Basel Committee
on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel large exposures regulations – Switzerland

December 2023

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

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Glossary

BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
C	Compliant (grade)
CAO	Capital Adequacy Ordinance
CCF	Credit conversion factor
CEM	Current exposure method
CET1	Common Equity Tier 1
CHF	Swiss franc
CRM	Credit risk mitigation
D-SIB	Domestic systemically important bank
FINMA	Swiss Financial Market Supervisory Authority
FINMASA	Financial Market Supervision Act
G-SIB	Global systemically important bank
LC	Largely compliant (grade)
LCR	Liquidity Coverage Ratio
LEX	Large exposures
MDB	Multilateral development bank
MNC	Materially non-compliant (grade)
NC	Non-compliant (grade)
PSE	Public sector entity
RCAP	Regulatory Consistency Assessment Programme
RWA	Risk-weighted assets
SA-CCR	Standardised approach for measuring counterparty credit risk
SFT	Securities financing transaction
SNB	Swiss National Bank

Preface

The Basel Committee on Banking Supervision (Basel Committee) places a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented in a full, timely and consistent manner by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel III framework.[1]

This report presents the findings of an RCAP Assessment Team (Assessment Team) on the adoption status of the Basel large exposures (LEX) framework in Switzerland on 31 October 2023. The assessment focused on the completeness and consistency of the Swiss LEX regulations with the Basel LEX framework and relied on the information provided by the Swiss authorities. The main counterpart for the assessment was the Swiss Financial Market Supervisory Authority (FINMA), which coordinated its responses with the State Secretariat for International Finance (SIF) and the Swiss National Bank (SNB).

The Assessment Team was led by Ms Ho Hern Shin, Deputy Managing Director (Financial Supervision) of the Monetary Authority of Singapore (MAS), and comprised technical experts from the Reserve Bank of India (RBI), the Hong Kong Monetary Authority (HKMA), the Bank of Italy (BdI) and De Nederlandsche Bank (DNB; see Annex 1). The work was coordinated by the Basel Committee Secretariat with support from MAS staff.

The assessment began in January 2023 and comprised: (i) a self-assessment by FINMA (January to May); (ii) an assessment phase (May to October); and (iii) a review phase (in November) including a technical review of the Assessment Team's findings by a separate RCAP Review Team and the Basel Committee. The assessment report ultimately reflects the view of the Basel Committee.

The Assessment Team acknowledges the cooperation received from FINMA throughout the assessment process.

[1] See www.bis.org/bcbs/implementation.htm.

Executive summary

In Switzerland, the LEX requirements have been implemented mainly through revisions to the Swiss Capital Adequacy Ordinance (CAO) and FINMA Circular 2019/1, which became effective on 1 January 2019. The LEX requirements are applicable to all banks in Switzerland, with concessions provided to some small and medium-sized banks (Categories 4 and 5), as well as to the securities firms that are subject to the CAO.

Overall, as of 31 October 2023, the LEX regulations in Switzerland are assessed as largely compliant with the Basel LEX framework. This is one notch below the highest overall grade.

The three components of the Basel LEX framework (scope and definitions; minimum requirements and transitional arrangements; and value of exposures) are assessed as compliant, compliant and largely compliant, respectively.

The overall grade is mainly driven by two potentially material findings related to the definition of exposure values and 10 findings that were deemed non-material. For the definition of exposure values, the Swiss regulations exempt the recognition of the exposure to the collateral issuer for repos on specified platforms recognised by the Swiss authorities (at present, there is only one such platform). Moreover, the Swiss regulations apply a 10% weight to calculate the exposure value of Swiss covered bonds (Swiss Pfandbriefe), which is below the 20% floor specified in the Basel LEX framework. The Assessment Team noted that, in one area, the Swiss regulations go beyond the minimum Basel requirements (see Annex 4). In accordance with the methodology and guidance provided in the RCAP Handbook for jurisdictional assessments, the stricter rules have not been taken into account as mitigants for the overall or component-level assessment of compliance.

Response from FINMA

FINMA would like to express its sincere thanks to Ms Ho Hern Shin, the Assessment Team and the supporting members from the Monetary Authority of Singapore and the BCBS Secretariat for their professionalism, expertise and integrity throughout the whole assessment process, and welcomes the opportunity to respond to the Basel Committee on the report's findings concerning the Swiss implementation of the Basel LEX framework.

FINMA strongly supports the implementation of a globally consistent Basel Framework in which member jurisdictions adhere to standards that are as strong as, or stronger than, the agreed minimum requirements. For this reason, FINMA highly appreciates the RCAP as an instrument for promoting consistency and thereby strengthening the credibility of the Basel Framework.

FINMA agrees with the overall assessment of "largely compliant" in the Swiss RCAP-LEX assessment report. This result confirms FINMA's self-assessment that all minimum standards of the international framework are largely met and there are no material differences that could give rise to prudential or supervisory concerns, or jeopardise comparability across international banks.

FINMA believes that the Assessment Team has rightly taken into account proportionality considerations, which were one of main implementation challenges. FINMA also agrees with the main findings by component and corresponding ratings of "compliant" for *Scope and definitions*, "compliant" for *Minimum requirements and transitional arrangements*, and "largely compliant" for *Value of exposures*.

This "largely compliant" overall assessment is driven by two potentially material differences from the Basel standards. However, in FINMA's view these two findings are justified by Swiss specificities. One deviation relates to the exemption from recognising indirect exposures to the collateral issuer in the case of repurchase agreement (repo) trades executed on a recognised platform which is used by the Swiss National Bank to implement its monetary policy. This deviation is therefore essential to ensure a well functioning repo market. The other deviation concerns the application of a 10% weight to the nominal value of Swiss Pfandbriefe to derive the exposure value, as opposed to the 20% weight applied to foreign covered bonds. Swiss Pfandbriefe are a Swiss-specific instrument with similarities to foreign covered bonds, but with higher quality in the collateral pool and lower risk given additional layers of security. A Swiss-specific instrument was in need of a specific weight. Swiss Pfandbriefe are rated AAA and there has never been a default since the creation of the Swiss Pfandbriefe system in 1931.

Overall, FINMA believes that the RCAP facilitates robust discussions on the appropriateness of each member state's implementation of the Basel Framework, thereby taking due account of local circumstances and revealing areas where national regulations can be improved. This assessment shows that, although local circumstances have required some adjustments, a faithful and robust implementation of the Basel LEX framework has been achieved in Switzerland.

1 Assessment context

1.1 Regulatory system

Swiss law is based on the continental European tradition of civil law. Switzerland's regulatory approach has been principles-based, with a substantial part of the Basel standards being established in Swiss primary legislation, complemented by secondary and tertiary regulation (see Annex 2). The relevant secondary and tertiary regulation is developed by FINMA pursuant to Article 7 paragraph 1 of the Financial Market Supervision Act (FINMASA), according to which FINMA may exercise its regulatory powers by issuing ordinances and circulars on the application of financial market legislation. The content of FINMA regulation must be materially related to, and must not conflict with, a superordinate enactment (ie ordinances and acts). The ordinances issued by the Swiss Federal Council and FINMA regulation are also supplemented by other administrative procedures that provide non-enforceable and non-binding guidance on certain prudential matters.

The relevant hierarchy of prudential regulations through which the Basel LEX framework is implemented in Switzerland consists of primary legislation, ie the Capital Adequacy Ordinance (CAO) issued by the Swiss Federal Council, and secondary legislation, ie Circular 2019/1 issued by FINMA.

The CAO is a legislative instrument and has the force of law. It has been issued by the Swiss Federal Council empowered by the Swiss Banking Act. FINMA Circular 2019/1 ensures uniform implementation of the LEX framework in Switzerland by specifying open, undefined legal norms and outlining generally abstract requirements for exercising discretionary powers.

1.2 Status of implementation of the large exposures framework

The Basel LEX framework has been implemented in Switzerland with effect from 1 January 2019 and is applicable to all banks and securities firms in Switzerland (254 as of end-2022) except those securities firms that are not subject to the CAO. FINMA assigns banks to five categories on the basis of their total assets, assets under management, privileged deposits and required minimum capital. Category 1 covers Swiss global systemically important banks (G-SIBs), Category 2 covers domestic systemically important banks (D-SIBs), Category 3 consists of large and complex institutions and Categories 4 and 5 comprise medium-sized and small banks, respectively. The majority of banks and all securities firms (157 as of end-2022) are in Category 5. Banks in Categories 4 and 5 which are liquid and well capitalised may apply for the Swiss "small banks regime", under which simplified LEX requirements are applied.[2] The LEX framework is applied in Switzerland to banks at both consolidated and entity level.

The main Swiss LEX regulation is the CAO, with technical elements provided in FINMA Circular 2019/1. The CAO is published in German, French, Italian and English, while the Circular is published in German, French and Italian. For the purpose of this assessment, the Circular was translated into English.

1.3 Scope of the assessment

The Assessment Team considered the LEX limits applicable to a sample of internationally active banks in Switzerland as of 31 October 2023. The assessment had two dimensions:

[2] To be eligible for the small banks regime, a bank must be in Category 4 or 5 and all of the following admittance criteria must be complied with at all times at the level of both the single entity and the financial group: the simplified leverage ratio (ie the ratio of Tier 1 capital and total on- and off-balance sheet assets after deduction of goodwill and participations) is at least 8%, the average LCR over 12 months is at least 110%, and the refinancing rate is at least 100% (see CAO Article 47b for details). FINMA may reject a bank's application for the small banks regime under certain circumstances.

- a comparison of Swiss regulations with the Basel LEX framework to ascertain that all the required provisions have been adopted (completeness of the regulations); and
- whether there are any differences in substance between the Swiss regulations and the Basel LEX framework and, if so, their significance (consistency of the regulations).

In its assessment, the Assessment Team considered all binding documents that effectively implement the Basel LEX framework in Switzerland. Annex 2 lists the Basel standards used as the basis for the assessment. The assessment did not evaluate the resilience of the banking system in Switzerland or the supervisory effectiveness of the Swiss authorities.

The Assessment Team evaluated the materiality and potential materiality of identified deviations between the Basel LEX framework and the Swiss regulations. The evaluation was conducted using a sample of seven internationally active Swiss banks. Together, these banks comprise about 83% of the assets of internationally active banks in Switzerland. In addition, the Assessment Team reviewed the non-quantifiable impact of identified deviations and applied expert judgment as to whether the Swiss regulations comply with the Basel LEX framework in letter and in spirit. The materiality assessment is summarised in Annex 3, which also lists the sample of banks.

The Assessment Team noted that, in one area, the Swiss rules go beyond the minimum Basel requirements. Although this element (listed in Annex 4) provides for a more rigorous implementation of the Basel LEX framework, this has not been taken into account for the assessment of compliance.

The outcome of the assessment is summarised using a four-grade scale, both for each of the three key components of the Basel LEX framework and for the overall assessment of compliance. The four grades are compliant (C), largely compliant (LC), materially non-compliant (MNC) and non-compliant (NC).

2 Assessment findings

2.1 Assessment grades and summary of findings

Overall, the Assessment Team finds the implementation of the LEX framework in Switzerland to be largely compliant with the Basel LEX framework. This grade is based on the materiality assessment as summarised in Annex 3 and is driven by two potentially material findings and 10 findings that were deemed not material.

Assessment grades — Table 1

Component of the Basel large exposures framework	Grade
Overall grade	LC
Scope and definitions	C
Minimum requirements and transitional arrangements	C
Value of exposures	LC

Assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

2.1.1 Scope and definitions

The Swiss regulations on scope and definitions are assessed as compliant with the Basel LEX framework. The Assessment Team identified two findings deemed not material: (i) breaches of LEX limits resulting from mergers and acquisitions are permitted; and (ii) exposures from unsettled transactions are given a grace period of five business days before recognition of such exposures is required.

The Assessment Team observes that the Swiss regulations provide concessions in the LEX requirements for Category 4 and 5 banks, which are medium-sized and small banks, respectively with insignificant international activities (if any).

2.1.2 Minimum requirements and transitional arrangements

The Swiss regulations on minimum requirements and transitional arrangements are assessed as compliant with the Basel LEX framework. No findings were identified.

There are two observations relating to concessions provided to Category 4 and 5 banks: (i) a LEX limit of 100% of Tier 1 capital (instead of 25%) applies for exposures to banks and securities firms in Switzerland which are not designated as systemically important banks or financial groups; and (ii) hidden reserves, which are essentially general provisions adjusted for tax, may be included in the eligible capital base for LEX purposes.

The Assessment Team also observes that the Swiss regulations exempt banks from reporting limit breaches that are settled within two business days where these breaches arise due to the use of trade date accounting.

2.1.3 Value of exposures

The Swiss regulations on value of exposures are assessed as largely compliant with the Basel LEX framework.

The Assessment Team identified 10 findings, of which two were assessed as potentially material findings and greatly contributed to the component grade as well as the overall grade. The two potentially material findings relate to: (i) exemption of exposures to the collateral issuer in the case of repurchase agreement (repo) trades on specified platforms recognised by the Swiss authorities (currently only SIX Repo AG); and (ii) the application of a 10% weight (below the 20% floor prescribed by Basel LEX framework) to the nominal value of Swiss covered bonds (Pfandbriefe) to derive the exposure value.

The other eight findings, which were deemed not material, are mainly related to exposures to collective investment undertakings, treatment of entities connected with sovereigns, recognition of CRM techniques, intraday interbank exposures and off-balance sheet commitments.

There are also six observations relating to this component, four of which relate to concessions provided to Category 4 and 5 banks.

2.2 Detailed assessment findings

2.2.1 Scope and definitions

Section grade	**Compliant**
Basel paragraph number	13, 18, 61, 65: Scope of counterparties and exemptions
Reference in the domestic regulation	CAO Article 99(3) and (4)
Finding	The Basel LEX framework exempts exposures to sovereigns and their central banks, and intraday interbank exposures from the LEX limit. The framework allows breaches of the limit only as an exception and any breaches must be communicated immediately to the supervisor and rapidly rectified. In addition to the exemptions allowed under the Basel LEX framework, the Swiss LEX regulations permit breaches of LEX limits resulting from mergers and acquisitions, either of the bank with other financial entities, or between two previously independent counterparties. Moreover, such breaches are granted a grace period for rectification of up to two years, during which the aggregate exposure exceeding the limit may not be actively increased.

	The Swiss authorities shared that mergers and acquisitions are rare, and corresponding limit breaches even more rare. From the implementation of the Basel LEX framework on 1 January 2019 until end-2022, there were no limit breaches due to mergers and acquisitions. In relation to the acquisition of Credit Suisse by UBS in 2023, the Swiss authorities informed the Assessment Team that there have only been two breaches observed arising from exposures to the merged entity, one by a Category 4 and one by a Category 5 bank, and both are non-sample banks. The Swiss authorities view this exemption as a flexibility that is needed in practice. Had this exemption not been included in the regulations, they would have been prepared to grant such exemptions on a case by case basis. The latter approach would lead to the same outcome, but with increased administrative burden for banks and the Swiss authorities. As breaches of LEX limits resulting from mergers and acquisitions are rare, and the Swiss regulations provide reasonable safeguards for such limit breaches, this deviation is assessed as not material.
Materiality	Not material
Basel paragraph number	13, 18, 30, 61, 65: Treatment of unsettled transactions
Reference in the domestic regulation	CAO Article 106; FINMA Circular 2019/1 margin no (mn) 79
Finding	The Basel LEX framework exempts exposures to sovereigns and their central banks, and intraday interbank exposures from the LEX limit. Unlike the Basel LEX framework, the Swiss LEX regulations also allow exposures from unsettled transactions, regardless of the settlement mechanism, to be recognised only after five business days. The Swiss authorities explained that a grace period shorter than five days will mainly result in the communication of breaches to the Swiss authorities that would probably have been resolved by the time of the notification. Four sample banks stated that they do not use this exemption and recognise any exposure arising from unsettled transactions as part of the relevant counterparty exposure. Since unsettled transactions are only temporarily exempted from the LEX limits, this deviation is assessed as not material.
Materiality	Not material

2.2.2 Minimum requirements and transitional arrangements

This component is assessed as compliant with the Basel LEX framework. No findings were identified.

2.2.3 Value of exposures

Section grade	**Largely compliant**
Basel paragraph number	33: Exposure measurement for banking book and trading book OTC derivatives (and any other instrument with counterparty credit risk)
Reference in the domestic regulation	CAO Article 148k; FINMA Circular 2019/1 mn 35 (which refers to FINMA Circular 2017/7 mn 32–3)
Finding	According to the Basel LEX framework, the exposure value for instruments that give rise to counterparty credit risk and are not securities financing transactions must be the exposure at default according to the standardised approach for measuring counterparty credit risk (SA-CCR). The Swiss regulations allow Category 3 banks with immaterial derivative exposures to use a simplified SA-CCR or the current exposure method (CEM) for a transitional period until 31 December 2023, instead of the SA-CCR. The Swiss authorities have clarified that the transitional period will be extended to 31 December 2024. These banks will also be permitted to use simplified approaches for derivatives after the implementation of the finalised Basel III reforms.

	A Category 3 bank is considered to have immaterial derivative exposures if it fulfils both the following conditions: (1) the risk-weighted assets (RWA) for derivatives, including the credit valuation adjustment capital requirements times 12.5, amount to less than 3% of the bank's total RWA; and (2) the bank holds derivative positions solely to hedge its own interest and forex risks and/or for the settlement of client business over a qualifying central counterparty. FINMA has confirmed that all Category 3 banks in the sample use the SA-CCR. The Assessment Team further notes that these Category 3 banks may adopt the simplified approaches only if their derivative exposures are immaterial. Hence, this deviation is assessed as not material.
Materiality	Not material
Basel paragraph number	34: Exposure measurement for securities financing transactions
Reference in the domestic regulation	CAO Article 115(3)
Finding	Under the Basel LEX framework, if a jurisdiction has yet to implement the revised standardised approach for credit risk under the Basel III reforms, banks can adopt either the simple or the comprehensive approach (but not both in parallel) to recognise the effect of credit risk mitigation (CRM) for securities financing transaction (SFT) exposures if they are permitted under the current implementation of the risk-based capital rules. The Swiss regulations allow both approaches to be used in parallel for recognising the CRM effects for SFT exposures. Given that all the sample banks exclusively use the comprehensive approach, this deviation is assessed as not material.
Materiality	Not material
Basel paragraph number	35: Exposure measurement for banking book "traditional" off-balance sheet commitments
Reference in the domestic regulation	CAO Article 103
Finding	According to the Basel LEX framework, off-balance sheet items should be converted to their credit exposure equivalents using the credit conversion factors (CCFs) set out for the standardised approach for credit risk under the risk-based capital requirements, with a floor of 10%. According to Basel rules for the standardised approach for credit risk, where the finalised Basel III reforms have yet to be implemented, a CCF of 20% applies to irrevocable commitments to securities underwriting with an original maturity of one year or less. For LEX purposes, however, firm commitments relating to securities underwriting receive special CCFs under the Swiss regulations, namely: 5% CCF from the day the firm commitment to underwrite is irrevocably entered into; 10% CCF on the issue's payment date; and 25%, 50%, 75% and 100% from the second, fourth, fifth and sixth business day after the issue's payment date, respectively. The Assessment Team notes that assigning a CCF below 20% from the day the commitment to underwrite is irrevocably entered into until the issue's payment date is a deviation from the Basel LEX framework. The Swiss authorities explained that this is a risk-oriented rule; the CCF starts very low at 5% but increases rapidly (becoming more conservative than the Basel CCF) to reflect the increasing probability of these commitments materialising as the securities issuance process progresses. For such securities underwriting, banks would have tested the market for interested investors quite early and before they actually firmly commit. Hence, while the bank legally commits to underwrite the full amount, it knows that it will, in practice, be able to sell a significant amount to investors. While there were no data available to quantify the impact of this deviation, the Swiss authorities shared that Swiss banks are not very active in securities underwriting and that such activities are undertaken typically on a best efforts basis (rather than with a firm commitment). For these reasons, the Swiss authorities indicate that there were no noteworthy firm commitments to securities underwriting in 2022. The authorities were also of the view that if there were any such exposures, they would have been very small, and not exposures to the banks' 20 largest counterparties.

	The Assessment Team notes that while the CCF starts at 5%, it steps up to 25% (above the 20% CCF prescribed by Basel) by the second day after the issue's payment date. Hence, this deviation is assessed as not material.
Materiality	Not material
Basel paragraph number	42, 43: Recognition of CRM techniques in reduction of original exposure; recognition of exposures to CRM providers
Reference in the domestic regulation	FINMA Circular 2019/1 mn 91
Finding	Paragraph 43 of the Basel LEX framework requires an exposure to the CRM provider to be recognised whenever a bank reduces the exposure to the original counterparty due to an eligible CRM technique. The amount assigned to the CRM provider is the amount by which the exposure to the original counterparty is reduced. The Swiss regulations exempt banks from recognising an exposure to the collateral issuer in the case of repo trades on specified platforms recognised by the Swiss authorities. This also includes foreign currency repos. Currently, SIX Repo AG is the only trading platform that is recognised by the Swiss authorities. The Swiss authorities have explained that SIX Repo AG is a fully automated system whereby the triparty agent allocates the initial collateral, monitors for collateral sufficiency and, if needed, substitutes or delivers additional collateral. The collaterals are automatically selected by the SIX computer system and assigned to banks. This happens on a continuous basis, typically twice a day, and the banks receive collateral without knowing in advance which securities they will receive. Collateral receivers are also not able to communicate exposure limits to the triparty agent. The Swiss authorities have also stated that this exemption is required for a well functioning repo market and the implementation of the SNB's monetary policy. The maximum impact of this deviation among the top 20 counterparties of the sample banks is a reduction in exposure by 3.7% of Tier 1 capital; the weighted average impact across the sample banks is 0.01% of Tier 1 capital. The Assessment Team notes, however, that this deviation would reduce one sample bank's exposure to a counterparty (which is not among its 20 largest counterparty exposures, however) by 5.8% of Tier 1 capital (from 6.5%). This data point was excluded from the quantitative assessment as the counterparty was not among the bank's 20 largest counterparty exposures if the Swiss rules were applied. Had the Basel rules applied though, the counterparty would have been among the bank's 20 largest counterparty exposures. This provides some indication that the materiality of this deviation could increase, especially if banks using this exemption do not separately monitor their exposures to collateral issuers arising from repo trades on SIX Repo AG for the purposes of managing their overall exposures (direct and indirect) to the collateral issuer. Hence, this deviation is assessed as potentially material. Nonetheless, the maximum exposure to a single counterparty, if the Basel rules were to apply, is well within the LEX limit at 12.1% of Tier 1 capital.
Materiality	Potentially material
Basel paragraph number	42, 43: Recognition of CRM techniques in reduction of original exposure; recognition of exposures to CRM providers
Reference in the domestic regulation	FINMA Circular 2019/1 mn 92–3
Finding	Paragraph 43 of the Basel LEX framework requires banks to recognise an exposure to the CRM provider whenever they reduce the exposure to the original counterparty due to an eligible CRM technique. The amount assigned to the CRM provider is the amount by which the exposure to the original counterparty is reduced. Where a bank recognises financial collateral as credit risk mitigation under the comprehensive approach, the Swiss regulations exempt the bank from recognising an exposure to the collateral issuer if the exposure (before considering the collateral) amounts to less than 0.25% of the bank's eligible Tier 1 capital and if it is smaller than CHF 100 million. If there is overcollateralisation of at least 30% (after consideration of supervisory haircuts and subject to weekly valuation) and the exposure is collateralised by collateral

	from at least three different issuers (each with an adequate proportion), a bank may use a threshold of 2%, instead of 0.25%. If a bank uses the exemption, the original (direct) exposure is still reduced, even though there is no recognition of indirect exposures to the collateral issuer. The Swiss authorities have indicated that the thresholds were meant to alleviate the operational efforts required to assign relatively insignificant exposures to the collateral issuer. Four out of the seven sample banks do not use this exemption (ie they recognise all exposures to collateral issuers). For one out of the three banks using the exemption, its largest aggregated exposure to a single CRM provider for all individual secured exposures below 0.25% of Tier 1 capital is 0.38% of Tier 1 capital. The other two banks were unable to provide equivalent data. Nonetheless, given the relatively low exemption thresholds, and the additional requirements that apply for the use of the 2% threshold, this deviation is assessed as not material.
Materiality	Not material
Basel paragraph number	42, 43: Recognition of CRM techniques in reduction of original exposure; recognition of exposures to CRM providers
Reference in the domestic regulation	FINMA Circular 2019/1 mn 94
Finding	Paragraph 43 of the Basel LEX framework requires banks to recognise an exposure to the CRM provider whenever they reduce the exposure to the original counterparty due to an eligible CRM technique. The amount assigned to the CRM provider is the amount by which the exposure to the original counterparty is reduced. Under the Swiss regulations, if the gross value of the entire Lombard loan portfolio of a Category 3 bank is not above 25% of its eligible Tier 1 capital, the bank need not recognise an exposure to the collateral issuer, provided it meets specified conditions, namely: (i) the individual Lombard loans must show a marked excess cover and the portfolio of pledged collateral for each loan must be diversified; and (ii) the bank adequately mitigates and monitors the large exposures arising from this and periodically performs stress tests on credit risk concentrations. In such a case, the original (direct) exposure is still reduced, even though there is no recognition of indirect exposures to the collateral issuer. FINMA has stated that two out of three Category 3 banks in the sample do not make use of this exemption. For the sole Category 3 sample bank that uses the exemption, the level of overcollateralisation for its Lombard loan portfolio is very high, with the market value of the pledged collateral being at least 12 times the loan portfolio amount. Assuming a hypothetical scenario where this exemption cannot be applied, the extent of overcollateralisation coupled with the diversification in the collateral portfolio would have provided the bank the flexibility to assign the counterparty exposure to collateral issuers in such a manner that the incremental exposure to each collateral issuer is not large. Hence, this deviation is assessed as not material.
Materiality	Not material
Basel paragraph number	62: Sovereign exposures and entities connected with sovereigns
Reference in the domestic regulation	CAO Article 109(5)
Finding	The Basel LEX framework states that where two (or more) entities that are outside the scope of the sovereign exemption are controlled by or economically dependent on an entity that falls within the scope of the sovereign exemption, and are otherwise not connected, those entities need not be deemed to constitute a group of connected counterparties. Under the Swiss regulations, entities outside the scope of sovereign exemption and their controlling public sector entity (PSE) need not be treated as a group of connected counterparties, provided that the PSE is not legally liable for the entity's obligation, or if the entity in question is a bank. This exemption applies to all PSEs, irrespective of whether they fall within the scope of the sovereign exemption. The Swiss authorities have explained that domestic PSEs can only be cantons or municipalities, all of which meet the criteria under CRE20.12 for treatment as sovereigns

	(although they are not treated as such under Swiss risk-based capital framework). There is a related observation on paragraph 61 of the Basel LEX framework in Section 2.3.3. Nonetheless, since the exemption also applies to foreign PSEs that may not qualify to be treated as sovereigns, the Swiss rule is assessed as a deviation from the Basel Framework. The Swiss authorities have stated that none of the sample banks currently make use of this exemption. Moreover, between 2019 and 2022, only eight Swiss banks reported exposures to foreign PSEs and most, if not all, of such exposures are eligible for the sovereign treatment. Therefore, this deviation is assessed as not material.
Materiality	Not material
Basel paragraph number	65: Intraday interbank exposures
Reference in the domestic regulation	CAO Article 96(3) (b); CAO Article 99(2)
Finding	Intraday interbank exposures are not subject to the LEX framework, either for reporting purposes or for application of the LEX limit. The Swiss regulations permit limit breaches related to the settlement of client payment transactions lasting for no more than five business days. The Swiss authorities explained that the five-day grace period applies only to interbank exposures relating to intraday client payment transactions that fail to settle before the end of the day for operational reasons. It is not intended to permit breaches due to non-operational reasons such as the counterparty's inability to pay. The Swiss authorities also indicated that there has not been any limit breach among the sample banks even without the five-day grace period. Therefore, this deviation is assessed as not material.
Materiality	Not material
Basel paragraph number	69: Covered bonds
Reference in the domestic regulation	CAO Article 113(2) (b) and (c); CAO Article 118(1) (c); FINMA Circular 2019/1 mn 52–62; Covered Bonds Act (Pfandbriefgesetz) Article 12(2)
Finding	The Basel LEX framework requires that a covered bond satisfying the conditions set out in paragraph 70 be assigned an exposure value of no less than 20% of the nominal value of the bank's covered bond holding. The Swiss LEX regulations apply a lower weight of 10% to the nominal value of Swiss Pfandbriefe to derive the exposure value. The Swiss authorities stated that the lower weight (ie 10%) reflects the higher quality and lower risk of Swiss Pfandbriefe compared to a typical covered bond. Swiss Pfandbriefe are rated AAA and there has never been a default since the creation of the Swiss Pfandbriefe system in 1931. There is also additional diversification of risks, since the cover pool of Pfandbriefe consists of intermediate loans to multiple member banks, which are in turn secured by the member banks' mortgages. The requirements for the pool of underlying assets of Swiss Pfandbriefe are stricter than those outlined in paragraph 70 of the Basel LEX framework. For instance, claims secured by mortgages on residential real estate that are included in the cover pool must have a loan-to-value ratio (LTV) of 2/3 or lower (instead of LTV of 80% or lower). The Swiss authorities have also represented that the over-collateralisation requirement for Swiss Pfandbriefe is stricter than that set out in the Basel LEX framework. Nevertheless, the Assessment Team notes that assigning a lower weight of 10% for covered bonds when the Basel LEX framework prescribes a floor of 20% is a deviation from the framework. Data provided by the Swiss authorities show that the maximum impact of this deviation is a reduction in exposure by 4.7% of Tier 1 capital. The maximum impact of this deviation has trended upwards across 2019–22 and the indication from the interviews with banks was that investments in Swiss Pfandbriefe, given their eligibility as Level 2A HQLA for the purposes of meeting LCR requirements, may increase further though the magnitude of increase is expected to be smaller than in the past. Given that the impact of this deviation is expected to increase, this deviation is assessed as potentially material. The Assessment Team notes, however, that the weighted average impact across the sample banks is significantly smaller at 0.04% of Tier 1 capital. The maximum

	exposure to a Pfandbriefe institution, if a 20% weight were to be applied, is also well within the large exposure limit at 10.4% of Tier 1 capital.
Materiality	Potentially material
Basel paragraph number	73: Collective investment undertakings, securitisation vehicles and other structures
Reference in the domestic regulation	FINMA Circular 2019/1 mn 65 and 68
Finding	The Basel LEX framework allows banks not to apply the look-through approach to exposures to investment structures, but to assign the exposure amount to the structure itself, defined as a distinct counterparty, if the bank can demonstrate that the exposure amount to each underlying asset of the structure is smaller than 0.25% of its eligible capital base, considering only those exposures to underlying assets that result from the investment in the structure itself and using the exposure value calculated according to paragraphs 78 and 79. The Swiss regulations raise this threshold to 2% for Category 3 banks with an insignificant exposure to investment structures. A Category 3 bank is considered to have an insignificant exposure to investment structures if the carrying value of units in managed funds makes up less than 1% of all risk-weighted assets excluding the units in managed funds (as defined in FINMA Circular 2017/7 mn 335). The Swiss authorities have represented that two out of the three Category 3 sample banks do not make use of the 2% threshold but rather apply the 0.25% threshold as set out in the Basel LEX framework. For the sample bank that uses the higher threshold, its exposure to investment structures is very low; the two largest exposures to investment structures represent 0.25% and 0.05% of Tier 1 capital. Therefore, this deviation is assessed as not material.
Materiality	Not material

2.3 Observations

The following observations highlight certain special features of the regulatory implementation of the Basel LEX framework in Switzerland. These are presented to provide additional context and information. Observations are considered compliant with the Basel standards and do not have a bearing on the assessment outcome.

2.3.1 Scope and definitions

Basel paragraph number	11: Scope of application
Reference in the domestic regulation	CAO Article 98 and 116, FINMA Circular 2019/01 mn 97–104
Observation	The Basel LEX framework is applicable to all internationally active banks. The Swiss LEX regulations apply to all banks in Switzerland, but some concessions are provided for Category 4 and 5 banks. The Swiss authorities explained that these are medium-sized and small banks (typically with total assets of less than CHF 15 billion) with insignificant international activities (if any). Category 4 and 5 banks with at least one branch or subsidiary abroad also account for less than 3% of the total assets of all Swiss banks. The concessions apply to the following Basel paragraphs: • 16: minimum requirement – the large exposure limit; • 17: eligible capital base for the large exposure limit; • 32, 36: exposure measurement for banking book on-balance sheet non-derivative assets, eligible credit risk mitigation techniques; • 33: exposure measurement for banking book and trading book OTC derivatives (and any other instrument with counterparty credit risk); • 42, 43: recognition of CRM techniques in reduction of original exposure, recognition of exposures to CRM providers; and • 73: collective investment undertakings, securitisation vehicles and other structures.

	Details of these concessions are set out in Sections 2.3.2 and 2.3.3.

2.3.2 Minimum requirements and transitional arrangements

Basel paragraph number	16: Minimum requirement – the large exposure limit
Reference in the domestic regulation	CAO Article 98
Observation	The Basel LEX framework states that the sum of all the exposure values of a bank to a single counterparty or to a group of connected counterparties must, at all times, not be higher than 25% of the bank's available eligible capital base. Under the Swiss regulations, for Category 4 and 5 banks, the LEX limit to banks and securities firms that are not designated as systemically important banks or financial groups is 100%. The Swiss authorities indicated that implementing the Basel LEX framework without such a proportional adjustment would have impacted the functioning of the interbank market from the perspective of these small banks, given their difficulty in accessing correspondent networks and placing funds in the interbank market at a short notice.
Basel paragraph number	17: Eligible capital base for the large exposure limit
Reference in the domestic regulation	FINMA Circular 2019/1 mn 102
Observation	The Basel LEX framework prescribes that the eligible capital base for calculating the LEX limit is Tier 1 capital under the risk-based capital framework. For Category 4 and 5 banks, the Swiss regulations allow hidden reserves (essentially excess general provisions adjusted for tax), which qualify only as Tier 2 capital under the risk-based capital framework (CAP10.18), to be included in the eligible capital base for LEX purposes. The Swiss authorities explained that this concession is granted since Swiss GAAP allows banks at stand-alone level to create hidden reserves that may, at any time, be converted into CET1, subject to additional taxes.
Basel paragraph number	18: Reporting of limit breaches
Reference in the domestic regulation	CAO Article 101
Observation	The Basel LEX framework requires breaches of the large exposure limit to be communicated immediately to the supervisor and rapidly rectified. The Swiss regulations exempt banks from reporting limit breaches that are settled within two business days, where these breaches arise due to the use of trade date accounting (ie these breaches would not arise if settlement date accounting was used). The Swiss authorities explained that the two business days grace period is meant to provide some flexibility to avoid the communication of "false" breaches.

2.3.3 Value of exposures

Basel paragraph number	32, 36: Exposure measurement for banking book on-balance sheet non-derivative assets; eligible credit risk mitigation techniques
Reference in the domestic regulation	CAO Article 116; FINMA Circular 2019/01 mn 97–101, 103
Observation	The Basel LEX framework defines exposure value as the accounting value of the exposure. Eligible CRM techniques for LEX purposes are those that meet the minimum requirements and eligibility criteria for the recognition of unfunded credit protection and financial collateral that qualifies as eligible financial collateral under the standardised approach for risk-based capital requirement purposes. Real estate collateral does not qualify. The Swiss regulations provide concessions to Category 4 and 5 banks in two areas:

	(1) a 50% weight applies to short-term interbank exposures against well rated non-systemically important banks, as well as to non-systemically important cantonal banks whose non-subordinated liabilities are guaranteed by the canton. This treatment applies only to exposures to a third-party banking group's parent bank.
	(2) a 0% weight applies to the portion of mortgages up to 50% of the value of residential real estate collateral in Switzerland.
	For (1), the Swiss authorities indicated that this concession was necessary for small banks to allow them to meaningfully participate in the interbank market.
	For (2), the Swiss authorities stated that this was intended to partly recognise the risk-mitigating effect of Swiss real estate collateral. This carve-out was viewed as necessary for small banks as their Tier 1 capital amount is relatively low while real estate prices in Switzerland are very high.

Basel paragraph number	33: Exposure measurement for banking book and trading book OTC derivatives (and any other instrument with counterparty credit risk)
Reference in the domestic regulation	CAO Article 148k; FINMA Circular 2019/1 mn 35 (which refers to FINMA Circular 2017/7 mn 32–3)
Observation	According to the Basel LEX framework, the exposure value of instruments that give rise to counterparty credit risk and are not securities financing transactions must be the exposure at default according to the standardised approach for counterparty credit risk (SA-CCR). The Swiss regulations allow Category 4 and 5 banks to use a simplified SA-CCR or the CEM for a transitional period until 31 December 2023, instead of the SA-CCR. The Swiss authorities have clarified that the transitional period will be extended to 31 December 2024. These banks will also be permitted to use simplified approaches for derivatives after the implementation of the finalised Basel III reforms.
Basel paragraph number	42, 43: Recognition of CRM techniques in reduction of original exposure; recognition of exposures to CRM providers
Reference in the domestic regulation	FINMA Circular 2019/1 mn 104
Observation	Paragraph 43 of the Basel LEX framework requires banks to recognise an exposure to the CRM provider whenever they reduce the exposure to the original counterparty due to an eligible CRM technique. The amount assigned to the CRM provider is the amount by which the exposure to the original counterparty is reduced. Under the Swiss regulations, Category 4 and 5 banks using the comprehensive approach do not have to recognise an exposure to the collateral issuer, provided that they adequately mitigate and monitor the large exposures arising from this and periodically perform stress tests on credit risk concentrations. In this case, the original (direct) exposure is still reduced, even though there is no recognition of indirect exposures to the collateral issuer.
Basel paragraph number	61: Sovereign exposures and entities connected with sovereigns
Reference in the domestic regulation	CAO Article 97(2) (a) to (c); CAO Article 113(2) (a)
Observation	The Basel LEX framework exempts PSE treated as sovereigns according to the risk-based capital framework. The Swiss authorities explained that Swiss PSEs (cantons and municipalities) could be considered as PSEs treated as sovereigns, since they meet the criteria in CRE20.12. Nevertheless, the national discretion in CRE20.12 is not exercised. The Swiss regulations allow banks to apply a 20% weight to exposures to well rated cantons for the purpose of LEX, although they are not treated as sovereigns according to the risk-based capital framework.
Basel paragraph number	66: Interbank exposures
Reference in the domestic regulation	CAO Article 112

Observation	The Basel LEX framework includes an explicit exemption for all intraday interbank exposures. It also states that, in stressed circumstances, supervisors may accept a breach of an interbank limit ex post. The Swiss authorities have a broad range of powers to adjust LEX requirements, including pre-approval of temporary limit breaches. However, pre-approvals have rarely been provided in practice.
Basel paragraph number	73: Collective investment undertakings, securitisation vehicles and other structures
Reference in the domestic regulation	FINMA Circular 2019/1 mn 65 and 68
Observation	The Basel LEX framework allows banks not to apply the look-through approach to exposures to investment structures, but to assign the exposure amount to the structure itself, defined as a distinct counterparty, if the bank can demonstrate that the exposure amount to each underlying asset of the structure is smaller than 0.25% of its eligible capital base, considering only those exposures to underlying assets that result from the investment in the structure itself and using the exposure value calculated according to paragraphs 78 and 79. The Swiss regulations raise this threshold to 2% for Category 4 and 5 banks.

Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

Ms Ho Hern Shin	Monetary Authority of Singapore

Assessment Team members

Ms G Jyothisree	Reserve Bank of India
Ms Giulia Mele	Bank of Italy
Mr Salvatore di Bella	Bank of Italy (10 September–16 October 2023)
Mr Eric Ng	Hong Kong Monetary Authority
Mr Tim Velthuis	De Nederlandsche Bank

Supporting members

Ms Priscilla Wong	Monetary Authority of Singapore
Ms Ethel Yeo	Monetary Authority of Singapore
Ms Irina Barakova	Basel Committee Secretariat
Mr Carsten Folkertsma	Basel Committee Secretariat
Mr Olivier Prato	Basel Committee Secretariat

Review Team members

Mr Simon Hall	Bank of England
Ms Alejandra Anastasi	Central Bank of Argentina
Mr Amar Munipalle	Office of the Superintendent of Financial Institutions
Mr Stefan Hohl	Basel Committee Secretariat

Annex 2: List of Basel standards and implementing regulations issued by the Swiss authorities

The following Basel standards were used as the basis of this RCAP assessment:

- *Supervisory framework for measuring and controlling large exposures, April 2014*
- *Frequently asked questions on the supervisory framework for measuring and controlling large exposures, September 2016*

Table A.1 lists the regulations issued by the Swiss authorities to implement the LEX framework in Switzerland. Table A.2 sets out the hierarchy of Swiss laws and regulatory instruments. Previous RCAP assessments of the Swiss implementation of the Basel standards considered the binding nature of regulatory documents in Switzerland.[3] This RCAP Assessment Team did not repeat that assessment, but instead relied on the previous assessments' findings. Those assessments concluded that the types of instruments described in Table A.1 could be considered as binding on banks and supervisors for the purposes of an RCAP assessment.

Overview of relevant large exposure regulations in Switzerland — Table A.1

Domestic regulations	Date and version
Capital Adequacy Ordinance (CAO)	Issued 22 November 2017
FINMA Circular 2019/1 Risk diversification – banks	Issued 7 December 2017, version 4 November 2020

Source: FINMA.

Hierarchy of Swiss laws and regulatory instruments — Table A.2

Domestic regulations	Type
Primary (1)	- Swiss Federal Acts (1.1) - Swiss Federal Council Ordinances (1.2) - FINMA Ordinances (1.3)
Secondary (2)	- FINMA Circulars (2.1) - Self-regulation recognised by FINMA (2.2)

Tertiary (3)	- Legal administrative procedures: FINMA rulings (3.1)
	- Other administrative procedures (3.2)
	   - FINMA guidance
	   - FAQs on supervisory matters
	   - Guidelines

Source: FINMA.

[3] See Section 1.2 and Annexes 2 and 6 in Basel Committee on Banking Supervision, Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III LCR regulations – Switzerland, October 2017, www.bis.org/bcbs/publ/d422.pdf.

Annex 3: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings described in Section 2.2 and summarised in Table A.3. Assessment teams evaluate the materiality of findings quantitatively where possible, or using expert judgment when the impact cannot be quantified.

The materiality assessment for quantifiable gaps is based on the cumulative impact of the identified deviations on the reported LEX of banks in the RCAP sample. These banks are listed in Table A.4.

Number of deviations by component

Table A.3

Component	Not material	Potentially material	Material
Scope and definitions	2	0	0
Minimum requirements and transitional arrangements	0	0	0
Value of exposures	8	2	0

RCAP sample banks

Table A.4

Banking group	Share of banks' assets in the total assets of the internationally active banks in the Swiss banking system (in per cent)
UBS AG	38.4
Credit Suisse Group AG	26.3
Zürcher Kantonalbank	9.0
Julius Bär Gruppe	4.3
Banque Cantonale Vaudoise	2.5
Raiffeisen-Gruppe	0.0
Pictet et Cie	2.0
TOTAL	**82.5**

For this purpose, banking assets are based on the measure of total exposures used in the leverage ratio, which includes both on- and off-balance sheet exposures.

Source: FINMA.

Annex 4: Areas where Swiss rules are stricter than the Basel standards

In one area, the Swiss authorities have adopted a stricter approach than the minimum standards prescribed by the Basel Committee. This is listed below for information. The stricter rules have not been taken into account as mitigants for the overall or component-level assessment of compliance.

- Under the Basel LEX framework (paragraph 57), where a bank buys credit protection in the form of a credit default swap (CDS), the exposure amount to the underlying obligor is reduced while an exposure amount is assigned to the credit protection provider. The Basel LEX framework does not explicitly address the treatment of more complex CDS, such as first-to-default, second-to-default and nth-to-default swaps. The Swiss regulations require banks which purchase such complex CDS to recognise the counterparty credit risk exposure value to the credit protection provider (using the SA-CCR) without any reduction in the exposure amount to the underlying obligor.