Julius Bär

Capital Adequacy **2011**
Julius Baer Group Ltd.

according to FINMA Circular 2008/22
"Capital Adequacy Disclosure Banks"

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Introduction

The Julius Baer Group Ltd. (the Group) is subject 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 Annual Report 2011 (AR 2011) of Julius Baer Group Ltd. under “Comment on risk and capital management” (pages 62-87). 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” (page 65 ff., AR 2011), 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, also the ratings of the Swiss Export Risk Insurance (SERV) are employed. The standardised approach and subsidiary approaches for calculating capital requirements for credit risks are described in the section “Approaches used for calculating required capital” on page 6 of this document.

In the section “Market risk (trading book)” (page 75 ff., AR 2011), the methods and processes employed for measuring and limiting market risks are explained. For the trading book, the Group calculates the capital requirements based on its internal value at risk (VaR) model.

The assumptions employed for determining interest rate risk are described in the section “Liquidity, financing and interest rate risks in the banking book” (page 79 ff., AR 2011). 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 AR 2011, page 83f.

The section “Management of capital including regulatory capital” (page 85 ff., AR 2011) describes the capital management principles, the legal parameters and the consolidation scope used for calculating the required capital. The therein disclosed capital adequacy according to the capital guidelines of the Basel Committee on Banking Supervision is supplemented in section “Capital adequacy”, page 3 ff. of this document, with the disclosure of figures according to Swiss law (SA-CH approach).

Capital adequacy
Capital ratios

The Group discloses the capital adequacy figures in the AR 2011 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 Swiss approach are disclosed.

Capital ratios

	31.12.2011 *CHF m*	31.12.2010 *CHF m*
Risk-weighted positions		
Credit risk	**8 528.6**	8 797.8
Non-counterparty-related risk	**2 095.3**	2 093.2
Market risk[1]	**671.5**	514.2
Operational risk[1]	**2 892.5**	2 896.3
Total	**14 187.9**	14 301.5
Eligible capital		
Eligible tier 1 capital	**2 788.5**	2 873.4
of which hybrid tier 1 capital	***225.0***	*225.0*
Eligible tier 1 and tier 2 capital	**3 040.0**	2 908.1
of which lower tier 2 capital	***242.1***	-
SA-CH tier 1 ratio	**19.7%**	20.1%
SA-CH total capital ratio	**21.4%**	20.3%
Ratio of eligible/required capital under Swiss law	**267.8%**	254.2%

[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 8.1% of the Group's total tier 1 capital. 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 Group Ltd., in the same amount and with mirror conditions. Their maturity is essentially perpetual and they are subordinate to all other borrowings. They have a preference over equity with regard to the payment of dividends and liquidation proceeds, though such dividends and liquidation proceeds will be paid only to the extent that they comply with the banking and company law regulations applicable to distributions made by Julius Baer Group Ltd. The preferential dividend right is not cumulative. The preferred securities are fully paid up, devoid of any voting rights or rights associated therewith, capable of sustaining losses, unsecured and repayable at the issuer's option only, no earlier than 2 December 2015 and only with the approval of the regulatory authorities. The hybrid equity created by the issue of preferred securities is recognised in full as core capital for the purpose of adherence to consolidated equity requirements.

Lower tier 2 capital

Lower tier 2 capital represents 7.9% of the Group's total capital and consists of subordinated unsecured bonds ("bonds"), fully paid up and listed on the SIX Swiss Exchange. The bonds have been issued by Julius Baer Group Ltd. ("the issuer") in December 2011 in the amount of CHF 250 million. They constitute valid and legally binding obligations of the issuer enforceable in accordance with their terms and rank at least pari passu with all other unsecured and subordinated obligations of the issuer. Maturity date of the bonds is 23 December 2021. From (and excluding) the issue date (23 December 2011) to (but including) the reset date (23 December 2016), the bonds pay a fixed rate of interest of 4.50% per annum and during the period (reset period) commencing on (and excluding) the reset date and ending on (but including) the maturity date (23 December 2021) a fixed rate of interest of the rate per annum equal to the sum of the benchmark rate (i.e. in principle the five-year CHF mid-market swap rate calculated on the basis of the rate displayed on ISDAFIX page CHFSFIX at 11:00 a.m. [CET] on the date falling five business days before the reset date, the "reset determination date") and the margin (i.e. 3.815%). The interest will be payable annually in arrear on 23 December, each an "interest payment date" (30/360). Julius Baer Group Ltd. may redeem the bonds on the reset date (23 December 2016, and upon the occurrence of a capital event or a tax event as defined in the prospectus) in whole but not in part at the par value per bond plus accrued but unpaid interest thereon, upon giving not less than 30 days' notice to the holders of the bonds.

Capital components

The main adjustments to capital are the addition of the innovative capital instruments (hybrid tier 1 capital and lower tier 2 capital) and the deduction of intangible assets to get to the total of eligible capital. These capital components are shown separately in the following table. Additionally a total of CHF 291 million (2010: CHF 22 million) is deducted from core capital tier 1 for treasury shares of Julius Baer Group Ltd. The reported high amount of own shares for 2011 is mainly the result of the share buyback programme carried out in the Year 2011.

Capital components

	31.12.2011 CHF m	31.12.2010 CHF m
Gross tier 1 capital after deduction of treasury shares	**4 427.3**	4 586.0
of which non-controlling interests	***1.9***	*2.2*
of which innovative capital instruments	***225.0***	*225.0*
Goodwill and other intangible assets	**-1 543.1**	-1 635.4
Other deductions	**-95.7**	-77.2
Eligible tier 1 capital	**2 788.5**	2 873.4
Tier 2 capital	**251.5**	34.7
of which lower tier 2 capital	***242.1***	-
Eligible tier 1 and tier 2 capital	**3 040.0**	2 908.1

Minimum capital requirement

The capital requirement 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, represents 60% (2010: 61%) of the total required capital according to SA-CH. The capital requirement for non-counterparty-related risk amounts to 15% (2010: 15%) of the total required capital. Under SA-CH, the positions bank premises are weighted at 250%, and capitalised other property and equipment as well as software, which are disclosed under the category of non-counterparty-related risk, are weighted at 625% respectively. The total weighted amount is subject to a capital requirement of 8%.

The capital requirement for market risk represents 5% (2010: 4%) of the total required capital. The share of operational risk represents 20% (2010: 20%).

Minimum capital requirement

	31.12.2011 CHF m	31.12.2010 CHF m
Credit risk	**682.3**	703.8
of which for equity securities in the banking book	***2.8***	*16.2*
Non-counterparty-related risk	**167.6**	167.5
Market risk	**53.7**	41.1
Operational risk	**231.4**	231.7
Total	**1 135.0**	1 144.1

Credit risk
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 Swiss Capital Adequacy Ordinance (CAO)) for disclosure of the capital figures in the AR 2011 as well as the standardised approach under Swiss law (SA-CH approach) for disclosure of the capital figures in this report. 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, whereas under the SA-CH approach for qualifying counterparties capital is only required to cover the difference between the margin provided (without any regulatory standard haircuts) and the securities position. For non-qualifying counterparties capital is required to cover the difference between the margin provided less a haircut and the securities position plus a risk premium.

Credit risk by legal risk weights

The credit risk breakdown, as presented in the table on page 7, 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.

The unrealised gains on the available-for-sale financial investments are deducted from the total amount of the financial investments. The total amount of the derivative financial instruments corresponds to the total of positive current replacement values, plus the calculated add-ons, minus permissible netting under netting agreements. The totals of the positions contingent liabilities and irrevocable commitments correspond to the calculated credit equivalents. The total of securities lending and repo transactions correspond to the market values of the disclosed transactions plus risk premiums, which have to be calculated for specific counterparty types.

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 55% (2010: 53%) of the total credit volume. The largest portion of the credit volume after deduction of the collateral is found in the risk weighting range from 25% to 75%; the corresponding share of the total credit volume amounts to 41% (2010: 41%). The remaining unsecured credit volume is concentrated primarily in the weighting category of 100%, though the equity holdings reported under the balance sheet position financial investments that are not traded on a regulated stock exchange and the subordinate claims are weighted at 250%.

Credit risk by regulatory risk weightings

										31.12.2011
	0% *CHF m*	25% *CHF m*	35% *CHF m*	50% *CHF m*	75% *CHF m*	100% *CHF m*	125% *CHF m*	150% *CHF m*	250% *CHF m*	**Total** *CHF m*
Due from banks[1]	4 472	3 730	-	166	-	12	-	-	-	**8 380**
Loans[2]	11 093	11	3 787	46	608	848	-	22	-	**16 415**
Financial investments available-for-sale	1 816	7 021	-	3 040	-	82	1	14	105	**12 079**
Derivative financial instruments[3]	843	231	-	331	4	208	-	-	-	**1 617**
Contingent liabilities[4]	768	1	-	-	5	97	-	-	-	**871**
Irrevocable commitments[4]	43	27	-	1	2	3	-	-	-	**76**
Securities lending and repo transactions[5]	6 211	63	-	-	-	475	-	2	-	**6 751**
Total	25 246	11 084	3 787	3 584	619	1 725	1	38	105	**46 189**

										31.12.2010
	0% *CHF m*	25% *CHF m*	35% *CHF m*	50% *CHF m*	75% *CHF m*	100% *CHF m*	125% *CHF m*	150% *CHF m*	250% *CHF m*	Total *CHF m*
Due from banks[1]	2 444	3 684	-	73	-6	11	-	16	-	6 222
Loans[2]	9 745	8	2 844	297	559	1 089	-	28	-	14 570
Financial investments available-for-sale	4 166	6 915	-	2 275	-	62	8	21	349	13 796
Derivative financial instruments[3]	1 116	425	-	381	7	373	-	-	-	2 302
Contingent liabilities[4]	723	8	-	-	6	81	-	-	-	818
Irrevocable commitments[4]	9	28	-	-	1	7	-	-	-	45
Securities lending and repo transactions[5]	4 698	38	-	-	-	388	-	-	-	5 124
Total	22 901	11 106	2 844	3 026	567	2 011	8	65	349	42 877

[1]Reverse repurchase transactions deducted; collective allowance deducted (weighted with 75%)
[2]Collective allowance deducted (weighted with 75%)
[3]Positive current replacement values plus the security supplement (add-ons) taking into account existing netting agreements
[4]Converted in credit equivalent
[5]Including reverse repurchase transactions

Additional numeric credit risk breakdowns by region, by sector and after deduction of recognised financial collaterals are presented in the AR 2011, pages 66-69, according to the BIS approach. Corresponding tables according to the SA-CH approach are not presented in this document.

Additional information

In the following table the risk-weighted, impaired loans are disclosed broken down by geographical region.

Impaired loans by region

	31.12.2011		31.12.2010	
	Gross loans *CHF 1000*	Specific allowance *CHF 1000*	Gross loans *CHF 1000*	Specific allowance *CHF 1000*
Switzerland	**3 907**	**-3 912**	3 862	-3 862
Europe	**13 301**	**-7 764**	6 048	-5 556
Americas	**41 387**	**-38 218**	51 772	-26 942
Asia/Pacific	**42 864**	**-14 083**	-	-
Other countries	**1 593**	**-1 111**	1 522	-803
Total	**103 052**	**-65 088**	63 204	-37 163

The Group does not disclose open credit derivatives as at the end of 2011 and 2010.

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