Coronavirus Information Hub: FAQ Regulatory

What are the regulatory capital requirements for COVID-19 credits with federal guarantees?

COVID-19 Loans and COVID-19 Loan Plus granted under the COVID-19 ordinance on joint and several guarantees will be jointly and severally guaranteed by the loan guarantee cooperatives to 100% or 85% of their value respectively and will in turn be guaranteed by the Confederation. COVID-19 Loans will be fully guaranteed by the Confederation, while COVID-19 Loans Plus will be guaranteed by the Confederation to 85% of their value.

How to calculate the minimum capital required?

When calculating the minimum capital required, the COVID-19 credits granted by the banks can be considered as credits guaranteed by the Confederation for the applicable level of coverage (i.e. 100% or 85%) and treated in accordance with margin no. 311 of FINMA Circ. 17/7 "Credit risks – banks[1]". For 85% coverage, 15% of the claim is therefore to be treated with the counterparty's risk weighting.

What is the LCR calculation in this context?

No outflow should be entered for the part covered by the Swiss National Bank (SNB) for COVID-19 refinancing facility. The SNB refinancing facility can be considered as collateral with Level 1 HQLA pursuant to margin no. 273 FINMA Circ. 15/2 Liquidity risks – banks[2].

What are the exemptions relating to the leverage ratio?

In this context where unusually high deposits are held at central banks, a reduction of the leverage ratio without increasing the banks' risk may occur. FINMA considers this pro-cyclical effect to be counterproductive in the present environment, as it unnecessarily restricts the ability of the banks to supply credit to the real economy. When calculating the leverage ratio in accordance with article 46 of the Capital Adequacy Ordinance (CAO), the following should therefore be excluded: deposits held at central banks in all currencies pursuant to margin nos. 5 and 7 of Annex 1 to FINMA Circular 2020/1 Accounting – banks[3].

This relaxation is based on article 4 para. 3 of the Banking Act (BA). FINMA has extended its period of application from 1 July 2020, initially, to 1 January 2021 and reserves the right to set further institution-specific limits on how the released capital can be used on a case-by-case basis.

For the duration of the exclusion of central bank deposits from the leverage ratio and from the total exposures, the disclosures for the leverage ratio as defined in FINMA Circ. 16/1 Disclosure – banks[4] are also to be made excluding these deposits. This also applies to the disclosure of the simplified leverage ratio within the scope of the small banks regime pursuant to articles 47a–47e CAO. The exclusion is to be referred to qualitatively by way of a footnote. Where disclosure is made using table LR1, the exclusion is to be considered in row 7 "Other adjustments".

What is the net stable funding ratio (NSFR) calculation in this context?

FINMA has set out in more detail the handling of durations for loans granted as part of the SNB's COVID-19 refinancing facility for calculating the NSFR. For the NSFR, the term of the loan obtained under the COVID-19 refinancing facility can be considered identical to the term of the claim assigned as collateral, without taking into account the SNB's termination option. Accordingly, for the available stable financing (ASF factor), the value 100% can currently be applied. The assigned claim is to be recorded as encumbered for the same term, which currently results in a 100% required stable financing (RSF factor).

How to proceed with the reduction of the relief in the leverage ratio calculation in the event of dividend distributions?

FINMA further specified how to proceed for institutions whose capital relief is to be reduced as a result of dividend distributions. The calculation basis for the leverage ratio is to be reduced by the amount of the dividend payment in CHF divided by:

- 3% for non-systemically important banks;
- 8% for banks that (i) are not of systemic importance and (ii) apply the small banks regime according to article 47a-47e OCA;
- the bank-specific Tier 1 levrage ratio requirement between 4.5% and 5% in the case of systemically important banks.

1 https://finma.ch/en/documentation/circulars/.

2 https://finma.ch/en/documentation/circulars/.

3 https://finma.ch/en/documentation/circulars/.

4 https://finma.ch/en/documentation/circulars/.

The maximum reduction is the amount of the relief as a result of central bank deposits being excluded (as mentioned before).

In disclosure table LR1, the value is to be determined in row 7 "Other adjustments" taking into account the reduction of the relief and a corresponding comment on the reduction is to be included. In the LERA form of the capital statement, the entries in rows 1.7 and 2.1.1 are to be adjusted according to the reduction.

Companies that are part of a FINMA-supervised financial group or Swiss sub-financial group of a foreign financial group are exempt from reducing the relief in the leverage ratio calculation in the event of a dividend distribution if:

– either the dividend distribution is to a supervised Swiss parent company; or
– the dividend distribution is to an (unsupervised) Swiss parent company within the supervised group or sub-group and no distribution from the group or sub-group to a third party takes place.

FINMA has extended the period of reduction of the relief in the leverage ratio calculation in the event of dividend distributions until 1 January 2021. It is however not planned to further maintain this reduction after the expiry of said extension.

What are the exemptions relating to risks diversification?

To give banks more time to manage such increased positions if needed (i.e., increasing margin payments to counterparties have been necessary), the strict upper limit may be exceeded temporarily as indicated below. This relaxation is based on article 4 para. 3 BA and is valid for cases where the upper limit is exceeded before 1 July 2020.

FINMA has decided that this exemption will not be further continued due to a lack of demand and will therefore end on 1 July 2020. As before the implementation of this temporary measure, financial institutions may submit a justified application for relief to FINMA according to Art. 112 para. 2 CAO in individual cases.

Relaxation in relation to the 25% upper limit pursuant to article 97 CAO

The concentration risk may not exceed:

– 35% for a maximum duration of 3 weeks
– 30% for a maximum duration of 5 weeks

The amount by which the regular 25% upper limit is exceeded is to be covered by free eligible Tier 1 capital.

What is the Basel Committee's position?

The Basel Committee's oversight body, the Group of Central Bank Governors and Heads of Supervision (**GHOS**), has endorsed a set of measures to provide additional operational capacity for banks and supervisors to respond to the immediate financial stability priorities resulting from the impact of the COVID-19 on the global banking system.

One of the most important measures endorsed by the GHOS is the deferral of the implementation date of the Basel III standards finalised in December 2017 by one year to 1 January 2023. The accompanying transitional arrangements for the output floor has also been extended by one year to 1 January 2028.

Derivatives trading: what measures are adopted at the international and national levels?

International level

To provide additional operational capacity for companies to respond to immediate impact of COVID-19 and allow them to focus resources on overcoming the challenges they are facing with the crisis, the Basel Committee on Banking Supervision (BCBS) and the International Organisation of Securities Commissions (IOSCO) have extended the deadline for completing the final two implementation phases of the margin requirements for non-centrally cleared OTC derivatives by one year[5]. This extension also aims at facilitating companies to act diligently to comply with the requirements by the revised deadline.

National level

On the basis of article 131 para. 6 of the Financial Market Infrastructure Ordinance (FMIO) and in light of the above-mentioned deferral by BCBS and ISCO, FINMA also extended the timeframes set out in article 131 para. 5 let. dbis and let. e FMIO by one year in each case.

Accordingly, the duty to exchange initial margins shall now apply for counterparties whose aggregated month-end average gross position of non-centrally-cleared OTC derivatives at group or financial or insurance group level:

– is greater than CHF 50 billion for each of the months of March, April and May 2021: from 1 September 2021; or
– is greater than CHF 8 billion for each of the months of March, April and May 2022: from 1 September 2022.

5 https://www.bis.org/press/p200403a.htm

Should banks still refer to IFRS?

On 1 January 2018 the International Accounting Standards Board (**IASB**) introduced the IFRS 9 Financial Instruments standard which contains a three-stage expected credit loss approach (ECL approach). FINMA calls on the affected banks to keep observing the requirements of IFRS 9 while also into account the "IFRS 9 and covid-19"[6] document published by the IASB on 27 March 2020. Given the current situation, FINMA emphasises that banks may make use of the flexibility provided by IFRS 9.

In addition, measures such as payment deferrals should not automatically, if other factors remain the same, result in a transfer of a credit to another stage in the IFRS9 categorisation. In exercising their judgment, banks should differentiate between borrowers with business models that seem sustainable in the longer term and borrowers where it seems unlikely that creditworthiness will be restored.

What treatment of COVID-19 credits for financial accounting purposes and interest risk report?

Financial accounting purposes

COVID-19 credits are to disclosed in the positions "Amounts due from customers" (Annex 1, let A of the Banking Ordinance).

The division according to the type of collateral required in the appendix "Presentation of collateral for loans / receivables and off-balance-sheet transactions, as well as impaired loans / receivables" according to margin no. 27 ff. of Annex 4 to FINMA Circular 2020/01 "Accounting – Banks"[7] must be carried out as follows:

- COVID-19 Loans must appear under "other collateral";
- COVID-19 Loans Plus Credits are to be disclosed as follows:
  - 85% as "other collateral"; and
  - the remaining 15% must be disclosed in one of the following categories depending to the type of collateral: "secured by mortgage", "other collateral" or "unsecured".

    The assessment of what qualifies as "collateral" for the purposes of FINMA Circular 2020/1 is based on margin no. 34 of Annex 4 FINMA Circular 2020/1.

Interest risk report

COVID-19 credits have a certain repricing maturity, as does any SNB COVID-19 refinancing facility claimed. These must therefore be reported in the interest risk report using form ZIR1_CHF under Category I positions in rows 28-30 (or 28-31). Due to the low interest rate (with little present value effect), which can be adjusted by the FDF annually, the remaining period can be used for the repricing maturity. The refinancing facility is to be reported in rows 59-61 (or 59-62). The relevant maturity band is 1-3 months.

What is the exemption with respect to backtesting results in the model approach to market risk?

Driven by the abrupt increase in volatility due to the COVID-19 pandemic, institutions that apply a model approach to market risk are recording an increased number of backtesting exceptions that occur if the loss incurred on a single day is greater than the loss indicated by the model (value-at-risk, 99% quantile). Above a certain number of exceptions an increasing supplement is added to the bank-specific multiplier, resulting in an immediate and substantial increase to the minimum capital requirements for market risks. The aim of this multiplier is to provide an incentive to rectify any shortcomings of the model. Most exceptions today are not due to shortcomings of the model, however, but due to the increase in volatility.

To mitigate this volatility-related heightened pro-cyclicality, FINMA has introduced the following exemption based on article 4 para. 3 BA and article 88 para. 3 CAO for institutions authorised to apply the model approach to market risk pursuant to articles 82 and 88 CAO. The number of exceptions that result in an increase in the bank-specific multiplier pursuant to margin no. 332 of FINMA Circular 2008/20 "Market risks – banks"[8] and consequently to the minimum capital requirements for market risks pursuant to article 88 para. 3 CAO will be frozen at the level of 1 February 2020 until 1 July 2020, date until when this exemption applies.

Exceptions must continue to be reported in accordance with margin no. 333 of the above mentioned FINMA Circular 2008/20. Within one month of new exceptions occurring, banks must submit an analysis of their causes. In particular they must investigate whether the exceptions remain even after the recalibrations of the value-at-risk model conducted regularly in accordance with the defined process. Based on this analysis, FINMA reserves the right to demand that new exceptions be considered in the bank-specific multiplier in exceptional cases.

6 https://cdn.ifrs.org/-/media/feature/supporting-implementation/ifrs-9/ifrs-9-ecl-and-coronavirus.pdf.

7 https://finma.ch/en/documentation/circulars/.

8 https://finma.ch/en/documentation/circulars/.

FINMA has confirmed that this exemption will continue to apply after 1 July 2020 as it will be adopted in principle in future supervisory practice. In accordance with margin no. 332 of FINMA Circular 2008/20 "Market Risks – Banks"[9], FINMA may leave individual exceptions unconsidered if it is proved that such exceptions are not due to a lack of accuracy (forecasting quality) of the risk co-aggregation model. In the recent phase of market volatility, there have been an increasing number of exceptions where FINMA felt that non-consideration in the capital calculation was justified.

In what extend the identification under AMLA is simplified due to the COVID-19 pandemic?

Based on article 17 of the Anti-Money Laundering Act (**AMLA**) in conjunction with article. 3 para. 2 of the FINMA Anti-Money Laundering Ordinance (**AMLO-FINMA**), FINMA has decided to grant facilitation[10] for the onboarding of new business relationships entered into before 1 July 2020 by extending the 30-day period set out in article 45 of the Swiss Banks' Code of Conduct with Regard to the Exercise of Due Diligence (**CDB 20**) to 120 days in cases where the identification document's *authenticity* has not been confirmed.

Where the institution is subject to CDB 20 and if this is necessary – in exceptional cases only – not to interrupt the ordinary course of business, an account may already be used if only particular information and/or documents are not available or particular documents have not been provided in the appropriate form and, on the basis of a risk-based assessment, the application of this exemption is deemed appropriate[11]. In such cases, sufficient information regarding the identity of the contracting partner and the beneficial owner or controlling person must be available.

According to FINMA, this can be applied to new business relationships for the time being, such that they can be entered into with a simple copy of the identification document. Regarding the lack of confirmation of authenticity only[12], the COVID-19 pandemic is generally recognised as a situation within the meaning of article 45 of CDB 20 that requires by way of exception that a business relationship already be utilised, so as not to interrupt the ordinary course of business. For business relationships with increased risks, however, it must continue to be assessed and documented on a case-by-case basis whether this application of the exception is acceptable in view of the associated money laundering risks.

Regardless of the risk category of the relationship, the confirmation of authenticity must be submitted within 120 days of the opening of the relationship at the latest (instead of 30 days in accordance with article 45 of CDB 20, and 90 days first granted by FINMA and further extended to 120 in mid-May). Where the client is domiciled abroad, this facilitation may be applied beyond 1 July 2020 until 1 October 2020. If such confirmation cannot be obtained within these adjusted deadlines due to specific restrictions associated with COVID-19 measures, this must be documented in individual cases and the confirmation of authenticity must be provided as soon as possible.

What are the measures taken by FINMA to help insurance companies?

Deadline extension for the submission of reports required by supervisory law

Due to the COVID-19 pandemic, if it is not possible for insurance companies, insurance groups and conglomerates to submit and/or publish the required reports[13] on time this year, this deadline will be extended until 31 May 2020 upon notice being given to FINMA – in advance i.e. before 30 April 2020. In such cases, a violation of article 86 para. 1 let. c ISA on grounds of the late submission of the regular reporting will not be prosecuted.

Extraordinary smooth regime for SST (Swiss Solvency Test)

Since the start of the COVID-19 pandemic, there has been a sharp increase in volatility, particularly for certain yield curves. As the SST is calculated on a specific date, this volatility can result in large fluctuations in the SST. A smoothing of the yield curves over a period of 10 days reduces these fluctuations significantly, without masking important market signals. Upon request, FINMA is therefore willing to accept a 10-day average of the yield curves as the calculation basis for the SST. Such a choice cannot be reversed within a calendar year and must be disclosed accordingly.

FINMA also confirmed that the SST report may be reduced in content this year[14]. The remaining minimum requirements for the SST report will be communicated to insurance companies within the next few days. A full SST reporting is, of course, still possible.

9 https://finma.ch/en/documentation/circulars/.

10 A self-regulatory organisation (**SRO**) may also grant facilitation. This does not need to be approved in advance, provided that it does not go further FINMA's rules in any way.

11 Article 45 CBD 20.

12 Note that this does not apply to any other missing documents or information, which must be considered on a case-by-case basis.

13 Regular reporting as defined in article 25 para. 3 of the Insurance Supervision Act (ISA); SST reporting (calculation and report according to article 53 paras. 1 and 2 of the Insurance Supervision Ordinance (ISO) and margin nos. 152 and 153 of FINMA Circular 2017/03 "SST"; and Financial condition report in accordance with article 111a paras. 1 and 3 and 203a ISO. All of them initially required to be submitted to FINMA and/or published on insurance companies' website by 30 April 2020 at the latest.

14 The requirements with respect to the content of the SST report are set forth in margin nos. 154 ff. the FINMA Circular 2017/03 and will be reduced under the current circumstances.

In these times of unusually high volatility and restricted liquidity, what options are available to Swiss open-ended collective investment schemes?

Investors in open-ended collective investment schemes are in principle entitled at all times to request the redemption of their units and payment of the redemption amount in cash. However, in extraordinary situations caused by general valuation difficulties, limited marketability of certain investments or extraordinary circumstances, the law provides for specific exceptions from the right to redeem at any time (article 79 of the Federal Act on Collective Investment Schemes (**CISA**)) or a time-limited deferral of repayment (article 81 CISA), as they may not be in the investors' interests.

Swiss law on collective investment schemes does not explicitly provide for time-limited restrictions on the right to redeem for all investors in addition to deferred repayment, therefore such rules are applicable only if they are set out in the FINMA-approved fund documents. In particular, deferred repayment and gating require explicit provisions so it may be necessary to amend the FINMA-approved fund documents in advance using the usual procedure. Besides, in both deferred repayment and gating the decision must (i) be reported without delay to the auditor and FINMA and (ii) be communicated to investors in an appropriate way (article 109 para 6 and article 110 para. 2 of the Federal Ordinance on Collective Investment Schemes (**CISO**)).

Exceptions from the right to redeem at any time (articles 79 CISA and 109 CISO)

The Federal Council has the power to grant specific exceptions (in accordance with the investment provisions) from the right to redeem at any time for collective investment schemes affected by valuation difficulties or limited marketability. The fund regulations of a collective investment scheme affected by such circumstances may generally provide for notice to be served only on specific dates, subject to a minimum of four times per year.

FINMA may also restrict the right to redeem at any time, subject to a justified request and depending on the investments and investment policy. Such possibility must be explicitly stated in the fund documents. This is a general exception from the right to redeem at any time rather than special rules in response to extraordinary circumstances.

Deferred repayment (articles 81 CISA and 110 CISO)

The Federal Council can determine the instances in which the fund regulations may specify a time-limited deferral of the repayment of units in the collective interests of all investors[15].

The fund regulations may provide for repayment to be deferred temporarily in the following exceptional cases (article 110 para 1 CISO):

a. where a market which serves as the basis for the valuation of a significant proportion of the fund's assets is closed, or if trading on such a market is restricted or suspended;

b. in the event of political, economic, military, monetary or other emergencies;

c. if, owing to exchange controls or restrictions on other asset transfers, the collective investment scheme can no longer transact its business; or

d. in the event of large-scale redemptions which may significantly endanger the interests of the other investors.

If repayment is deferred according to letters a to c above, it is as a rule temporarily not possible to value the collective investment scheme, i.e. no net asset value (NAV) can be published. In this case, it is also not possible to issue new units.

In the case of large-scale redemptions (letter d above), it is still possible to value the collective investment scheme, but payment is deferred to enable the controlled liquidation of investments required to repay the investors who have redeemed their units. The aim of this provision is to prevent "fire sales", which tend to depress the value of the units held by the remaining investors. Since a NAV is still calculated in such cases, it is still possible to issue new units. However, the fund management company or SICAV may restrict the issuance of new units at any time (this is referred to as "soft closing"). The duties of loyalty and information toward investors must be fulfilled at all times. This means in particular that every prospective investor must be informed about the deferral when subscribing units.

When repayment is deferred under article 110 para. 1 let. d CISO, units are redeemed at the NAV calculated on the valuation date. The effective repayment is merely made at a later date (the value date).

Gating (article 109 paras 5 and 6 CISO)

The revision of the CISO in connection with the Federal Acts on Financial Services (**FinSA**) and on Financial Institutions (**FinIA**) added an explicit provision on gating to article 109 para. 5. The fund management company or SICAV may therefore process a reduced proportion of redemption requests if a predetermined percentage or threshold value is reached within a predetermined period of time (gating) when extraordinary circumstances apply and provided this is in the interests of the remaining investors.

The redemption requests that are not processed are regarded as having been received in time for the next valuation date and

15 In exceptional cases and where it is in the collective interests of all investors, FINMA may also grant a time-limited deferral of repayment (article 81 para. 2 CISA).

the NAV calculated on that date will be paid out (article 109 para. 5 CISO).

As stated above, details must be set out in the fund regulations and FINMA must approve the inclusion of gating in said fund regulations.

What are the additional recommendations from SFAMA?

To help its members facing the current situation, SFAMA also recommends to:

- check the liquidity tools needed in their products;
- test their processes and process documentation, including the decision-making powers needed in specific cases;
- review their redemption frequencies and adjust them if necessary (in the medium term);
- consider whether they need to increase their liquidity reserves.

What about representatives of foreign collective investment schemes?

SFAMA recalls that foreign collective investment schemes:

- are subject first and foremost to the regulations that apply in their country of domicile;
- must additionally comply with the obligations to report, publish, and inform and the SFAMA code of conduct (article 124 para. 2 CISA);
- are subject to the publication and reporting obligations only when they are offered in Switzerland to non-qualified investors (article 133 CISO); and
- representatives of such collective investment schemes – which must also have their documents approved by FINMA – must comply with margin nos. 24-52 of FINMA Circular 2013/9 "Distribution of collective investment schemes"[16] that remains in force at the time of writing.

Contributed by Thomas Müller (Partner) and Anaëlle Genoud (Associate).

Coronavirus Information Hub
Walder Wyss is committed to supporting our clients through the challenges the pandemic presents. We will be publishing regular insights on this Information Hub.

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16 https://finma.ch/en/documentation/circulars/.