



Strengthening financial sector stability (too big to fail)

Questions and answers

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What is meant by "too big to fail"?

The term "too big to fail" became popular during the latest global financial and economic crisis. It describes the fact that a state cannot allow an ailing firm to fail. The services provided by the firm in question are indispensable for the national economy and cannot be assumed by another market player within a short space of time. The state is forced to come to the rescue if such a firm becomes distressed. It thus has an implicit state guarantee. In Switzerland, this problem is currently limited to the two big banks UBS and Credit Suisse.

What are the systemic risks in the Swiss financial sector?

In particular, the domestic deposit and lending business as well as payment transactions are systemically important. A breakdown concerning these functions would give rise to significant economic costs. Consequently, access to domestic deposits must be ensured at all times, and the payment transaction infrastructure necessary for this must be kept functional.

Who decides which financial institutions are systemically important?

The Federal Council sets out the supplementary requirements for systemically important banks in an ordinance. The Swiss National Bank (SNB) determines in an order which banks are systemically important. And the Swiss Financial Market Supervisory Authority (FINMA), based on the Federal Council ordinance, orders the supplementary requirements for individual institutions.

Is there not a danger that the Swiss big banks will be less competitive if less stringent regulatory requirements are provided for internationally?

It is too short-sighted to stigmatise more stringent regulatory requirements merely as a cost factor. The new requirements will ensure that the big banks' solvency and stability are above average by international standards. Once the planned capital base has been achieved, the banks will also be able to benefit from better ratings and lower refinancing costs. At the same time, the financial centre's stability and reputation will be further enhanced.

Is there a danger that Swiss banks will offshore parts of their business in order to circumvent the stricter regulations?

The choice of financial centre is not determined by regulatory costs alone. The quality of the political institutions, legal certainty, stability, reputation and a reliable fiscal policy are also important factors in decision-making. Moreover, the regulatory requirements, which in Switzerland already go beyond the international standards, are to be seen as additional bank quality features and they are rewarded accordingly also by clients and capital providers.

Does the too big to fail bill go further than the Commission of Experts' proposals?

The bill is based on the report of the Commission of Experts submitted at the end of September 2010. The draft does not go beyond the experts' report in material terms. However, the laws have been given concrete form. The Commission of Experts' general comments on the FINMA Circular on Remuneration Schemes have also been made concrete for crisis situations. Finally, as called for by the Commission of Experts, tax measures for developing a bond and CoCo market in Switzerland have been integrated into the bill.

How should the capital base be strengthened?

Three capital components form the core. The basic requirement serves to maintain normal business activities. The capital buffer allows banks to absorb losses without having to suspend normal business activities. And the progressive component ensures that systemically important banks are more strongly capitalised. It thus creates the financial freedom of manoeuvre to deal with a crisis.

New instruments will be made available to the affected banks for implementation of the more stringent capital requirements. These include contingent convertible bonds (CoCos), which are converted into equity capital or are written off when a specific event occurs (when a trigger is reached). It is planned to trigger mandatory conversion when equity falls below 5% of risk-weighted assets.

What is the aim of the more stringent risk diversification requirements?

More stringent risk diversification requirements will reduce the degree of interconnectedness within the banking sector and thus lower the risk of other banks being "contaminated" by the difficulties of an individual bank. Reducing the dependencies will also reduce banks' systemic importance.

How must a systemically important bank be organised in order to allow for orderly resolution in the event of collapse?

Systemically important banks are initially free to develop forms of organisation that make it possible to maintain systemically important functions and either liquidate or restructure the remaining components. The bank must prove that the systemically important functions can be maintained in the event of a crisis. The Federal Council will define the criteria to evaluate this proof and will establish the measures which may be ordered by FINMA if proof has not been provided.

Why are tax measures needed?

CoCos should preferably be issued in Switzerland and under Swiss law. To enable this, their attractiveness must be enhanced for the Swiss capital market. Consequently, the issue tax on bonds and money market paper should generally be abolished. In addition, the Federal Council is planning to submit the switch from the debtor principle to the paying agent principle for withholding tax as recommended in the consultation draft in a separate dispatch by September 2011 at the latest.

Why will bonuses be limited only in the case of state support, and not in general?

In the case of financial institutions receiving state support, the state has a fundamental interest in influencing the remuneration, and particularly variable salary components, as excessive remuneration would further weaken the existing financial substance and be charged to taxpayers. A total ban on bonus payments would overshoot the mark, however.

What are the economic implications of the regulatory proposals?

The benefits of regulations dominate in the long term. The frequency and intensity of financial crises will decline with more capital. Justifiable transition costs are to be expected in the short term. The stability of the financial sector and Switzerland in its entirety as a business location will be strengthened in the long term and competitiveness will be improved.