Questions and answers

Federal Council report on banking stability of 10 April 2024

About the report

What is the status of this report?

Article 52 of the Banking Act requires the Federal Council to report every two years to Parliament on the implementation of the international too-big-to-fail standards, and to indicate the potential need for adjustments. On 29 March 2023, the Federal Council also instructed the Federal Department of Finance (FDF) to comprehensively review, within one year, the circumstances of UBS's takeover of Credit Suisse, the associated state measures and the too-big-to-fail regulations; other federal units and external expert opinions were to be included. The report also addresses a number of questions and points raised in parliamentary procedural requests.

Will the report be debated in Parliament?

The report itself will be presented to Parliament but does not have to be formally approved by it. The Federal Council will submit the legislative amendments proposed in the report to Parliament separately, for approval under the ordinary legislative procedure.

How is the report aligned with other publications on the same subject (PInC/COMCO)?

The report of the Parliamentary Investigation Committee (PInC) entitled "Management by the authorities – CS emergency merger" is due to be published at the end of 2024. Its findings will need to be taken into account for potential future amendments to the TBTF regime, especially with regard to the role of and cooperation between the authorities. The Competition Commission's report on the takeover of Credit Suisse by UBS is scheduled for publication in summer 2024; it is currently being examined by FINMA.

How were the Swiss Financial Market Supervisory Authority (FINMA) and the Swiss National Bank (SNB) involved in the preparation of the report?

FINMA and the SNB collaborated actively at specialist level in the report, and regular exchanges took place between the authorities.

Too-big-to-fail issue

> **What does too-big-to-fail mean?**
> Too-big-to-fail describes financial institutions that, owing to their size and interconnectedness with a country's financial system and economy, cannot be allowed to fail. Measures to mitigate the too-big-to-fail issue are intended to minimise this risk, sustainably reduce the likelihood of future financial crises and contain their costs, and avoid state aid.

What counts as a systemically important bank in Switzerland?
Banking groups and banks are systemically important if their failure would significantly damage the Swiss economy and financial system. In Switzerland, four financial institutions are designated as systemically important banks (SIBs) by the SNB: UBS, PostFinance, Raiffeisen and Zürcher Kantonalbank (until 2023, also Credit Suisse). Systemically important banks must meet higher prudential requirements than other institutions. Moreover, they are required to draw up a recovery plan and an emergency plan. In addition, FINMA engages in resolution planning for these banks. The Financial Stability Board also considers UBS (and, until 2023, Credit Suisse) to be a global systemically important bank (G-SIB).

Is the existing too-big-to-fail regime insufficient?

The existing TBTF regime, which was introduced in 2012 and has been gradually refined since then, has strengthened the resilience of systemically important banks. This was demonstrated, for example, during the Covid-19 pandemic and in autumn 2022 in the case of Credit Suisse. However, the Credit Suisse case in March 2023 also revealed gaps and a clear need for action in order to further develop and strengthen the existing regime. The capital requirements are fundamentally not forward-looking in nature and the parent bank's capitalisation is a critical point for the disposal of foreign participations. As regards liquidity, the scale and speed of outflows exceeded all previous experience. Moreover, the emergency liquidity assistance provided by the SNB was far from sufficient. Finally, implementing the restructuring plan drawn up for Credit Suisse entailed considerable disadvantages and risks. It was questionable whether it would have restored market confidence.

In a worst-case scenario, could UBS be wound up ("resolved")?

Yes, this is the aim of the too-big-to-fail regulations. In the event of imminent bankruptcy, resolution – wherever possible, in the form of a restructuring – is the baseline scenario. It cannot be predicted for every conceivable case whether, under certain circumstances such as the crisis at Credit Suisse, other non-state solutions will also be available and will be selected instead. What is clear, however, is that resolution must be feasible in a wide range of crisis scenarios.

Can state aid be ruled out in the future?

As a rule, state aid should be avoided wherever possible. The aim of the TBTF regulations is to preclude state aid. Nonetheless, the possibility for the Federal Council to act in the interests of the country and on the basis of the Federal Constitution under emergency law in specific crisis situations cannot be ruled out categorically.

Can the TBTF issue be eliminated?

The further development of the existing too-big-to-fail regime will help to significantly reduce the likelihood of a serious crisis at a systemically important bank in Switzerland. Moreover, in the event of a crisis, the existing planned solutions could be considerably better implemented. Completely and definitively excluding all risks is not possible, or would render all economic activities by systemically important banks impossible.

Why is a segregated banking system not proposed?

Even segregated banks are not immune to crises, as illustrated by the bankruptcy of Lehman Brothers, which was purely an investment bank. The Federal Council also believes that fundamental structural measures represent a disproportionate encroachment on economic freedom.

Is UBS too big for Switzerland?

Due to the size and international interconnectedness of the Swiss banking sector, the framework for ensuring financial stability is of particular importance for Switzerland. Because of this, over and above the requirements that apply to all banks, systemically important banks are subject to additional regulatory requirements, referred to as the TBTF regime. Swiss G-SIBs' total assets compared to GDP were considerably lower than during the 2007-08 financial crisis. This is also true of UBS, although its total assets have grown significantly again, following the takeover of Credit Suisse. Moreover, it is not the bank's size which is decisive, but its risk exposure. Existing measures, and those now proposed in the TBTF report by the Federal Council in the area of capital among others, provide incentives to limit both risk and growth.

Does Switzerland need G-SIBs?

Switzerland has a broad-based and internationally oriented financial centre which contributes roughly 5% of GDP and employs over 100,000 people. In its financial centre strategy of 2020, the Federal Council stated its ambition that the Swiss financial centre should continue to be one of the leading international financial centres. The Federal Council is maintaining this strategy.

What are the implications of the Federal Council's package of measures for the international competitiveness of Swiss systemically important banks?

The proposed measures are in line with international regulations and instruments, and strengthen the international competitiveness of the Swiss financial centre. At the same time, they take account of the specific circumstances in Switzerland as a major financial centre with UBS as the only global systemically important bank.

Recommendations and measures

What are the main focus areas of the proposed package of measures?

1. Strengthening the regime in the area of prevention: the aim is to reduce the likelihood of a systemically important bank getting into a critical situation.
2. Ensuring liquidity in a crisis: this applies both to the banks' own liquidity levels and to liquidity provision through the SNB and a public liquidity backstop.
3. Expanding the crisis toolkit: this involves expanded resolution plans and improved crisis coordination between the authorities.

Which new powers will FINMA be given?

Firstly, more explicit legally regulated requirements should enable FINMA to intervene more easily in various areas. Secondly, an expansion of the toolkit (e.g. in the area of corporate governance, or for early intervention purposes) should make enforcement more effective. The introduction of powers for FINMA to impose fines on legal entities is also being examined.

What is planned in the area of capital requirements?

The capital requirements for systemically important banks (SIBs) already contain a progressive component, i.e. the percentage requirements increase depending on the size and market share of a SIB. This leads to a significant rise in the capital requirements for the enlarged UBS following the takeover of Credit Suisse – of roughly 10% compared to today for the same size of entity.

However, the Credit Suisse crisis showed clearly that the capitalisation of the parent bank was too low. With regard to SIBs, therefore, the capital requirements for the parent bank's foreign participations should be increased.

Moreover, there should be a targeted increase in the capital base of banks, and especially of SIBs, including as regards the quality of capital. The institution-specific capital surcharge ("Pillar 2 surcharge") should be supplemented with forward-looking elements and regularly determined by FINMA based on stress tests and ongoing supervision. When setting the Pillar 2 surcharges, elements such as profitability and the risk profile of the business model, market-based indicators (e.g. market capitalisation, ratings and CDS premia) and, if necessary, corporate governance factors (e.g. complexity and corporate governance) should be taken into account The regulatory treatment of assets that are not sufficiently recoverable in crises (e.g. capitalised IT costs, deferred tax assets) and of fair value items that are difficult to value (those without current market prices or observable valuation parameters) should be reviewed and tightened. In addition, the risk-bearing function of AT1 instruments on a going-concern basis should be strengthened, i.e. before a crisis-hit bank reaches the point of non-viability.

How high should the capital requirements for systemically important banks be?

As is already the case today, the capital requirements for SIBs will depend on a variety of factors – especially size, market share and group structure. This principle has proved its worth and should be maintained. The planned increase in capital requirements for the parent bank should bring about targeted improvements. This measure will raise capital requirements for SIBs overall, irrespective of the group structure.

How much additional capital does UBS need under the new proposals?

This ultimately depends on the specific implementation of the measures, and on the future size and structure of UBS. Under the currently applicable requirements, the UBS parent bank must provide 60% capital backing for participations in a foreign subsidiary. The Federal Council is aiming for a significant increase in this capital backing, taking into account the other measures. The increase in the requirements will therefore be substantial, especially if UBS were to retain its current size and structure, or even grow. The new requirements reduce the incentive to set up complex corporate structures.

Capital: what is changing in terms of quality? And what is changing in terms of quantity?

In quantitative terms, the capital requirements for SIBs should be increased via a more stringent treatment of foreign participations at the level of the parent bank. Better capital quality should be achieved by reviewing and tightening the regulatory treatment of assets that are not sufficiently recoverable in crises and of fair value items that are difficult to value. In addition, the risk-bearing function of AT1 instruments on a going-concern basis should be strengthened.

What is planned in the area of banks' own liquidity?

Compared to other Swiss banks and to foreign comparator banks, since 1 January 2024, systemically important banks have been required by law to hold additional liquidity buffers (TBTF liquidity requirements). FINMA defined these institution-specific surcharges. In doing so, it took account of the individual SIBs' risks. The surcharge levels will not be published. However, the increase in liquidity requirements will be substantial. The Swiss SIBs will have to hold considerably more liquidity than foreign comparator banks. UBS and other Swiss SIBs have until the end of 2024 to build liquidity. The liquidity levels will then be visible in the SIBs' balance sheets. Thus, for SIBs, the strengthening of banks' own liquidity holdings as a first line of defence is already being implemented. The effectiveness of the new provisions must be reviewed by the Federal Department of Finance by the end of 2026.

Will the liquidity assistance by the Swiss National Bank (SNB) be expanded?

In response to a parliamentary postulate (23.3445 "Review of the SNB's toolkit), the existing legal basis and framework conditions should be reviewed, and where necessary refined and made more detailed. The aim is to expand the potential for liquidity provision in a crisis via the SNB by using both ordinary and emergency facilities.

Will deposit withdrawals at short notice be restricted in future?

No. That would be too great an interference in bank customers' withdrawal options and in the banks' business model. Depositors should not be tied to a bank by regulation, and thus exposed to a risk that they do not themselves wish to bear. Moreover, introducing withdrawal restrictions could mean that, in a crisis, bank customers would become even more suspicious of the bank concerned, owing to the limited amount that can be withdrawn, and might bring forward their deposit withdrawals, thereby potentially exacerbating the crisis.

The Federal Council already submitted the public liquidity backstop (PLB) to Parliament for approval in 2023. Does that still apply?

Yes. No measures that go beyond the existing legislative bill have been identified. Extending the PLB to non-systemically important banks is not considered to be appropriate.

> **What is a public liquidity backstop?**
> A public liquidity backstop (PLB) is a state liquidity provision that is a standard instrument internationally in banking crises. It comes into play when, firstly, the bank's own liquid assets are no longer sufficient to meet its financial obligations and, secondly, the option for the central bank to provide emergency liquidity assistance against collateral has been exhausted. It is then possible, thirdly, for the central bank to provide additional liquidity which is guaranteed by the state as part of a restructuring of the affected bank. The level of the guarantee is defined on a case-by-case basis.

What changes is the Federal Council planning as regards the restructuring of a systemically important bank?

The assessment of the Credit Suisse case revealed a need to further reduce the legal and implementation risks in the resolution of a systemically important bank. At Credit Suisse, these resolution risks were too high compared to the risks involved in a takeover by UBS. The resolvability of a systemically important bank as a credible option in a crisis should be ensured. Specifically, the available options for resolution should be expanded and tailored to various crisis scenarios. Proposed measures on capital for the parent bank would also make a resolution easier.

How can accountability for mismanagement be increased, not just for institutions but also for individuals, in the future (senior managers regime)?

FINMA already has the power to prohibit individuals from practising a profession and from performing an activity, as well as other measures. However, in supervisory practice, it is difficult to prove misconduct by specific individuals, especially at large institutions. At international level, some jurisdictions increasingly have approaches under which individuals who are directly responsible for irregularities can be called to account (UK, Hong Kong, Singapore, Ireland). The Federal Council is proposing to introduce a senior managers regime and enshrine it in law as an explicit organisational requirement. During implementation, it should be ensured that the costs for the affected institutions are limited and that there is also a benefit for the institutions. A senior managers regime should apply for systemically important banks in particular. The introduction of such a regime for other banks should also be examined. In addition, however, the report contains measures to provide more detail to corporate governance measures in financial market legislation (including responsibility for the corporate culture), as well as various proposals on sanctioning misconduct (including the design of variable remuneration or clawbacks; see next question).

What is a senior managers regime?
Essentially, this involves the financial institution assigning the key areas of responsibility within the company to a specific person – a senior manager. Accordingly, special rules of conduct apply to senior managers. They must take appropriate measures to ensure that misconduct does not occur in their area of responsibility. Violations of the rules are sanctioned by the bank itself (e.g. through a reduction in variable remuneration) or the supervisory authority (including prohibitions from practising a profession and from performing an activity, or the withdrawal of recognition for the guarantee of proper business conduct).

What measures will be taken on variable remuneration (bonuses)?

A clear legal basis for requirements and interventions in the area of remuneration must aim to ensure that the remuneration systems are closely aligned with an institution's long-term economic success and do not allow any risk-taking detrimental to this success to become attractive. FINMA must be able to enforce the requirements. The Federal Council considers the following measures to be appropriate, for example: a regulation on retention periods for variable remuneration components, the linking of variable remuneration to long-term economic success criteria, and the introduction of effective clawbacks allowing remuneration components that have already been paid out to be reclaimed.

Should it be possible to reclaim remuneration components that have already been paid out, in cases of mismanagement (clawbacks)?

In the report, the Federal Council advocates the introduction of "effective clawbacks", which could be used as a basis for reclaiming remuneration components that have already been paid out. However, the report does not make any specific proposals on how to implement such clawbacks.

Why does the report not envisage a cap on variable remuneration (bonuses)?

Capping or banning variable remuneration is not considered to be appropriate. Scientific studies have shown that there are clear disadvantages to this approach. For instance, higher fixed salaries have been observed as a side effect. This increases the institution's fixed costs, which can limit the options for cost-cutting, especially in a crisis.

Why are fines not going to be introduced for individuals?

Fines levied by FINMA against individuals are not recommended for implementation at this time. Priority should be given to the work on examining fines against legal entities. If FINMA were to be authorised to impose administrative fines on individuals, there is a risk that this would impair the supervisor's investigations in enforcement proceedings and thus significantly weaken the effectiveness of supervision. FINMA already has at its disposal sanctions with far-reaching impacts on individuals, such as industry and activity bans, the withdrawal of recognition for guarantees of proper business conduct and the confiscation of unlawfully acquired profits (disgorgement).

Why is nothing being changed as regards depositor protection?

The Credit Suisse crisis has shown that the loss of confidence and the associated high deposit outflows are scarcely attributable to the design of depositor protection. Thus, adjustments to deposit insurance would achieve only a very slight mitigation of the TBTF issue.

What is deposit insurance?
Deposit insurance serves to protect the balances of bank customers in the event of bank insolvency. In Switzerland, the deposit insurance scheme insures deposits up to a maximum of CHF 100,000 in total for each customer and bank or securities firm.

Why should cooperation be improved between the authorities in the event of a crisis at a systemically important bank?

The roles and responsibilities should be further clarified and decision-making between FINMA, the SNB and the FDF should be regulated more clearly. The findings of the Parliamentary Investigation Committee (PInC) will have to be taken into account in this regard.

The next steps

What measures in the report can the Federal Council implement rapidly on its own authority, and where are changes to the law needed which require parliamentary approval?

The report lists in detail what measures are required, and at what level. In the fields of action relating to capital requirements and recovery planning, the measures would largely be regulated at ordinance level, as would some measures in other fields of action. The changes at ordinance level can be approved directly by the Federal Council. As regards liquidity provision, corporate governance and resolution planning, legislative amendments are required. The Federal Council will draw up corresponding amendments at legislative level and submit them to Parliament.

What is the timetable for implementing the recommended measures?

The Federal Council wants to implement the package of measures quickly. In the first half of 2025, it intends to simultaneously present two packages for implementation: one with changes at ordinance level which can be approved by the Federal Council, and the other with the parameters for the legislative amendments which will be submitted to Parliament. The timetable depends on the publications of the Parliamentary Investigation Committee (PInC) and the Competition Commission (COMCO). It should be possible to take their findings into account.