

Final Basel III, the output floor and the Swiss mortgage

*Dr Alexander Ressos, TEP
Attorney-at-Law (Switzerland), Solicitor (Hong Kong),
Solicitor (England & Wales)*

The final Basel III package of December 2017 was the international response to a problem that the Swiss authorities had addressed with the leverage ratio: the variability of risk weights calculated with internal models. Studies by the Basel Committee had shown that banks calculated very different capital requirements for identical hypothetical portfolios. The package therefore introduced an output floor, under which the risk-weighted assets calculated with internal models may not fall below seventy-two and a half per cent of the amount calculated with the standardised approaches, after a transitional period.¹

For Swiss banks, the output floor has a specific significance because of the weight of mortgages in their balance sheets. The Swiss mortgage market, with a volume of more than a thousand billion francs, is one of the largest in the world relative to the size of the economy. Most Swiss households rent their homes. Those who own them traditionally do not repay their mortgages in full. The tax system long encouraged this practice, since mortgage interest was deductible while the owner was taxed on the imputed rental value of the property. The banks that use internal models, in particular the big banks and some of the larger cantonal banks, had calculated low risk weights for these mortgages, which reflected the historically low losses on Swiss residential property.² The output floor limits the benefit of such models and increases the capital requirements for mortgage portfolios of banks that use them.

The Swiss implementation of the final standards revised the risk weights for mortgages in the standardised approach as well. The Basel text differentiates the risk weights for residential property by the loan-to-value ratio and distinguishes owner-occupied property from property whose repayment depends on rental income. The Swiss rules adopted this structure. According to FINMA, the risk weights of investment properties

with high loan-to-value ratios became significantly higher than before, which reflected losses that had been observed in such portfolios in the past.³ The guidelines of the Swiss Bankers Association on minimum requirements for mortgage financing, which Part E, Chapter II described as recognised self-regulation, were adapted to the new rules. Since the stricter requirements of 2019 for investment properties were replaced by the new risk weights, an element of self-regulation gave way to a rule of Basel origin.

Two Swiss specificities complicate the translation. The first concerns the affordability of mortgages. Swiss banks traditionally assess whether a borrower could bear the costs of the property at an imputed interest rate well above market rates, usually five per cent plus maintenance costs, lending only if these costs do not exceed about one third of the borrower's income. The Basel standard does not contain such a criterion. FINMA has repeatedly criticised the banks for granting too many loans that do not meet their own affordability rules as exceptions to policy and for using unrealistic assumptions. It has indicated that it might regulate affordability by rule if the practice did not improve.⁴

The second specificity is the macroprudential instrument that Switzerland applies to mortgages, the sectoral countercyclical capital buffer described in Part E, Chapter II. It shows how a national authority can use an instrument of Basel origin in a form adapted to its own market. The Basel standard foresees a countercyclical buffer applied to all private-sector credit exposures. Switzerland applies it only to residential mortgages, because the national authorities identified the property market as the main source of cyclical risk.⁵ The Swiss sectoral buffer has since been cited as a reference in the debate on sectoral macroprudential instruments in other countries, among them several member states of the European Union.

The timing of the implementation raised its own problem. Switzerland implemented the final Basel III standards on 1 January 2025, as planned. The European Union began to apply most of the rules at the same time but postponed the new market risk framework, and the United Kingdom and the United States delayed their implementation further, the American agencies after a contested proposal of July 2023.⁶ The Swiss authorities kept to the timetable because the credibility of the Swiss commitment in Basel was at stake and because the reforms had been prepared for years. The Swiss banks, and UBS in particular, pointed to the competitive consequences of being among the first to implement. The episode illustrates the collective action problem that runs through the history of the Basel Committee, as the previous chapter showed. Since each member

benefits from the international standard only if the others implement it as well, each faces a temptation to wait.

1 Notes

1. Basel Committee on Banking Supervision, Basel III: Finalising post-crisis reforms (December 2017), on the output floor of 72.5 per cent with a phase-in period, and the Committee's regulatory consistency assessments of risk-weighted assets for credit risk in the banking book (2013 and later). To be verified. ↩
2. On the volume and structure of the Swiss mortgage market, the low home ownership rate, the practice of partial amortisation and the tax treatment of owner-occupied property (imputed rental value and deductibility of mortgage interest; the abolition of the imputed rental value approved by the popular vote of 28 September 2025, with the date of entry into force still open), see the SNB Financial Stability Report and the publications of the Federal Tax Administration. Status to be verified. ↩
3. FINMA press release of 27 March 2024 on mortgage financing and the final Basel III standards (differentiated risk weights for owner-occupied and income-producing property, higher risk weights for investment properties with high loan-to-value ratios, independence of property valuation) and the revised FINMA Credit Risks Ordinance. To be verified. ↩
4. On the affordability assessment in Swiss mortgage lending (imputed interest rate of about 5 per cent plus ancillary costs, maximum of about one third of gross income) and FINMA's criticism of exceptions to policy and its statements on possible further measures, see FINMA's Risk Monitor and the press release of 27 March 2024. To be verified. ↩
5. On the countercyclical capital buffer in the Basel III framework (BCBS, Guidance for national authorities operating the countercyclical capital buffer, December 2010) and its sectoral application in Switzerland (Art. 44 CAO), see the publications of the BIS and the SNB. To be verified. ↩

Final Basel III, the output floor and the Swiss mortgage

6. On the application of Regulation (EU) 2024/1623 (CRR3) from 1 January 2025 with the postponement of the market risk rules (FRTB), the postponement of the implementation of Basel 3.1 in the United Kingdom, and the US "Basel III endgame" proposal of July 2023 and its subsequent treatment, see the publications of the European Commission, the Bank of England and the US federal banking agencies. Status to be verified. ↩

For general information only. This article does not constitute legal or tax advice, does not replace advice on an individual case and creates no lawyer-client relationship. It reflects the legal position as of September 2026.

Online version: helveticaregister.com/basel-final-basel-iii-the-output-floor-and-the-swiss-mortgage