Too-big-to-fail factsheet

Capital

The capital requirements define the minimum amount of capital that banks must hold in order to adequately cover the risk of losses arising from their business activities. The capital requirements are intended to ensure that a bank does not become insolvent even in the event of substantial losses. Compared to other banks, systemically important banks (SIBs) have been subject to stricter requirements since 2012, which have been amended several times since then. These are divided into:

- **Going-concern** capital to cushion losses during ongoing operations and
- Additional loss-absorbing funds (**gone-concern** capital) in the event of resolution.

There are two types of capital requirements:

- Risk-based, as a percentage of **risk-weighted assets (RWA)**
- The unweighted **leverage ratio (LR)**.

The Credit Suisse problem

Even during the months when it was experiencing its greatest difficulties, Credit Suisse Group's capital ratios were always above the regulatory requirements. However, the parent bank's limited capital levels drastically restricted its room for manoeuvre during the crisis. The parent bank has a FINMA banking licence and, in addition to its own banking business, holds all significant participations in its foreign subsidiaries (primarily in the United States and United Kingdom). Although the parent company also had to meet the capital requirements, significant relief was available. In particular, the parent company did not have to fully capitalise its participations in foreign subsidiaries. This had a fatal impact during the crisis: sales of foreign participations – which are desirable and liberating in a crisis situation – were effectively impossible because this would have substantially weakened the parent company's capital levels. This severely restricted the bank's scope for strategic realignment – and, later on in the crisis, for recovery and restructuring.

Federal Council recommendation

In its report on banking stability of 10 April 2024, the Federal Council proposes a series of measures regarding capital requirements:

- For SIBs, the capital adequacy requirements for foreign participations – and thus for parent banks – within a financial group will be increased.
- Introduce forward-looking elements into the institution-specific Pillar 2 capital surcharges for SIBs, based in particular on stress tests (examine how best to disclose the results).
- Tighten regulatory requirements regarding the prudent valuation and the recoverability of certain balance sheet items.

The proposed change for parent banks formally affects all systemically important banks (SIBs) in Switzerland, but it will only take effect for internationally active SIBs with complex structures and large foreign subsidiaries, namely UBS.

The Federal Council has decided against a general increase in capital requirements through a higher leverage ratio or a higher progressive component for the leverage ratio and the RWA ratio.

Impact on UBS of the measures in the area of capital requirements

The capital requirements for UBS are already high in an international comparison:

- The existing progressive component in the capital requirements is currently very effective. It results in the capital requirements for the new UBS rising by around 10% compared to today, for the same size of entity. This accumulation of capital was considered to be so challenging that, in 2023, FINMA was obliged to give UBS until 2030 for a gradual transition.
- Once the transitional period is completed in 2030, UBS will have similarly high going-concern requirements and much higher requirements for total loss-absorbing capital (TLAC) when compared to foreign comparator banks. Specifically, the requirements for the risk-weighted asset (RWA) ratio of total loss-absorbing capital are 27.6% for UBS (from 2030 onwards), 24.2% for Deutsche Bank and 21.5% for Morgan Stanley.
- The requirements for the unweighted leverage ratio (LR) in Switzerland are already higher than the corresponding requirements for foreign comparator banks. Specifically, the leverage ratio requirements for total loss-absorbing capital are 9.6% for UBS (from 2030 onwards), 7% for Deutsche Bank and 9.5% for Morgan Stanley.
- With the entry into force of the Final Basel III standard in Switzerland, which is provisionally planned for 1 January 2025, capital requirements will be comprehensively revised and made more risk-sensitive. In addition, the removal of certain relief ("regulatory filters") granted to Credit Suisse will result in higher requirements, and hence higher capital, for UBS.

The proposed measures lead to a significant increase in UBS's capital requirements:

- Firstly, for SIBs, FINMA should also include forward-looking elements in the institution-specific capital surcharges ("Pillar 2 surcharges") and set them regularly on the basis of stress tests and ongoing supervision. FINMA will determine the level of the surcharges for UBS.
- Secondly, capital requirements for the UBS parent bank should be increased in a targeted way. To this end, UBS should be required to back its foreign participations with more capital. Raising the capital backing for participations increases the parent bank's capitalisation, reduces the incentives to set up complex corporate structures and improves the likelihood of the bank being successfully restructured.

  Under the currently applicable requirements, the parent bank must provide 60% capital backing for participations in a foreign subsidiary. The Federal Council is aiming for a significant increase in this capital backing, taking into account the other measures. This measure alone will result in a substantial increase in capital at UBS.
- Thirdly, the regulatory requirements regarding the prudent valuation and the recoverability of certain balance sheet items should be reviewed and tightened. This involves the valuation of assets that quickly lose value in a crisis, such as proprietary software, tax claims or bonds with long residual maturities. The level of the resulting additional capital requirement for UBS still has to be examined in detail.