

# FINMA: temporary exemptions for banks due to COVID-19 crisis

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## Introduction

The COVID-19 pandemic is having a significant impact on the financial markets and the real economy. The federal government, the Swiss National Bank (SNB) and the Swiss Financial Markets Supervisory Authority (FINMA) have already taken various measures to limit the consequences for the economy and the financial system.

FINMA issued three letters on 31 March 2020, 7 April 2020 and on 14 April 2020 providing banks with clarifications on:

- dealing with COVID-19 credits with federal guarantees within the framework of the capital and liquidity requirements;
- temporary exemptions relating to the leverage ratio;
- risk diversification;
- temporary exemption regarding back-testing results for institutions authorised to apply the model approach to market risk; and
- extension of timeframes regarding the final two implementation phases of the margin requirements for non-centrally cleared over-the-counter (OTC) derivatives.

Among other measures, FINMA decided the following. The Financial Services Act's (FinSA's) more liberal approach to transaction-related investment advice is a significant facilitation for financial service providers, but may also lead to uncertainties regarding its actual scope. This article gives clarity on the sometimes difficult differentiation between the different types of investment advice and the regulatory consequences of this categorisation.

## Simplified identification under AMLA

Due to shift to online business during the COVID-19 crisis, FINMA grants some facilitations for certain duties under the Anti-money Laundering Act (AMLA). In particular, FINMA grants exemptions for financial intermediaries when identifying customers.

This facilitation applies for new business relationships entered into before 1 July 2020: it is 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 to 90 days in cases where the identification document's authenticity has not been confirmed. In addition, until 1 July 2020, opening a new business relationship is possible with a simple copy of the identification document, which needs to be authenticated only after 90 days.

When opening a business relationship with increased risk, a case-by-case assessment must be made

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to determine whether a simple identification suffices, even with the longer deadline applicable.

Financial intermediaries supervised by a self-regulating organisation may also implement these facilitations as they see fit. Those facilitations need not be authorised by FINMA.

### **Capital requirements for COVID-19 credits with federal guarantees**

The Federal Council decided that credits 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 federal government. Credits of up to Sfr500,000 will be fully guaranteed by the federal government, while credits in an amount between Sfr500,000 and Sfr20 million will be guaranteed up to 85% of their nominal value.

For banks, FINMA clarified that when calculating the minimum capital required the COVID-19 credits can be considered as credits guaranteed by the federal government for the applicable level of coverage (ie, 100% or 85%) and treated in accordance with Margin 311 of FINMA Circular 17/7 Credit risks – banks. For loans with 85% coverage by the government, 15% of the claim is therefore to be treated with the counterparty's risk weighting.

FINMA also stated that COVID-19 credits fall within the scope of the leverage ratio.

### **Liquid coverage ratio calculation taking into account SNB COVID-19 refinancing facility**

For credit facilities granted to companies within the scope of the COVID-19 programme, no outflow should be entered for the part covered by the SNB COVID-19 refinancing facility. The SNB refinancing facility can be considered as collateral with Level 1 high-quality liquid asset pursuant to Margin 273 FINMA Circular 15/2 Liquidity risks – banks.

### **Exemptions relating to leverage ratio**

In the current environment, for a number of reasons various banks are holding large deposits with central banks. The regulatory framework of the leverage ratio provides that all balance sheet items should be backed by capital, regardless of the risk.

The leverage ratio thus serves as a complement to the risk-weighted approach. Unusually high deposits held at central banks can therefore lead to a reduction of the leverage ratio without increasing the banks' risk. 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 Swiss Capital Adequacy Ordinance (CAO), according to FINMA, deposits held at central banks in all currencies pursuant to Margins 5 and 7 of Annex 1 to FINMA Circular 2020/1 Accounting – banks should therefore be excluded.

This facilitation is based on Article 4(3) of the Banking Act. It applies until 1 July 2020 and can be extended by FINMA if necessary. FINMA will announce a possible extension by the beginning of June 2020 at the latest.

As communicated by the Federal Council, the capital freed up through this relief in the leverage ratio calculation is not to be distributed. Thus, no dividends must be paid out of this freed capital.

For banks whose shareholders approved after this date dividends or other similar distributions relating to 2019, or that plan to seek such shareholder approval, the capital relief will be reduced by the amount of the dividend payment in Swiss francs divided by:

- 3% in the case of non-systemically important banks;
- 8% in the case of non-systemically important banks that apply the small banks regime in accordance with Articles 47a to 47e of the CAO; and
- the bank-specific Tier 1 leverage ratio requirement between 4.5% and 5% in the case of systemically important banks.

In contrast, FINMA stated that 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.

## **Exemptions relating to risk diversification**

Owing to market turbulence, increasing margin payments to counterparties have been necessary. This can lead to the upper limit of 25% or 100% of Tier 1 capital as set out in Articles 97 and 98 of the CAO being exceeded in the context of the risk diversification requirements.

To give banks more time to manage such increased positions if needed, FINMA grants to following exceptions:

- Relaxation in relation to the 25% upper limit pursuant to Article 97 of the CAO – the concentration risk may not exceed:
  - ◊ 35% for a maximum duration of three weeks; and
  - ◊ 30% for a maximum duration of five weeks.

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

- Relaxation in relation to the 100% upper limit in interbank business pursuant to Article 98 of the CAO for banks in Categories 4 and 5 – the concentration risk may not exceed:
  - ◊ 140% for a maximum duration of three weeks; and
  - ◊ 120% for a maximum duration of five weeks.

The amount by which the 100% upper limit is exceeded is to be covered by free eligible Tier 1 capital.

This facilitation is based on Article 4(3) of the Banking Act. It is valid for cases where the upper limit is exceeded before 1 July 2020 and can be extended by FINMA if necessary. FINMA will announce a possible extension by the beginning of June 2020 at the latest.

## **IFRS 9 and COVID-19**

Based on Articles 81(1) or Article 65(1) of the FINMA Accounting Ordinance in conjunction with Article 3(1) thereof, Swiss banks can use the International Financial Reporting Standards (IFRS) for their consolidated financial statements as well as their true and fair view statutory single-entity financial statements. Eight banks currently apply the IFRS.

FINMA calls on the affected banks to take into account the IFRS 9 and COVID-19 document published by the International Accounting Standards Board on 27 March 2020. Further, FINMA emphasises that banks may make use of the flexibility provided by IFRS 9.

## **Temporary exemption regarding back-testing results for institutions authorised to apply model approach to market risk**

FINMA acknowledged that due to the volatile markets in the time of the COVID-19 pandemic, many institutions using a model approach for market risk are registering an increased number of back-testing exceptions. Such an exception occurs 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.

Thus, FINMA has decided to freeze the number of exceptions that will result in the increase of the bank-specific multiplier at the level of 1 February 2020 until 1 July 2020. However, exceptions must still be reported and explained to FINMA.

## **Extension of timeframes regarding final two implementation phases of margin requirements for non-centrally cleared OTC derivatives**

Following the decisions of the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions to extend the deadline for completing the final two implementation phases of the margin requirements for non-centrally cleared OTC derivatives by one year, FINMA has decided the following:

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:

- Sfr50 billion for each of the months of March 2021, April 2021 and May 2021 from 1 September 2021; and
- Sfr8 billion for each of the months of March 2022, April 2022 and May 2022 from 1 September 2022.

## Comment

With this guidance, FINMA has provided much needed relief and clarification, particularly with respect to capital requirements and risk diversification. With the general assembly season beginning, banks must adhere to the aforementioned restrictions in regard to possible dividends.

FINMA will likely further specify these guidelines or issue additional rules depending on the development of the current crisis.

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