SENIOR MANAGERS REGIME IN SWITZERLAND

The Swiss Federal Council recently reviewed rules for banks that are systemically important, and adopted the Report on Banking Stability of April 2024, which stressed the need to improve the current too-big-to-fail regime. This briefing will focus especially on the proposed Senior Managers Regime in Switzerland, which aims to increase individual responsibility within financial institutions. Moreover, the briefing will discuss the current Swiss legal framework, then compare it with the UK regime and evaluate the possible challenges of implementing it in Switzerland.

THE REPORT OF THE FEDERAL COUNCIL

The Swiss Federal Council has conducted a thorough evaluation of the regulation surrounding systemically important banks, based on Article 52 of the Swiss Banking Act, prompted by the crisis faced by Credit Suisse in mid-March 2023. On 10 April 2024, it adopted the associated Report on Banking Stability (Report). The Report reveals the necessity to enhance the existing too-big-to-fail regime to mitigate risks to the economy, state, and taxpayers. The Federal Council proposes a comprehensive set of measures aimed at strengthening and refining the regulatory framework, with 22 measures for immediate implementation and seven for further examination. The Federal Council's package of measures is divided into the following three focus areas: Strengthening prevention; strengthening liquidity; and expanding the crisis toolkit.

This briefing will focus on the first point, which includes the planned implementation of a so-called Senior Managers Regime (SMR), along the lines of the already existing UK regime. The SMR shall assign specific responsibilities to the senior management in affected institutions, allowing the Swiss Financial Market Authority (FINMA) to attribute misconduct to individuals and hold them accountable.

RESPONSIBILITY OF MANAGERS IN THE CURRENT SWISS LEGAL SYSTEM

Currently, FINMA already has the following instruments at its disposal to directly target individuals: The fit and proper assessment and ultimately the withdrawal of recognition for guarantees of proper business conduct.

Further, FINMA may prohibit individuals from practicing a profession or performing an activity if it detects a serious violation of supervisory provisions. FINMA may also publish its final ruling as soon as it takes full legal effect, disclosing the relevant personal data and issue a declaratory ruling. Finally, FINMA may confiscate any profit that a supervised person or entity or a responsible person in a management position has made through a serious violation of the supervisory provisions.

These measures intend to establish individual responsibility and accountability through its preventative effects. However, proving individual breaches, especially in large institutions, seems challenging for FINMA as proof of direct causal responsibility is required.

In response to past calls for improved individual accountability among senior managers in FINMA-supervised institutions, notable initiatives such as the Andrey Postulate "Make financial market senior executives more accountable with lean tools" have emerged. This demand has been further emphasized through parliamentary procedural requests. FINMA itself has also advocated for enhanced individual accountability through the implementation of a SMR.

THE UK REGIME

Internationally, the UK has set an example with its Senior Managers and Certification Regime (SMCR) with the aim of increasing the accountability of individuals.

The UK regime applies to institutes supervised by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) since 2016. Key features of the regime include the following:

As part of the approval process, a Statement of Responsibilities (SoR) is mandated for all executives who could pose a significant risk to the bank or market integrity, indicating a broad scope beyond just executive management. However, at the supervisory board level, the target audience is narrower. This document assigns specific areas of responsibility to individual senior manager functions and includes prescribed responsibilities that must be attributed to the individual managers. If the responsibilities of a senior manager change, the SoR must be promptly updated and resubmitted.

Further, the SCMR requires a Management Responsibilities Map, which provides a comprehensive overview of management and governance within the institution, including details on reporting structures, responsibilities across various areas, and the competencies of key personnel. This document intends to improve internal corporate governance by defining decision-making structures and ensuring clear delineation of responsibilities, as well as providing supervisory authorities with insight into the internal decision-making processes of the institution.

Additionally, individuals in senior manager function roles are obligated to uphold a Duty of Responsibility that goes beyond mere compliance with laws and regulations. It requires them to take proactive measures to prevent or address violations within their area of responsibility, whether they occur through active actions or inactions.

In the UK, the regulators appear to be convinced that the predominantly preventative impacts on corporate culture tend to be positive. However, the tangible benefits of the SMCR in enforcement have yet to be convincingly proven, and it remains to be seen whether they outweigh the drawbacks of tying up extensive resources during enforcement actions. Proceedings against individuals often require more effort than those against financial institutions. For example, it remains uncertain whether issues within the firm have in fact been promptly escalated in accordance with the Conduct Rules.

ADOPTION OF THE SMR IN SWITZERLAND

The Federal Council proposed the establishment of an SMR as an explicit organizational requirement at legislative level, with specifics regulated at ordinance level. According to the Report, it could be introduced for "internationally active [systemically important banks] (SIBs), for all SIBs, for all banks or, if appropriate, for other financial institutions". The Report discusses the following possible measures:

A documentation of responsibilities, which (aligned with regulatory requirements) would have to be regularly updated and submitted to FINMA when necessary. By clearly outlining which responsibilities are assigned to which individuals, this documentation shall enable institutions to hold those responsible for misconduct more easily accountable.

The SMR should primarily target individuals at senior management levels, including members of the supreme governing body and the management body, such as the board of directors and the executive board in the case of a company limited by shares. However, considering the broad decision-making powers often held by individuals below the management body, especially in large institutions, the scope of the regime might be extended to such individuals. Flexibility in defining the target group shall further allow for adaptation to an institution's specific management structures.

Establishing a standard of due diligence on a legal basis shall clarify the extent of an individual's responsibility for its area of operation. This standard shall require individuals to take all necessary and reasonable steps to avoid misconduct.

In cases where individuals breach their responsibilities, financial sanctions, such as adjustments to their remuneration, might be imposed by the institution or, if necessary, ordered by FINMA.

Several implementation issues still need to be addressed for an effective implementation and operation of the SMR. These include determining the territorial scope of the regime, designing rules proportionally based on institution size and risks, defining documentation requirements for responsibilities, establishing supervision and compliance mechanisms, identifying interfaces with other supervisory issues, aligning enforcement tools with the regime, and considering implications for private and criminal law responsibilities.

According to the Federal Council, individuals need proper incentives to comply. Breaching obligations should therefore lead to sanctions from either the institution itself (e.g., a reduction in variable remuneration) or the supervisory authority (such as industry bans). For FINMA to perform such interventions by order, a clear legal basis is required.

OPPORTUNITIES AND RISKS OF THE SMR

The SMR aims at simplifying the task for FINMA to prove individual responsibility by the assignment of clear responsibilities to senior managers. This might raise awareness and have a preventive effect which could therefore strengthen the corporate governance and leadership culture in the affected institutions. Consequently, institutions might (re-)gain trust from their stakeholders.

However, its implementation may bring challenges for the affected institutions, such as increased bureaucracy, resources, and commitment for its implementation leading to additional costs. While the SMR aims to promote accountability, experiences show that the preventive effect of regulations cannot avoid every misconduct. It is further conceivable that some top candidates might pass up promotions to avoid the responsibility risks arising from the SMR. However, thanks to the regime individuals would be encouraged to challenge established norms and discuss previously unaddressed issues. If the balance within the SMR framework is not properly maintained, it may result in excessive bureaucracy and governance without the essential critical challenge, which is crucial. Achieving this balance, including fostering positive yet insightful challenges in governance meetings among peers, can yield better outcomes under the regime. Senior managers must be confident in articulating their personal narrative. They would be forced to think about their own responsibilities, how to discharge them and how to be confident in their judgement. It further emphasizes the need to be able to trust people to fulfill tasks in the name of the senior managers that fall under their area of responsibility. These questions underscore the need for accountability, confidence, and trust within the organization.

Further, critics suggest that solely targeting individuals may not suffice for complex organizations. They doubt the effectiveness, noting that many projects in supervised entities undergo complex approval processes that individuals could use as due diligence defense.

Moreover, regulatory approval frameworks for senior management can lead to individuals not being approved for future senior management roles if they were associated with previously investigated or sanctioned institutions. For instance, in Ireland, criticism of the regulator's approach to interviewing and assessing individuals for approval to senior management positions has prompted an independent review of its processes.

Finally, potential individual liability or exposure might complicate the finding of facts by means of internal investigations. This includes issues such as confidentiality conflicts, senior individuals' roles as relevant witnesses, the need for separate legal representation, and the overlap between regulatory assessments and local employment rights.

CONCLUSION AND OUTLOOK

In conclusion, the proposed SMR might represent a step towards enhancing individual accountability within Swiss financial institutions, particularly in response to recent crises and growing calls for regulatory reform. Advocates of the regime claim that by allocating clear responsibilities for senior managers and establishing mechanisms for holding them accountable, the SMR aims to strengthen the regulatory framework and implement a culture of responsibility and integrity. The Federal Council's proposal is a proactive approach towards addressing systemic risks and restoring trust in the financial sector.

However, the adoption of the SMR may also present challenges and uncertainties for affected institutions. Concerns have been raised regarding the potential for increased bureaucracy and costs, as well as the limitations of solely targeting individuals within complex organizational structures. Critics warn that while the SMR may improve accountability to some extent, it may not fully address the systemic issues that contribute to misconduct and risk-taking.

Looking ahead, the successful implementation of the SMR will require an ongoing dialogue between regulatory authorities in Switzerland and abroad, financial institutions, and other stakeholders to get the balance right between setting the right incentives for executives versus another tool which will make it more difficult to run an inquiry or investigation with regard to potential shortcomings in a financial institution. It will be essential to monitor its effectiveness, identify areas for improvement, and adapt to evolving market dynamics and regulatory requirements for financial institutions which are active in markets outside Switzerland.

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