 60f sovereign floor	0.5%	0.7%	3.1 bps	3.8 bps
Para 60f residual maturity	2.1%	3.6%	12.6 bps	21.8 bps
Para 74f CRE	1.7%	3.3%	12.2 bps	26.9 bps
Para 82 CCF	0.3%	0.7%	2.0 bps	4.2 bps
Para 145 CRM Lombard	0.0%	0.0%	0.4 bps	0.4 bps
Para 145 CRM Life insurance	1.2%	3.2%	7.2 bps	19.5 bps
Para 160f Haircut	0.3%	0.3%	2.5 bps	2.5 bps
Para 166 Repo	2.5%	6.0%	19.0 bps	47.7 bps

Note: The impact was normalised to 10%, ie for a tier 1 ratio of 15% and a computed impact of 15 basis points, the assigned impact would be 10 basis points.

Materiality of gaps for Credit Risk, IRB

Table 10

Component	Average impact on RWAs	Maximum impact on RWAs	Average impact on Tier 1 ratios (basis points)	Maximum impact on Tier 1 ratios (basis points)
Para 231f Lombard	0.3%	0.3%	1.7 bps	2.3 bps
Para 244f. TBTF Liquidity	0.1%	0.2%	0.9 bps	1.3 bps
Para 244f. IRB Rollout	0.6%	0.6%	3.6 bps	3.6 bps

Note: The impact was normalised to 10%, ie for a tier 1 ratio of 15% and a computed impact of 15 basis points, the assigned impact would be 10 basis points. Rectified issues are not shown.