

Julius Bär

Capital Adequacy **2008**
Julius Baer Holding Ltd.

according to FINMA Circular 2008/22
“Capital Adequacy Disclosure Banks”

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1 Introduction

The Julius Baer Group (the Group) is subject for the first time to the full disclosure requirements for capital adequacy according to the conditions defined in Circular 2008/22 “Capital Adequacy Disclosure Banks” of the Swiss Financial Market Supervisory Authority (FINMA).

The required qualitative information is disclosed in the 2008 Annual Report (2008 AR) of Julius Baer Holding Ltd. under “Comment on risk and capital management” (pages 47-64, 2008 AR). This specifically includes the description of the strategy, processes and organisation employed for managing credit risks or counterparty risks, risks in the trading book and banking book as well as operational risks.

In the section “Credit risk” (pages 49ff, 2008 AR), the risk practice and the practice in relation to collateral are explained. External ratings from Moody’s, Standard & Poor’s and Fitch are employed for determining the risk weighting of amounts due from banks and of the interest rate instruments reported under financial investments. For the risk weighting of bonds issued by central governments and central banks, the ratings of the Swiss Export Risk Insurance are used. The standardised approach and subsidiary approaches for calculating capital adequacy requirements for credit risks are described in section 3 of this document.

In the section “Market risk (trading book)” (pages 53ff, 2008 AR), the methods and processes employed for measuring and limiting market risk are explained. For the trading book, the Group calculates the capital adequacy requirements based on its internal value at risk (VaR) model.

The assumptions employed for determining interest rate risk are described in the section “Liquidity and financing risk as well as interest rate risks in the banking book” (pages 56ff, 2008 AR). This section also contains an explanation of the methods used in practice to hedge or reduce the risks related to changes in interest rates. Quantitative figures on the income effect of a major change in interest rates in the banking book are also provided in the aforementioned section.

The standardised approach is used for calculating the capital adequacy for operational risks. Management and control of the operational risks are described in the 2008 AR, pages 59ff.

In the section “Capital management including regulatory capital” (pages 61ff, 2008 AR), the capital management principles, the legal parameters and the consolidation scope used for calculating capital adequacy are described. The capital adequacy information indicated there according to the capital guidelines of the Basel Committee on Banking Supervision is supplemented in section 2 of this document with the disclosure of figures according to Swiss law. The disclosure of figures is limited to the 2008 financial year.

2 Capital adequacy

2.1 Capital ratios

The Group discloses the capital adequacy figures in the 2008 Annual Report for the 2008 financial year according to the revised capital guidelines (Basel II) of the Basel Committee on Banking Supervision (BIS guidelines). For calculating the capital adequacy under Swiss law, the standardised approach (SA-CH) according to the Ordinance concerning Capital Adequacy and Risk Diversification for Banks and Securities Traders (Capital Adequacy Ordinance, CAO) is used. In the table below, the calculations under the international and Swiss approaches are disclosed separately.

Total credit risk is weighted slightly higher under SA-CH than under the BIS guidelines. Non-counterparty-related risk, such as bank premises, other property and equipment as well as software, is weighted significantly higher under SA-CH than under BIS. Market and operational risks are calculated the same way under both SA-CH and BIS.

The eligible capital "Tier 1" is the same under both approaches. The difference between the reported totals "Tier 1 and 2" under BIS and SA-CH is attributable primarily to the inclusion of the collective allowance for credit losses of approximately CHF 20 million as Tier 2 capital in the BIS approach.

The capital adequacy ratios calculated under the international BIS approach (Tier 1 as well as Tier 1 and 2) are higher than those under SA-CH. This is because of the higher weighting of total credit risk under SA-CH and the higher weighting of non-counterparty-related risk under SA-CH.

Capital ratios

	31.12.2008	31.12.2008
	BIS	SA-CH
	CHF m	CHF m
Risk-weighted positions		
Credit risk	9 473	9 509
Non-counterparty-related risk	498	2 024
Market risk ¹	781	781
Operational risk ¹	4 791	4 791
Total	15 543	17 105
Eligible capital		
Eligible Tier 1 capital	2 121	2 121
<i>of which hybrid Tier 1 capital</i>	<i>225</i>	<i>225</i>
Eligible Tier 1 and 2 capital	2 198	2 177
BIS Tier 1 ratio	13.6%	
BIS Tier 1 and 2 ratio	14.1%	
SA-CH Tier 1 ratio		12.4%
SA-CH Tier 1 and 2 ratio		12.7%
Ratio of eligible/required capital under Swiss law		159%

¹ Risk-weighted figure calculated by taking 12.5 times the capital adequacy requirement according to the applied approach

Hybrid Tier 1 capital

Hybrid Tier 1 capital represents 11.9% of the core capital of the Group. The hybrid Tier 1 capital consists of preferred securities issued by Julius Baer Capital (Guernsey) I Limited. The preferred securities were issued in exchange for a note of Julius Baer Holding Ltd., in the same amount and with mirror conditions. They fundamentally have no maturity and are subordinate to all other borrowings. They have a preference over equity in the payment of dividends and liquidation proceeds, though such dividends and liquidation proceeds will only be paid to the extent that they comply with the banking and corporate regulations applicable to the payouts of Julius Baer Holding Ltd. The preferential dividend right is not cumulative. The preferred securities are fully paid, devoid of any voting rights or rights associated therewith, capable of sustaining losses, unsecured and only repayable at the issuer's option, after an initial period of five years and only with the approval of the regulatory authorities. In compliance with the consolidated equity regulations, the hybrid equity created by the issue of preferred securities is recognised in full as core capital.

2.2 Capital components

The main adjustments on capital are the addition of the innovative capital instruments (hybrid Tier 1 capital) and the deduction of treasury shares and of intangible assets to get to the total of eligible capital. These and other capital components are shown in the table below. In the Tier 2 capital, there is a difference between the eligible capital disclosed under the BIS and SA-CH approaches. Under BIS, the collective allowance for credit losses is included in the Tier 2 capital. Under SA-CH, however, 75% of the collective allowance is deducted from the risk weighted assets.

A total of CHF 334 million is deducted from core capital Tier 1 for treasury shares of Julius Baer Holding Ltd. "Other deductions" include the deduction of approximately CHF 123 million of unrealised gains on financial investments credited directly to equity. There is also a deduction of CHF 0.4 million resulting from the deconsolidation of Julius Baer Life (Bahamas) Ltd.

Capital components

	31.12.2008	31.12.2008
	BIS	SA-CH
	CHF m	CHF m
Gross Tier 1 capital after deduction of treasury shares	6 690	6 690
<i>of which non-controlling interests</i>	1	1
<i>of which innovative capital instruments</i>	225	225
Goodwill and other intangible assets	-4 445	-4 445
Other deductions	-124	-124
Eligible Tier 1 capital	2 121	2 121
Eligible Tier 2 capital	77	56
Eligible capital	2 198	2 177

2.3 Minimum capital requirement

The capital requirements for credit risk (see table below), which arises from amounts due from banks, loans, financial investments, derivative financial instruments, other assets exposed to credit risk and off-balance-sheet positions exposed to credit risk, represent 61% of the total required capital under BIS and 56% under SA-CH.

The capital adequacy requirement for non-counterparty-related risk amounts to 3% of the total required capital under BIS, which is markedly lower than the corresponding figure of 12% under SA-CH. The weighting percentages under BIS are uniformly 100% of the book value of the non-counterparty-related risk positions. Under SA-CH, the positions bank premises at CHF 290 million and capitalised other property and equipment as well as software at CHF 208 million, which are disclosed under the heading of non-counterparty-related risk, are weighted at 250% and at 625% respectively. The total weighted amount is subject to a capital adequacy requirement of 8%, which results in the required capital figure of CHF 162 million disclosed in the table.

The capital requirements for market risk are equally high in absolute amounts under both approaches (percentage shares: BIS 5.0%, SA-CH 4.5%). The capital requirements for operational risk are also identical in absolute amounts under both approaches. At approximately 31% under BIS and 28% under SA-CH, the capital requirements for operational risk represent a significant share of the respective total required capital.

Minimum capital requirement

	31.12.2008	31.12.2008
	BIS	SA-CH
	CHF m	CHF m
Credit risk (standardised approach)	758	761
<i>of which for equity securities in the banking book</i>	<i>20</i>	<i>32</i>
Non-counterparty-related risk	40	162
Market risk (model approach)	62	62
Operational risk (standardised approach)	383	383
Total	1 243	1 368

3 Credit risk

3.1 Approaches used for calculating required capital

For calculating the required capital for credit risk, the Group uses the standardised approach under the BIS guidelines (i.e. the SA-BIS approach before application of the multipliers according to the Capital Adequacy Ordinance (CAO)) for disclosure of the capital figures in the 2008 Annual Report as well as the standardised approach under Swiss law (SA-CH) for disclosure of the capital figures according to Swiss law. In the CAO and the circulars referred to therein, the calculation procedures for both approaches are described in detail.

In addition, the following subsidiary approaches are used:

- Collateral is handled under the comprehensive approach, which means that the credit position is netted against the collateral provided. This takes into account add-ons or haircuts on the receivable and the collateral to reflect possible changes in value based on market developments. The resulting net unsecured position remains in the original position category and is risk weighted according to the criteria applicable to this category.
- Lombard loans are also handled under the comprehensive approach described above.
- The regulatory standard haircuts are used for collateral eligible under the comprehensive approach.
- Credit equivalents for derivatives are calculated using the mark-to-market method. The credit equivalent corresponds to the sum of the current replacement value and the add-on which is calculated on the basis of the notional amount of the contract.
- Securities lending, repo and repo-style transactions are handled under the comprehensive approach, and the regulatory standard haircuts under the BIS approach are used, contrary to the SA-CH approach, under which capital is only required to cover the difference between the margin provided (without any regulatory standard haircuts) and the securities position.

3.2 Credit risk by risk weighting

The credit risk breakdown, as presented numerically in the tables in sections 3.2 to 3.5, is provided before deduction of the eligible collateral. All positions subject to capital adequacy requirements and exposed to credit risk are disclosed, with the exception of the balance sheet positions accrued income and prepaid expenses, deferred tax assets and other assets in the total amount of CHF 617 million (risk weighted CHF 495 million).

Under both the BIS and SA-CH approaches, the unrealised gains on the financial investments are deducted from the total amount of the financial investments.

The total amount of the derivative financial instruments corresponds to the total in the balance sheet, plus the calculated add-ons, minus permissible netting under netting agreements. The total amounts disclosed under the BIS and SA-CH approaches differ from each other because of the divergent measurement criteria for determining the add-ons and the divergent netting rules.

The totals of the positions contingent liabilities and irrevocable commitments correspond to the calculated credit equivalents. In these cases, the total amounts under the BIS and SA-CH approaches differ from each other because of the divergent conversion factors for determining the credit equivalent.

The securities lending and repo transactions are disclosed under the BIS approach, including risk premiums. The criteria of the regulatory standard haircuts are applied for the calculation of the risk premiums. No risk premium has to be taken into account under the SA-CH approach.

The risk weighting breakdown is presented under the BIS approach as well as under the SA-CH approach. The structures are not identical given that the risk weighting categories of 125% and 250% do not exist in the BIS approach. The secured portion of credit, which corresponds to the collateral after adjusting for the haircuts (use of regulatory standard haircuts), is assigned to the 0% column; the 0% column represents 51% of the total credit volume under BIS and 54% under SA-CH. Under both approaches, the largest portion of the credit volume after deduction of the collateral is found in the risk weighting range from 20%/25% to 50%; the corresponding share of the total credit volume amounts to 42% under BIS and 39% under SA-CH. The remaining unsecured credit is concentrated primarily in the weighting category of 100% under both approaches, though the equity holdings reported under the balance sheet position financial investments that are not traded on a regulated stock exchange and the majority of the subordinate claims are weighted at 250% under the SA-CH approach.

The sums of the risk weighted amounts, including the CHF 495 million mentioned in the first paragraph of this section, correspond to the disclosed risk weighted amounts for credit risk under BIS and SA-CH in the table in section 2.1.

Risk weights according to BIS approach

	31.12.2008							Total
	0%	20%	35%	50%	75%	100%	150%	CHF m
	CHF m	CHF m	CHF m	CHF m	CHF m	CHF m	CHF m	CHF m
Due from banks	5 292	3 198	-	339	-	9	25	8 863
Loans ¹	6 254	-	1 431	111	125	1 783	19	9 723
<i>of which mortgages</i>	-	-	1 431	90	-	312	-	1 833
Financial investments available-for-sale ²	1 796	5 104	-	5 122	-	159	135	12 316
Derivative financial instruments ³	1 026	500	-	840	5	278	-	2 649
Contingent liabilities ⁴	368	-	-	-	3	61	-	432
Irrevocable commitments ⁴	5	6	-	-	-	12	-	23
Securities lending and repo transactions ⁵	7 275	1 434	-	-	-	553	-	9 262
Total	22 016	10 242	1 431	6 412	133	2 855	179	43 268

¹ Before deduction of collective allowance for credit losses of CHF 19.8 million

² Net long positions in securities and money market instruments in the banking book

³ Positive current replacement values plus the security supplement (add-on) taking into account existing netting agreements

⁴ Converted in credit equivalent

⁵ Disclosed with risk premium

Risk weights according to SA-CH approach

	31.12.2008									Total
	0%	25%	35%	50%	75%	100%	125%	150%	250%	CHF m
	CHF m	CHF m	CHF m	CHF m	CHF m	CHF m	CHF m	CHF m	CHF m	CHF m
Due from banks	5 312	3 383	-	112	22	9	-	25	-	8 863
Loans ¹	6 247	2	1 431	20	400	1 585	-	18	-	9 703
<i>of which mortgages</i>	-	-	1 431	-	294	108	-	-	-	1 833
Financial investments available-for-sale ²	1 766	6 822	-	3 110	-	92	49	-	477	12 316
Derivative financial instruments ³	1 034	770	-	447	4	243	-	-	-	2 498
Contingent liabilities ⁴	646	-	-	-	9	107	-	-	-	762
Irrevocable commitments ⁴	5	7	-	-	-	15	-	-	-	27
Securities lending and repo transactions ⁵	7 787	239	-	-	-	167	-	-	-	8 193
Total	22 797	11 223	1 431	3 689	435	2 218	49	43	477	42 362

¹ Deduction of collective allowance (weighted with 75%)

² Net long positions in securities and money market instruments in the banking book

³ Positive current replacement values plus the security supplement (add-ons) taking into account existing netting agreements

⁴ Converted in credit equivalent

⁵ Disclosed without risk premium

3.3 Credit risk by region

In the table below, the counterparty domicile serves as the fundamental basis for the geographical breakdown. For the secured portion of credit, however, the domicile of the pledger, e.g. the domicile of the issuer of securities which are pledged as collateral, or the domicile of the guarantor, is the determining factor. This differs from the disclosure provided in the annual report, which in the corresponding table presents the geographical breakdown strictly by the counterparty domicile (page 50, 2008 AR).

For the lombard loans, the geographical breakdown principles described above apply, not the domicile country in which the place of jurisdiction of the lombard loan agreement is located.

The same guidelines apply to the domicile breakdown under the BIS and SA-CH approaches, thus making it unnecessary to present a corresponding table under the SA-CH approach.

Taking into account the domicile of the pledger, the following regional breakdown results: Switzerland 19%, Europe (excl. Switzerland) 60%, Americas 14%, Asia/Pacific 7% and other countries rounded to 0%.

Credit risk by region (figures disclosed according to BIS approach)

	Switzerland CHF m	Europe CHF m	Americas CHF m	Asia/Pacific CHF m	Other countries CHF m	31.12.2008 Total CHF m
Due from banks	1 685	5 932	595	650	1	8 863
Loans ¹	2 880	2 754	2 527	1 397	165	9 723
<i>of which mortgages</i>	1 735	89	-	9	-	1 833
Financial investments available-for-sale ²	131	10 378	1 307	488	12	12 316
Derivative financial instruments ³	1 107	1 086	265	183	8	2 649
Contingent liabilities ⁴	57	194	138	32	11	432
Irrevocable commitments ⁴	22	-	1	-	-	23
Securities lending and repo transactions ⁵	2 158	5 759	1 212	133	-	9 262
Total	8 040	26 103	6 045	2 883	197	43 268

¹ Before deduction of collective allowance for credit losses of CHF 19.8 million

² Net long positions in securities and money market instruments in the banking book

³ Positive current replacement values plus the security supplement (add-on) taking into account existing netting agreements

⁴ Converted in credit equivalent

⁵ Disclosed with risk premium

3.4 Credit risk by sector

In the table below, the counterparty industry code serves as the fundamental basis for the sector breakdown. For the secured portion of credit, however, the industry code of the pledger, e.g. the industry code of the issuer of securities which are pledged as collateral, or the industry code of the guarantor, is the determining factor. This differs from the disclosure provided in the annual report, which in the corresponding table presents the sector breakdown strictly by the counterparty industry code (page 51, 2008 AR).

The sector breakdown principles described above also apply to lombard loans. Loans to companies outside of the financial sector are assigned to the column private clients given that they are granted only if they are connected with private banking as the core element of the business relationship.

The column other is used for disclosure of securities from companies outside of the financial sector: these consist of proprietary positions of the Group which are reported under the balance sheet position financial investments available-for-sale as well as of the portion of credit secured by securities of companies outside of the financial sector.

The same guidelines apply to the sector breakdown under the BIS and SA-CH approaches, thus making it unnecessary to present a corresponding table under the SA-CH approach.

Credit risk by sector (figures disclosed according to BIS approach)

	31.12.2008				
	Government and agencies CHF m	Financial institutions CHF m	Private clients CHF m	Other CHF m	Total CHF m
Due from banks	46	8 817	-	-	8 863
Loans ¹	244	2 348	5 122	2 009	9 723
<i>of which mortgages</i>	-	-	1 833	-	1 833
Financial investments available-for-sale ²	1 878	8 720	-	1 718	12 316
Derivative financial instruments ³	18	2 069	442	120	2 649
Contingent liabilities ⁴	11	202	156	63	432
Irrevocable commitments ⁴	7	-	15	1	23
Securities lending and repo transactions ⁵	1 409	5 975	-	1 878	9 262
Total	3 613	28 131	5 735	5 789	43 268

¹ Before deduction of collective allowance for credit losses of CHF 19.8 million

² Net long positions in securities and money market instruments in the banking book

³ Positive current replacement values plus the security supplement (add-ons) taking into account existing netting agreements

⁴ Converted in credit equivalent

⁵ Disclosed with risk premium

3.5 Credit risk after deduction of recognised financial collaterals

As collateral to cover lombard loans, OTC derivatives positions as well as securities lending and repo transactions, primarily readily marketable securities are pledged. In the table below, all of the collateral accepted within scope of the capital adequacy regulations is disclosed.

The haircuts applied to the collateral are based on the regulatory standard haircuts.

The secured portion of credit, disclosed in the column secured by recognised collaterals, amounts to 51% of the total credit volume according to the following table. If the financial investments are deducted from the total credit volume, the secured portion of credit amounts to 71%.

The same coverage criteria apply under the BIS and SA-CH approaches, thus making it unnecessary to present a corresponding table under the SA-CH approach.

Credit risk after deduction of recognised financial collaterals (figures disclosed according to BIS approach)

	31.12.2008		
	Secured by recognised collaterals ¹ <i>CHF m</i>	Not secured by recognised collaterals <i>CHF m</i>	Total <i>CHF m</i>
Due from banks	5 252	3 611	8 863
Loans	8 132	1 591	9 723
<i>of which mortgages</i>	<i>1 821</i>	<i>12</i>	<i>1 833</i>
Financial investments available-for-sale	-	12 316	12 316
Derivative financial instruments	1 026	1 623	2 649
Contingent liabilities	368	64	432
Irrevocable commitments	5	18	23
Securities lending and repo transactions	7 275	1 987	9 262
Total	22 058	21 210	43 268

¹Taking into account recognised collaterals with applied discount factors according to CAO and the circulars referred to therein

3.6 Additional information

The risk weighted, impaired loans abroad represent less than 15% of all risk weighted, impaired loans. Hence, according to the Circular “Capital Adequacy Disclosure Banks”, it is unnecessary to provide separate disclosure broken down by geographical region.

The Group did not have any open credit derivatives to report as of the end of 2008.

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