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Switzerland: Trends & Developments

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Trends and Developments

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Introduction

The year 2023 will be reminded as a turbulent one for Switzerland's financial centre, as its second largest bank, Credit Suisse, was rescued and acquired by its bigger competitor, UBS. The deal, advocated for by the federal government and the Swiss Financial Market Supervisory Authority (FINMA), caused a stir at home and abroad, and attracted huge international attention.

Interestingly, this (in)famous event followed certain, much less emphasised legal developments in Swiss insolvency regulations for banks and the country's deposit protection scheme. These innovations, which had been adopted by the Swiss Parliament on 17 November 2021 and came into force on 1 January 2023, are presented and explained in more detail in this article.

Insolvency Regulation for Banks

When there are material reasons to fear that a bank is overly indebted, has serious liquidity problems or can no longer fulfil the capital adequacy requirements, FINMA may order:

- protective measures pursuant to Article 26 of the Federal Act on Banks and Savings Banks (BA);
- restructuring proceedings pursuant to Article 28 to 32 of the BA; or
- the bankruptcy of the bank pursuant to Article 33 to 33g of the BA (Article 25 of the BA).

The provisions relating to restructuring measures have been amended and supplemented, whereas the provisions in regard to protective measures have not been significantly modified.

FINMA may initiate restructuring proceedings if it appears likely that the bank can recover from its problems or can continue to provide individual banking services. Article 30 of the BA provides an overview of the various measures that FINMA's restructuring plan for a bank can include, namely:

- the transfer of all or part of the bank's assets, liabilities or contracts to a bridge bank or other legal entities;
- the merger of the bank with another legal entity;
- the takeover of the bank by another legal entity; and
- a change to the bank's legal form.

The restructuring plan may also provide for the continuation of selected banking services,

regardless of whether the affected bank is or is no longer a going concern.

The new Article 30b of the BA enumerates capitalisation measures which can be included in the restructuring plan. These measures actually reflect the measures previously set out in FINMA's Banking Insolvency Ordinance (BIO-FINMA). Capitalisation measures under Article 30b of the BA are (i) the reduction of existing and creation of new equity capital, (ii) the conversion of third-party funds into equity capital (debt to equity swap) and (iii) the write-down of receivables. Former owners do not have subscription rights to new equity capital. Article 30b(2) of the BA forbids the conversion or write-down of various claims, namely:

- first and second-class preferential claims under Article 219(4) of the Federal Act on Debt Enforcement and Bankruptcy (DEBA), within the limits of the preference;
- covered claims, within the limit of their coverage;
- claims that can be set off, within the limits of the conditions necessary for their set-off; and
- claims arising from commitments the bank was entitled to enter into, whether with FINMA's, the investigating officer's or the appointed reorganisation delegate's approval during the restructuring proceedings.

If necessary for the ongoing operations of the bank, FINMA may also exclude from the conversion or write-down the claims arising from the supply of goods and services (Article 30b(4), BA). In addition, under restructuring proceedings, the conversion of third-party funds into equity and the write-down of receivables are only possible if, beforehand:

- convertible capital under Article 11(1)(b) of the BA is fully converted into equity, and loans with a write-down feature under Article 11(2) of the BA are fully written down; and
- the share capital is fully reduced.

Article 30(b)(7) of the BA is a waterfall provision which sets out a specific order for the conversion and/or write-down process, namely (i) subordinated claims, (ii) claims based on loss-absorbing debt instruments ("bail-in bonds"), (iii) other claims (excluding deposits) and (iv) deposits.

The restructuring plan must satisfy various conditions contained in Article 30c(1) of the BA, namely:

- be based on a prudent valuation of the bank's assets, and on a prudent estimate of the required restructuring;
- not be, in all likelihood, economically less favourable to creditors than the prospects of the immediate opening of the bank's bankruptcy;
- take appropriate account of the priority of the creditors' interests over those of owners, and of the ranking of creditors; and
- take appropriate account of the legal or economic links between the bank's assets, liabilities and contracts.

Furthermore, pursuant to Article 30c(2) of the BA, the restructuring plan must contain and comment on the broad outlines of the restructuring and details in regard to:

- the restructuring plan's compliance with the conditions set out in Article 30c(1) of the BA;
- how the bank will comply with the licensing and other legal requirements after the restructuring;

- the bank's future capital structure, business model, assets and liabilities;
- the future organisation and management of the bank, the appointment and dismissal of its governing bodies and, if applicable, the future organisation of the group;
- if applicable, how and to what extent the rights of owners and creditors are affected;
- if applicable, the possible exclusion of liability claims under Article 39 of the BA or the bank's right of revocation under Article 32(1) of the BA; and
- transactions requiring entries in the commercial or land registers.

FINMA approves the restructuring plan provided that it complies with Article 30c of the BA; the approval of the owners is not needed. An important exception is set out in regard to systemically important banks: FINMA may approve the plan even if it is economically less favourable to the creditors than the bank's bankruptcy. However, such approval is subject to appropriate compensation of the creditors (Article 31(3), BA).

Other new provisions, such as in regard to owner's compensation in case of capitalisation measures (Article 31c, BA) and to the legal effects of the restructuring plan (Article 31d, BA), were also added to the BA.

Deposit Protection

The provisions in regard to privileged depositors and the deposit protection scheme have been revised in both the BA and the implementing Banking Ordinance (BO).

According to Article 37a(1) of the BA, which has been only slightly amended, deposits in the name of the depositor, including certain medium-term bond deposits in the depositor's name, are assigned to the second-class of creditors in the case of a bank's bankruptcy, for an amount up to CHF100,000 per depositor (privileged deposits). New provisions in the BO now provide additional guidance in relation to the meaning and scope of various terms, such as "privileged depositors" (Article 42c, BO), "privileged amount" (Article 42b, CO), and "privileged deposits" (Article 42a, BO).

According to Article 42c BA, "privileged depositors" comprise (i) the contracting partners that are entitled to the relevant claims in the relationship with the bank; and (ii) the depositors of medium-term notes, as they appear in the bank's books at the time of the order of a protective measure as per Article 26(1)(e) to (h) of the BA or a bank's bankruptcy. The following persons are not considered to be "privileged depositors":

- "financial intermediaries" within the meaning of the BA, the Federal Act on Financial Institutions (FinIA) and the Federal Act on Collective Investment Schemes (CISA), and insurance companies subject to the Insurance Supervision Act (ISA) (previously, financial intermediaries were considered to be privileged depositors as well);
- foreign clients subject to prudential supervision, such as financial intermediaries or insurance companies;
- central banks;
- banking foundations or vested benefit foundations; and
- customers of securities firms which do not maintain accounts themselves under Article 44(1)(a) of the FinIA.

Under Article 42b of the BO, the "privileged amount" is determined by aggregating the various balances, accrued interest included, in favour of the depositor. Mortgages, loans or overdrafts on other accounts, as well as interest

and fees not booked in favour of the bank, are not taken into account.

As to what counts as "privileged deposits", the new Article 42a of the BO contains the following list:

- Claims on a bank (i) which are recorded as a balance on accounts with the bank, and are denominated in a currency issued by a state or a central bank, or (ii) which are denominated in gold, silver, platinum or palladium, and confer on the depositor an exclusive right or other entitlement to a benefit in a currency issued by a state or a central bank. Term and overnight deposits are included.
- Bank medium-term notes (*obligations de caisse/Kassenobligationen*), which are recorded as such in the bank's balance sheet and are deposited with the bank in the name of the depositor.
- Payments ordered by the depositor, but which have not yet left the bank or its account with a clearing house or correspondent at the time where either a protective measure under Article 26(1)(e) to (h) of the BA or the bank's bankruptcy have been ordered, even if such payments have already been debited from the depositor's account.
- Payments in favour of a depositor, which have been credited to the bank or its account with a clearing house or correspondent before either a protective measure under Article 26(1)(e) to (h) of the BA or the bank's bankruptcy have been ordered, even if such payments have not been credited to the depositor's account yet.

By contrast, the following do not fall within the scope of privileged deposits:

- bearer debts;
- medium-term notes that are not deposited with the bank;
- contractual and other claims for compensation, such as claims arising from the failure to restitute deposited assets under Article 16 of the BA;
- rights or claims arising from derivatives;
- dormant assets; and
- claims against the bank which do not arise from banking activities.

Before the new provisions came into force, claims which were held by several persons, such as joint accounts, were divided between the relevant persons and every depositor had a protected amount up to CHF100,000 of its own. Under the new provisions, where several holders have a claim, all holders are collectively considered as one single depositor – ie, the holders may claim the protected amount only once and up to the legal cap of CHF100,000 in aggregate (Article 42c(3), BO).

Various other aspects relating to the implementation of the deposit protection scheme are clarified and specified in the revised BA. Privileged deposits must be backed by Swiss covered claims and other assets held in Switzerland by the bank in a coverage ratio of 125% (see Article 37a(6), BA). In order to remedy any shortfall, before accepting privileged deposits, the banks must adhere to "esisuisse", a self-regulatory organisation for banks in Switzerland which guarantees the privileged deposits. When protective measures under Article 26(1)(e) to (h) of the BA or a bank's bankruptcy are ordered, esisuisse must cover the shortfall on the privileged deposits to the appointed liquidator no later than on the seventh working day following receipt by the liquidator of a communication from FINMA announcing the order of the protective measure or the bank's bankruptcy (Article

37h(3), BA). Previously, the deadline to pay out the privileged deposits was 20 working days.

The liquidator must draw up a repayment plan, invite the affected privileged depositors to send their payment instructions, and ensure that the privileged deposits are paid out immediately, but not later than on the seventh business day following the receipt of the payment instructions (Article 37j(3), BA). The new deadline will have to be respected as of 1 January 2028 – ie, five years after the entry in force of Article 37j(3) of the BA.

As opposed to the previously fixed sum of a guaranteed total of CHF6 billion, banks now must contribute a dynamic 1.6% of the aggregate of all protected deposits (Article 37h(3)(b), BA). Under the old rules, banks were obliged to secure half of their contribution in the form of additional liquidity. As of now, banks may choose to guarantee half of their contribution either by (i) depositing easily realisable high-quality securities or cash with a third-party custodian, or (ii) granting esisuisse a liquidity loan (Article 37h(3), BA).

A New Chapter XIIa

The former Article 24 of the BA, which excluded possible appeals against FINMA's decision to approve the restructuring plan or order measures, has been abrogated. Provisions in regard to such appeals are now set out in a new chapter XIIa of the BA.

Creditors and owners of a bank, the bank's holding company and important group companies may now file an appeal against FINMA decisions (i) approving the restructuring plan, (ii) ordering realisation operations, or (iii) approving the distribution table and the final account (Article 37gter(1), BA). Realisation operations ordered by the liquidator are deemed "real acts" under Article 25a of the Federal Act on Administrative Procedure (APA). Any person who has an interest worthy of protection may request FINMA to issue a decision susceptible of appeal (Article 37gter(2), BA).

The deadline to appeal against decisions approving the restructuring plan is ten days, beginning on the day following the publication of the restructuring plan (37gquater, BA). The deadline is not subject to legal holidays under Article 22a of the APA. No suspensive effect may be granted by the court for appeals against FINMA's decisions (i) ordering protective measures, (ii) starting of restructuring proceedings, (iii) approving the restructuring plan or (iv) ordering the bank's bankruptcy (Article 37gquinquies, BA). Should an appeal against the decision approving a restructuring plan be admitted, the court may not cancel the restructuring plan, but only award compensation in a form set out in Article 37gbis of the BA.

Segregation of Securities

In addition to the BA and BO, the Federal Act on Intermediated Securities (FISA) has also been amended, in particular through the introduction of a new Article 11a, which also applies to banks and other custodians.

Custodians of intermediated securities must now record their own securities and those held for clients separately (Article 11a(1), FISA), even when the custodian holds the securities with a sub-custodian in Switzerland (Article 11a(2), FISA). If the sub-custodian is abroad, there must be an agreement on the same segregation. If such an agreement is not possible, whether because of the law of the country that governs the sub-custodian abroad or for operational reasons, the Swiss custodian must take measures

that provide its clients with a comparable level of protection, unless custody can only take place in the relevant country due to characteristics of the held securities or unless the client has expressly instructed the custodian to hold its securities with a sub-custodian in the relevant country (Article 11a (4 and 5), FISA).

Where securities are held with a sub-custodian, Swiss custodians must now, in advance, provide their clients with information, namely (i) that the securities will generally be held with a sub-custodian, (ii) that the sub-custodian may have its registered office abroad and is subject to foreign law, (iii) that custody abroad carries risks for account holders, and what general risks are involved, and (iv) the costs of the custody (Article 11a(6), FISA).

Public Liquidity Backstop – A Future Tool… Already Tested

Currently, and based on Article 5(2)(a) and (e) and Article 9(1) of the National Bank Act (NBA), the Swiss National Bank (SNB) is entitled to grant credit to banks provided that eligible collateral is posted. Such transactions are also designated as “emergency liquidity assistance loans”. In 2022, the federal government expressed its wish to introduce a new feature called Public Liquidity Backstop (PLB), which would enable the SNB to provide state-guaranteed liquidity facilities to systemically important banks in need. The proposal made by the federal government was not immediately transposed into the law.

Due to the difficulties faced by Credit Suisse, the federal government adopted, on 16 March 2023, an emergency ordinance: the Ordinance on Additional Liquidity Assistance Loans and the Granting of Federal Default Guarantees for Liquidity Assistance Loans from the Swiss National Bank to Systemically Important Banks (the “Emergency Ordinance”). The Emergency Ordinance, which provided a framework for the rescue package of Credit Suisse, enabled the SNB to grant emergency liquidity loan facilities to systemically important banks; one of these facilities was a PLB facility granted to Credit Suisse on 19 March 2023, which the borrower could reimburse later in the year.

Following the takeover of Credit Suisse by UBS, the Federal Council adopted the dispatch on the introduction of the PLB in the BA on 6 September 2023. A new Article 32a of the BA would regulate the extension of state-guaranteed loans, which would be reserved to systemically important banks or financial groups only. The prerequisites for such loans would be as under the Emergency Ordinance (including the prerequisites of Article 4(4) of the Emergency Ordinance – ie, that the borrowing bank must have exhausted other sources of funding), with an additional prerequisite being that FINMA has started or is about to start resolution proceedings of the borrowing entity.

Systemically important banks or financial groups would pay an annual lump-sum charge – a form of commitment fee – for the potential making available of a default guarantee by the Confederation (Article 32c(1). BA). The sum would be assessed for each relevant bank, based on the risk of loss arising from any provision of such a guarantee in the long term and on the business results of the bank. The scope of the relevant banks will be determined by considering (i) the bank’s total exposure under Basel Minimum Standards, deducted of regulatory capital, high-quality liquid assets and collateral prepared for the SNB liquidity assistance, net of risk-value haircuts; and (ii) special features of the canton’s guarantee in regard to cantonal banks.

In addition, the draft law provides for certain restrictions on the borrowing bank or its subsidiaries until full repayment of the loan principal, accrued interest and risk premium; namely that common equity tier-one capital, additional tier-one capital, tier-two capital and additional loss-absorbing instruments may not be reimbursed until full repayment has occurred (Article 32g(1)(b) BA).

Conclusion

The new rules bring many clarifications on how a bank facing turmoil is treated and which measures can be ordered by FINMA. In addition, the deposit protection scheme has been reinforced, which should bring a higher level of protection to privileged depositors, particularly due to the now dynamic contribution of concerned banks and the shortening of payment deadlines.

Furthermore, the introduction in legislation of the Public Liquidity Backstop, which proved to be a key instrument when Credit Suisse faced liquidity problems in March 2023, has added a new tool to the Swiss National Bank's ability to mitigate systemic risks.

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