Berne, 6 June 2025

Background information and assessments regarding the capital backing of foreign participations

The Swiss National Bank supports the amendments at legislative and ordinance level proposed by the Federal Council on 6 June 2025 in the area of capital regulation. These amendments constitute a key package of measures aimed at strengthening banks' resilience and hence the stability of the financial system.

The SNB already gave its opinion on the capital backing of foreign participations by parent banks in its Financial Stability Report 2024 and called for an adjustment to be made. As regards the methodological implementation, the SNB recommended that the adjustment be achieved by deducting foreign participations from capital, as proposed by the Federal Council. This document contains further background information and the SNB's assessments on this topic.

Full backing of participations with CET1 capital avoids double counting of capital

Under the current capital adequacy regulations, banks must back their business activities with capital – both at the level of the consolidated group (consolidated financial statements of the group) and at the level of the individual group entities (specifically the parent bank at the standalone level as well as its subsidiaries in Switzerland and abroad).[1] Intragroup linkages thus play an important role in determining capital adequacy. Subsidiaries are capitalised via the parent bank.[2] The new regulation is intended to ensure that capital which the parent bank

[1] Cf. Federal Council report on banking stability of 10 April 2024, box 3.
[2] In addition to receiving direct capital injections from the parent bank, subsidiaries can also build up capital by retaining profits.

passes on to foreign subsidiaries in the form of a participation can no longer be counted by the parent bank as capital for covering its own risks.

Under the current requirements, parent banks are not required to fully back their participations in subsidiaries; instead, in the case of foreign subsidiaries, they only have to provide approximately 45% backing with Common Equity Tier 1 (CET1) capital. This partial backing of participations means that a proportion of the subsidiaries' capital is financed using debt. This, in turn, means that the parent bank has to back an asset booked at its subsidiary with less capital than if the same asset were booked directly at the parent bank. However, the risk of the asset remains the same irrespective of where it is booked.

The best way to correct this is to have full capital backing of participations. Full capital backing ensures that the parent bank has to adequately back the risks from both its own and its subsidiaries' business.

Under the current regulations, the parent bank's capital ratios are vulnerable to losses at subsidiaries

The crisis at Credit Suisse (CS) demonstrated that the risk associated with participations is not adequately covered by the current regulatory requirements. For example, substantial impairments of CS's foreign participations led to a strong decline in the parent bank's capital ratios from the fourth quarter of 2021. This weakening of the parent bank was also increasingly recognised by the market. The capital erosion ultimately created a vicious circle, which impeded the bank's restructuring measures. The high value of participations requiring only partial capital backing led to an overly positive presentation of the capital situation at the CS parent bank.

The CS case shows that partial capital backing of participations makes parent banks' capital ratios vulnerable to impairments. Full backing of participations with CET1 capital is aimed at eliminating these negative effects in the future.

With the full backing of foreign participations with CET1 capital now proposed, the capital regulation of the parent bank will be strengthened in a targeted way, namely in those areas where weaknesses became apparent during the crisis at CS.

Full capital backing supports the option to sell a subsidiary as a stabilisation measure in a crisis

Selling a subsidiary in the event of a crisis can be a valuable stabilisation measure for the bank and the authorities, provided that such a sale does not lead to a deterioration in the parent bank's capital situation. Full capital backing of the participation creates a good basis for this.

In the event that a bank has to sell a participation as a recovery or restructuring measure, the impact on the parent bank's capital situation depends on the capital backing as well as on the sale proceeds that the bank can achieve under pressure in crisis situations. In such situations, it is to be expected that the sale proceeds will be less than the value of the participation on the balance sheet and the parent bank will therefore incur a loss from the sale. If this loss is greater than the capital backing, the parent bank's capital situation deteriorates. If the loss from the sale is less than the capital backing, the capital situation improves, since the risks associated with the participations have been removed from the balance sheet and the loss recorded on the sale has not fully depleted the capital backing.

How much of a profit or loss is made from the sale of participations depends on the scenario. The CS case illustrated just how quickly substantial impairments of participations can occur in a crisis. Yet this was a stress situation that was confined to CS and some banks in the US, in an otherwise stable macroeconomic environment. In a severe recession or in the context of a strong correction in the real estate or financial markets, participations could lose even more value given the systemic stress.

Since a large proportion of the subsidiary's assets are financed by debt, even relatively small losses in value lead to a full write-down of participations. For example, if the subsidiary has a leverage ratio of 5%, losses of 5% of total assets may be enough to wipe out that subsidiary's capital and render the participation worthless. It should also be noted that the parent bank's losses from a participation can even exceed the latter's book value.

The proposed adjustment to the capital regulations has a clear benefit for the Swiss economy

The proposed adjustment to the capital regulations will significantly strengthen the parent bank's resilience. As well as reducing the likelihood of a large systemically important bank such as UBS getting into financial distress, this measure also increases a bank's room for manoeuvre to stabilise itself in a crisis through its own efforts. This makes it less likely that UBS has to be bailed out by the government in the event of a crisis.

UBS already fully meets all the capital requirements of the current TBTF regulations, which it has to fulfil by 2030 due to the increase in its systemic importance following the acquisition of CS. UBS has a profitable business model and its profitability targets imply annual profits of over USD 10 billion after the integration of CS.[3] With sufficiently long transition periods, UBS is able to comply with the Federal Council's proposed adjustment to the capital regulations, while still distributing a large proportion of its profits to its shareholders.

There are no signs, in the SNB's view, that the targeted gradual build-up will have any noticeable negative impact on the Swiss economy. The domestically focused banks in Switzerland demonstrate that functions which are systemically important for the country, such

[3] Regarding profitability, UBS is targeting an underlying return on CET1 capital (RoCET1) of approximately 15% by the end of 2026 (exit rate). Its long-term ambition is to achieve a reported RoCET1 of around 18% by 2028. These targets, combined with the bank's guidance of a CET1 capital ratio of approximately 14% and risk-weighted assets (RWA) of approximately USD 500 billion, imply profits of over USD 10 billion.

as the deposit and lending business, can be provided even with higher capital ratios. There is no clear correlation between the banks' capital levels and the credit conditions they offer.

Capital backing of participations differentiated by business model would not achieve the desired result

In the SNB's view, capital backing of foreign participations differentiated by business model – with participations in a wealth management bank, for example, requiring less capital backing than participations in an investment bank – would not achieve the desired result. Full capital backing already takes into account the risks of different business models in an appropriate and conceptually convincing way. If a subsidiary operates a low-risk business model, the required capital and thus the value of the participation will also be lower for that subsidiary. An additional risk differentiation at the parent bank level would lead to an unwelcome lower capital backing for business activities such as wealth management. The crisis at CS showed that even supposedly safe business activities such as wealth management can rapidly lose value in a crisis, especially if clients start withdrawing their assets.