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Countercyclical capital buffer: proposal of the Swiss National Bank and decision of the Federal Council

On the basis of art. 44 of the Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Traders (Capital Adequacy Ordinance, CAO) and following consultation with the Swiss Financial Market Supervisory Authority (FINMA), the Swiss National Bank (SNB) has submitted a proposal to the Federal Council, requesting the activation of the countercyclical capital buffer (CCB). The proposed capital buffer is targeted at mortgage loans financing residential property located in Switzerland. The proposal sets a level of 1% of associated risk-weighted positions, and a deadline for compliance with the CCB of 30 September 2013.[1]

The SNB's proposal is motivated by strong growth in both bank credit and real estate prices over the last several years, which has resulted in imbalances on the residential mortgage and real estate markets. These imbalances intensified further during the second half of 2012, reaching levels that pose a risk to the stability of the banking sector, and hence to the Swiss economy.

The Federal Council has today decided to activate the CCB, following the SNB's proposal. As agreed between the SNB and the Federal Department of Finance, and following consultation with the Federal Council, the SNB is publishing its proposal and the main reasons for its assessment. These can be found in the appendix to this press release.

The SNB will continue to closely monitor developments on the mortgage and real estate markets, and will regularly reassess the need to either adjust the level of the CCB, or deactivate it.

Press release

[1] Risk-weighted, direct or indirect mortgage-backed positions secured by domestic residential property, as set down in art. 72 CAO.

Appendix: extracts from the Swiss National Bank's proposal

Formal proposal to activate the countercyclical capital buffer for specific market segments

Under art. 44 of the Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Traders (Capital Adequacy Ordinance, CAO), the Swiss National Bank (SNB) can submit a proposal to the Federal Council which obliges banks to hold a countercyclical capital buffer (CCB) in the form of Common Equity Tier 1 capital amounting to a maximum of 2.5% of their risk-weighted positions in Switzerland. The SNB submits such a proposal if it becomes necessary to strengthen the resilience of the banking sector against the risks of excessive credit growth, or to combat excessive credit growth. The CCB can be targeted at specific segments of the credit market.

On the basis of art. 44 CAO, and following consultation with the Swiss Financial Market Supervisory Authority (FINMA), the SNB proposes to the Federal Council that:

banks be obliged to hold a countercyclical capital buffer amounting to 1% of their risk-weighted, direct or indirect mortgage-backed positions secured by residential property in Switzerland, as defined by art. 72 CAO. The countercyclical capital buffer is to be held from 30 September 2013.

Rationale

The Swiss residential mortgage and real estate markets have been growing strongly for a number of years. Despite continued weak economic growth and the introduction of revised self-regulation rules for mortgage financing in July 2012, mortgage lending volumes and residential real estate prices increased sharply again in the second half of last year. This sustained momentum has resulted in imbalances which pose a considerable medium-term risk to the stability of the Swiss banking sector, and hence to the Swiss economy.

Currently, there is limited scope for monetary policy to increase interest rates, a measure which would also exert a dampening effect on the mortgage and real estate markets. Given the sustained period of extremely low interest rates, it is unlikely that the strong momentum in the mortgage and real estate markets will ease off in the near future. This holds true, even in the event that the measures already taken to contain risks in the Swiss mortgage and real estate markets (revised self-regulation rules for mortgage financing, and stricter capital requirements for mortgage loans) begin to take full effect during 2013. For these reasons, the SNB is convinced of the need to activate the CCB as soon as possible.

Activating a CCB targeting specific market segments, as described in the SNB's proposal, will temporarily raise the capital requirements for mortgage loans on residential property in Switzerland. These requirements apply to both owner-occupied and rental residential properties. The CCB thereby increases the resilience of the banking sector, and hence that of the Swiss economy, against a correction of the imbalances on the mortgage and real estate markets. Moreover, the CCB acts to counter a further build-up of such imbalances, by making it less attractive for banks to grant residential mortgage loans compared to other forms of lending.

However, in order for this preventive effect to be achieved, early activation of the CCB is essential. Activating the CCB later – and possibly at a higher level – would reverse at least part of this preventive effect and, in extremis, might even be counterproductive.

The SNB is proposing that the CCB be targeted towards residential mortgage loans, and that it be set at 1% of the associated risk-weighted positions.[2] The SNB's proposal thus takes into account that the imbalances are currently concentrated in this segment of the Swiss lending market. As regards the level of the CCB, the level proposed by the SNB is well below the maximum – 2.5% of total domestic risk-weighted positions – provided for in the CAO. This reflects the fact that the current imbalances are still smaller than those immediately prior to the onset of the real estate and banking crisis at the end of the 1980s. Nevertheless, to reduce the risk of the Swiss economy experiencing a similarly severe crisis in the medium term, it is important that action be taken before the magnitude of the imbalances becomes so great that measures can no longer be applied preventively.

The deadline for compliance with the CCB is relatively short, as the buffer takes effect at the end of September 2013. This reflects the urgency of the need for action, based on the risks outlined above. At the same time, given the proposed level of the buffer, this deadline should allow banks enough time to make the necessary adjustments.

The Federal Council introduced the CCB by ordinance with effect from July 2012. It aims to increase the resilience of banks against excessive credit growth, and to combat excessive credit growth. Such excessive credit growth, coupled with strong price growth in residential property, is currently observable on the Swiss mortgage and real estate markets. This is true for both the owner-occupied and the rental segments of the residential property market. This constellation poses a considerable risk to the stability of the Swiss banking sector, and hence to the Swiss economy. Thus, in the view of the SNB, the immediate activation of the CCB as provided for by the CAO is necessary. If the situation improves, the CCB can be rapidly reduced or deactivated.

[2] Risk-weighted, direct or indirect mortgage-backed positions secured by domestic residential property.