Circular 2013/1 Eligible capital - banks

Eligible Capital at Banks for Regulatory Purposes

KPMG

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Addressees

BA			ISA			SESTA	FMIA						CISA									AMLA			OTHERS	
Banks	Financial groups and congl.	Other intermediaries	Insurance companies	Ins. groups and congl.	Intermediaries	Securities dealers	Trading Venues	Central Counterparties	Central depositories	Trade repositories	Payment systems	Participants	Fund management companies	SICAV	Limited partnerships for CIS	SICAF	Custodian banks	Managers domestic CIS	Distributors	Representatives of foreign CISs	Other intermediaries	SROs	DSFIs	SRO Supervised	Audit firms	Rating Agencies
X	X					X																				

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I. Subject matter

The present circular shall:

- define implementing provisions for banks, securities firms and financial groups ("banks") from a general perspective as described in the 2nd Title of the Capital Adequacy Ordinance (CAO; SR 952.03) regarding eligible capital. 1*

- include special requirements for banks that prepare their financial statements using internationally recognized financial reporting standards approved by FINMA ("internationally recognized standards"). 2

A. Companies to be Consolidated for Regulatory Purposes

The consolidated calculation of required and eligible capital shall be based on the regulatory scope of consolidation in accordance with Articles 7– 9 CAO. 3

B. Eligible Capital for All Banks

Margin nos. 11–121 of the circular shall contain implementing provisions related to the 2nd Title of the Capital Adequacy Ordinance, Eligible Capital. 4

In addition to Title 2, the relevant terminology defined in Article 4(c)-(f) CAO in Title 1, General Provisions, must be taken into account. 5

C. Special Requirements for Banks Using Internationally Recognized Reporting Standards

According to Articles 65 and 81 in conjunction with Article 3(1) of the FINMA Accounting Ordinance, banks shall be allowed to prepare their financial statements under the rules set by the International Accounting Standards Board (IFRS/IAS) or the Generally Accepted Accounting Principles of the USA (US GAAP). 6 *

The recognized standards may only be used for consolidated financial statements and potential supplementary single-entity financial statements. 7

According to Article 31(3) CAO, FINMA shall be authorized to issue guidelines for the calculation of the required and the eligible capital if a bank prepares its financial statements under a recognized standard. 8

II. Scope of application

The following scopes of application shall apply to the individual parts of this circular:

- Part 1 – Eligible capital for all banks at single-entity and consolidated level; and 9

- Part 2 – Special requirements for banks using internationally recognized standards that are domiciled in Switzerland and prepare their financial statements in one of the internationally recognized standards specified in margin no. 6. 10

Part 1 Eligible Capital for All Banks

III. Principles

Only capital components of the highest qualitative standard of a bank shall be allocated to Common Equity Tier 1 (CET1) (equity shares as defined in Article 4(d) CAO). 11

Quality, as defined in margin no. 11, shall be measured according to the capital's characteristics of senior loss absorption during on-going operations. 12

Should a bank claim two or several different equity shares as CET1, this shall require that these shares be treated equally regarding profit and loss sharing (also in the event of a liquidation). 13

For FINMA-supervised banks and financial groups that are organized as public limited companies (in German: AG) and whose common stock is listed on a Swiss stock exchange or foreign stock exchange (with a supervision that is equivalent to that of the Swiss one), no other instruments of the company capital apart from the common stock shall be eligible as CET1. 13.1*

The FINMA may demand that a bank prove the correct allocation in a specific capital component as defined in Article 18 CAO. 14

Equity shares that do not qualify as CET1 of a bank must be allocated to Additional Tier 1 capital (AT1) or to Tier 2 capital (T2), provided they meet the necessary requirements. 15

Margin nos. 11–15 do not exclude elements outside the share capital (Article 21(1)(b)-(e) and (2) CAO) from being eligible as CET1 capital. 16

If premiums on the nominal value of a share capital component (additional paid-in capital) are added to a bank's statutory capital reserves without restriction or ring-fencing, it shall be eligible as CET1, regardless of the capital quality of that specific instrument. 17

IV. Funding of Equity Instruments at the Time of Issue

According to Article 20(2)(a) CAO, issuing own equity instruments does not satisfy capital adequacy requirements if the bank itself finances the investors investing in these securities. 18

Generally, the period of issue shall be decisive. The CAO does not permit situations where a bank can only issue capital instruments (in part or in full) if simultaneously, it makes a significant quantity of funds available to investors who will invest them in these securities. 19

Should the FINMA identify such funding by a bank, the equity instrument shall not be eligible to the extent of the financing until the bank has terminated the credit relationship with the relevant investor. 20

Granting a loan to a bank customer against collateral consisting of own, already issued capital instruments as is considered customary in banking, does not constitute funding of own capital instruments at the time of issuance. 21

V. Participation capital

Share capital in the form of participation capital shall be considered to be a capital component as per margin nos. 11–15. 22

No explicit contractual clauses regarding loss absorbency (conversion or debt reduction) as per Article 27(3) CAO must be stated if participation capital qualifies as Additional Tier 1 capital (AT1). 23

The exemption stated in margin no. 23 does not exempt the participation capital from loss absorbency in case of an impending insolvency (Article 29 CAO, PONV). 24

VI. Profits of the Current Year

A bank may include interim profits (on a quarterly or a semi-annual basis) in its CET1 by applying Article 21(1)(e) CAO, provided it fulfills the requirements stipulated in the Ordinance. 25

The requirement of a critical assessment of the income statement as a prerequisite for the regulatory recognition of interim profits shall take into consideration the fact that, in practice, the external auditor does not perform a full audit of the interim financial statements. 26

In accordance with the Ordinance, an estimated stake set aside for dividends must be deducted pro rata from interim profits. 27

An expected profit distribution shall be determined based on explicit evidence such as, in particular, the distribution practice in previous years or the bank's planning. 28

The fact that the interim profit's eligibility is reduced for regulatory purposes does not oblige the bank to actually pay a dividend. 29

VII. Capital Components of Minority Interests

The consolidated capital calculation shall show the capital components held by minorities if third parties hold parts of the regulatory capital of an entity that is fully consolidated (subsidiary). 30

Article 21(2) CAO stipulates that in order for the subsidiary to be recognized as a regulated entity as per Article 4(c) CAO, it shall show operational activity. 31

Non-affiliated investors in a subsidiary shall be considered third parties. As such, they may not be affiliated with a super-ordinated bank or a bank's holding company of the subsidiary, by holding voting rights or capital either directly, indirectly or otherwise. 32

Affiliated investors of a subsidiary shall be companies that are subsumed under common management with the super-ordinated bank or the bank holding company by a majority in voting rights or by other means. 33 *

As a prerequisite for minority interests to be eligible on a consolidated level, the following shall apply:

- had they been issued by the bank itself, they would be considered to be part of its CET1 capital and 34
- they are eligible in the subsidiary itself. 35

In contrast to the determination of minority interests for accounting purposes, regulatory eligibility is given only to the extent that the minority interests in the subsidiary do not constitute excess capital. 36

Minority interests that exceed the capital requirements defined in Article 41 CAO shall not be eligible. 37

The capital requirements stated in margin no. 37 shall be calculated based on the lower requirements of: 38

- local provisions applicable to the subsidiary; or 39
- consolidated provisions applicable to the bank/financial group for the subsidiary's risks. 40

When calculating the consolidated capital at the level of the financial group, the same principle for minority interests in Common Equity Tier 1 in accordance with Articles 27(6) and 30(3) CAO shall also apply to shares in other regulatory capital (AT1 and T2) in consolidated subsidiaries. 41

The provisions on minority interests are not intended to restrict the recognition of Additional Tier 1 Capital or Tier 2 capital issued by a special purpose vehicle (SPV) and transferred within a group. 42

VIII. Capital Components of Non-Stock Corporations

The definition of the eligible capital in the CAO shall depend mainly on the legal form of stock corporations. These criteria shall also be applicable to non-public limited companies, taking into account their specific legal form and the characteristics of their share capital (Articles 22(3)) and 23(2) CAO). 43

A. Cantonal Banks and other Banks in the Legal Form of an Entity under Public Law

The state guarantee currently provided to a large number of cantonal banks and other banks under public law may not be included in the banks' calculation of the regulatory capital because Article 20(1) CAO stipulates as a prerequisite that capital must be fully paid in. 44

The eligibility of endowment capital of banks under public law as CET1 shall require that: 45

- it be made available to the bank for an unlimited period; 46
- it be the first to absorb losses; and 47
- the bank is not obliged to pay dividends to the owner. 48

If cantonal banks and other banks subject to public law dispose of participation capital apart from 49

endowment capital and share capital, its eligibility shall be determined in accordance with margin nos. 13–15 and 22–24 of this circular.

B. Private Bankers

Private bankers as per the Banking Act (BA, SR 952.0: single proprietorship, general and limited partnerships) shall be characterized by the unlimited liability of at least one of their partners. The amount subject to unlimited liability does not qualify as regulatory capital, as it does not meet the basic prerequisite of Article 20(1) CAO that stipulates that capital must be fully paid in. 50

The CAO stipulates that for private bankers two capital components shall be eligible as CET1: the limited-partner contribution and the capital contributed by the general partner. 51

At the time when the FINMA approves a partnership (Article 25(1)(a) CAO), it shall also review the regulatory quality of the capital components. 52

If, specifically in the case of a going concern, the limited-partner contribution has to absorb losses only after capital contributions, it shall be considered AT1. 53

According to Article 30(4)(b) CAO, capital contributions of general partners that do not meet CET1 capital requirements shall be considered Tier 2 capital (cf. margin nos. 104 and 105). 54

A preferential dividend for CET1 capital contributed by partners shall be permitted if this compensates the unlimited liability. 55

C. Cooperative Capital

Banks organized in the legal form of cooperatives that consider participation certificates as CET1, in principle shall draw up their articles of incorporation in accordance with the CAO's requirements for CET1 capital. 56

Article 26 CAO describes the FINMA's minimum requirements imposed on capital, taking into account the laws governing cooperatives. 57

Cooperatives must be organized in such a manner that they can meet the requirements for CET1 capital, which means that the bank can deny the repayment of CET1 capital to owners. 58

If a cooperative bank wishes to grant its members only a limited liquidation share, such a provision may not be made for the benefit of other members of the cooperative, another group of shareholders or other investors. 59

Dividends to holders of participation certificates may only be limited by the articles of incorporation if a corresponding provision does not oblige the bank to pay a dividend. 60

IX. Capital Instruments with Conditional Conversion Rights or Debt Waivers

A. Background

The CAO shall basically treat bonds with conditional debt waivers in the same way as capital instruments with conditional conversion rights. 61

At a time of impending insolvency (PONV, Article 29 CAO and margin nos. 79-94) both forms of loss absorbency stated in margin no. 61 shall be permitted. 62

Outside of a PONV, only obligations related to Additional Tier 1 capital must be able to absorb specific losses (at the latest when the CET1 share falls below 5.125%). 63

A contractual definition of a loss absorbency for Tier 2 capital instruments outside a PONV shall be permitted. 64

B. Eligibility as Regulatory Capital

According to Article 20(4) CAO, the eligibility of capital instruments with conditional conversion rights or a debt waiver shall depend on their regulatory quality without considering their specific loss absorbency qualities. 65

Whether or not capital instruments with conditional convertibility or a debt waiver are eligible to cover additional capital requirements for institutes other than the systemically important banks as per art. 20 para. 4 lit. a CAO was not clarified in FINMA circ. 11/2 "Capital Buffers and Capital Planning - Banks". 66

C. Scope of Debt Waivers and Conversions

A conditional debt waiver concerning AT1 or T2 debt instruments must allow for a complete debt reduction (in relation to the nominal value). 67

As a rule, this shall entail a full conversion or a complete debt reduction. 68

As an exception, FINMA may grant a partial conversion or debt reduction. 69

D. Share of Improvement After a Debt Waiver

Article 27(4) CAO foresees that capital instruments with a conditional debt waiver may also contain a contractual clause entitling these to a deferred conditional participation in an improvement of the bank's financial situation. 70

When reviewing requests defined in Article 27(5)(b) CAO, FINMA shall take into consideration the degree of international acceptance of capital instruments with claims in a company's financial improvement. 71

If it is to be expected that the valuation of a claim to improvement after a debt reduction will result in a 72

substantial obligation for the bank, this amount must be deducted from the regulatory capital as of the date of issuance.

When approving the improvement, FINMA shall specifically review:

- whether the prerequisites stipulated by company law for the conditional granting of such claims are fulfilled; 73
- the amount of the claim; 74
- the structure of the claim, specifically the earliest date of implementation of an improvement, the degree of complexity and the maximum duration of a claim; and 75
- the viability for the bank at the time of the distribution. 76

E. Treatment of Adjustments

Capital instruments in financial sector companies with conditional conversion rights or debt reduction outside of a PONV shall be treated using the applicable deduction approach for equity instruments at the thresholds (Articles 36-38 and 40 CAO) according to their characteristics before conversion or debt reduction. 77

F. Repealed

Repealed 78*

X. Contractual Provisions at the Time of Impending Insolvency (Point of Non-viability, PONV)

A. General aspects

According to Articles 29 CAO (AT1) and 30(3) CAO (T2), capital instruments must contractually provide for loss absorbency to contribute towards the restructuring of the bank/financial group at the time of impending insolvency (point of non-viability, PONV). 79

Similar to conditional capital instruments, and depending on the contractual arrangement, CET1 at a PONV shall be created by: 80

- converting into share capital; or 81
- triggering a full debt reduction. 82

At the time of an impending insolvency (PONV), the debt reduction shall always be complete and no longer allow for a claim in the improvement of a bank's financial situation as per margin nos. 70-76. 83

B. Trigger Events

In accordance with the Basel Minimum Standards, Article 29(2) CAO stipulates that a PONV shall have taken place:

- before emergency financial aid offered by the government is drawn down; or 84
- if the FINMA deems it necessary in order to avoid an insolvency. 85

Acts by a public authority of a predominantly commercial character and which could have also been performed by a third party are not to be considered as a trigger event as per margin no. 84. 86

The decision to trigger the capital instruments to mitigate events in accordance with margin no. 85 shall require a subjective assessment by FINMA. 87

The triggering of a PONV even without drawing down governmental emergency financial aid shall aim at leveraging the potential of creating CET1 in the PONV, thus averting the bank's impending insolvency. 88

C. Special Aspects within a Financial Group

If a financial group issues capital instruments in a regulated subsidiary abroad, the regulatory authority of the host country may declare itself competent for triggering the PONV of the subsidiary. 89

If a Swiss bank issues AT1 and T2 through a subsidiary regulated abroad and if the assets are transferred to a domestic group unit using an internal capital instrument, FINMA may decide on their eligibility at the consolidated level. However, the FINMA also take into account the host country's regulations regarding the PONV. 90

D. Ratio of External to Internal Capital Instruments

Requirements regarding the issuance by a non-operational SPV (Articles 28 and 30(3) CAO) demand that the internal capital instrument also include a contractual PONV clause, whereby the internal capital instrument shall have the quality of regulatory capital or higher. 91

If the external capital instrument foresees the conversion into CET1 share capital in the case of a PONV, the bank must ensure in the contractual clauses that the effect of a PONV in an internal capital instrument does not conflict with this. 92

Special attention is required if the PONV does not refer to the same company in the external and in the internal capital instrument. 93

If the conditional capital instrument foresees a conversion, the order of external and internal instruments in the event of a PONV must be defined in a way that the CET1 improvement occurs in the entity that was originally intended to be strengthened by the capital instrument. 94

XI. Components of Tier 2 Capital (T2)

A. Value adjustments

For exposures treated according to the SA-BIS, value adjustments for non-impaired exposures may be treated in accordance to Article 25 FINMA-AO and provisions in accordance to Article 28(6) FINMA-AO, as follows below: 95 *

- eligible as T2 capital either up to a maximum of 1.25% of the sum of the risk-weighted exposures for credit risk (in accordance with Article 49 CAO); or 95.1*

- netted with the corresponding asset or off-balance sheet items before these are risk weighted. The netting shall take place within the exposure categories in accordance with Article 63 CAO. If different risk weightings are applied to an exposure category, value adjustments and provisions shall be allocated proportionally. The parts shall correspond to each risk weighting in relation of the related unweighted exposures to the total of all unweighted exposures in that exposure category. In case of netting, the limit of 1.25% does not apply. The netted value adjustments and provisions may not be included in the T2 capital. 95.2*

Banks using a recognized international standard shall treat the value adjustments and provisions for default risks recorded in accordance with the respective standard in a similar way.[1] The value adjustments and provisions for default risks eligible for T2 capital may not be netted with the corresponding asset or off-balance sheet items for capital purposes. 95.3*

Banks using the IRB approach may allocate (within the scope of the IRB) a possible excess balance in value adjustments to T2 capital, subject to FINMA approval. 96

An excess balance shall exist if the value adjustments in accordance with the Basel Minimum Standards exceed the expected losses as calculated according to the IRB approach. 97

An excess balance shall be eligible only up to 0.6% of the positions valued according to the IRB. 98

B. Reserves

The following shall qualify as Tier 2 capital:

- hidden reserves in the item "provisions", provided they are disclosed in a separate account and identified as capital. Any deferred taxes shall be deducted if no specific provision was created for these; 99 *

- hidden reserves in the items "participations" and "tangible fixed assets". Any deferred taxes must be deducted if no specific provision was created for these; 100 *

- reserves in equity securities and bonds to be recognized according to the lower of cost or market principle in financial investment, up to 45% of unrealized profit. 101

[1] Value adjustments and provisions that according to IFRS 9 are in the so-called Levels 1 and 2 may generally be used to cover default risk of unimpaired exposures.

In its regulatory audit report, the external auditor shall confirm the eligibility as Tier 2 capital of the components in accordance with margin nos. 99 and 100. Banks must also report these amounts to the tax authorities at their own initiative. 102

C. Subordinated Debt of Cantonal Banks

Article 30 CAO shall also apply to cantonal banks if subordinated loans granted to the bank are not covered by a state guarantee, either by a creditor waiver or otherwise. 103

D. Capital Contributions of Fully Liable Partners Outside of CET1

In order for capital contributions of fully liable partners which do not fully meet the requirements of Article 25 CAO to become eligible as T2 capital, the following shall be required:

- that they meet requirements applicable to eligible capital as per Article 20 CAO; and 104

- that the bank deposits a written statement with the external auditors that commits the bank not to pay out any capital contributions to the partners if this infringes the requirements of Article 41 CAO or the applicable implementing rules of the FINMA. 105

XII. Adjustments

A. Deferred Tax Assets (DTA)

Deferred tax assets that depend on the bank's future profitability shall be deducted when calculating CET1 capital. 106

Offsetting DTAs with deferred tax liabilities (DTL) shall be permitted if the DTAs and DTLs refer to the same tax authority and the latter allows offsetting these. 107

DTL that may be netted with DTA shall exclude amounts that have already been included when determining the relevant amount pursuant to Articles 31(2) and 32 CAO, such as in the case of goodwill, intangible assets or recognized receivables held towards defined-benefit pension funds. 107.1*

If DTA are netted with DTL, their allocation must be proportional, i.e. they must be calculated on a pro-rata basis subject to thresholds (DTAs due to temporary differences as per Article 39(1)(b) CAO) on one hand, and on the other hand those DTA, which are subject to full deduction (DTA whose the realization depends on future profitability as per Article 32(d) CAO). 107.2*

The CAO shall differentiate between:

- the full deduction from CET1 capital (Article 32(d) CAO), specifically in relation to operational losses; and 108

- the deduction of amounts above a certain threshold (Article 39(1)(b) CAO) provided the DTA refers to temporary differences, such as in particular non-recognized adjustments for credit losses. 109

B. Various Deductions

Banks that treat software as an intangible asset due to the accounting standards applied must deduct it from the CET1 capital in accordance with Article 32(c) CAO. 110

Banks do not need to deduct contributions made to defined benefit pension plans (Article 32(g) CAO), provided the bank has unrestricted power of disposal over these assets at all times. 111

Unrestricted power of disposal over these assets (margin no. 111) does not exist, in particular, if the bank requires the approval of a body of the pension plan for this purpose. 112

On the other hand, a bank loan granted to the pension fund that does not permit the right to net (especially not with contributions to benefits) does not have to be deducted from CET1 capital. 113

The requirement to deduct from the CET1 capital all directly held participations in financial companies in the scope of consolidation (Article 32(j) CAO) applicable to the calculation of CET1 capital at stand-alone level shall prevent the multiple usage or allocation of regulatory capital at different levels in a financial group. Therefore, this deduction is not subject to a threshold. 114

Deductions arising from the deduction options selected by the bank in view of its consolidation rules (Article 32(k) CAO) shall result from the scope of consolidation defined for regulatory purposes in accordance with Articles 7-9 CAO. This step must take place before equity securities held in financial companies are considered. Therefore, this deduction is not subject to a threshold. 115

In the case of a bank's own capital instruments, the CAO differentiates between:

- treasury shares which must be deducted from the CET1 capital (Article 32(h) CAO); and 116
- other own capital instruments which are treated in the corresponding deduction approach (Article 34 in conjunction with Article 4(f) CAO). 117

When calculating its net position, the bank shall determine whether, in addition to the examples explicitly stated in Article 52 CAO, there are further contractual obligations to acquire own equity instruments and if necessary, include such instruments. 117.1*

Concerning derivatives, all value adjustments resulting from the bank's own credit risk must be deducted from CET1 capital. It is not permitted to offset value adjustments resulting from the bank's own credit risk with value adjustments based on counterparties' credit risk. 117.2*

C. Deductions in accordance with Thresholds

Equity instruments of entities in the financial sectors that are held directly, indirectly or synthetically – except for treasury shares (margin nos. 116 and 117), qualifying reciprocal holdings (Article 32(i) CAO) and the special provisions stated in margin nos. 114 and 115 – shall be subject to a deduction according to thresholds. 118 *

In doing so, the treatment of all capital instruments held in a company shall depend on the percentage of 119

equity shares in that company (Article 36 CAO).

All equity instruments of a company of which a bank holds:

- between zero and a maximum of 10 % equity shares shall be treated according to Threshold 1 (Article 37 CAO) 120

- or more than 10%, Articles 38–40 CAO shall become applicable and they are treated without thresholds in accordance with the relevant deduction (for AT1 and T2 instruments). CET1 instruments, on the other hand, shall be measured in two steps using Thresholds 2 and 3 and, if and necessary, deducted. 121

Indirect exposures shall be engagements or parts thereof that, in case of a value depreciation of the direct exposures, will cause a loss to the bank that on the whole is equal to the loss in the direct exposure. 121.1*

An indirect exposure must be recognized in the context of the deductions according to thresholds if the potential change in the value of such an exposure closely correlates with the change in value of directly holding that regulatory-capital instrument. 121.2*

Part 2 Special Requirements for Banks Using Internationally Recognized Reporting Standards

XIII. Additional Adjustments for Banks with Financial Statements based on Internationally Recognized Standards

According to Article 81 in conjunction with Article 3(1) FINMA-AO, banks may use the international accounting standards IFRS or US GAAP to prepare their consolidated financial statements. FINMA shall recognize the relevant consolidated financial statements as basis for the calculation of capital requirements as well as for risk diversification, subject to adjustments or corrections in accordance with margin nos. 123 or 135-143, respectively. 122 *

For regulatory purposes, the consolidated financial statements with the regulatory scope of consolidation as described in Article 7 CAO shall be of relevance. 123 *

The adjustments in accordance with margin nos. 135–143 shall be required as specific and recurring adjustments in order to reasonably limit the impact of unrealized profits on capital from a regulatory perspective. 124 *

FINMA may request detailed information (e.g. on the auxiliary documents for the reporting on financial instruments valued at fair value[2]) or, in the case of heavily fluctuating capital or large unrealized prof- 125 *

[2] www.finma.ch > Documentation > Circulars > Appendices

its, additional adjustments or more stringent requirements applicable to the bank's capital based on Article 4(3) BA or Article 45 CAO.

Repealed 126 *

XIV. Repealed

Repealed 127 *

XV. Adjustments in financial statements under IFRS

The adjustments shall be made in the corresponding capital components. 128 *

A. Repealed

Repealed 129*-131*

B. Repealed

Repealed 132*-133*

C. Repealed

The following adjustments must be made and documented in the capital adequacy report. 134 *

Moreover, the capital adequacy report shall provide an analysis of the impact of the adjustments on the scope of consolidation. 135 *

Trading portfolios and derivatives are not subject to recurring adjustments. 136 *

Subject to margin no. 125, as a rule no recurring adjustments must be made to other assets and liabilities if fluctuating values are recognized in the income statement. 137 *

The following adjustments shall be made on a recurring basis: 137.1*

- deduction of positive valuation differences contained in reserves and minority interests concerning equity securities, debt securities and other assets whose fair-value valuation directly influences other comprehensive income (OCI). 138 *
- deduction of unrealized gains and additions of unrealized losses in liabilities valued according to fair value (in the current and the previous years) based on the change in own credit ratings as recorded in OCI. 139 *
- deduction of positive valuation differences for investment properties recognized in the income statement that are included in the profits of the current year, in the reserves (including in the profits 140 *

carried forward) and in minority interests.

- deduction of positive valuation differences for other tangible assets included in the reserves and in minority interests recorded through OCI. 141 *

- Repealed 142 *

- deduction of profits and the addition of losses resulting from the valuation of cash-flow hedges recorded through OCI. 143 *

If the unrealized net profits (after taxes) are deducted from Tier 1 capital, the capital requirements of the corresponding assets may be calculated using the book value minus the unrealized gross profits (before taxes). 143.1*

However, if unrealized net losses (after taxes) are added back to Tier 1 capital, the capital requirements of the assets affected shall be determined by using the book value plus the unrealized gross losses (before taxes). 143.2*

Assets, liabilities and off-balance sheet transactions recorded in accordance with the standard cannot be subjected to an internal revaluation (with the exception of the adjustments mentioned in margin nos. 135-143 above) in order to reduce capital requirements or to increase eligible capital.[3] 144 *

The value adjustments and provisions for default risks that are now recorded due to the introduction of the expected loss approach may be included in CET1 capital for the transition period. The bank may choose this option only for the first-time application (i.e. implementation date), which then makes applicable the provisions in margin nos. 144.2-144.6. 144.1*

The amounts shall be recognized in accordance with the dynamic approach and after tax effects (also see Basel Committee prescriptions in its document "Regulatory treatment of accounting provisions – interim approach and transitional arrangements" dated March 2017). Any related DTA shall be exempted from treatment in accordance with Article 39 CAO because the positive recognition takes place after tax effects. 144.2*

The eligibility shall be reduced with a linear approach semi-annually until the end of 2022 at the latest for institutions under IFRS regime and 2024 or 2025 for those applying US GAAP (depending on the date of first application). Should the first-time application take place in 2018, the eligibility shall be as follows: 90% until 30 June 2018, 80% until 31 December 2018, 70% until 30 June 2019, 60% until 31 December 2019, 50 % until 30 June 2020, 40% until 31 December 2020, 30% until 30 June 2021, 20% until 31 December 2021, 10% until 30 June 2022 and 0% thereafter. 144.3*

For capital purposes, value adjustments and provisions for default risks recognized in CET1 capital are not eligible as T2 capital nor can they be netted with the corresponding asset or off-balance sheet items if applying the SA-BIS approach. In order to determine the exposures to be weighted, a bank may apply certain procedures stated in Article 473a(7)(b) in accordance with the Regulation (EU) 2017/2395 of the 144.4*

[3] For example: The liabilities disclosed in the balance sheet in connection with occupational pension schemes may not be subject to a positive regulatory adjustment. The same shall apply to leasing transactions similarly recognized in the balance sheet

European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on capital and for the treatment as large exposures of certain high-risk public-sector exposures denominated in the domestic currency of any Member State (ABl. L345 dated 27.12.2017, p. 27–33), whereas the percentages stated in margin no. 144.3 must be applied.

If an institution uses the IRB approach, a recognition in CET1 capital may only take place if the value adjustments and provisions calculated in accordance with the recognized international standard leads to an excess as per margin no. 97, i.e. if value adjustments and provisions exceed the expected losses calculated under the IRB approach. Only the excess resulting from value adjustments and provisions for default risks in accordance with margin no. 95.3 may be used as a basis for the decreasing eligibility. For the simplified calculation of the amounts to be recognized, the corresponding approach in the EU Regulation 2017/2395 as mentioned in margin no. 144.4 may be used, whereby the percentages stated in margin no. 144.3 must be used. For capital purposes, the value adjustments and provisions for default risks (after taxes[4]) recognized in CET1 capital may not be recognized as T2 capital. 144.5*

Banks shall disclose the application of these transitional provisions in their Pillar 3 reports. In doing so, the banks shall disclose the impact this has on their capital ratios and leverage ratios, as well as the capital ratios and leverage ratio that they would have had, had they not used the transitional provisions. 144.6*

XVI. Adjustments in financial statements under US GAAP

The adjustments are based on the ones used for IFRS financial statements. 145 *

Should there be any amendments to the US GAAP standard or the internal approach, the bank shall immediately contact FINMA to deliver information on the valuation principles applied to financial instruments. FINMA shall determine adjustments, if any. 146 *

Repealed 147*-154*

XVII. Using stand-alone internal financial statements based on recognized international standards

Articles 65 and 81 in conjunction with Article 3(1) FINMA-AO restrict the use of IFRS and US GAAP on true and fair view supplementary single-entity financial statements and consolidated financial statements. As such, companies shall continue to prepare statutory annual financial statements and the corresponding interim financial statements in accordance with the BO, the FINMA-AO and the FINMA circular 20/1 "Accounting – banks". As a rule, these financial statements shall form the basis of the calculation of eligible and required capital at the level of the individual institution. 155 *

[4] Only tax effects attributable to value adjustments and provisions that exceed expected losses calculated in accordance with the IRB approach must be taken into account.

FINMA shall examine justified requests for calculating the eligible and required capital on the stand-alone level based on figures that were issued using a recognized international standard and approve them in special circumstances. 156 *

XVIII. Repealed

Repealed 157 *

XIX. Audit

Audit firms shall audit the compliance with the provisions of this circular according to FINMA circular 13/3 "Auditing" and capture the findings of their audit procedures in their audit report. 158 *

XX. Transitional provisions

Repealed 159*-160*

For the 2020 financial statements, margin nos. 95, 95.3 and 144.5 in their version of 20.6.2018 may be used for valuation adjustments and provisions. 161*

List of amendments

The circular has been amended as follows:

These amendments were passed on 6 December 2012 and enter into force on 1 January 2013.

Amended margin no.	158

These amendments were passed on 18 September 2013 and shall enter into force on 1 January 2014.

Newly inserted margin nos.	13.1, 107.1, 107.2, 117.1, 117.2, 121.1, 121.2, 159
Amended margin nos.	118, 149
Repealed margin nos.	150

These amendments were passed on 27 March 2014 and enter into force on 1 January 2015.

Newly inserted margin no.	160
Amended margin nos.	6, 99, 100, 129, 146

These amendments were passed on 20 June 2018 and shall enter into force on 1 January 2019.

Newly inserted margin nos.	95.1, 95.2, 95.3, 137.1, 143.1, 143.2, 144.1, 144.2, 144.3, 144.4, 144.5, 144.6
Amended margin nos.	33, 95, 122, 123, 124, 125, 128, 134, 135, 136, 137, 138, 139, 140, 141, 143, 144, 145, 146, 155, 156
Repealed margin nos.	78, 126, 127, 129, 130, 131, 132, 133, 142, 147, 148, 149, 151, 152, 153, 154, 157, 159, 160

These amendments were passed on 31 October 2019 and shall enter into force on 1 January 2020.

Newly inserted margin no.	161
Amended margin nos.	1, 6, 95, 95.3, 122, 144.5, 155

The annexes to the circular were amended as follows:

This amendment was passed on 20 June 2018 and shall enter into force on 1 January 2019.

Repealed	Annex: Reporting In Application of the Fair Value Option

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