



# Circular 2019/1 Risk diversification – banks

Risk diversification rules for banks

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# Circular 2019/1

## Risk diversification – banks

Risk diversification rules for banks

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## Addressees

	BA	ISA	SESTA	FMIA	CISA	AMLA	OTHERS
X Banks							
X Financial groups and congl.							
Other intermediaries							
Insurance companies							
Ins. groups and congl.							
Distributors							
X 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							

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## I. Objective

This Circular clarifies Articles 95-119 of the Capital Adequacy Ordinance (CAO; SR. 952.03). It shall regulate the interconnectedness of counterparties, risk mitigation and the measurement of exposures in the trading book, exposures to central counterparties, covered bonds as well as collective investment schemes, securitizations and other investment structures. It is not applicable for determining minimum capital requirements. 1

## II. Basel Minimum Standards

These regulations on risk diversification shall be based on the following minimum standards of the Basel Committee on Banking Supervision (the "Basel Minimum Standards"): 2

- „Supervisory framework for measuring and controlling large exposures“ of April 2014 ("LE") 3
- „Frequently asked questions on the supervisory framework for measuring and controlling large exposures“ of September 2016 ("LE-FAQ1") 4

References in the text in square brackets shall refer to the Basel minimum standards; the abbreviations mentioned below after margin nos. 3–4 will be used. 5

## III. Connected counterparties (Article 109 CAO)

### A. Connected by control relationship

[LE§23-24] Two or more individual persons or legal entities are deemed to be a group of connected counterparties and are to be treated as a single counterparty, if one of them directly or indirectly controls the other(s) through the ownership of half of the votes or otherwise exerts a controlling influence. Financial institutions must assess the interconnectedness between counterparties through control or significant influence using at least the following criteria: 6

- Voting agreements (e.g. control of a majority of voting rights based on an agreement with other shareholders); 7
- Significant influence on the appointment or dismissal of an entity's administrative, management or supervisory body (e.g. the right to appoint or remove a majority of members in those bodies, or the fact that a majority of members have been appointed solely as a result of the exercise of an individual entity's voting rights); 8
- Significant influence on senior management (e.g. an entity has the power, based on a contract or otherwise, to exercise a controlling influence over the management or policies of another entity, for instance through participation rights in key decisions). 9

The criteria of the accounting standards recognized by FINMA shall serve as additional qualitative guidelines for assessing whether a controlling relationship exists. 10

## B. Connected by economic interdependence

[LE§26] Two or more natural persons or legal entities shall be deemed to be a group of connected counterparties and shall be treated as a single counterparty, if there are identifiable economic dependencies between them that make it likely that the other entities will encounter payment difficulties if one of them becomes financially troubled. In establishing the connectedness of counterparties based on economic interdependence, banks shall consider at least the following criteria: 11

- At least 50% of a party's gross income or gross expenditure (annually) comes from transactions with another party (e.g. an owner of a residential/commercial property or a tenant who generates a significant portion of the rental income); 12
- One party fully or partly guarantees the commitments of the other party, or is otherwise liable, and the liabilities are so substantial that the guarantor may become insolvent if the guarantee is called upon; 13
- A significant part of one party's output is sold to the other party, which cannot easily be replaced by other customers; 14
- The expected source of funds for the repayment of both counterparties' loans is the same, and no other party has another independent source of income from which the loan may be fully repaid; [LE-FAQ1, p. 2] 15
- It is likely that the financial problems of one party would cause difficulties for the other parties in terms of full and timely repayment of liabilities; 16
- The insolvency or default of one counterparty would presumably lead to the insolvency or default of the other; 17
- If at least two parties rely on the same source for the majority of their funding and if the parties would not find other funding in the event of this provider's default, one party's funding problems are likely to spread to another due to a one-way or reciprocal dependence on the same main funding source. 18

## C. Exposures to a syndicate

Several syndicates shall not be regarded as connected counterparties even if individual or all members of the syndicate are identical; by the same token, other exposures to individual members of the syndicate shall not be added, either. 19

## D. Exposures to group companies

Two or more members of a group shall form, as a group of connected counterparties, a single risk exposure. 20

## IV. Exposures in the trading book (Article 118(1)(a) CAO)

### A. Calculating exposures

[LE§46] The exposure value of debt instruments and equities shall be the carrying amount of the respective instruments. 21

Exposures with a credit risk and a counterparty credit risk (derivatives and securities financing transactions<sup>1</sup>) shall be measured for both risks. The counterparty credit risk shall be measured in a standard way for exposures in the banking book and the trading book; both shall be based on Article 57 CAO. To measure the credit risk, it is imperative to break down the original exposures in accordance with margin no. 23–26. [LE§45] Exposures in this section (IV. Exposures in the trading book) shall refer exclusively to exposures and risks associated with the default of a single counterparty or a group of connected counterparties in the trading book. Therefore, interest rate risk, commodities risk and currency risk do not have to be addressed. 22

[LE§47 ] Linear derivatives, such as swaps, futures, forwards and credit derivatives, shall be converted into positions and decomposed into their individual legs following the minimum capital requirements for market risk. For instance, a future on share X must be decomposed into a long position in share X and a short position in a risk-free government bond in its relevant currency funding. The notional government bond does not have to be included in the total exposure to that particular government. 23

[LE§48, 53-56] Credit derivatives that represent sold protection shall be recognized as exposure to the referenced debtor in the amount due if the protection is triggered, minus the absolute value of the credit protection. In the case of credit-linked notes, the protection seller shall recognize the exposure in both the bond of the note issuer as well as the note's underlying asset. The treatment with credit derivatives is described in margin nos. 33–44. 24

[LE§49] The exposure value used to recognize a credit risk resulting from non-linear derivatives in the trading book must be calculated based on the change(s) in option prices that would result from a complete default (jump to zero) of the respective assets underlying a derivative. The exposure value for a long call option would therefore be its market value and for a short put option this would be the strike price minus the market value of the put option. In the case of short call or long put options, a default of the underlying shall lead to a profit (i.e. a negative exposure) instead of a loss. The resulting positions in the underlying shall be aggregated with those from other exposures. After aggregation, the negative net exposures must be set to zero. 25

[LE§50] The exposure values of other transactions (i.e. index positions, securitizations, hedge funds or investment funds) must be calculated applying the same rules as for similar instruments in the banking book (see margin nos.63–78). 26

<sup>1</sup> These shall be bonds, repos or similar transactions.



## B. Netting long positions with short positions in the trading book

Long positions and short positions in debt and equity shares as well as exposures in derivatives and other exposures (see margin nos. 21–26) may be netted if the following restrictions are observed. 27

### a) Netting of issues in the form of equity shares and debt securities

[LE§51] Banks may offset long and short positions in the same issue of equity securities, if the issuer and the currency are identical. Long and short positions in the same issue of debt securities may be netted if the issuer, coupon, currency and maturity are identical. 28

[LE§52] Exposures in different issues from the same counterparty may be netted only if: 29

- the short position is junior to the long position, or 30
- if the positions are of the same seniority. 31

[LE§54-55] In order to determine the relative seniority of exposures, securities may be allocated into broad buckets depending on their seniority (for example, “Equity”, “Subordinated Debt” and “Senior Debt”). Banks that find it excessively burdensome to allocate securities to different buckets based on relative seniority may not recognize any netting of long and short positions in different issues relating to the same counterparty when calculating exposures. 32

### b) Exposures hedged with credit derivatives

[LE§53] If the underlying asset of the hedge and hedged exposure meet the criteria of 29–31, they may be netted. 33

[LE§56] In the case of exposures hedged with credit derivatives, any reduction in the exposure to the original counterparty shall correspond to a new exposure to the credit protection provider (cf. margin no. 89). 34

[LE§57] If the credit protection takes the form of a CDS and either the CDS provider or the referenced debtor is not a financial entity, the amount to be assigned to the credit protection provider shall be the counterparty credit risk exposure value calculated according to the standard approach (SA-CCR), and not the amount by which the exposure to the original counterparty is reduced as is usually the case according to margin no. 89. Institutions allowed to use the simplified standardized approach (SSA-CCR) because they fulfill the requirements made in margin nos. 32-33 of FINMA circular 17/7 “Credit Risk - Banks” may use the current exposure method or the simplified standard approach (SSA-CCR) instead of the SA-CCR. 35\*

Financial entities according to margin no. 35 shall comprise: 36

- supervised institutions, where all substantial legal entities in the consolidated group are subject to appropriate supervision that imposes prudential requirements consistent with international norms; and 37
- non-supervised institution, defined as legal entities whose main business includes: asset management, lending, factoring, leasing, provision of credit enhancements, securitization, investments, 38

financial custody services, central counterparty services, proprietary trading and other financial services activities identified by FINMA.

For more complex CDS, the following shall apply: 39

First-to-Default-Swaps: given their non-specific hedge effect, the debtors' total exposure may not be reduced by exposures hedged with first-to-default swaps. However, a credit equivalent for the first-to-default swap is to be taken into account as a component of the total exposure for the particular protection seller. 40

Second-to-default swaps and nth-to-default swaps: The debtors' total exposure may also not be reduced by second-to-default swaps and nth-to-default swaps for exposures hedged by such contracts. A credit equivalent for the second-to-default swap and the nth-to-default swap respectively shall be taken into account as a component of the total exposure for the particular protection seller. 41

First-to-default swaps: all hedging commitments entered into in the form of first-to-default swaps must be added to the debtor's total exposure for the receivables in question. In addition, a credit equivalent must be included as a component of the total exposure of the protection buyer in question. However, this may not exceed the sum of the outstanding premium payments that have not been discounted. 42

Second-to-default swaps: second-to-default swaps shall be taken into account in the same way as first-to-default swaps (cf. margin no. 40). However, until the first position in the basket has defaulted, the smallest exposure in the basket in terms of risk-weighting does not have to be added to the debtor's total exposure. For the consideration of the credit equivalent, the provisions set out in margin no. 42 shall be applicable. 43

nth-to-default swaps: their consideration shall correspond to the one in margin nos. 42 and 43. The smallest n-1 exposure in the basket in terms of risk-weighting does not have to be added to the issuer's total exposure. Whenever one of the exposure in the basket defaults, the variable n shall decrease by one. For example, following the default of one of the exposures in the basket, a fifth-to-default swap shall become a fourth-to-default swap. For the consideration of the credit equivalent, the provisions set out in margin no. 42 shall be applicable. 44

#### **a) Treatment of net short positions**

[LE§59] If the result of the offsetting is a net short position with a single counterparty, the corresponding trading book exposure shall be zero. 45

## **V. Exposures to central counterparties (Article 118(1)(b) CAO)**

[LE§84] A qualifying central counterparty (qualifying CCP, QCCP) shall be an entity that is licensed to operate as a CCP (including a license granted by way of confirming an exemption), and is licensed to operate as such with respect to the products offered by the relevant supervisory authority. In addition, the CCP shall have its domicile in a jurisdiction where it is supervised for regulatory purposes and the competent 46

supervisory authority publicly declares that the local rules and regulations are consistent at all times with the CPMI-IOSCO Principles for Financial Market Infrastructures<sup>2</sup>.

[LE§85] In the case of non-QCCPs, banks shall measure their exposure as a sum of clearing exposures described in margin nos. 48–49 and the other exposures described in margin no. 51, and must respect the ceiling for large exposures. 47

### a) Exposures from clearing activities

[LE§87] Banks must identify exposures to a CCP related to clearing activities and add these exposures together. Exposures related to clearing activities are listed in the table below together with the exposure value to be applied: 48

Trade exposures	The exposure value of trade exposures must be calculated using the exposure measures prescribed in Title 4 of the CAO and this circular for the respective type of exposures (e.g. using the SA-CCR for derivative exposures).	49
Bankruptcy-remote (segregated) margin <sup>3</sup>	The exposure value shall be 0.	
Non-bankruptcy-remote (non-segregated) margin <sup>3</sup>	The exposure value shall be the carrying amount of the margin posted.	
Pre-funded default fund contributions	The exposure value shall be the carrying amount of the pre-funded contribution posted.	
Unfunded default fund contributions	The exposure value shall be 0.	
Equity stakes	The exposure value is the carrying value.	

### b) Exposures from clearing services and other exposures

[LE§88] If the bank acts as a clearing member or is a client of a clearing member, it shall determine the counterparty to which exposures must be assigned by applying the provisions used to determine minimum capital requirements. 50

[LE§89] Other types of exposures that are not directly related to clearing services provided by the CCP, such as funding facilities, credit facilities, guarantees etc., shall be measured according to the general rules used to calculate the total exposure. 51

<sup>2</sup> The “Principles for financial market infrastructures” were published in April 2012 by the then Committee on Payments and Settlement Systems (CPSS) and the technical committee of the International Organization of Securities Commissions (IOSCO). The CPSS was renamed the Committee on Payments and Market Infrastructures (CPMI) in September 2014.

<sup>3</sup> This means there is no loss risk for the margin because it is segregated from the CCP’s assets and kept bankruptcy remote (e.g. by a third party acting as custodian)

## VI. Covered bonds (Article 118(1)(c) CAO)

[LE§68, 69, 70, 71] A covered bond satisfying the conditions set out in margin nos. 53–60 at the time it is issued and during its entire term may be assigned an exposure value of 20% of its nominal value: 52

- If the covered bond has been issued by a bank or a mortgage institution; 53
- By law it is subject to special public supervision for the purpose of creditor protection; 54
- The proceeds of the issue of such bonds is invested in assets that serve to cover the payment obligations arising during the entire term of the bond and where these take precedence for the repayment of capital and the accrued interest in case of the issuer's default; 55
- With the exception of margin no. 61, the pool of underlying assets may only contain: 56
- Exposures to, or guaranteed by, sovereigns, their central banks, public sector entities or multilateral development banks; 57
- Exposures secured by mortgages on residential real estate that would qualify for a 35% risk weight under the SA-BIS approach for credit risk and which have a loan-to-value ratio of 80% or lower; and/or 58
- Exposures secured by mortgages on commercial real estate that would qualify for a 100% risk weight under the SA-BIS approach for credit risk and which have a lending limit-to-value ratio of 60% or lower. 59
- The value of the pool of assets assigned to the covered bond(s) by its issuer shall exceed its nominal value by at least 10%. If the legislative framework does not stipulate a requirement of an excess cover of 10%, the issuing bank needs to nevertheless disclose on a regular basis that its cover pool amounts to 110% of the bond's nominal value. 60

[LE§70] In addition to the assets allowed as per margin nos. 56–59, the cover pool may temporarily include cash or short-term liquid and secure assets to offset portfolio changes as well as derivatives entered into to hedge the risks from covered bonds. 61

[LE§71] In order to calculate the maximum loan-to-value ratio for residential real estate and other real estate, the operational requirements stipulated in the Basel Basic Text, B2§509, as referenced in margin no. 3 of FINMA circular 17/7 "Credit Risk – Banks" regarding the objective market value of collateral and the frequent revaluation must be used. These conditions shall be satisfied at the inception of the covered bond and throughout its remaining maturity. 62

## VII. Collective investment schemes, securitizations and other investment structures (Article 118(1)(d) CAO)

[LE§72] For risk diversification purposes, banks shall also account for those exposures which they hold indirectly through an entity that itself holds exposures in collective investment schemes, securitization assets or other investment structures. 63

[LE§72] Banks shall assign the exposure amount, i.e. the amount invested in a particular structure, to the underlying counterparties following the approach described in margin nos. 65–78. 64

### A. Determination of the relevant counterparty to be considered

[LE§73] Banks may assign the exposure amount in collective investment schemes, securitizations or other investment structures to the structure itself, defined as a distinct counterparty, if they can demonstrate that their exposure amount (measured according to margin nos. 71-74) to each underlying asset of the structure is smaller than 0.25% of its eligible Tier 1 capital. Proof of this shall be if the bank's entire exposure for all assets in a structure is less than 0.25% of its eligible Tier 1 capital. 65

[LE§74] A bank must look through the structure to identify those underlying assets for which the underlying exposure value is equal to or above 0.25% of its eligible Tier 1 capital. In this case, the counterparty corresponding to each of the underlying assets must be identified so that these underlying exposures can be added to any other direct or indirect exposure to the same counterparty. The bank's exposure amount to the underlying assets that are below 0.25% of the bank's eligible Tier 1 capital may be assigned to the structure itself. 66

[LE§75] If a bank is unable to identify the underlying assets of a structure and where the total amount of its exposure is smaller than 0.25% of its eligible Tier 1 capital, the bank shall assign the total exposure amount of its investment to the structure. If the entire invested amount exceeds 0.25 % of the eligible Tier 1 capital, it must assign this total exposure amount to "unknown client". The bank shall aggregate all unknown exposures as if they related to a single counterparty ("unknown client") without any netting. 67

Banks in Category 3 that hold insignificant amounts of CIS units (cf. margin no. 335, FINMA circ. 17/7 Credit Risk – Banks) and banks in Categories 4 and 5 may in margin no. 65–67 use a threshold of 2% instead of 0.25%, 68

[LE§76] Banks may not circumvent the obligation to apply the look-through approach (LTA) by investing in several individually immaterial transactions with identical underlying assets. 69

### B. Calculation of the underlying credit exposures

[LE§77, 83] If the LTA does not have to be applied, a bank's exposure to the structure shall be the nominal amount it invests in the structure. 70

### C. Structures with investors of the same seniority (collective investment schemes)

[LE§78] When using the LTA, the exposure value assigned to a counterparty is equal to the pro rata share that the bank holds in the structure multiplied by the value of the underlying asset in the structure. These exposures shall be added to any other exposures the bank has to that counterparty. 71

### D. Structures with investors of different seniorities

[LE§79] If the LTA is required according to margin no. 66, the exposure value to a counterparty shall be measured for each tranche within the structure, assuming a pro-rata distribution of losses amongst investors in a single tranche. To compute the exposure value of the underlying asset, a bank shall: 72

- first consider the lower of the value of the tranche in which the bank invests and the nominal value of each underlying asset included in the underlying portfolio of assets; and 73
- second apply the pro-rata share of the bank's investment in the tranche to the value determined in step one as per margin no. 73. 74

### E. Identification of additional risks

[LE§80] Banks must identify third parties that may constitute an additional risk factor inherent in a structure itself rather than in the underlying assets. Such a risk factor (for instance, a protection seller) may apply to more than one structure that a bank invests in. 75

[LE§81] Structures with a common additional risk factor shall be aggregated to a group of connected counterparties. If the bank has invested in various structures that are connected to a third party representing a common additional risk factor and this third party also holds further exposures to the bank, these exposures shall be aggregated with the other exposures of that third party. 76

[LE§82] If a bank considers several third parties to be the potential drivers of additional risk, it shall assign the exposure resulting from the investment in the relevant structures to each of these third parties. 77

[LE§83] The bank shall in any case disclose any inherent risk within a structure instead of the risk arising from the underlying exposure (in accordance with margin nos. 70-71), that is, regardless of the risk assessment results from the identification and possible consideration of additional risks. 78

## VIII. Exposures from non-settled transactions (Article 118(1)(e) CAO)

Transactions that have not been settled after five bank working days (Article 76 CAO) shall be included in the total exposure at their net exposure value, i.e. the exposure value (delivered value plus any increase in value, i.e. replacement value) minus any value adjustments. For transactions that are settled according to the principle of delivery against payment or payment for payment in a settlement system, the exposure amount that is not exposed to any risk can be left unaccounted for. 79

## IX. Risk-mitigating Measures (Article 119 CAO)

### A. General rules

[LE§34, 38] If the bank uses recognized credit risk mitigation (CRM) measures or measures to mitigate the counterparty risk when calculating the minimum capital requirements, this method must also be used to calculate the total exposure, provided that the conditions required for this are met in the risk diversification framework. 80

[LE§41] A bank may calculate the total exposure values according to the calculation it uses for minimum capital requirements purposes (i.e. according to FINMA circ. 17/7 "Credit Risk – Banks", margin no. 136) if it has in place legal and contractual netting of loans and deposits on the balance sheet. 81

### B. Treatment of maturity mismatches

[LE§40] If there is a maturity mismatch in respect of credit risk-mitigating measures, the calculation of large exposures shall be determined according to the same rules that apply to the calculation of the minimum capital requirements. 82

[LE§39] Hedges with maturity mismatches shall be recognized only if the original maturity of the underlying exposure is greater than or equal to one year. In any case, hedges with maturity mismatches shall not be recognized if the residual maturity of the hedge is less than or equal to three months. 83

### C. Reduction of exposure values

[LE§34, 42] Banks shall reduce the value of the exposure to the original counterparty by the amount of the recognized CRM technique. This recognized amount shall be equal to: 84

- the value of the protected portion in the case of unfunded guarantees and credit derivatives; 85
- the value of the portion of the exposure collateralized with financial collateral at fair value if the bank uses the simple approach to calculate the minimum capital requirements (cf. FINMA circ. 17/7 "Credit Risk – Banks", margin nos. 163-190). 86
- the value of the collateral as recognized in the calculation of the counterparty credit risk exposure value for all exposures with counterparty credit risk, such as OTC derivatives; [LE-FAQ1, p. 6 on §42] 87
- the value of the collateral adjusted after applying the required haircuts (regulatory standard haircuts) to financial collateral if the bank applies the comprehensive approach. The haircuts used to mitigate the collateral amount are the supervisory haircuts under the comprehensive approach. No bank-internally estimated haircuts may be used. Also, no model approaches may be used. 88

### D. Recognition of exposures to CRM providers

[LE§43] If a bank mitigates the exposure to the original counterparty with a recognized CRM technique, it must in turn recognize an exposure to the CRM provider. The amount assigned to the CRM provider shall be the amount by which the exposure to the original counterparty is reduced (may be different for CDSs, cf. margin no. 35). 89

[LE§64 with a reference to §43, 57] If a bank has an exposure to an entity exempted from the risk diversification rules which is hedged by a credit derivative, the bank shall nevertheless recognize an exposure to the counterparty providing the credit protection if the risk-mitigating measures were included in the calculation of the minimum capital requirements as described in margin no. 80 (cf. margin nos. 22, 35). 90

Collateral assigned to the bank through a system which meets the criteria of margin nos. 250-259 of FINMA circ. 17/7 "Credit Risk – Banks" do not need to be included in the total exposure to that issuer. This shall also include transactions where the repurchase agreement is in a foreign currency. 91

When using the comprehensive approach, the bank may waive recording the collateral at the issuer as per margin no. 89 for the counterparty for collateralized exposures if this exposure (before considering the collateral) amounts to less than 0.25 % of the bank's eligible Tier 1 capital and if it is smaller than CHF 100 million. 92

If there is a clear excess cover and the collateral is diversified, a bank may also use a threshold of 2% instead of 0.25% for margin no. 92. There is a clear excess cover if the total value of collateral exceeds the required amount even after the application of the regulatory haircut of at least 30% and collateral is valued at least once a week. Collateral may be deemed as diversified if the results from the bank's own diversification rules meet the following concept or are more conservative than the following concept: it involves at least three different items of collateral issued by different issuers and the value of each collateral equals an adequate portion of the total value of collateral. 93

If the gross value of the entire lombard loan portfolio of a bank in supervisory category 3, i.e. without considering collateral, amounts to a maximum of 25% of the eligible Tier 1 capital, the bank may waive recording collateral as prescribed by margin no. 89 and apply margin no. 104. In addition, the following conditions must be fulfilled: The individual lombard loans must show a marked excess cover and the portfolio of pledged collateral for each loan shall also be diversified. 94

## **E. Temporary exceedances of the exposure limit due to recorded collateral**

Should the bank experience an exceedance of the exposure limit to the CRM provider due to the collateral recorded as per margin no. 89 at the CRM provider (issuer of the collateral), this exceedance may not last longer than 3 months.<sup>4</sup> In this period, the bank shall determine whether the exceedance is a one-off or if further exceedances are to be expected. If the latter is the case, the bank shall implement measures (e.g. hedging), so that an identified exceedance can be eliminated. If the bank justifies this accordingly, FINMA may grant a longer period upon request. 95

If another exceedance occurs due to collateral recorded in accordance with margin no. 89, this shall be permissible for 3 months at the longest. 96

<sup>4</sup> For instance, if the bank determines on 31.3. that there is an exceedance, it has to be rectified by 29.6. at the latest.



## X. Alleviations for banks in categories 4 and 5 (Article 112(1) CAO)

### A. Short-term interbank positions

Contrary to Article 113(1) CAO, a bank may use a weighting of 50% for sight and overnight exposures to a bank rated 1 or 2 as per Article 63(2)(d) CAO in conjunction with Article 68(1) CAO to facilitate interbank settlements, provided this bank has not been designated as systemically important, and to cantonal banks that are not systemically important and where all non-subordinated liabilities are guaranteed by the canton. Systemically important banks shall be those that are deemed systemically important as per Article 8(3) BA and by the Financial Stability Board as Global Systemically Important Banks. 97

The ratings used in margin no. 97 must come from a FINMA-recognized rating agency. These ratings must be long-term ratings. If several rating agencies issue ratings for a specific counterparty, the rating class mentioned in margin no. 97 is determined in accordance with margin no. 6 of FINMA circ. 17/7 "Credit Risk – Banks". 98

The preferential weighting rate stipulated in margin no. 97 shall be applied only to exposures in respect of the parent company or to the foreign parent bank or the cantonal bank whose non-subordinated liabilities are all guaranteed by the canton. It is not applicable to other companies (banks and non-banks) belonging to the same group. The weightings applicable to these must be the usual ones set out in Article 113(1) CAO. 99

Bank subsidiaries affiliated in accordance with Article 8(3) BA may not apply the alleviation stipulated in margin no. 97. 100

Bank subsidiaries are not permitted to apply the preferential weightings specified in margin nos. 97 to exposures to their parent company in Switzerland or abroad. Likewise, bank subsidiaries of cantonal banks whose non-subordinated liabilities are all guaranteed by the canton are not entitled to apply the alleviations specified in margin no. 97 to exposures to the parent cantonal bank. However, where the conditions for group-internal counterparties stipulated in Article 111(1) CAO are fulfilled, the positions to the banks in question must be excluded from the ceiling. 101

### B. Hidden reserves

In derogation of Articles 97(1) and (98) CAO, a bank may use the eligible Tier 1 capital (adjusted in accordance to Articles 31-40 CAO) plus hidden reserves in the item "other reserves" and after deducting deferred taxes to determine the ceiling. 102

### C. Financing residential property

In derogation of Article 113(1) CAO, banks may use a weighting of 0% applicable to the portion of exposures that are 50% below the market value covered by rights to residential real estate lien in Switzerland and which are used by the borrowers themselves. 103

#### **D. Recording collateral under the comprehensive approach**

Banks using the comprehensive approach may waive recording the collateral received (margin no. 89) in the exposure to the CRM provider.

If a bank uses this, it shall adequately mitigate and monitor the large exposures arising from it and periodically perform stress tests in regard to the credit risk concentrations, including the realizable value for the collateral received for this. 104

### **XI. Transitional provisions**

Repealed 105\*

## Amendments

**The Circular has been amended as follows:**

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

Amended margin no. 35

Repealed margin no. 105

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