KPMG

Circular 2013/7 Limitation of Intragroup Positions – Banks

Limitation of Intragroup Positions for Banks

Unofficial translation issued in March 2016

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dated 29 May 2013

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2. Appendix: Form for detailed report not included

2 Other Languages

DE: Limitierung gruppeninterner Positionen – Banken

FR: Limitation des positions internes du groupe – banques

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Limitation of Intragroup Positions for Banks

Reference:	FINMA circ. 13/7 "Limitation of Intragroup Positions for Banks"
Issued:	29 May 2013
Entry into force:	1 July 2013
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Legal bases:	FINMASA Article 7(1)(b) BA Articles 3g, 4(2) SESTO Article 29 CAO Articles 2, 99(2), 112(1) and (2)(a), (d), (g)
Appendix:	Form for detailed report

Addressees

BA			ISA			SESTA		CISA									AMLA			OTHERS	
Banks	Financial groups and congl.	Other intermediaries	Insurers	Insurance groups and congl.	Insurance intermediaries	Stock exchanges and participants	Securities dealers	Fund management companies	SICAVs	Limited partnerships for CISs	SICAFs	Custodian banks	Asset managers CIS	Distributors	Representatives of foreign CIS	Other intermediaries	SROs	DSFIs	SRO-supervised institutions	Audit firms	Rating agencies
X	X						X														

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I. Object

If a bank or a securities dealer is part of a financial group or conglomerate which is subject to adequate consolidated supervision, intragroup positions may be excluded from the upper limit as per Article 99(1) of the Capital Adequacy Ordinance (CAO; SR 952.03), provided the companies in question are fully included in the capital adequacy and risk diversification consolidation (full consolidation) and a) individually are subject to adequate supervision or b) only have group companies as counterparties which are subject to adequate supervision. 1

On the basis of Articles 99(2) and 112(2)(d) CAO, the FINMA is authorized to limit intragroup positions as per (1). This circular provides more concrete information on the FINMA's practice regarding intragroup positions and shows examples of when it limits such positions. It also lists the most important criteria for limiting such positions. 2

II. Scope of application

The circular addresses banks as per Article 1 of the Swiss Federal Act on Banks and Savings Banks (BA; SR 952.0), securities dealers as per Articles 2(d) and 10 of the Swiss Act on Stock Exchanges and Securities Trading (SESTA; SR 954.1) and financial groups and conglomerate as per Article 3c(1) and (2) BA, which form an integral part of a foreign financial group not subject to consolidated supervision by the FINMA. 3

Banks and securities dealers are referred to as "institutions". Swiss structures which encompass several group companies and which are part of a group which is not managed in Switzerland are considered to be "subordinated Swiss groups". 4

The positions which are in the scope of this circular are the intragroup positions of receivables, payables and contracts as per Article 99(1) CAO held towards group companies domiciled abroad which could present a credit risk to the institution or to the subordinated Swiss group. These not only include on and off-balance sheet positions but also rights which would have the same impact (e.g. receiving guarantees from affiliated entities to cover positions held by third parties or collateral pledged to cover the institution's positions held as a deposit by affiliated entities). 5

III. Intragroup positions

A. Total position

Article 113 CAO provides guidance on how to calculate the total position.[1] Fiduciary investments made on behalf of clients are excluded from the calculation of the total position if the risk was not passed on to the custodian institution. 6

[1] Until the transitional period stipulated in Article 138 CAO ends, the total position can still be calculated according to previous law, i.e. according to the Swiss finish for risk diversification. However, the new risk weighting determined for exposures owed by other banks as per Article 138(2) is already applicable.

B. Positions of group companies

According to Article 111 CAO, from the viewpoint of each group institution or the subordinated Swiss group, other group companies are to be considered as a group of affiliated counterparties. The total exposure to a group of affiliated counterparties is the sum of the total position for each counterparty. 7

According to Article 102 CAO, the institution or the subordinated Swiss group must send to the audit firm as well as to the company's governing body for the guidance, supervision and control either a quarterly or a semi-annual report on the intragroup positions, simultaneously with its list of risk concentrations. The FINMA may demand this document in order to assess the expediency of the implemented measures as per Section IV (following below). Should the FINMA require additional information, it may demand a detailed report as per the appendix of this circular, provided it respects the principle of proportionality. 8

C. Netting

Netting possibilities are only recognized as risk-mitigating measures if there is a written netting agreement which is legally enforceable as per legal opinion. The institution must closely follow the developments in regulatory law and the supervisory practice in the various jurisdictions where it has group companies. The institution must have its legal counsel confirm periodically that the conclusions of the legal opinions continue to be applicable and, if necessary, have the legal opinions updated. The audit firm is to audit the existence of the legal opinions, critically assess these and confirm that the institution has sufficiently striven to determine the legal validity and enforceability of the netting agreement. In its standard audit strategy, the audit firm defines an annual basic audit with audit depth "audit" of new and existing netting agreements if the institution uses the netting approach as per Article 102 CAO in its statement on intragroup positions. This has to happen for the first time after this circular enters into force. 9

IV. Limitation of intragroup positions

The FINMA considers quantitative and qualitative criteria when ordering measures to limit an institution's or subordinated Swiss group's intragroup positions held towards other group companies which basically fulfill the requirements to be exempted from the ceiling defined in Article 99(1) CAO. 10

A. Contractual counterparty

The complexity of group relationships should be streamlined as much as possible, so that the FINMA can comprehensively assess the risks arising from these inter-relationships as well as the payments of the receivables which would arise if the group in which it is consolidated or the subordinate Swiss group belongs were to default. As a rule, group-internal horizontal and diagonal financing (i.e. interlinking the finances of group companies which are not in the same holding line), as well as cumulated financing with a number of group companies should be avoided. 11

B. Solvency of counterparty or that of its country of provenance

If external indications (e.g. a low rating given to the counterparty of the institution, the subordinated Swiss group or its country of provenance, negative market indicators on this counterparty or its country of provenance) make the solvency of a counterparty doubtful, the FINMA can then limit or even forbid such a group relationship. 12

C. Quality of consolidated supervision

Should the FINMA perceive the quality of the consolidated supervision to which the institution or the subordinated Swiss group are subject as inadequate, it can limit or even forbid intragroup exposures. This enables a more flexible application of the limitation as per Article 99(2) CAO but also the application of the generic ceiling as per Article 99(1) CAO. 13

D. Disproportion between exposures and equity

a) Passing on risks to an affiliated company

If an institution grants its clients loans or advances and if it passes these risks on to its group companies which are subject to Article 99(1) CAO and it does this in such a manner that the passing on will cause the risk to be disproportionate to the equity, the FINMA can limit or even forbid these types of intragroup positions. A possible indicator of a disproportionate relationship is to be assumed if the risk as calculated in accordance with Article 113 et seqq. CAO and passed on to the group companies exceeds the institution's eligible CET1[2]. Risk-mitigating measures may only be considered if these do not cause risk positions towards other group companies. 14

b) Positions similar to factual repayment of equity

The FINMA shall carefully scrutinize exposures entered into by an institution towards a group company which exceed equity[3] and which are not covered by guarantees without a right to advance claims or by netting agreements. Should FINMA conclude that such intragroup positions are in fact similar to a repayment of equity, it may limit or even forbid these, especially if they have a maturity horizon of more than a year. 15

It should be noted that such loans may be contrary to Article 680 CO and are incompatible with Article 20(2) CAO, which stipulates that equity may not directly or indirectly be financed with a loan granted by the bank. 16

2 This refers to the net CET1 as determined after the adjustments stipulated in Articles 31-40 CAO.

3 Eligible capital ./. required capital (Article 41 CAO) ./. capital used to cover large exposures [amount greater than 25% (Article 97 CAO) or 100% of eligible capital or greater than CHF 250m (Article 116 CAO)].

c) Loans granted to clients, the guarantees of which are held by a group company

If an institution or a subordinated Swiss group grants a loan or substantial advances to its clients which are directly covered by a guarantee supplied by this group company or indirectly covered with assets deposited at this group company and if this institution or subordinated Swiss group does not fully control this entity by way of majority interest or other dependency, the FINMA may demand that a part or all of the pledged assets must be transferred to the institution or the subordinated Swiss group in order to have the loan covered as defined in Article 61 CAO. If, on the contrary, the positions are not pledged with the bank itself or at least secured with a position of equivalent value or covered with debt securities which were not issued by the bank itself and which were not pledged or deposited at the bank, the FINMA may only partially or not at all recognize the credit risk mitigation provided by these guarantees or securities. 17

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