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Basel III & TBTF: Introduction Risk Management Course

Daniel Zuberbuhler

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Basel III & TBTF:
Introduction
Risk Management Course
Centro di Studi Bancari
Vezia / TI
6 September 2013

Daniel Zuberbühler, Senior Financial Consultant, KPMG AG
1. International Financial Architecture and BCBS

2. Lessons learned from the crisis: more and better quality capital & liquidity
   ■ Capital surcharges for UBS & CS: pioneer move of EBK & SNB in 2008

3. Basel 2.5 & III
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International Financial Architecture and Basel Committee
International Financial Architecture

- G-20
- Financial Stability Board (FSB)
- Bank for International Settlements (BIS)
- GHOS
- BCBS (Basel Committee on Banking Supervision)
- IOSCO (International Organization of Securities Commissions)
- IAIS (International Association of Insurance Supervisors)
- International Monetary Fund
- World Bank
- EU
- FATF (Financial Action Task Force on Money Laundering)
- OECD
- Joint Forum
- IASB (International Accounting Standards Board)
- FASB (US) Financial Accounting Standards Board
The tower of Basel: BIS building
## Basel Committee membership

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<th>From 1975: G 10 plus</th>
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<td>• United States</td>
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<td><strong>Observers:</strong> EU Comm., FSI, IMF</td>
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Established under auspices of BIS in 1975 after failure of Bank Herstatt

Mandate: primary global standard-setter for the prudential regulation of banks and forum for cooperation on banking supervisory matters → strengthen regulation, supervision and practices of banks worldwide → enhance financial stability

Legal status: No formal supranational authority; no legal force of decisions. BCBS relies on its members’ commitments, in particular to

• implement & apply BCBS standards in their jurisdictions within prescribed timeframe
• undergo and participate in BCBS reviews to assess consistency & effectiveness of domestic rules and supervisory practices in relation to BCBS standards
• promote interests of global financial stability and not solely national interests, while participating in BCBS work and decision-making

Membership: Organisations with direct banking supervisory authority and central banks. Criterion for new members: importance of their national banking sector to international financial stability. → 27 countries, 42 organisations; CH: SNB & FINMA

Representation at Committee meetings: senior officials with authority to commit

Oversight: BCBS reports to a joint committee of central bank Governors and (non-central bank) Heads of Supervision from its member countries (GHOS) and seeks endorsement for its major-decisions and work program
BCBS decisions: taken by consensus

Chairman: Appointed by GHOS for term of three years, renewable once. → Stefan Ingves, Governor of Sveriges Riksbank

Secretariat: Provided by BIS, located in Basel. → Secretary General Wayne Byres, supported by a staff of ~17 professionals, mostly on temporary secondment from BCBS members

Frequency of meetings: four times per year, additional meeting decided by Chairman

Levels of standard-setting:

• Standards: BCBS expects full implementation by BCBS members and their internationally active banks. To be incorporated into local legal frameworks through each jurisdiction’s rule making process; if deviation unavoidable, seek greatest possible equivalence. Minimum requirements → members may decide to go beyond them.

• Guidelines: considered desirable, supplement standards by additional implementing guidance

• Sound practices: Describe actual observed practices to promote common understanding and improving supervisory or banking practices. Members expected to compare / improve own prac.
Observers: EU Commission, ECB, EBA, IMF, FSI (Financial Stability Institute)

Outreach: Links with supervisors not directly participating in the committee with a view to strengthening prudential supervisory standards in all major markets, e.g.

- Development and dissemination throughout the world of policy papers on a wide range of supervisory matters;
- Pursuit of supervisory cooperation through support for regional supervisory committees and sponsorship of a global biennial conference (International Conference of Banking Supervisors, ICBS);
- Cooperation with the FSI in providing supervisory training both in Basel and at regional or local level. BCBS-FSI High Level Meetings for senior policymakers in central banks and supervisory authorities.

Cooperation with other international financial bodies: esp. FSB, Joint Forum

Public consultation process: Compulsory for BCBS standards. Interaction with Institute of International Finance (IIF) as main lobby-group of global banks (and insurers)

BCBS Charter: The BCBS established for the first time its own written charter in 2013, approved by GHOS on 6 January 2013.
Main groups reporting to the Basel Committee

Group of Governors and Heads of Supervision
Chair: Mervyn King, Governor of the Bank of England

Basel Committee on Banking Supervision
Chair: Stefan Ingves, Governor of Sveriges Riksbank

- Accounting Experts Group
- Supervision and Implementation Group
- Policy Development Group
- Macroprudential Supervision Group
- Basel Consultative Group
- Joint Forum (BCBS, IOSCO, IAIS)

Secretariat
Secretary General: Wayne Byres

10 June 2013
Organisation chart
August 2011

Basel Committee on Banking Supervision
Basel I (Capital Accord) 1988
“International Convergence of Capital Measurement and Capital Standards”

• 2 Objectives:
  • Strengthen **soundness and stability** of international banking system
  • Diminish **competitive inequality** among international banks

• Captures **only credit risks**

• **Minimum standard:** national authorities free to adopt higher levels

• **Definition of capital**
  • Core capital (Tier 1)
  • Supplementary capital (Tier 2), max. 50% of Tier 1; subordinated debt max. 50% of Tier 2
  • Deductions from capital

• **Standardised risk weights for on balance-sheet assets** (very simplified here)
  • 0%: cash, claims on **OECD central governments & central banks** (Club approach)
  • 20%: claims on **OECD incorporated banks** or other banks up to 1 year residual maturity
  • 50%: residential mortgages
  • 100%: claims on **private sector**, other assets like real estate, plants etc.

• **Credit conversion factors** for off-balance sheet items

• **Minimum Capital Ratio:** total capital 8% of RWA (of which 4% Tier 1)

30 pages only!
Market Risk Amendment 1996 – internal models approach

In 1996, BCBS published an amendment to the 1988 Basel Accord to provide an explicit capital cushion for the price risks to which banks are exposed, particularly those arising from their trading activities. This amendment was brought into effect in 1998.

• Allows banks to use proprietary in-house models for measuring market risks

• Banks using proprietary models must compute VaR daily, using 99th percentile, one-tailed confidence interval with a time horizon of 10 trading days using a historical observation period of at least one year.

• The capital charge for a bank that uses a proprietary model will be the higher of the previous day’s VaR and 3 times (multiplication factor) the average of the daily VaR of the preceding 60 business days.

• Use of ‘back testing’ (ex-post comparisons between model results and actual performance) to arrive at the ‘plus factor’ that is added to the multiplication factor of three.

• Standardized approach using the ‘building block’ approach where general market risk and specific security risk are calculated separately and added up.

• Banks to segregate trading book and mark to market all portfolios/positions in the trading book.

• Applicable to both trading activities of banks and non-bank securities firms (agreed with IOSCO / US-SEC only in 2005)
Internal VaR Models Approach

VaR = Value at Risk is the predicted threshold amount, which should not be exceeded within a specific time horizon (holding period) at a given confidence level (probability) by (mark-to market) losses on a specific portfolio of financial assets (assuming no trading in the portfolio).

Confidence level = 99%, Time horizon = 10 days
Basel II 2004: More risk sensitive – internal approaches for credit risks (IRB) & operational risks (AMA)

- Significantly more risk sensitive capital requirements and takes into account operational risk of banks apart from credit and market risks. It also provides for risk treatment based on securitization.
- Great use of assessment of risk provided by banks’ internal systems as inputs to capital calculations.
- Provides a range of options for determining the capital requirements for credit risk and operational risk.
- Promotes strong risk management practices by providing capital incentives for banks having better risk management practices.

Basel II does not include liquidity risk, interest rate risk in banking book, strategic risk, and business risk. These risks would fall under the Supervisory Review Process:

- If capital held by a bank is considered not sufficient, supervisors can require the bank to reduce its risk or increase its capital or both.
- Interest rate risk in banking book: Criteria for outliers. Where a bank under 200 basis points interest rate shock faces reduction in capital by 20% or more, such banks would be outliers.

3 Pillars:
1. Minimum Capital Requirement
2. Supervisory Review Process
3. Market Discipline through Disclosure
Basel II – Pillar 1: Minimum Capital Requirements – Range of Options

- **Capital for Credit Risk**
  - **Standardized** Approach
  - **Foundation Internal Ratings** Based Approach (F-IRB)
  - **Advanced Internal Ratings** Based Approach (A-IRB)

- **Capital for Market Risk**
  - **De Minimis** Approach
  - **Standardized** Approach (Maturity or Duration Method)
  - **Internal Models** Method

- **Capital for Operational Risk**
  - **Basic Indicator** Approach
  - **Standardized** Approach
  - **Advanced Measurement** Approach

Transitional **floors** based on Basel I: Year 1: 90%; Year 2: 80%
Lessons learned from the crisis: more and better quality capital & liquidity
Risk-weighted assets as base for capital requirements – credit risk ex.
Weaknesses of Basel II / Lessons from the crisis: more and better quality of capital

  - VaR 99% (no tail-risks)
  - Holding period of 10 days (wrongly assumes liquid markets)
  - Multiplier ≥ 3 (3 x virtually zero will not result in much more capital)
  - Trading book definition: intention sufficient, no active trade
- Massive expansion of **trading assets** via transfer of credit risks / structured loans with tiny capital → excessive **Leverage**
- Extremely procyclical effect

**AAA Home Equity Subprime**
2003 – July 2009
10-day spread-returns (bp)
Lessons: more and better quality of capital

• **New approaches of Basel II (IRB & AMA) calibrated too low:**
  - (modest) **objective** of maintaining capital in banking system not achieved → preferential treatment of internal risk management approaches vs. standardised approaches for SM-banks
  - long-term **trend** towards lower capital requirements for „sophisticated“ global large banks
    – CH-Non-large Banks: Ø 100% above capital minimum
  • **No permanent floors for internal approaches → free fall**
  • **Leverage Ratio rejected by BCBS in 2006**

• **Procyclical effect of banking system:** small capital in low-volatility boom periods / no reserves for loss absorption → reduction of problem assets exacerbates shock

• **Capital definition:** BCBS tolerated proliferation of „financial innovations“ (above all hybrid capital) → not fully loss-absorbent in going concern → quality neglected → harmonisation deferred post Basel II
Lessons: more and better liquidity

• Liquidity taken as a free good due to abundant supply before crisis
• Complex instruments without regard of potential illiquidity
• Liquidity demand from off-balance-sheet vehicles neglected
• (over)Reliance on interbank market and wholesale funding
• Stress scenarios: w/o assumption of drying-out of core asset- and refinancing markets or systemic connections
• Massive liquidity injections from central banks required

• No international standards for liquidity risks
  • BCBS in 2000: only qualitative principles → poor implementation
  • Liquidity issues deferred post Basel II
  • Quantitative national rules very diverse
  • BCBS Principles for Sound Liquidity Risk Management and Supervision, September 2008, as first reaction to crisis
Capital surcharges for UBS & CS: pioneer move of EBK & SNB in 2008

- **Objective**
  - Protection for Swiss economy & financial center against **systemic risks** of large banks, especially IB trading activities; increase crisis resilience

- **Two complementary measures under Pillar 2**
  - **Risk-weighted target ratios**, based on **Basel II** (Tier 1+2)
    - 200% (= 100% above Pillar 1) in good times (earnings)
    - 150%: supervisory intervention level
  - **Capital conservation buffer** similar to Basel III
  - **Leverage Ratio** mainly based on **US-model**
    - Tier 1 capital / Balance sheet
    - Minimum ratio: 3% Group / 4% Parent Bank
    - 5% target ratio in good times
    - Exemption for Swiss loans, CHF reverse repos, cash
    - Adjustments for accounting differences IFRS / US-GAAP; deduction of goodwill & intangibles

*Capital definition*: Basel II based on EU → **quality** neglected
RWA-Ratios over business cycles – capital conservation buffer

Risk-weighted targets

Target

Intervention level

Supervisory action:
instant remediation

Time

120%

150%

200%

(Pillar 1) 100%
Risk Weighthed Assets vs. Leverage Ratio
Swiss capital adequacy framework for large banks 2008 - conditions

• Short memory of bankers (& politicians) → set ambitious targets in crisis, but give enough time for implementation
• Gradual implementation until 1 January 2013 based on earnings & de-leveraging → annual capital plan with FINMA
• Expiration of eligibility of subordinated debt 2020
• Opposition of banks & politicians overcome under stress
  • (Large) banking lobby still strong in summer 2008
    • Standard objection: international competitiveness
    • Political concession of EBK & SNB: exemption from Leverage Ratio for domestic loans → avoid SME issue
  • Failure of Lehman Brothers (15/09/08) turning point
• 15/10/08: agreement with CS on key parameters
• 20/11/08: EBK-decrees for CS & UBS based on Law & Ordin.
  • Adaptation to future international standards (BCBS) reserved
Basel III overview

from Basel II ..

Tier 1 Ratio = \( \frac{\text{Tier 1 Capital}}{\text{RWA}} \) ≥ 4%

- Loss absorbent
- Counterparty credit risks
- Market risks (“Basel 2.5”)
- Securitizations in banking book

.. to Basel III

CET 1 + Add. Tier 1 ≥ 6%

- RWA

Conservation buffer
- Countercyclical buffer

Leverage ratio

\[ \text{LR} = \frac{\text{Tier 1}}{\text{Total Assets}} \] ≥ 3%

Minimum standards for liquidity risks

\[ \text{LCR} = \frac{\text{Stock of high quality liquid assets}}{\text{Net stressed outflow}} \] ≥ 1

\[ \text{NSFR}_{1\text{year}} = \frac{\text{Available amount stable funding}}{\text{Required amount stable funding}} \] > 1
## Schedule Basel 2.5 & III: Compromise on hard targets vs. long transition

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Predominant form of capital must be fully loss-absorbing in going concern → common shares & open reserves / retained earnings = CET1. 14 criteria. Hybrid capital ≠ CET1

Deductions from CET1 (Basel II: 50/50 from Tier1/Tier2)
- Goodwill & other intangible assets
- Investments in own shares (treasury stock)
- Shortfall of provisions to expected losses (IRB)
- Deferred Tax Assets
- Non-consolidated participations in financial sector > 10%
- Mortgage Servicing Rights
- Defined benefit pension fund assets & liabilities

Minority interest of third parties in fully consolidated subsidiaries
- Recognition at group level, minus surplus capital (e.g. CET1 > 7%)
- Reg. filters: fair value gains / losses on own debt neutralised
Add. Tier 1 & Tier 2: PONV-clause = conversion / write-off by authorities

• Non-CET1 & Tier 2 only recognised as reg. capital, if issuing conditions or national laws provide, at the option of relevant authorities, that instruments be either written off or converted into CET1 upon following trigger decisions
  • Bank considered not viable (point of non-viability = PONV), or
  • Public sector capital injection or equivalent support (e.g. purchase of toxic assets / guarantee)
✓ Capital investors & subordinated creditors must bear losses, before taxpayers are exposed, if orderly wind-down not possible (esp. TBTF-banks)
✓ Same effect as CoCos. PONV may override contractual trigger
✓ Applicable to internationally active banks (not only TBTF)
• From 2013; Phasing-out for old instruments without PONV-clause (10% per year); CH: from 1.1.2012
Basel III: Combination of two capital buffers

1. **Capital conservation buffer**: building up capital in good times to absorb losses under stress; observe minimum requirements at all times
   - Fixed buffer target: 2.5% CET1 of RWA
   - Restrictions on discretionary pay-out (dividends, buy-backs, bonuses), increasing with growing distance from target ratio
   ~ CH capital surcharges for UBS & CS (2008)

2. **Countercyclical buffer**: enhance shock-resilience of banks and limit expansion in periods of excessive credit growth
   - Based on credit aggregates, e.g. deviation from long-term trend of loan to GDP ratio. Scope: all domestic loans or focussed on specific asset classes, e.g. residential mortgages
   - Applicable system-wide. Variable: 0 – 2.5% CET1. Normal = 0
   - National implementation; for internat. banks mix of geographic asset distribution → reciprocal application from 2016
   CH: Early implementation of CCB for real estate bubble
Market Risks

• Higher capital requirements for trading activities and reduction of arbitrage opportunities between trading / banking book via...
  • Stressed VaR: based on 1 year stress period x ≥ 3
  • Incremental Risk Charge: default- & migration risks of debt instr.
  • Securitisations: similar to tightened banking book rules
  • Comprehensive Risk Measure for correlation trading portfolio
  • More conservative rules for equities

Securitisations: ↑ Re-securitisations / liquidity commitments for SPVs

B 2.5 in force: BCBS 31.12.11 / CH 1.1.11

Basel III: Counterparty credit risk from OTC derivatives, securities financing

• **Credit Valuation Adjustment**: capital charge for potential mark-to-market losses associated with deterioration of creditworthiness of counterparties from derivatives and sec. financing (repos, sec. lending)

• **Stressed inputs for capitalisation of counterparty credit risk**

• **Higher IRB-RWs for exposures to large regulated financial institutions (≥ USD 100 bn) und all unregulated FI → asset value correlation multiplier of 1.25 for systemic risk of interconnectedness**

• **Promotion of clearing via central counterparties (CCPs)**
  - Collateral & MTM exposures to CCPs → 2% RWA
  - Default fund exposures to CCPs: risk-sensitive capital charge
  - Compliance of CCPs with IOSCO-CPSS standards for FMI

• **Collateral mgmt. / initial margins: longer margining periods**

• **Risk management standards for:**
  - wrong-way risk (exposure increases when credit quality of CP deteriorates)
  - back-testing
Objective: supplement risk-based capital requirements by a simple, transparent, independent measure of risk

Constrain leverage in banking sector → mitigate destabilising deleveraging processes which can damage financial system and economy

Credible back-stop against model risk and measurement error

Minimum LR: Tier 1 (new def.) / Total Exposure = 3%, test phase

Total Exposure: balance & off-balance items, generally based on accounting measure; adjust for differences in accounting standards

Securities Financing Transactions: acc. & Basel II netting-rules

Derivatives: current exp. & add-on for potential future exp. & Basel II netting-rules

Off.-B/S: 100% credit conversion factor; 10%, if unconditionally cancellable at any time by bank w/o prior notice (US credit cards)

No Swiss exceptions for domestic loans or liquidity (≠ 2008 CH-rules)

Transition regime: observation from 2011 / disclosure from 2015 / review & decision on migration to Pillar1 and final rules in 2017 → in force 2018
Leverage Ratio vs. RWA-Ratio Basel II

International comparison of capital ratios

Major internationally active banks; by accounting standards

IFRS  US GAAP

Source: SNB Financial Stability Report 2011
1. **Liquidity Coverage Ratio LCR**

Promote *short-term* resilience of liquidity risk profile through sufficient high quality resources to survive an *acute stress scenario* lasting for **one month**

\[
\frac{\text{(Stock of high quality liquid assets)}}{\text{(Net cash outflows over a 30-day time period)}} \geq 100\%
\]

Comparable with CH G-SIBs regime of 2010; Basel III: milder scenario, narrower definition of liquid assets

2. **Net Stable Funding Ratio NSFR**

Promote *longer-term* resilience through more stable sources of funding on an ongoing structural basis (sustainable structure of A/L) over **one year** horizon

\[
\frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} > 100\%
\]

**Transition regime:** Observation LCR until 2014, NSFR until 2017, both with **review** clause → 7 Jan. 2013 BCBS decision on LCR
Basel III: the new bible
Impact of Basel 2.5 & III on Swiss banks
• **Definition of capital**
  - G-SIBs: massively affected (≠ hybrids; deductions from CET1)
  - Others: almost only hold CET1; add PONV-clause for sub. debt issued from 2013

• **RWA-requirements**
  - G-SIBs: major increase for Investment Bank
  - Others: marginal increase for trading / OTC derivatives → large existing capital buffers (cf. FINMA circ. 2011/2 for non-G-SIBs)
  - Abolition of Swiss finish reduces average RWAs (unrelated with Basel III)

• **Leverage Ratio**
  - Exclusive, serious problem for G-SIBs; others comply easily

• **Liquidity**
  - G-SIBs: already comply with LCR and NSFR
  - Others: major implementation effort; Reporting from 2012, in force 2015

• **Implementation in Switzerland**
  - Revision of Capital Adequacy Ordinance (CAO) of 1 June 2012, in force 1 Jan. 2013 (basis for anti-cyclical buffer & higher RWAs for riskier mortgages from 1 July 2012)
  - Abolition of Swiss Finish (SA-CH / Multipliers in SA-BIS) with transition until end 2018; change only as a “package” (no cherry-picking)
  - FINMA-Circulars
Basel II → Basel 2.5 → Basel III: RWA-projections in Q310 Credit Suisse

Risk-weighted assets projection under Basel rule changes

CHF bn

228

+15

+20

+10

Approx. 270

+45

+130

Approx. 400

(50) to (70)

330 to 350

Change to Basel 2.5

Gross-up of Deductions

CVA & other

Basel 2.5

Basel 3 (before mitigation)

Mitigation impact

Basel 3 (after mitigation)

Mitigation impact

Businesses primarily affected:

- Emerging markets
- Credit
- Equity derivatives

- Emerging markets
- Credit
- Structured products

- Structured products
- "Exit businesses"

- Rates
- Foreign exchange
- Equities

Note: Estimates based on current positions; certain Basel 3 methodology changes are still subject to validation.
Exceeded year-end 2013 RWA reduction target

Group Basel 3 "look-through" risk-weighted assets (RWA) in CHF bn

3Q11  | 4Q11  | 3Q12  | 4Q12  | 1Q13  | 2Q13  | Goal
370   | 339   | 307   | 284   | 290   | 281   | < 285

(24)%

Other (3)
Investment Banking
(5)

FX impact (1)

Goal 2013 Year-end

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July 25, 2013 23
Progress on RWA reduction (fully applied)

We continue to target future RWA for the Group of <CHF 200 billion

UBS

Refer to slide 36 for details about adjusted numbers, Basel III numbers and FX rates in this presentation

1. RWA associated with UBS’s option to purchase the SNB StabFund’s equity (treated as a participation with full deduction from CET1 capital starting 2Q12)
2. Legacy Portfolio included on a pro-forma basis from 30.9.11; Non-core and Legacy Portfolio included on a pro-forma basis from 31.12.12
Strong 2Q13 Basel 3 capital ratios

Swiss core and BIS CET1 capital in CHF bn

- Shareholders' equity 2Q13: 42.4
- Regulatory adjustments: 2.0
- Tier 1 participation securities: 1.4
- Swiss core: 45.8 (15.7%)
- BIS CET1: 44.4 (15.3%)

"Look-through" Swiss core and BIS CET1 capital in CHF bn

- Shareholders' equity 2Q13: 42.4
- (0.2) Own debt gains
- (8.8) Goodwill & intangibles
- (7.3) Other regulatory adjustments
- "Look-through" deductions: 3.3
- Tier 1 participation securities: 26.1 (9.3%)
- Swiss core: 29.4 (10.4%)
- BIS CET1: 281

Basel 3 risk-weighted assets in CHF bn: 290

Rounding differences may occur.
1 Includes an adjustment of CHF 2.6 bn for the accounting treatment of pension plans pursuant to phase-out requirements and other regulatory adjustments and regulatory adjustments of CHF (0.6) bn not subject to phase in, including the cumulative dividend accrual.
2 Consists of tier 1 participation securities of CHF 2.5 bn, additional tier 1 deductions for which there is not enough tier 1 capital available and therefore is deducted from Swiss Core Capital, and other Swiss regulatory adjustments.
3 Consists of existing tier 1 participation securities of CHF 2.5 bn and other Swiss regulatory adjustments.

July 25, 2013
Basel III capital

Basel III fully applied CET1 ratio improved by 110 bps

Swiss SRB Basel III (phase-in\(^1\))

- 30.9.11: ~10.0%
- 31.12.11: ~10.7%
- 31.12.12: 15.3%
- 31.12.13: 15.3%
- 30.6.13: 2.1%

Swiss SRB Basel III (fully applied\(^1\))

- 30.9.11: ~6.2%
- 31.12.11: ~6.7%
- 31.12.12: ~9.8%
- 31.12.13: 10.1%
- 30.6.13: 2.1%

2013 target: 11.5%
2014 target: 13.0%

Low trigger loss-absorbing capital
- 30.9.11: 5.0%
- 31.12.11: 5.0%
- 31.12.12: 5.0%
- 31.12.13: 5.0%
- 30.6.13: 5.0%

High trigger loss-absorbing capital
- 30.9.11: 0.5%
- 31.12.11: 0.5%
- 31.12.12: 0.5%
- 31.12.13: 0.5%
- 30.6.13: 0.5%

CET1 capital
- 2013 target: ~39.4%
- 2014 target: ~26.8%

RWA
- 2013 target: 243
- 2014 target: 239

We are on track to achieve our 13% fully applied CET1 target in 2014

Refer to slide 36 for details about adjusted numbers, Basel III numbers and FX rates in this presentation.

1 BIS Basel III CET1 ratios as of 30.6.13: phase-in (16.2%), fully applied (11.2%). The BIS Basel III rules are in line with the Swiss SRB Basel III rules (applicable to systemically relevant banks in Switzerland), except that under the BIS Basel III rules our high trigger loss-absorbing capital which was granted as part of UBS's deferred compensation programs is amortized and that Tier 2 phase-out capital is recognized; 2 Debt issued as part of UBS's 2012 deferred compensation programs. We could build ~100 bps of high trigger loss-absorbing capital from these deferred compensation programs over the next 5 years; CHF 0.5 billion are eligible under Swiss SRB rules (systemically relevant banks in Switzerland) while under BIS rules the amount is amortized and CHF 0.4 billion are eligible on 30.6.13.

UBS
Swiss leverage exposure reduced by CHF 147 bn since 3Q12

Swiss leverage exposure end of period in CHF bn

- 1,405
- 1,288
- 1,258

(10)%

<1,190 Exposure target

- 382
- 341
- 338

<290 Exposure add-ons

1

- 1,023
- 947
- 920

<900 Balance sheet assets (US GAAP)

Year-end 2013

3Q12 1Q13 2Q13

Well advanced leverage reduction program with exposure reduced by CHF 147 bn since 3Q12

Phase-in leverage ratio of 3.9% at end 2Q13 projected to be at ~4.5% by end 2013

"Look-through" leverage ratio projected to be at ~3.2% by end 2013

The future issuance of low-trigger contingent capital, in line with the 1.1% requirement, will enable Credit Suisse to exceed the Swiss leverage requirement of 4.2% ahead of the 2019 deadline

Reported 2Q13 Swiss leverage ratio

Including:

- CHF 4.2 bn of issued high-trigger BCNs
- CHF 2.5 bn of issued Tier 1 participation securities (Claudius)

Projected year-end 2013 leverage ratio

Assumptions:

- CHF 1,224 bn for Swiss leverage exposure, based on simple average of end 2Q13 amount and year-end 2013 target
- Consensus retained earnings for 2H13
- Agreed exchange in October 2013 of CHF 3.8 bn Tier 1 Capital Notes into additional high-trigger BCNs

Note: this projection assumes no redemption of Tier 1 participation securities or issuance of low-trigger contingent capital

1 Off-balance sheet exposures and regulatory adjustments. Actual amounts may differ significantly.

2 Based on net income and dividend per share estimates as per Bloomberg consensus as of July 23, 2013, which is not endorsed or verified and is used solely for illustrative purposes.

July 25, 2013
Swiss leverage calculation and year-end 2013 projection

<table>
<thead>
<tr>
<th>Common equity tier 1 (CET1)</th>
<th>Phase-in view</th>
<th>as % of CHF 1,224 bn exposure¹</th>
<th>&quot;Look-through&quot; view</th>
<th>as % of CHF 1,224 bn exposure¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>in CHF bn</td>
<td>2Q13</td>
<td>End 2013 projections</td>
<td></td>
<td>2Q13</td>
</tr>
<tr>
<td>Common equity tier 1 (CET1)</td>
<td>44.4</td>
<td>+1.2³</td>
<td>45.6</td>
<td>26.1</td>
</tr>
<tr>
<td>Swiss regulatory adjustments²</td>
<td>(1.1)</td>
<td>(1.1)</td>
<td>(0.1)%</td>
<td>0.8</td>
</tr>
<tr>
<td>Tier 1 participation securities (Claudius)</td>
<td>2.5</td>
<td>2.5</td>
<td>0.2%</td>
<td>2.5</td>
</tr>
<tr>
<td>Swiss Core Capital</td>
<td>45.8</td>
<td>47.0</td>
<td>3.8%</td>
<td>29.4</td>
</tr>
<tr>
<td>High-trigger Buffer Capital Notes</td>
<td>4.2</td>
<td>+3.8⁴</td>
<td>8.0</td>
<td>0.7%</td>
</tr>
<tr>
<td>Low-trigger contingent capital</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Swiss Total Capital</td>
<td>50.0</td>
<td>55.0</td>
<td>~4.5%</td>
<td>33.6</td>
</tr>
</tbody>
</table>

The future issuance of low-trigger contingent capital, in line with the 1.1% requirement, will enable Credit Suisse to exceed the Swiss leverage requirement of 4.2% ahead of the 2019 deadline.

Rounding differences may occur.

1 Simple average of Swiss leverage exposure of CHF 1,258 bn at end 2013 and target of CHF 1,190 bn at year-end 2013.
2 Consists of additional tier 1 deductions for which there is not enough tier 1 capital available and is therefore deducted from Swiss Core Capital and other Swiss regulatory adjustments.
3 Based on net income and dividend per share estimates per Bloomberg consensus as of July 23, 2013, which is not endorsed or verified and is used solely for illustrative purposes. Actual amounts may differ significantly.
4 Assumes exchange in October 2013 of remaining CHF 3.8 bn hybrid tier 1 notes into high-trigger BCNs, subject to FINMA approval.

July 25, 2015

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Leverage ratio

Swiss SRB Basel III leverage ratio (phase-in) 3.9% at 30.6.13

**Swiss SRB Basel III leverage ratio denominator (total exposure)**

- 31.12.12: ~1,216
- 31.3.13: 1,175
- 30.6.13: 1,141

**Cumulative impact on leverage ratio over time (illustrative example, bps)**

- **Leverage ratio numerator**
  - Exercise of the SNB StabFund option: ~20-25²
  - Loss-absorbing capital (high-trigger): ~10-15³
  - Loss-absorbing capital (low-trigger): ~30-35⁴

- **Leverage ratio denominator⁵**
  - Non-core and Legacy Portfolio run-down: ~50-95

**Total leverage ratio uplift**: 110-170 bps

- Fully applied Swiss SRB Basel III leverage ratio will become effective in 2019; on this basis our leverage ratio was 2.9% at 30.6.13
- Illustrative example shows an uplift over time of up to 170 bps helping us to exceed the estimated minimum requirement of 4.2% before 1.1.19⁶

Refer to slide 36 for details about adjusted numbers, Basel III numbers and FX rates in this presentation.

¹ Pro-forma number; ² The value of UBS’s option to purchase the equity of the SNB StabFund was CHF 2.5 billion at 30.6.13 and fully deducted from regulatory capital; ³ We could build up ~100 bps of high trigger loss-absorbing capital from deferred compensation programs over the next 5 years based on our RWA target of <CHF 200 billion; ⁴ CHF 9 billion of low trigger loss-absorbing capital based on 17.5% fully applied total capital requirement expectation; ⁵ Any additional measures to reduce leverage ratio denominator are not included; ⁶ Minimum leverage ratio is based on 17.5% fully applied total capital requirement expectation.
Balance sheet

Total assets CHF 1,129 billion or CHF 765 billion excluding PRV and OTC margins
30.6.13

- Investment Bank: 272 CHF billion
  - Funded assets: 179 CHF billion
  - OTC margin: 83 CHF billion
  - PRV: 9 CHF billion

- Other business divisions: 333 CHF billion
  - Corporate Core Functions: 224 CHF billion
    - Funded assets: 182 CHF billion
    - OTC margin: 42 CHF billion
  - Corporate Center Non-core: 266 CHF billion
    - to be exited
  - Corporate Center Legacy Portfolio: 34 CHF billion
    - Funded assets: 31 CHF billion
    - OTC margin: 15 CHF billion
    - PRV: 1 CHF billion

---

1 Funded assets defined as total IFRS balance sheet assets less positive replacement values (PRV) and collateral delivered against over-the-counter (OTC) derivatives.
Our balance sheet, funding and liquidity positions are strong

Our balance sheet structure has many characteristics of a AA-rated bank

- **Strong and significantly reduced balance sheet**
  - Funded assets down >50% from peak in 2007
  - Phase-in Swiss SRB Basel III leverage ratio 3.9%\(^2\)

- **Strong funding profile**
  - Well diversified funding sources
  - High proportion of stable funding sources with deposits >50% and long-term debt 20%
  - Limited use of short-term wholesale funding
  - 109% Basel III NSFR\(^3\)

- **Strong liquidity position**
  - 114% Basel III LCR\(^3\)

---

1. As a percentage of total funding sources defined as: repurchase agreements, cash collateral on securities lent, due to banks, short-term debt issued, due to customers, long-term debt (including financial liabilities at fair value), cash collateral payables on derivative transactions and prime brokerage payables.
2. CHF 1,527 billion on 31.12.07 and CHF 702 billion on 30.6.13; 2 As of 30.6.13. Refer to the 2Q13 financial report for more information about UBS’s Swiss SRB Basel III leverage ratio; 3 As of 30.6.13. Refer to the 2Q13 financial report for details about the calculation of UBS’s Basel III LCR and NSFR
Strong funding and liquidity

Assets and liabilities by category, end 2013 in CHF bn

<table>
<thead>
<tr>
<th>Assets</th>
<th>Equity &amp; Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reverse repo</td>
<td>Match funded</td>
</tr>
<tr>
<td>Encumbered trading assets</td>
<td></td>
</tr>
<tr>
<td>Funding-neutral assets</td>
<td></td>
</tr>
<tr>
<td>Cash &amp; due from banks</td>
<td></td>
</tr>
<tr>
<td>Unencumbered liquid assets</td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td></td>
</tr>
<tr>
<td>Other longer-maturity assets</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
</tr>
<tr>
<td>Total equity</td>
<td>49</td>
</tr>
</tbody>
</table>

Well prepared for Basel 3 liquidity requirements

- Basel 3 Net Stable Funding Ratio (1-year) in excess of 100%
- Short-term (30 days) liquidity under Swiss regulation in excess of requirement

1 Primarily includes brokerage receivables/payables, positive/negative replacement values and cash collateral.
2 Primarily includes excess of funding neutral liabilities (brokerage payables) over corresponding assets.
3 Primarily includes unencumbered trading assets, unencumbered investment securities and excess reverse repurchase agreements, after haircuts.
4 Excludes loans with banks.
5 Excludes due to banks and certificates of deposit.
6 Estimate under current FINMA framework. Basel 3 liquidity rules and FINMA framework are not finalized; amounts and statements and ratios shown here are based on interpretation of current proposals.

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### Basel III Liquidity Coverage Ratio & Net Stable Funding Ratio

#### UBS’s Basel III Liquidity Coverage Ratio and Net Stable Funding Ratio in excess of 100%\(^1\)

<table>
<thead>
<tr>
<th>Liquidity Coverage Ratio (LCR)</th>
<th>31.12.12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash outflows under 30-day stress scenario(^2)</td>
<td>260</td>
</tr>
<tr>
<td>Cash inflows</td>
<td>124</td>
</tr>
<tr>
<td>Net cash outflows</td>
<td>136</td>
</tr>
<tr>
<td>Liquidity asset buffer(^3)</td>
<td>153</td>
</tr>
</tbody>
</table>

**Regulatory LCR ( = 153 / 136) 113%**

- Additional contingent funding sources\(^4\) 64
- Management LCR ( = (153 + 64) / 136) 159%

<table>
<thead>
<tr>
<th>Net Stable Funding Ratio (NSFR)</th>
<th>31.12.12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Available stable funding(^5)</td>
<td>362</td>
</tr>
<tr>
<td>Required stable funding(^6)</td>
<td>336</td>
</tr>
<tr>
<td><strong>NSFR ( = 362 / 336)</strong></td>
<td>108%</td>
</tr>
</tbody>
</table>

---

Refer to slide 61 for details about adjusted numbers, IAS 19R, pro-forma Basel III estimates and FX rates in this presentation.

1. Pro-forma: Based on current regulatory guidance, 100% = future requirement under the Basel III Liquidity Framework.
2. Out- and in-flows up to 30 days under severe general market and firm-specific stress.
3. Assets eligible in Basel III LCR framework including dedicated group liquidity reserve, excess cash at major central banks, unencumbered collateral pledged to central banks.
4. Additional contingent funding sources including dedicated local liquidity reserves and additional unutilized borrowing capacity.
5. Consists mainly of client deposits from our wealth management businesses, long term debt issued and capital.
6. Residential mortgages and other loans are the main consumers of stable funding.
Swiss implementation of the Basel framework
Banking Law Art. 4: Capital and Liquidity

1. Banks must maintain individually and on a consolidated basis appropriate capital adequacy and liquidity.

2. The Federal Council determines the elements of the capital adequacy and liquidity. It establishes the minimum requirements in accordance with the business practices and the risks. FINMA is authorized to issue implementing provisions.

3. In special cases, FINMA is authorized to permit less stringent application of the guidelines or to seek enforcement of more stringent provisions.

4. The qualified participation of a bank in a company outside of the financial or insurance industries may not exceed 15 percent of its eligible capital. Such participation may not amount to more than 60 percent of the eligible capital. The Federal Council defines the exceptions.
Swiss implementation of Basel III & TBTF: CAO & FINMA Circulars

**Capital Adequacy Ordinance, CAO 952.03**
Ordinance concerning Capital Adequacy and Risk Diversification for Banks and Securities Dealers (Capital Adequacy Ordinance, CAO)
of 1 June 2012 (status as at 1 January 2013)

**FINMA Circulars for the implementation of Basel III and TBTF, of 18 July 2012**

- 2008/19  Credit Risks – Banks
- 2008/20  Market Risk – Banks
- 2008/21  Operational Risks – Banks
- 2008/22  Capital Adequacy Disclosure – Banks
- 2008/23  Risk Diversification – Banks
- 2011/2   Capital Buffer and Capital Planning – Banks
- 2013/1   Eligible Capital – Banks
CAO Art. 45 Additional Capital – Pillar 2: differentiated buffers based on supervisory categories

1 FINMA requires banks to hold **additional capital**. FINMA may exclude certain categories of banks from this obligation.

2 This additional capital should specifically cover the **risks that are not covered or not sufficiently covered by the minimum required capital** if applying a risk-oriented approach. Together with the capital buffer, the additional capital is meant to **ensure compliance with minimum capital requirements** as per art. 43 even in **unfavorable conditions**.

3 If a bank does not have additional capital as per para. 1, FINMA may stipulate **special measures to monitor and supervise** the capital adequacy and risk situation.

4 Under special circumstances, FINMA may on an **individual basis demand further capital**, namely if the minimum required capital, the capital buffer and the additional capital do not ensure an appropriate level of security in view of that bank’s business activities, its risks taken, its business strategy, the quality of its risk management or the state of development of the techniques used.
Swiss Pillar 2 for non-G-SIBs – Principles

• Banking Act Art. 4 para. 3: Competence of FINMA to raise or lower capital requirements / change capital definition in special cases

• Capital Adequacy Ordinance Art. 45: Additional Capital (Pillar 2)

• FINMA Circular 2011/2 “Capital buffer and capital planning in the banking sector” → applicable from 1/7/11; transition until 31/12/16; amended on 5/7/12

• Objective:
  ■ Hold capital for any risks not covered by Pillar 1
  ■ Ensure meeting minimum requirements even in adverse circumstances
  ■ Avoid procyclical behaviour & enhance overall financial stability
  ■ Guidelines for internal capital planning processes & further P2 req.

• Scope of application:
  ■ All banks and securities firms, except Category 1 (UBS & CS)
  ■ For groups: at consolidated and solo level
<table>
<thead>
<tr>
<th>Category</th>
<th>Criteria (in CHF billions)</th>
<th>≤</th>
<th>≥</th>
<th>≤</th>
<th>≥</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Category 1</strong></td>
<td>Total assets</td>
<td>250</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assets under management</td>
<td>1,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Privileged deposits</td>
<td>30</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Required equity</td>
<td>20</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td><strong>Category 2</strong></td>
<td>Total assets</td>
<td>100</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assets under management</td>
<td>500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Privileged deposits</td>
<td>20</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Required equity</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Category 3</strong></td>
<td>Total assets</td>
<td>15</td>
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<td></td>
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<tr>
<td></td>
<td>Assets under management</td>
<td>20</td>
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<tr>
<td></td>
<td>Privileged deposits</td>
<td>0.5</td>
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<tr>
<td></td>
<td>Required equity</td>
<td>0.25</td>
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<tr>
<td><strong>Category 4</strong></td>
<td>Total assets</td>
<td>1</td>
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<td></td>
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<tr>
<td></td>
<td>Assets under management</td>
<td>2</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Privileged deposits</td>
<td>0.1</td>
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<tr>
<td></td>
<td>Required equity</td>
<td>0.05</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Category 5</strong></td>
<td>Total assets</td>
<td>&lt;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assets under management</td>
<td>&lt;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Privileged deposits</td>
<td>&lt;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Required equity</td>
<td>&lt;</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In order to meet the requirements for a category, at least three of the criteria listed above must be satisfied.
### Target ranges for capital buffers

<table>
<thead>
<tr>
<th>Category</th>
<th>Capital ratio determining adequacy target</th>
<th>Capital ratio below which immediate and extensive action is taken under regulatory law (intervention threshold)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category 2</td>
<td>13.6-14.4%</td>
<td>11.5%</td>
</tr>
<tr>
<td>Category 3</td>
<td>12%</td>
<td>11%</td>
</tr>
<tr>
<td>Category 4</td>
<td>11.2%</td>
<td>10.5%</td>
</tr>
<tr>
<td>Category 5</td>
<td>10.5%</td>
<td>10.5%</td>
</tr>
</tbody>
</table>

### Quality of capital to meet the target ranges

<table>
<thead>
<tr>
<th>Category</th>
<th>CET1 (art. 21 seqq. CAO)</th>
<th>AT1 (art. 27 seqq. CAO) or better</th>
<th>T2 (art. 30 seqq. CAO) or better</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category 2</td>
<td>8.7%-9.2%</td>
<td>2.1%-2.2%</td>
<td>2.8%-3.0%</td>
</tr>
<tr>
<td>Category 3</td>
<td>7.8%</td>
<td>1.8%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Category 4</td>
<td>7.4%</td>
<td>1.6%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Category 5</td>
<td>7%</td>
<td>1.5%</td>
<td>2%</td>
</tr>
</tbody>
</table>
Swiss Pillar 2 for non-G-SIBs – Capital Planning

• **Fundamental requirements**
  - Specific for institution and economic cycle
  - Three-year horizon
  - Proportionate approach (business model, risk profile, size, complexity)
  - Transparent & comprehensive documentation of assumptions

• **Content**
  - Analysis in relation to strategic targets / integrated in overall planning (esp. income targets & budget process)
  - Reliable forecast of available capital, incl. future profits, dividend policy & corporate actions
  - Realistic assumptions with regard to business performance

• **Governance & process**
  - **Management** determines plan & is responsible for process; **Board of Directors** approves capital plan at least annually

• **Review**
  - **Audit firm** in supervisory audit; **FINMA** along categories
Higher capital requirements for riskier residential mortgages (permanent)

### CAO Annex 3: Risk Weights for mortgages

<table>
<thead>
<tr>
<th></th>
<th>Positions in directly or indirectly secured mortgage loans</th>
<th>Risk Weights</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>Residential properties in Switzerland and abroad, up to two-thirds of the current market value.</td>
<td>35%</td>
</tr>
<tr>
<td>3.2</td>
<td>Residential properties in Switzerland and abroad, above two thirds and up to 80% of the current market value.</td>
<td>75%</td>
</tr>
<tr>
<td>3.3</td>
<td>Residential properties in Switzerland and abroad, above 80% of the current market value.</td>
<td>100%</td>
</tr>
<tr>
<td>3.4</td>
<td>Other properties and objects</td>
<td>100%</td>
</tr>
</tbody>
</table>

#### Art. 72 Para. 5 CAO

5 The risk weighting for mortgage-backed positions according to Appendix 3 is 100% as long as the credit business does not comply with the self-regulation minimum standards recognized by the FINMA (art. 7 para. 3 of the Financial Market Supervision Act of 22 June 2007). The minimum standards must include:

- a. the borrower has contributed a reasonable minimum of capital to finance the property that neither originates from a pledge nor from an advance withdrawal as per art. 30b and 30c of the Federal Act on Occupational Retirement, Surviving Dependents' and Disability Pension (BVG);
- b. the loan will be amortized in a reasonable timeframe and amount.
2.1 Fonds propres

Pour les financements hypothécaires, une part minimale de fonds propres sur la valeur de nantissement, ne provenant pas de l’avoir du 2\textsuperscript{e} pilier (versement anticipé et mise en gage), est requise. Cette part minimale s’élève à 10%.

Cette disposition ne s’applique pas aux cas suivants énumérés de manière exhaustive:

- nouvelles réglementations de conventions d’utilisation (p. ex. prolongation d’hypothèques à taux fixe);
- reprises avec montant de crédit inchangé;
- augmentations dans le cadre de la gestion de positions Recovery;
- octroi de crédits d’exploitation avec des immeubles comme couverture complémentaire.

2.2 Amortissement

La dette hypothécaire doit être ramenée aux deux tiers de la valeur de nantissement de l’immeuble en l’espace de 20 ans maximum.
Regional risk map – second quarter 2013
CAO Art. 44: Counter-cyclical buffer

1 Upon the **Swiss National Bank’s** request, the **Federal Council** may, if necessary, require the banks to hold a **counter-cyclical buffer of a maximum of 2.5%** of their risk-weighted positions in Switzerland in the form of common equity tier 1 capital to:
   a. **enhance** the banking sector’s **resilience** against the **risk of excessive credit growth**; or
   b. **counteract excessive credit growth**.

2 The Swiss National Bank must **consult FINMA** prior to issuing such a request and simultaneously informs the Federal Department of Finance. If the Swiss Federal Council approves the request, this ordinance will be amended with a corresponding appendix.

3 The counter-cyclical buffer **may be limited to cover only certain credit positions**. Should the prevailing criteria for the buffer no longer apply, it will be **abolished or adjusted** to reflect the changed conditions. This procedure is based on paras. 1 and 2.

4 Art. 43 paras. 2 and 3 also apply to the counter-cyclical buffer.

**Federal Council decision of 13 Feb. 2013: partial activation** of CCB → 1% on residential mortgages from 30 Sept. 2013
Too big to fail (TBTF)
Too big to fail – systemically important banks (SIBs)

Not just a Swiss problem, but an extreme case: UBS & CS

- **Dominant domestic** market share
  - **added** ~ 40% of deposits & loans; 45% of unsecured loans; 70% of export / trade finance
  - UBS customers: ⅓ of households & pension funds; 40% of corporates; 85% of CH-domiciled banks
  - Assets u. Management: UBS & CS ~ 50%
  - Payment system (UBS: 1 mio trans. / day) & financial infrastructure

- **Balance sheet** before crisis (Q2/07)
  - UBS 2‘542 bn CHF = 5,2 x GDP (2Q13: 1’129 bn. CHF) IFRS
  - CS 1‘415 bn CHF = 2,9 x GDP (2Q13: 920 bn. CHF) US-GAAP

- Main risks in **Investment Banking** abroad / risks in USA
- Potential damage of **bankruptcy**: GDP 15-30% s-t / 60-300% l-t

➢ Too big to fail / too big to rescue: CH-SIBs = TBTF²
Switzerland: TBTF

[Image of two leaning towers with flags and logos]

SILVAN WEGMANN
Objectives of Swiss SIB policy

1. **Reduce risks** for the stability of Swiss financial system by enhancing resilience of SIBs
   → **reduce probability** of failure

2. **Safeguard continuation of (systemically) important functions for the economy** in case of imminent insolvency of SIBs and enable orderly resolution / liquidation for global group
   → **reduce impact** of failure

3. **Avoid public sector support** and **eliminate implicit state guarantee for SIBs**
   → protection of **tax-payers** / reinstate **market economy**
Systemically important banks: definition and purpose of measures in Banking Law

Art. 7 Definition and purpose

1 **Systemically important banks** are banks, financial groups and bank-dominated financial conglomerates, the failure of which would cause considerable damage to the Swiss economy and the Swiss financial system.

2 The provisions of this section, in conjunction with the generally applicable Banking Act provisions, **aim** at further mitigating the risks presented by systemically important banks to the stability of the Swiss financial system, thus ensuring the **continuation of these banks' economically important functions** and **avoiding recourse to state aid**.
Criteria and designation of systemic relevance in Banking Law

Art. 8 Criteria and determination of systemic relevance

1 *Functions* are **system-relevant** if they are **indispensable to the Swiss economy** and cannot be substituted at short notice. System-relevant functions are, in particular, the domestic deposit and lending business as well as payment transactions.

2 A *bank's systemic importance* is determined by its **size**, its **interconnectedness** with the financial system and the economy as well as the **speed** at which the bank's services can be substituted. The following **criteria** in particular apply:

a. the **market share** of system-relevant functions as per para. 1;

b. the **amount of secured deposits** as per art. 37h para. 1 that **exceeds the maximum amount** as per art. 37 para. 3 lit. b;

c. the **ratio of the bank's total assets to Switzerland's annual Gross Domestic Product**;

d. the bank's **risk profile** as determined by its business model, balance sheet structure, asset quality, liquidity and debt/equity ratio.

3 After consulting the FINMA, the **Swiss National Bank** (SNB) will issue a **formal decision designating** the **systemically important banks** and their **system-relevant functions**.
1. **Capital**
   - Increase ability to absorb financial shocks (more and better quality capital)
   - New capital instruments (reserve and convertible capital)

2. **Liquidity**
   - Increase crisis resilience with liquidity requirements based on sufficiently severe stress scenarios
   - Liquidity Coverage Ratio (~ Basel III) implemented by FINMA 30.6.10 at group level

3. **Risk diversification**
   Reduce interconnectedness within banking sector (large exposure limits / operational dependence) → lower limits for exposures of other banks to G-SIBs & G-SIBs’ exposures

4. **Organisation (Resolvability)**
   - Minimum: ensure continuation of systemically important functions in a crisis
   - Improve resolvability / orderly liquidation of entire banking group

**Effective combination of elements**
- Contingent capital to fund resolution while maintaining vital services / functions
- Discounts from progressive capital charge for significantly improved global resolvability
Core elements: inter-related

- Trust
- Capital
- Orderly market exit
- Organisation
- Liquidity
- Time for problem solution
- Risk Diversification

TBTF Bank
Special requirements for systemically important banks in Banking Law

Art. 9 Special requirements

1 Systemically important banks must meet special requirements. The scope and structure of these are based on the degree of systemic importance of the bank concerned. The requirements must be proportionate to their benefit, make allowance for their impact on the banks concerned and on their competitiveness, and must also take into account internationally recognized standards.

2 In particular, systemically important banks must:

a. dispose of capital that:
   1. shows a higher loss absorbency than that of not systemically important banks, as defined by legal requirements,
   2. significantly contributes to ensuring the continuation of system-relevant functions in the event of impending insolvency (PONV),
   3. is of a quality that sets incentives for the banks to limit their degree of systemic importance as well as to improve their capacity to be restructured or liquidated in Switzerland and abroad,
   4. is measured for its risk-weighted assets on the one hand and for its non-risk-weighted assets (that may also contain off-balance sheet transactions) on the other hand;

b. dispose of liquidity that ensures a better absorbency of liquidity shocks compared to banks that are not systemically important and that can also service its outstanding payment commitments even in times of unusual stress;

c. diversify risks so as to limit counterparty risk and large exposures;

d. design its emergency planning with respect to structure, infrastructure, management and control as well as intra-group liquidity and capital flows in a way that it can be implemented immediately and ensures the continuation of the bank's system-relevant functions in the event of impending insolvency.
Titre 5 Dispositions applicables aux banques d’importance systémique

Chapitre 1 Dispositions générales
Art. 124 Principe
Art. 125 Assouplissements pour les groupes financiers et les établissements individuels

Chapitre 2 Capital convertible pris en compte
Art. 126 Description et émission
Art. 127 Prise en compte

Chapitre 3 Exigences en matière de fonds propres pondérées en fonction des risques
Art. 128 Exigence de base
Art. 129 Volant de fonds propres
Art. 130 Composante progressive
Art. 131 Taux de progression
Art. 132 Volant anticyclique

Chapitre 4 Exigences non pondérées en matière de fonds propres («leverage ratio»)
Art. 133 Principe
Art. 134 Calcul
Art. 135 Engagement total

Chapitre 5 Prescriptions particulières sur la répartition des risques
Art. 136 Gros risque
Risk-weighted capital requirements
CH-TBTF rules vs. Basel III & G-SIBs

- **Basel III minimum for all banks**
  - Tier 1: 6.5% CET1
  - Tier 2: 4.5% CET1
  - Additional Tier 1: 2.5% CET1
  - Capital conservation buffer: 2.5% CET1
  - Minimum: 4.5% CET1

- **BCBS / FSB capital surcharge for G-SIBs**
  - Tier 1: 1.5% CET1
  - Tier 2: 2% CET1
  - Capital conservation buffer: 3.5% CET1
  - Minimum: 4.5% CET1

- **CH-TBTF framework**
  - Resolution CoCos (trigger @ 5% CET1): 1 to ~ 6%
  - Recovery CoCos (trigger @ 7% CET1): 3%
  - Capital conservation buffer: 5.5% CET1
  - Minimum: 4.5% CET1

- National discretion:
  - 13%

- Progressive component:
  - 14 to ~ 19%

- Buffer:
  - Δ 5-20%: Swiss finish

- **Risk-weighted capital requirements**
- CH-TBTF rules vs. Basel III & G-SIBs
Progressive component of Swiss capital surcharge
Design & Calibration as of end 2009

Assumption for each bank:
20% of share in domestic, systemic markets
Add-on = 3% RWA

Assumption for each bank:
Balance sheet 1500 bn CHF
Add-on = 3% RWA

Total add-on = 6% RWA
Discounts for enhanced resolvability
FINMA Basel III total capital requirements for large Swiss banks

UBS’s total capital requirement will be a function of total exposure, market share in Switzerland and a possible capital rebate

A. Total exposure: assuming ~1.5% add-on
- Based on size of balance sheet + adjustments

B. Market share in Switzerland: assuming ~3% add-on
- Based on higher of (i) market share of domestic lending and (ii) market share of domestic deposit-taking
- 3% base case assumes 20% market share

C. Capital rebate: assuming no rebate
- Capital rebate is possible subject to measures taken to improve resolvability

Our total capital requirements are expected to fall to 17.5% reflecting the planned decrease in RWAs and balance sheet
CoCos - Conversion Mechanisms

RECOVERY
Going concern

Low-trigger CoCos ~ fund for shut-down & disposal of nuclear power plants

RESOLUTION
Gone concern

Conversion of high trigger CoCos

Conversion of low trigger CoCos

Losses

Conversion
CH-TBTF Rules: illustration of risk-weighted requirements in CHF billion

Assumptions for each bank (end 2009)

- RWAs Basel III: 400 bn CHF
- B/S: 1500 bn CHF
- Market share: 20%
  (domestic, system. relevant)

Risk-weighted capital requirements

- 10% CET1
  @ 400 bn RWAs = 40 bn CHF
  @ 300 bn RWAs = 30 bn CHF
  @ 200 bn RWAs = 20 bn CHF

UBS crisis losses (Q3 07 – Q4 09)

- Net loss: 40 bn CHF
- Losses/write-downs: 57 bn USD

Losses in going concern!
Gone concern much more expensive
CH-TBTF Rules: Leverage Ratio – progressive, but wrongly calibrated

Calibration of LR under status quo: in normal case slightly below RW-requirements and thus no constraint for banks

- If RWA and B/S change in same proportions: LR should keep same distance below RW-requirements
- LR with buffer & progressive component as in RWA-Ratio
  - Principle of higher LR for Swiss G-SIBs correct (no 3% flat rate as in Basel III)
  - but diluted by design

Problems of CH-LR vs. Basel III LR

Definition of capital: includes all CoCos for LR in same proportion as RWA-Ratio (35% of buffer & 100% of progressive component) → wider definition than Basel III test LR (=Tier 1); low-trigger CoCos @5% CET1 not eligible as Tier 1 → only gone concern ~ reserve for shut-down & disposal of nuclear power plants

Low Assumption for Ratio RWAs / Total Exposure → high leverage
- CH-TBTF Expert Commission: 400 / 1500 bn. = 27%
- Basel III Minimum: 3% LR / 6% Minimum Tier 1 RWA-Ratio = 50%
- Art. 134 CAO: Leverage Ratio fixed at 24% of RWA-Ratios
Swiss SRB Basel III leverage ratio

UBS’s phase-in Swiss SRB Basel III leverage ratio above minimum requirements

- UBS’s phase-in Swiss SRB Basel III leverage ratio of 3.9% on 30.6.13

\[
\frac{\text{Total capital}}{\text{Total exposure}} = \frac{\text{Phase-in CET1 + loss absorbing capital}}{\text{Total IFRS assets + adjustments}} = \frac{\text{CHF 44.9 billion}}{\text{CHF 1,141 billion}} = 3.9\%
\]

- The minimum leverage ratio is defined as the total capital requirements x 24% (e.g. expected 17.5% total capital requirement x 24% = 4.2%)

Swiss SRB Basel III leverage ratio – illustrative example (based on expected 17.5% total capital requirement)

<table>
<thead>
<tr>
<th>Year</th>
<th>Leverage Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>2.0%</td>
</tr>
<tr>
<td>2014</td>
<td>2.5%</td>
</tr>
<tr>
<td>2015</td>
<td>3.0%</td>
</tr>
<tr>
<td>2016</td>
<td>3.4%</td>
</tr>
<tr>
<td>2017</td>
<td>3.7%</td>
</tr>
<tr>
<td>2018</td>
<td>4.0%</td>
</tr>
<tr>
<td>2019</td>
<td>4.2%</td>
</tr>
</tbody>
</table>

Refer to slide 36 for details about adjusted numbers, Basel III numbers and FX rates in this presentation. For information on the leverage ratio refer to pages 75-76 of the 2Q13 financial report.
Swiss capital and leverage ratio phase-in requirements for Credit Suisse

as of 2013

Capital ratio requirements

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Progressive component</td>
<td>1.10%</td>
<td>2.02%</td>
<td>2.76%</td>
<td>3.31%</td>
<td>3.77%</td>
<td>4.13%</td>
<td>4.41%</td>
</tr>
<tr>
<td>Buffer component</td>
<td>3.50%</td>
<td>4.50%</td>
<td>5.12%</td>
<td>6.25%</td>
<td>7.12%</td>
<td>7.68%</td>
<td>8.50%</td>
</tr>
<tr>
<td>Minimum component</td>
<td>3.50%</td>
<td>4.00%</td>
<td>4.50%</td>
<td>4.50%</td>
<td>4.50%</td>
<td>4.50%</td>
<td></td>
</tr>
<tr>
<td>Swiss leverage ratio</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Effective as of January 1, for the applicable year


- Swiss Core Capital
- High-trigger BCN
- Low-trigger contingent capital

\* The progressive component requirement is dependent on our size (leverage ratio exposure) and the market share of our domestic systemically relevant business and is subject to potential capital rebates that may be granted by FINMA. Using 2012 year-end data, we estimate that the 2019 progressive component will be further reduced in 2014.
Despite progress achieved, the SNB considers that, in view of the loss potential under this scenario, the big banks’ loss-absorbing capital is still below the level needed to ensure sufficient resilience. At the end of March 2012, risk-weighted capital ratios calculated using loss-absorbing capital¹ and risk-weighted assets under the new regulations, i.e. Basel III and Swiss ‘too big to fail’ regulations, came to about 5.9% for Credit Suisse² and 7.5% for UBS.³ Relative to the net balance sheet total,⁴ however, loss-absorbing capital only amounted to around 1.7% at Credit Suisse and 2.7% at UBS. This capital would, for example, be insufficient to absorb losses such as those experienced by UBS in the recent crisis (over 3% of the net balance sheet total).

The SNB is therefore of the view that both big banks should further expand their loss-absorbing capital. For UBS, this implies a continuation of its capital strengthening process; and for Credit Suisse, an acceleration of the process, with a marked increase during the current year. Strengthening both institutions should report each quarter on the new regulatory indicators under full Basel III implementation – as, indeed, UBS has done in the two most recent presentations of its quarterly results. To transparently demonstrate their ongoing progress in risk reduction, they should calculate and disclose their risk-weighted assets not just according to internal models, but also according to the Basel standardised approach.
Impact on total loss-absorbing capital ratio as per SNB Financial Stability Report 2012

End 1Q12 Swiss total loss-absorbing capital ratio, as per SNB Financial Stability Report 2012

Immediate capital actions during July 2012
- Hybrid exchange into Buffer Capital Notes (BCNs)
- Equity issuance
- Sale of residual stake in Aberdeen
- Tier 1 participation securities

Additional capital actions by end 2012
- Employee equity investment through exchange offer for deferred cash compensation award
- Strategic divestments and real estate sales
- 2H12 earnings consensus
- Other movements in equity, deductions and risk-weighted assets (RWA) changes

Other movements & changes in RWA

End 2012 total loss-absorbing capital ratio simulation

Capital ratio impact after exchange in October 2013 of residual CHF 4.1 bn hybrid tier 1 instruments into BCNs

1 End 2012 actual adjusted for immediate capital measures and related benefit from lower threshold deductions. Using actual end 1Q12 regulatory deductions, instead of end 2012, the ratio would be 8.5% (see page 20).
Note: Strategic divestments may be announced but potentially not closed by year-end 2012; simulation assumes constant FX rates

As of today

=12.2%
"Look through" Swiss core capital ratio of 9.4% by end 2012

End 2012 "look through" capital ratio, as per end 1Q12 simulation

- **Immediate capital actions during July 2012**
  - Equity issuance via mandatory convertibles
  - Tier 1 participation securities
  - Changed dividend accrual to 100% scrip
  - +2.4%

- **Additional capital actions by end 2012**
  - Employee equity investment through exchange offer for deferred cash compensation award
  - Strategic divestments
  - +0.8%

- **Other movements & changes in RWA**
  - Change to 2012 earnings consensus
  - Other movements in equity, deductions and risk-weighted assets (RWA) changes
  - (0.8%)

End 2012 "look through" capital ratio simulation

- +2.4%
- 9.4%
Swiss Exemptions from capital surcharge on solo basis

• Law: surcharges apply on consolidated and solo level, just as general rules of Banking Act on capital, liquidity, large expos.

• Banks’ position: ExCo only agreed on level of surcharges at consolidated group level – application of 19% RWA-charge to parent bank would raise aggregate charge to 23-26%

• Parliamentary debate: big confusion and strong minority for total cap at 19%

• Non-Alignment between group and solo level comes from
  • Deduction of participations in Subs. from parent CET1, circumvented by intermediate financial holding companies
  • Centralised treasury function of parent for funding of Subs.: exempted from capital requir. at parent by EBK via G10-Relief

• FINMA forced to grant exemptions at parent bank / solo level → weakening of parent bank 🔔 Art. 125 CAO (ERV / OFP)
1 **FINMA** grants **alleviated provisions at individual entity level**, if:
   a. the **requirements at financial group level increase** due to the requirements imposed at stand-alone entity level; and
   b. the bank has taken **reasonable measures to avoid increased requirements at financial group level**.

2 Measures enforcing the implementation of a **specific corporate structure or organization** are considered **unreasonable**.

3 Changes to the corporate structure or organization make a bank entitled to alleviated provisions only if doing so will satisfy the requirements of paragraph 1.

4 In particular, the following **alleviated provisions** may be granted **individually or in combination** according to paragraph 1:
   a. the **capital adequacy** requirements for individual entities are defined in view of the requirements of the financial group. For **systemically important individual entities** the capital must amount to **at least 14%** of risk-weighted positions;
   b. the deductions for interests are reduced;
   c. the capital adequacy requirements are **reduced for intra-group exposures**; and
   d. the **group’s financing** is exempt.

5 The **particular requirements** at financial group level and at systemically important stand-alone entity level as well as the **granted alleviated provisions** are to be **disclosed** by:
   a. FINMA in regard to their main features; and
   b. the bank or financial group concerned in its ordinary disclosures, including the capital ratio.
Resolution and Organisation

• **Domestic Resolution Regime**
  • Allows continuation of banking services in an insolvency → transfer to bridge-bank
  • Supports rapid restructuring
  • Facilitates recognition of measures adopted by foreign resolution authorities

• **International Regime**
  • Cross Border Crisis preparation groups
  • Bilateral agreements / MoUs
  • International resolution regime

• **Preparation by Banks**
  • **Recovery** (Bank) and **Resolution** (Authorities) Plans
  • Reduce internal interconnectedness
  • Ensure continuation of vital services in an insolvency
  • Reduce complexity of structures, intra-group financial flows and commitments
  • Avoid geographical asymmetries

FSB Document 4/11/11: Effective Resolution of Systemically Important Banks
FSB Thematic Review on Resolution Regimes, Peer Review Report, 11 April 2013
Section XV: Transitional and Final Provisions

Art. 52

The Swiss **Federal Council** must **review** the provisions in regard to their **comparability** with the corresponding international standards and their degree of implementation abroad no later than **3 years after the entry into force** of Sections V and VI of the amendment dated 30 September 2011, and after this, at an interval of **2 years**. It will **report** its findings to the Swiss **Federal Assembly** and highlight the **possible need for amending laws and ordinances**.
Swiss political debate about tail risks

OF COURSE SUCH AN ABSOLUTE WORST-CASE SCENARIO SHOULD NEVER EVER HAPPEN AGAIN....!

BUT STILL – SWITZERLAND HAS GOT THE HIGHEST SAFETY STANDARDS...

IN OUR COUNTRY THE RISKS ARE NEGLIGIBLY LOW...

NUCLEAR POWER DEBATE?

NO, BANK REGULATION...

Source: Tages-Anzeiger, Zurich, 24.03.2011; Translated by FINMA
International measures – SIFI / SIB Policy of BCBS & FSB

• Identification of SIFIs (initial focus on banks = SIBs)
  • Global = **G-SIBs** ~ 28
  • **Methodology** comprises **5 indicators**: global activity / size (total assets) / interconnectedness / substitutability / complexity
  • domestic / regional SIBs (D-SIBs) → from 2016

• Measures / policy framework to address G-SIBs
  • Higher loss absorbency (**CET1**, CoCos, bail-in bonds)
  • Large exposure rules / enhanced **liquidity**?
  • Supervisory intensity & effectiveness → **FSB SIE Recommendations** 2/11/10
  • Resolvability (incl. nat. resolution frameworks / cross-border crisis management / RRPs = recovery & resolution plans of banks & authorities) → **FSB Key Attributes of Effective Resolution Regimes for FI, Oct. 2011**
    • (Bank levies)
  • **FSB Peer Review** to monitor implementation

• **FSB SIB Policy Framework approved by G20-Summit on 4/11/11 → phase-in 1/1/2016 - 2019**
### BCBS indicators for systemic relevance

<table>
<thead>
<tr>
<th>Category (and weighting)</th>
<th>Individual indicator</th>
<th>Indicator weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cross-jurisdictional activity (20%)</td>
<td>Cross-jurisdictional claims</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td>Cross-jurisdictional liabilities</td>
<td>10%</td>
</tr>
<tr>
<td>Size (20%)</td>
<td>Total exposures as defined for use in the Basel III leverage ratio</td>
<td>20%</td>
</tr>
<tr>
<td>Interconnectedness (20%)</td>
<td>Intra-financial system assets</td>
<td>6.67%</td>
</tr>
<tr>
<td></td>
<td>Intra-financial system liabilities</td>
<td>6.67%</td>
</tr>
<tr>
<td></td>
<td>Securities outstanding</td>
<td>6.67%</td>
</tr>
<tr>
<td>Substitutability/financial institution infrastructure (20%)</td>
<td>Assets under custody</td>
<td>6.67%</td>
</tr>
<tr>
<td></td>
<td>Payments activity</td>
<td>6.67%</td>
</tr>
<tr>
<td></td>
<td>Underwritten transactions in debt and equity markets</td>
<td>6.67%</td>
</tr>
<tr>
<td>Complexity (20%)</td>
<td>Notional amount of over-the-counter (OTC) derivatives</td>
<td>6.67%</td>
</tr>
<tr>
<td></td>
<td>Level 3 assets</td>
<td>6.67%</td>
</tr>
<tr>
<td></td>
<td>Trading and available-for-sale securities</td>
<td>6.67%</td>
</tr>
</tbody>
</table>
### BCBS progressive capital surcharges for G-SIBs

**Table 2**

<table>
<thead>
<tr>
<th>Bucket</th>
<th>Score range*</th>
<th>Higher loss absorbency requirement (common equity as a percentage of risk-weighted assets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>empty</td>
<td>3.5%</td>
</tr>
<tr>
<td>4</td>
<td>C–D</td>
<td>2.5%</td>
</tr>
<tr>
<td>3</td>
<td>B–C</td>
<td>2.0%</td>
</tr>
<tr>
<td>2</td>
<td>A–B</td>
<td>1.5%</td>
</tr>
<tr>
<td>1</td>
<td>Cutoff point–A</td>
<td>1.0%</td>
</tr>
</tbody>
</table>

* All score ranges are equal in size. Scores equal to one of the boundaries are assigned to the higher bucket.
Illustrative distribution of scores of G-SIBs and their allocation to buckets (BCSB report July 2013: updated assessment methodology)
G-SIBs as of November 2012 allocated to buckets corresponding to required level of additional loss absorbency (FSB, 1 November 2012)

<table>
<thead>
<tr>
<th>Bucket&lt;sup&gt;4&lt;/sup&gt;</th>
<th>G-SIBs in alphabetical order within each bucket</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 (3.5%)</td>
<td>(Empty)</td>
</tr>
<tr>
<td>4 (2.5%)</td>
<td>Citigroup</td>
</tr>
<tr>
<td></td>
<td>Deutsche Bank</td>
</tr>
<tr>
<td></td>
<td>HSBC</td>
</tr>
<tr>
<td></td>
<td>JP Morgan Chase</td>
</tr>
<tr>
<td>3 (2.0%)</td>
<td>Barclays</td>
</tr>
<tr>
<td></td>
<td>BNP Paribas</td>
</tr>
<tr>
<td>2 (1.5%)</td>
<td>Bank of America</td>
</tr>
<tr>
<td></td>
<td>Bank of New York Mellon</td>
</tr>
<tr>
<td></td>
<td><strong>Credit Suisse</strong></td>
</tr>
<tr>
<td></td>
<td>Goldman Sachs</td>
</tr>
<tr>
<td></td>
<td>Mitsubishi UFJ FG</td>
</tr>
<tr>
<td></td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td></td>
<td>Royal Bank of Scotland</td>
</tr>
<tr>
<td></td>
<td>UBS</td>
</tr>
<tr>
<td>1 (1.0%)</td>
<td>Bank of China</td>
</tr>
<tr>
<td></td>
<td>BBVA</td>
</tr>
<tr>
<td></td>
<td>Groupe BPCE</td>
</tr>
<tr>
<td></td>
<td>Group Crédit Agricole</td>
</tr>
<tr>
<td></td>
<td>ING Bank</td>
</tr>
<tr>
<td></td>
<td>Mizuho FG</td>
</tr>
<tr>
<td></td>
<td>Nordea</td>
</tr>
<tr>
<td></td>
<td>Santander</td>
</tr>
<tr>
<td></td>
<td>Société Générale</td>
</tr>
<tr>
<td></td>
<td>Standard Chartered</td>
</tr>
<tr>
<td></td>
<td>State Street</td>
</tr>
<tr>
<td></td>
<td>Sumitomo Mitsui FG</td>
</tr>
<tr>
<td></td>
<td>Unicredit Group</td>
</tr>
<tr>
<td></td>
<td>Wells Fargo</td>
</tr>
</tbody>
</table>
Have we solved the TBTF problem? – No!


http://www.swissfinanceinstitute.ch/podcasts.htm
Basel III review - Regulatory Consistency Assessment Program
BCBS: Fundamental review of trading book capital requirements
Consultative Document, May 2012

• More objective boundary between Trading Book – Banking Book → reduce scope for regulatory arbitrage. Two alternative boundary definitions:
  • Trading evidence: evidence on ability to trade & risk manage on trading desk
  • Valuation based: when changes in fair value pose risks to solvency

• Move from VaR to expected shortfall → better capture tail risk – expected value of losses beyond given confidence level

• Stressed calibration for both SA and internal models

• Comprehensive incorporation of risk of market illiquidity

• Reduce model risk by more granular models approval process & constraints on diversification

• Revised Standardised Approach (SA) → more risk sensitive and credible fallback to internal models

• Strengthen relationship between internal models and SA
  • Mandatory calculation of SA by all banks
  • Consider merits of SA as floor or surcharge to internal models approach
  • Closer alignment of treatment of hedging & diversification in both approaches
• **Level 1: Timely adoption of Basel III**
  
  Ensure that Basel III is transformed into domestic regulation according to international timelines. **No review of content / substance** of domestic rules.

• **Level 2: Regulatory consistency**
  
  Ensure **compliance of domestic regulations with international minimum requirements**, starting with EU, Japan and US; 2013 SGP, CH, China (priority: home countries of G-SIBs)

• **Level 3: Consistency of outcomes, initially focused on risk-weighted assets**
  
  Examine whether there are **unjustifiable inconsistencies in risk measurement approaches** across banks and jurisdictions → review of banks’ risk-weighting practices via test portfolio exercises, horizontal reviews & joint on-site visits to large, internationally active banks → **expert groups** on banking / trading book → **policy recommendations** to address identified inconsistencies

• BCBS report: Analysis of RWA for **market risk in trading book**, January 2013

• BCBS report: Analysis of RWA for **credit risk in banking book**, July 2013
BCBS Regulatory Consistency Assessment Program – Analysis of RWAs for market risk in the trading book, January 2013: key findings

• Analysis based on public reports:
  • Considerable variation in average published mRWAs / trading assets
    • from 10% to nearly 80% (most banks between 15% to 45%)
    • Only part of the variations can be explained by actual risk taking, but other factors may be driving variations across banks & jurisdictions:
      • Differences in supervisory approaches and requirements
      • Differences in methodologies and modelling choices
  • Hypothetical test portfolio exercise
    • Substantial difference between bank with lowest / highest mRWAs, due to
      • Variation caused by banks’ model choices (e.g. length of data period)
      • Variation caused by differences in supervisory multipliers (¼ of total)
        • ranging from 3 to 5.5
  • Potential policy responses: improved public disclosure; narrow down banks’ modelling choices; further harmonisation of supervisory practices
BCBS Regulatory Consistency Assessment Program – Analysis of RWAs for credit risk in the banking book, July 2013: key findings

- **Focus on credit risk important**: largest component of RWAs (60-80%); dominant source of variation at bank level (77% of observed variation)

- Focus on banks under **internal ratings-based (IRB) approach**

- **Top down analysis**: Supervisory data on > 100 major banks worldwide

- **up to ¾ of RWA-variation** driven by underlying **differences in risk composition** of banks’ assets → consistent with higher risk sensitivity intended by Basel framework

- **Remaining variation** driven by **practices of supervisors** (e.g. floors, partial use of standardised app.) or **banks** under IRB (e.g. Advanced vs. Foundation; model assumptions)

- **Bottom up hypothetical portfolio benchmarking exercise (HPE)**: matching **wholesale exposures** (sovereign, bank, corporate) of 32 large international banking groups from 13 jurisdictions (~ G-SIBs)

- **High degree of consistency** in banks’ assessment of the **relative riskiness of obligors** (same ranking order of individual borrowers within portfolio); however, **differences in levels** of estimated risk → notable **dispersion in estimates for PD and LGD** assigned to same exposures

- **Material impact on capital ratios**: extremes of 1.5 – 2 percentage points around 10% benchmark; however most banks (22 of 32) lie within one percentage point

- **Policy options for consideration**: enhanced disclosure (short-term); further harmonise national implementation & put constraints on IRB parameter estimates (medium term)
Risk-weighted assets as base for capital requirements – credit risk standardised approach

- **Cash, Gov.**
- **Banks**
- **Resid. Mortgage**
- **Retail**
- **Private sector**

Bar chart showing the distribution of risk-weighted assets (%)

- B/S
  - 0%
  - 20%
  - 35%
  - 75%
  - 100%

- RWA
  - 0%
  - 100%

- Capital-req.
  - Cash, Gov.
  - Banks
  - Resid. Mortgage
  - Retail
  - Private sector
### Risk density: Ratio of RWAs / Total Exposure

#### 2Q13

<table>
<thead>
<tr>
<th></th>
<th>B/S Assets</th>
<th>Total Exposure</th>
<th>RWA Basel III</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UBS</strong></td>
<td>1129</td>
<td>1141</td>
<td>239</td>
</tr>
<tr>
<td><strong>CS</strong></td>
<td>920</td>
<td>1282</td>
<td>290</td>
</tr>
<tr>
<td><strong>Domestic Bank</strong></td>
<td>150</td>
<td>150</td>
<td>75</td>
</tr>
</tbody>
</table>

- Risk density for UBS: 21%
- Risk density for CS: 23%
- Risk density for Domestic Bank: 50%
IMF: Swiss G-SIBs have among the lowest ratios of RWAs/Total Assets within G-SIBs

Risk Weighted Assets to Total Assets (Percent)

Sources: Bankscope

IMF: Swiss G-SIBs are still well below their peer average and below most of their peers – simple leverage ratio: tangible equity / total assets

## Table 1: Capitalization Ratios for Global Systemically Important Banks

Data as of Fourth Quarter 2012

<table>
<thead>
<tr>
<th>Institution</th>
<th>Basel Risk-Based Capital</th>
<th>Tangible Capital</th>
<th>Components of Tangible Capital</th>
<th>Price-to-Book</th>
<th>Price-to-Adjusted Tangible Book</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Tier 1 Capital²</td>
<td>Risk-Weighted Assets</td>
<td>Tier 1 Capital Ratio³</td>
<td>Leverage Ratio²</td>
<td>Total Assets (Billion)</td>
</tr>
<tr>
<td>U.S. G-SIBs</td>
<td>155</td>
<td>1,206</td>
<td>12.89</td>
<td>2,212</td>
<td>5.79</td>
</tr>
<tr>
<td>Bank of America</td>
<td>17</td>
<td>111</td>
<td>15.02</td>
<td>359</td>
<td>4.02</td>
</tr>
<tr>
<td>Bank of New York Mellon</td>
<td>137</td>
<td>971</td>
<td>14.06</td>
<td>1,865</td>
<td>5.61</td>
</tr>
<tr>
<td>Citigroup</td>
<td>667</td>
<td>400</td>
<td>16.75</td>
<td>939</td>
<td>7.07</td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>160</td>
<td>1,270</td>
<td>12.59</td>
<td>2,359</td>
<td>5.89</td>
</tr>
<tr>
<td>JPMorgan Chase</td>
<td>54</td>
<td>307</td>
<td>17.72</td>
<td>781</td>
<td>5.79</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>14</td>
<td>72</td>
<td>19.13</td>
<td>222</td>
<td>5.78</td>
</tr>
<tr>
<td>State Street</td>
<td>127</td>
<td>1,077</td>
<td>11.75</td>
<td>1,423</td>
<td>8.13</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>730</td>
<td>5,415</td>
<td>13.49</td>
<td>10,160</td>
<td>6.17</td>
</tr>
<tr>
<td>Average U.S. G-SIBs</td>
<td>80</td>
<td>716</td>
<td>11.17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign G-SIBs</td>
<td>61</td>
<td>1,149</td>
<td>10.54</td>
<td>939</td>
<td>6.53</td>
</tr>
<tr>
<td>Banco Santander (Spain)</td>
<td>46</td>
<td>423</td>
<td>10.77</td>
<td>819</td>
<td>4.04</td>
</tr>
<tr>
<td>Bank of China Limited (China)</td>
<td>97</td>
<td>709</td>
<td>13.63</td>
<td>2,451</td>
<td>3.47</td>
</tr>
<tr>
<td>Barclays (UK)</td>
<td>60</td>
<td>491</td>
<td>12.17</td>
<td>1,474</td>
<td>4.27</td>
</tr>
<tr>
<td>BBVA (Spain)</td>
<td>79</td>
<td>617</td>
<td>12.86</td>
<td>2,580</td>
<td>2.72</td>
</tr>
<tr>
<td>BNP Paribas (France)</td>
<td>65</td>
<td>458</td>
<td>14.19</td>
<td>2,734</td>
<td>4.17</td>
</tr>
<tr>
<td>BPCE Group (France)</td>
<td>151</td>
<td>1,224</td>
<td>13.44</td>
<td>2,693</td>
<td>5.16</td>
</tr>
<tr>
<td>Credit Agricole Group (France)</td>
<td>61</td>
<td>358</td>
<td>14.35</td>
<td>1,074</td>
<td>4.11</td>
</tr>
<tr>
<td>Deutsche Bank (Germany) *</td>
<td>51</td>
<td>358</td>
<td>14.35</td>
<td>1,074</td>
<td>4.11</td>
</tr>
<tr>
<td>HSBC (UK)</td>
<td>31</td>
<td>276</td>
<td>11.17</td>
<td>870</td>
<td>3.65</td>
</tr>
<tr>
<td>ING Bank (Netherlands)</td>
<td>90</td>
<td>726</td>
<td>12.43</td>
<td>2,073</td>
<td>3.72</td>
</tr>
<tr>
<td>Nordea bank (Sweden)</td>
<td>52</td>
<td>416</td>
<td>12.50</td>
<td>1,607</td>
<td>2.84</td>
</tr>
<tr>
<td>Royal Bank of Scotland (UK)</td>
<td>41</td>
<td>302</td>
<td>13.45</td>
<td>637</td>
<td>5.77</td>
</tr>
<tr>
<td>Société Générale (France)</td>
<td>44</td>
<td>205</td>
<td>21.69</td>
<td>1,285</td>
<td>2.52</td>
</tr>
<tr>
<td>Standard Chartered (UK)</td>
<td>63</td>
<td>549</td>
<td>11.44</td>
<td>1,191</td>
<td>5.57</td>
</tr>
<tr>
<td>UBS (Switzerland)</td>
<td>1,151</td>
<td>9,129</td>
<td>12.61</td>
<td>27,540</td>
<td>3.70</td>
</tr>
<tr>
<td>Other Foreign G-SIBs</td>
<td>37</td>
<td>239</td>
<td>15.56</td>
<td>986</td>
<td>3.69</td>
</tr>
<tr>
<td>Credit Suisse (Switzerland; CHF, U.S. GAAP)</td>
<td>136</td>
<td>1,114</td>
<td>12.22</td>
<td>2,672</td>
<td>5.07</td>
</tr>
<tr>
<td>Mitsubishi UFJ FG (Japan; JPY, Local GAAP)</td>
<td>81</td>
<td>633</td>
<td>12.75</td>
<td>2,654</td>
<td>3.66</td>
</tr>
<tr>
<td>Mizuho FG (Japan; JPY, Local GAAP)</td>
<td>84</td>
<td>654</td>
<td>12.81</td>
<td>1,692</td>
<td>4.76</td>
</tr>
<tr>
<td>Sumitomo Mitsui FG (Japan; JPY, Local GAAP)</td>
<td>1,489</td>
<td>11,769</td>
<td>12.65</td>
<td>34,954</td>
<td>3.85</td>
</tr>
<tr>
<td>Average All Foreign G-SIBs</td>
<td>730</td>
<td>5,415</td>
<td>13.49</td>
<td>10,160</td>
<td>6.17</td>
</tr>
<tr>
<td>Average U.S. BHC by Size Group³</td>
<td>171</td>
<td>1,499</td>
<td>11.41</td>
<td>1,913</td>
<td>8.21</td>
</tr>
<tr>
<td>U.S. G-SIBs</td>
<td>10 Largest Non-G-SIBs²</td>
<td>24</td>
<td>191</td>
<td>12.85</td>
<td>293</td>
</tr>
<tr>
<td>Ten Largest Less Than $50 Billion</td>
<td>7</td>
<td>7</td>
<td>13.40</td>
<td>8.67</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: Bankscope (Data updated as of April 4, 2013), Bloomberg LP, Federal Reserve Y-9C Reports, International Monetary Fund, and 10-Q reports.

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Base II Capital: A Well Intended Illusion
T. Hoenig, FDIC, Speech at IADI, 9/4/13
<table>
<thead>
<tr>
<th></th>
<th>Risk Weights</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.</td>
<td>Residential properties in Switzerland and abroad, up to two-thirds of the current market value.</td>
</tr>
<tr>
<td>3.1</td>
<td>Residential properties in Switzerland and abroad, up to two-thirds and up to 80% of the current market value.</td>
</tr>
<tr>
<td>3.2</td>
<td>Residential properties in Switzerland and abroad, above 80% of the current market value.</td>
</tr>
<tr>
<td>3.3</td>
<td>Other properties and objects</td>
</tr>
<tr>
<td>3.4</td>
<td>Positions in directly or indirectly secured mortgage loans</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

RWA for residential mortgages – Standardised Approach (CAO, App. 3)
Ø RWA for residential mortgages – A-IRB UBS 2012

<table>
<thead>
<tr>
<th></th>
<th>Investment grade</th>
<th>Sub-Investment grade</th>
<th>Regulatory net credit exposure-weighted average risk weight</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Internal UBS rating</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In %</td>
<td>0/1</td>
<td>2/3</td>
<td>4/5</td>
</tr>
<tr>
<td>Internal UBS rating</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0/1</td>
<td>2/3</td>
<td>4/5</td>
</tr>
<tr>
<td></td>
<td>0/1</td>
<td>2/3</td>
<td>4/5</td>
</tr>
<tr>
<td>Regulatory net credit exposure-weighted average risk weight</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporates</td>
<td>6</td>
<td>10</td>
<td>45</td>
</tr>
<tr>
<td>Sovereigns</td>
<td>1</td>
<td>20</td>
<td>94</td>
</tr>
<tr>
<td>Banks</td>
<td>11</td>
<td>12</td>
<td>26</td>
</tr>
<tr>
<td>Retail</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential mortgages</td>
<td>3</td>
<td>7</td>
<td>17</td>
</tr>
<tr>
<td>Lombard lending</td>
<td>3</td>
<td>10</td>
<td>18</td>
</tr>
<tr>
<td>Other retail</td>
<td>3</td>
<td>4</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average 31.12.12</td>
<td>2</td>
<td>8</td>
<td>17</td>
</tr>
<tr>
<td>Average 31.12.11</td>
<td>2</td>
<td>9</td>
<td>20</td>
</tr>
</tbody>
</table>

UBS Annual Report 2012, p. 195
### Ø RWA for residential mortgages – A-IRB Credit Suisse 2012

<table>
<thead>
<tr>
<th></th>
<th>A-IRB Pre-substitution</th>
<th>A-IRB Post-substitution</th>
<th>Standardized</th>
<th>Risk-weighted assets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sovereigns</td>
<td>64,930</td>
<td>63,378</td>
<td>6,165</td>
<td>69,543</td>
</tr>
<tr>
<td>Other institutions</td>
<td>5,737</td>
<td>5,431</td>
<td>-</td>
<td>5,864</td>
</tr>
<tr>
<td>Banks</td>
<td>46,403</td>
<td>50,822</td>
<td>1,122</td>
<td>51,967</td>
</tr>
<tr>
<td>Corporates</td>
<td>177,115</td>
<td>174,554</td>
<td>1,014</td>
<td>176,073</td>
</tr>
<tr>
<td><strong>Total institutional credit exposures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential mortgage</td>
<td>294,185</td>
<td>294,185</td>
<td>8,225</td>
<td>303,447</td>
</tr>
<tr>
<td>Qualifying revolving retail</td>
<td>155</td>
<td>156</td>
<td>-</td>
<td>260</td>
</tr>
<tr>
<td>Other retail</td>
<td>57,766</td>
<td>57,766</td>
<td>-</td>
<td>57,776</td>
</tr>
<tr>
<td><strong>Total retail credit exposures</strong></td>
<td></td>
<td></td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Other exposures</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>14,164</td>
</tr>
<tr>
<td><strong>Total gross credit exposures</strong></td>
<td></td>
<td></td>
<td>1,037</td>
<td>22,397</td>
</tr>
</tbody>
</table>

Credit Suisse Basel II Pillar 3 – disclosures 2012, p. 9
### CAO, Appendix 2

<table>
<thead>
<tr>
<th>No.</th>
<th>Position categories (SA-BIS) with the option to use external ratings</th>
<th>Rating categories</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th>Unrated</th>
<th>Fixed</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Corporates</td>
<td>20%</td>
<td>20%</td>
<td>50%</td>
<td>100%</td>
<td>100%</td>
<td>150%</td>
<td>150%</td>
<td>100%</td>
</tr>
</tbody>
</table>

### CAO, Appendix 3

<table>
<thead>
<tr>
<th>1.</th>
<th>Individuals and small businesses (retail positions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1.</td>
<td>Retail positions, if the total position value as per art. 49 para. 1, excluding residential mortgage-backed security, does not exceed CHF 1.5m or 1% of all retail positions to a single counterparty.</td>
</tr>
<tr>
<td>1.2.</td>
<td>Other retail positions</td>
</tr>
<tr>
<td>Internal UBS rating</td>
<td>Investment grade</td>
</tr>
<tr>
<td>--------------------</td>
<td>------------------</td>
</tr>
<tr>
<td>In %</td>
<td>0/1</td>
</tr>
<tr>
<td>Corporates</td>
<td>6</td>
</tr>
<tr>
<td>Sovereigns</td>
<td>1</td>
</tr>
<tr>
<td>Banks</td>
<td>11</td>
</tr>
<tr>
<td>Retail</td>
<td></td>
</tr>
<tr>
<td>Residential mortgages</td>
<td>3</td>
</tr>
<tr>
<td>Lombard lending</td>
<td>3</td>
</tr>
<tr>
<td>Other retail</td>
<td>3</td>
</tr>
<tr>
<td>Average 31.12.12</td>
<td>2</td>
</tr>
<tr>
<td>Average 31.12.11</td>
<td>2</td>
</tr>
</tbody>
</table>
### Gross credit exposures by regulatory approach and risk-weighted assets

<table>
<thead>
<tr>
<th></th>
<th>Pre-substitution</th>
<th>Post-substitution</th>
<th>A-IRB</th>
<th>Standardized</th>
<th>Total</th>
<th>Risk-weighted assets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>PD/LGD</td>
<td>SRW</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>end of 2012 (CHF million)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sovereigns</td>
<td>64,930</td>
<td>63,378</td>
<td>6,165</td>
<td>69,543</td>
<td>4,831</td>
<td></td>
</tr>
<tr>
<td>Other Institutions</td>
<td>5,737</td>
<td>5,431</td>
<td>433</td>
<td>5,864</td>
<td>1,387</td>
<td></td>
</tr>
<tr>
<td>Banks</td>
<td>46,403</td>
<td>50,822</td>
<td>1,122</td>
<td>51,967</td>
<td>14,382</td>
<td></td>
</tr>
<tr>
<td>Corporates</td>
<td>177,115</td>
<td>174,554</td>
<td>1,014</td>
<td>505</td>
<td>176,073</td>
<td>76,373</td>
</tr>
<tr>
<td>Total institutional credit exposures</td>
<td>294,185</td>
<td>294,185</td>
<td>1,037</td>
<td>8,225</td>
<td>303,447</td>
<td>98,973</td>
</tr>
<tr>
<td>Residential mortgage</td>
<td>96,425</td>
<td>96,425</td>
<td>23</td>
<td>96,425</td>
<td>10,148</td>
<td></td>
</tr>
<tr>
<td>Qualifying revolving retail</td>
<td>155</td>
<td>155</td>
<td>155</td>
<td>260</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other retail</td>
<td>57,768</td>
<td>57,768</td>
<td>8</td>
<td>57,776</td>
<td>9,823</td>
<td></td>
</tr>
<tr>
<td>Total retail credit exposures</td>
<td>154,349</td>
<td>154,349</td>
<td>8</td>
<td>154,357</td>
<td>20,231</td>
<td></td>
</tr>
<tr>
<td>Other exposures</td>
<td>14,164</td>
<td>14,164</td>
<td>7,876</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total gross credit exposures</td>
<td>448,534</td>
<td>448,534</td>
<td>1,037</td>
<td>22,397</td>
<td>471,968</td>
<td>125,080</td>
</tr>
</tbody>
</table>

43% 17%
Die Selbstregulierung der Grossbanken hat versagt

Das Konzept der Berechnung risikogewichteter Aktiven mittels bankeigener Modelle der UBS und der CS steht zunehmend in der Kritik

Martin Lanz, NZZ vom 25.5.2013, S. 31

Weitergeleiteter Artikel aus der «Neuen Zürcher Zeitung» vom 21.06.2013, Seite 21:

Die Grossbanken und des Kaisers neue Kleider

Die Credit Suisse und die UBS können sich nicht mehr hinter ihren vergleichsweise hohen risikogewichteten Kapitalquoten verstecken. Einfache Masse sind gefragt. Von Martin Lanz
Measures to correct too low RWAs – Bottom-up approach

- Enhanced disclosure
  - Internal models: parallel calculation based on standardised approach (Art. 47 CAO, FINMA) and publish (SNB recom. in FSR 2012 & 2013)
  - Publish quantitative assessment of total risk, e.g. CS Economic Risk Capital (SNB recom. in FSR 2013)
  - Increase transparency of RWA-reduction: break-down by cause, esp. proportion attributable to model adjustments (SNB recom. FSR 2013)

- Multipliers on internal models (as on VaR for market risk)
  - FINMA-Multiplier for IRB residential mortgages (incremental from 2013)
  - Multipliers for all internal models

- Permanent floor for internal models based on standardised approach
  - e.g. 30% for residential mortgages

- Countercyclical buffer: multiplier for IRB banks (A-IRB ≈ 3)
  - Urgent: stop additional competitive distortion / maximise macro impact
Calibration of LR under status quo: in normal case slightly below RW-requirements and thus no constraint for banks

- If RWA and B/S change in same proportions: LR should keep same distance below RW-requirements
- LR with **buffer & progressive component** as in RWA-Ratio
  - Principle of higher LR for Swiss G-SIBs correct (**no 3% flat rate** as in Basel III)
  - But diluted by design

**Problems of CH-LR vs. Basel III LR**

- **Definition of capital**: includes all CoCos for LR in same proportion as RWA-Ratio (35% of buffer & 100% of progressive component) → **wider definition** than Basel III test LR (=Tier 1); low-trigger CoCos @5% CET1 not eligible as Tier 1 → only gone concern ~ reserve for shut-down & disposal of nuclear power plants

- **Low Assumption for Ratio RWAs / Total Exposure** → high leverage
  - CH-TBTF Expert Commission: 400 / 1500 bn. = 27%
  - Basel III Minimum: 3% LR / 6% Minimum Tier 1 RWA-Ratio = 50%
  - Art. 134 CAO: **Leverage Ratio fixed at 24% of RWA-Ratios**
Swiss SRB Basel III leverage ratio

UBS’s phase-in Swiss SRB Basel III leverage ratio above minimum requirements

- **UBS’s phase-in Swiss SRB Basel III leverage ratio of 3.9% on 30.6.13**

  \[
  \frac{\text{Total capital}}{\text{Total exposure}} = \frac{\text{CHF 44.9 billion}}{\text{CHF 1,141 billion}} = 3.9\%
  \]

- The minimum leverage ratio is defined as the total capital requirements x 24% (e.g. expected 17.5% total capital requirement x 24% = 4.2%)

**Swiss SRB Basel III leverage ratio – illustrative example (based on expected 17.5% total capital requirement)**

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Ratio</td>
<td>2.0%</td>
<td>2.5%</td>
<td>3.0%</td>
<td>3.4%</td>
<td>3.7%</td>
<td>4.0%</td>
<td>4.2%</td>
</tr>
</tbody>
</table>

Refer to slide 36 for details about adjusted numbers, Basel III numbers and FX rates in this presentation.

1 For information on the leverage ratio refer to pages 75-76 of the 2Q13 financial report.
### Swiss capital and leverage ratio phase-in requirements for Credit Suisse

As of 2013

<table>
<thead>
<tr>
<th>Capital ratio requirements</th>
<th>Progressive component</th>
<th>Buffer component</th>
<th>Minimum component</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.10%</td>
<td>2.02%</td>
<td>2.76%</td>
</tr>
<tr>
<td></td>
<td>3.50%</td>
<td>4.50%</td>
<td>5.12%</td>
</tr>
<tr>
<td></td>
<td>3.50%</td>
<td>4.00%</td>
<td>4.50%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Swiss leverage ratio requirements</th>
<th>Effective as of January 1, for the applicable year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Swiss Core Capital</td>
<td>1.94%</td>
</tr>
<tr>
<td>High-trigger BCN</td>
<td>0.26%</td>
</tr>
<tr>
<td>Low-trigger contingent capital</td>
<td>0.24%</td>
</tr>
</tbody>
</table>

1. The progressive component requirement is dependent on our size (leverage ratio exposure) and the market share of our domestic systemically relevant business and is subject to potential capital rebates that may be granted by FINMA. Using 2012 year-end data, we estimate that the 2019 progressive component will be further reduced in 2014.
4.1 RESILIENCE OF THE BIG BANKS

When assessing the big banks’ resilience, the SNB focuses on loss-absorbing capital in a “going concern” perspective. This loss-absorbing capital comprises Common Equity Tier 1 (CET 1), using the definition of the fully implemented Basel III framework, plus high-trigger contingent capital instruments as set out in the Swiss “too big to fail” regulations.

Leverage ratio low

In terms of the leverage ratio – the unweighted capital ratio – Credit Suisse has improved significantly, and UBS’s leverage ratio has increased moderately. In the first quarter of 2013, leverage ratios, calculated as loss-absorbing capital relative to total exposure, came at 2.3% at both banks. From 2019, these leverage ratios are required to be at least 3.1% under the provisions of the “too big to fail” regulations. In terms of total capital, the leverage ratio the SNB still considers current leverage ratios at the Swiss big banks to be low. For instance, during the recent crisis, UBS suffered losses amounting to around 2% of its total exposure. In addition, a number of comparative studies imply that, in terms of leverage ratios, the two big banks are currently below the international average. These
Measures to correct too low RWAs – Top-down approach

• **Leverage Ratio to be given equal weight to RWA-Ratios** (Haldane)
  • Credible back-stop against RWA-erosion and model manipulation
  • Ideally LR and RWA-Ratios should constantly be in competition
  • Not abolish RWA-requirements; LR alone would encourage excessive risk taking
  • RWA-Ratio alone is not robust

• **Capital surcharge for G-SIBs not to be limited to RWA-Ratios**
  • Flat rate LR for all banks conceptually wrong ≠ one-size-fits-all
  • Historic reasons of BCBS no longer valid
  • LR was highly controversial in Basel III discussions (2010)
  • Capital surcharge for G-SIBs was a difficult compromise (2011)
Align Leverage Ratio with RW-Ratios in Capital Adequacy Ordinance

Chapter 4  Capital Adequacy Requirements with No Risk-Weighting (Leverage Ratio)

Art. 133  Principle

1 Systemically important banks must fulfill particular capital adequacy requirements relative to their total commitment.

2 The capital adequacy requirements consist of a basic requirement, a capital buffer and a progressive component. Subject to art. 134, they are informed by the provisions of Chapter 3 in regard to risk-weighted capital.

Art. 134  Calculation

The non-risk-weighted capital adequacy requirements calculated based on the total commitment amounts to 50% of the percentages of:

a. the basic requirements as per art. 128 para. 1;

b. the capital buffer as per art. 129 paras. 1 and 2; and

c. the progression rate as per art. 131 para. 1.

CET1: 5%
CoCos@7: 1.5%
CoCos@5: 2.5%
CAPITAL TO ASSET RATIOS

Distribution of Tier 1 capital to total asset ratios of domestically focused commercial banks

Sources: FINMA, SNB

Financial Stability Report 2013
U.S. Weighs Doubling Leverage Standard for Biggest Banks

By Yalman Onaran - Jun 21, 2013 10:28 PM GMT+0200

U.S. regulators are considering doubling a minimum capital requirement for the largest banks, which could force some of them to halt dividend payments.

The standard would increase the amount of capital the lenders must hold to 6 percent of total assets, regardless of their risk, according to four people with knowledge of the talks. That's twice the level set by global banking supervisors.

**Hoenig Rule**

FDIC Vice Chairman Thomas Hoenig has called for scrapping risk-based rules entirely in favor of a 10 percent leverage ratio, calculated to include even more off-balance-sheet assets than allowed under Basel and define capital more narrowly. To reach Hoenig’s requirements, the three largest U.S. banks -- JPMorgan, Bank of America and Citigroup (C) -- would have to stop distributing dividends for about five years, according to FDIC data and analysts’ earnings expectations compiled by Bloomberg.

The Systemic Risk Council, an advisory group led by former FDIC Chairman Sheila Bair, has called for 8 percent. Bair fought for a global leverage ratio in Basel committee meetings when she led the U.S. agency.
For immediate release

July 9, 2013

Agencies Adopt Supplementary Leverage Ratio Notice of Proposed Rulemaking

The Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) on Tuesday proposed a rule to strengthen the leverage ratio standards for the largest, most systemically significant U.S. banking organizations.

Under the proposed rule, bank holding companies with more than $700 billion in consolidated total assets or $10 trillion in assets under custody (covered BHCs) would be required to maintain a tier 1 capital leverage buffer of at least 2 percent above the minimum supplementary leverage ratio requirement of 3 percent, for a total of 5 percent. Failure to exceed the 5 percent ratio would subject covered BHCs to restrictions on discretionary bonus payments and capital distributions. In addition to the leverage buffer for covered BHCs, the proposed rule would require insured depository institutions of covered BHCs to meet a 6 percent supplementary leverage ratio to be considered "well capitalized" for prompt corrective action purposes. The proposed rule would currently apply to the eight largest, most systemically significant U.S. banking organizations.
Even more equity capital

Leverage Ratio of 20 – 30% CET1 for biggest banks
Capital levels – the right direction?

Historic ratios of capital to balance sheet of Swiss Large Banks

From 1995 consolidated data (Source: Swiss National Bank)
Andrew Haldane: The dog and the frisbee – less may be more

• Decision-making in a complex environment can benefit from the use of simple decision rules of thumb

• Regulatory responses to financial crises have been to increase complexity with a combination of more risk management, more regulation and more regulators

• Evolution of Basel Accords: higher opacity and complexity associated with increasingly granular model-based risk-weighting & dramatically increased detailed rule writing & scale and scope of resources dedicated to regulation

• 5 policy lessons for financial regulation

1. **Basel framework** to take more sceptical view of role and robustness of internal risk models in regulation → use simplified standardised approaches for CR & MR, on broad asset class basis

2. **Leverage Ratio** to be placed on equal footing with risk-weighted capital ratios

3. **Financial supervision** less rules-focussed and more judgment based → more experienced regulators working to smaller, less detailed rulebook & simpler disclosure

4. **Tackling complexity** at the source → capital charge for complexity

5. **Quantity based restrictions** such as Volcker rule or UK (Vickers) or EU (Liikaanen) proposals o.k., but risk being mired in implementation detail → cleaner solutions

**Radical U-turn** of regulatory community from path followed for 50 years, but less may be more

_http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech596.pdf_
• 2012 BCBS mandated **Task Force on Simplicity and Complexity**: Review Basel capital framework to identify opportunities to **remove undue complexity** and **improve comparability of its outcomes**. Acknowledgement that framework has steadily grown over time as risk coverage has been expanded and more sophisticated measurement technologies have been introduced.

• Paper discusses **reasons** behind evolution of current framework and outlines potential **benefits and costs** that arise from a more risk sensitive methodology. Discusses **ideas** that could possibly be explored to further reform the framework with the **objective** that it continues to strike an appropriate **balance** between the **complementary goals of risk sensitivity, simplicity** and **comparability**.

• **No decision yet to pursue any of the ideas** presented: seek comments and feedback from interested stakeholders.

• BCBS remains firmly of the view that **full, timely and consistent implementation of Basel III** remains fundamental to building a resilient financial system. Adopting Basel III reforms is itself an **important step in improving consistency of bank regulation globally**.
• Para. 29: Ideas should be assessed against the primary aims of the capital adequacy framework:

• Sound minimum standard for internationally active banks, but also capable of application to smaller institutions

• Well understood measure that is comparable across banks and over time

• Support a reasonable level playing field between banks

• Take into account effects of capital requirements on banks’ risk-taking incentives, e.g. when faced with regulatory constraints on their capital (and size of balance sheet), to seek higher-risk assets as a means of boosting expected returns

• Promote improved risk measurement and management within banks
Potential ideas to improve simplicity and comparability

Explicitly recognising simplicity as an additional objective

Enhancing disclosure

Using additional metrics

Ensuring the effectiveness of the leverage ratio

Utilising added floors and benchmarks to mitigate the consequences of complexity

Reconsidering the linkage between internal and regulatory models

Limiting national discretion and improving supervisory consistency

Improving the accessibility of Basel Committee documents

Addressing factors driving complexity in a more fundamental manner
Conclusions on the evolution of capital adequacy frameworks

- 4 decades of **international capital adequacy rules** as core of bank regulation → limited national discretion, but no level playing field → **maximum harmonisation** neither feasible nor desirable (≠ one-size-fits-all)

- **Minimum standards**: result of **bargaining and political compromises**

- **Started with simple rules**, but growing **complexity of financial sector** and regulatory arbitrage led to ever more **complex regulation**

- **Regulation is reactive**: response to past **failures and crises**

- **Trial and error / regulatory cycles**: cat and mouse game
  - **Strong influence of banking lobby in boom times** to optimise capital and return on equity → **market-friendly** regulation → expansive use of **internal models** as an **incentive** for better **risk management** & **risk sensitivity** → resulted in **much less capital** for “sophisticated” G-SIBs
  - Long domination by **industrialised world** and needs of its **global firms**
Conclusions on the evolution of capital adequacy frameworks

- Financial crisis 2008 reversed trend and increased power of regulators
  - Crisis of western banking system → shift of power to emerging markets
  - Financial “innovations” questioned: what is their use for society?
  - Public bank bail-outs made banks unpopular and politically weaker
  - TBTF acknowledged as fundamental problem → measures initiated, but insufficient (including Switzerland)

- Back to basics and restrictions on use of internal models
  - Higher quantity and quality of capital
  - Leverage ratio as simple back-stop to risk-weighted ratios
  - Floors based on standardised approaches (not decided yet)
  - Trend to utility banks → lower returns & pay → unattractive investments
• Shift to the **shadow banking system**: chasing waterfalls

• The clock is turned back but the **cat and mouse game will continue**. **Tables will turn again** when the **next boom** comes or when politicians believe that **economic growth is promoted** by relaxing bank regulation.

„Capital is there to absorb losses from risks we understand and risks we may not understand. Evidence suggests that neither risk-takers nor their regulators fully understand the risks that banks sometimes take. That’s why banks need an appropriate level of loss absorbing equity.“

*Robert Jenkins, Member of the Financial Policy Committee, Bank of England*

*Article published by The Independent on 27 April 2012*
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