Swiss Banking

**POSITION**

# The demise of Credit Suisse – measures

The takeover of the foundering Credit Suisse by UBS, along with the measures taken at the same time by the Swiss authorities, provided immediate stability and enabled Switzerland to avert the risk of an international financial crisis by its own efforts. Deposits and banking services were protected at all times.

Swiss banks have successfully undergone a fundamental regulatory transformation in recent years. For example, they now have significantly larger liquidity and capital buffers. This is precisely what made UBS's takeover of Credit Suisse possible. The Swiss banking centre is therefore robust and well positioned by international standards. The "too big to fail" (TBTF) regulations have proven their worth in the real world in key respects, but need to be analysed in their entirety and fine-tuned where necessary.

The investigation into the events that led to the demise of Credit Suisse is still ongoing. A number of initial findings are available, however, and the reports published to date contain recommendations on various action areas in banking regulation. Our response to these is set out below.

## In brief

- Swiss banks make a vital contribution to Switzerland's economy and to the prosperity of its population. A regulatory framework that is competitive internationally is key to ensuring that it can continue to do so.
- The factors that over a long period destroyed Credit Suisse's reputation and confidence in the bank, ultimately leading to its demise, are now largely understood. Obvious gaps in the existing regulatory framework can be closed with targeted measures.
- In our view, the main priorities are to expand further the provision of liquidity to the banking system by the Swiss National Bank (SNB), introduce a public liquidity backstop, implement changes in the areas of remuneration and responsibility, and improve the supervisory activities of the Swiss Financial Market Supervisory Authority (FINMA).
- However, we believe that the existing capital requirements for systemically important banks are sufficient and see no need for stricter measures across the board. The Swiss requirements, which are in line with international standards and already strict in comparison with other financial centres, will also be significantly more rigorous following the implementation of Basel III Final in 2025.
- Credit Suisse was a global systemically important bank; the intervention by UBS and the authorities ensured that its demise did not have global repercussions. There are thus two key criteria with regard to potential measures. Firstly, differentiation in line with the problem at hand is important (proportionality), meaning that any regulatory response must focus on a bank's size, systemic importance, business model and international interdependencies. Secondly, the robustness of the sector as a whole should be meaningfully improved so that it is better able to absorb external shocks, primarily via the provision of liquidity by the SNB against collateral.

## Provision of liquidity

The crisis surrounding Credit Suisse demonstrated the crucial importance of a robust apparatus for securing liquidity. The first aspect of this is sound liquidity management within banks. Secondly, it is vital that all banks, as long as they are solvent and fulfil certain conditions, are able to obtain liquidity from the SNB flexibly and quickly against readily available and fungible collateral, particularly if they are no longer able to refinance their operations on the market. Providing liquidity in this way does not involve a state guarantee, makes a major contribution to maintaining system stability, and significantly reduces the risks for the Confederation. Thirdly, it is also vital in the interests of system stability that Switzerland has access to a public liquidity backstop (PLB) mechanism to support the recovery of a systemically important bank.

*Liquidity management within banks*

The requirements for liquidity management within banks should be reassessed in light of the Credit Suisse crisis and adjusted in specific areas where necessary. This is the first line of defence for maintaining stability in the event of a crisis. In this regard, FINMA is proposing to review the parameters used for the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR). The deposit outflow rates recorded appear to have significantly exceeded the outflow rates assumed in the LCR.

It would seem sensible to review just how realistic the assumed stress scenarios are, but any adjustments would require a well-founded economic justification and a regulatory impact assessment. International alignment is essential for any recalibration of the parameters in question.

*Provision of liquidity by the SNB*

Stability was maintained through a combination of liquidity provision and the takeover of Credit Suisse. It also became clear, however, that there are certain situations in which emergency liquidity assistance (ELA), in other words the current procedure for providing liquidity in an emergency against collateral without a state guarantee, is at present not sufficient to cover increased liquidity requirements in a crisis. As a result, a public liquidity backstop (PLB) also had to be activated whereby the SNB provided liquidity in return for privileged status in bankruptcy, protected by a federal default guarantee in favour of the SNB.[1] This creates a need for action to significantly reduce the likelihood of instruments that entail higher risks for the State and taxpayers having to be used.

[1] In order to maintain stability, the SNB was also forced to push the limits of its mandate by deploying ELA+, under which it again provided liquidity in return for privileged status in bankruptcy, but without a federal default guarantee. This should be seen as an absolutely exceptional case that is not to be repeated, and came about because insufficient collateral was available for ELA.

The Swiss Bankers Association (SBA) therefore welcomes the recommendations of the Expert Group on Banking Stability set up by the Federal Department of Finance (FDF, "The need for reform after the demise of Credit Suisse", report published on 1 September 2023) on the provision of liquidity to banks by the SNB. In the report, the experts recommend in particular expanding the range of collateral that the SNB accepts for ELA, for example by explicitly including corporate and Lombard loans in addition to mortgages.

Over and above existing initiatives there is thus potential, in line with market principles, for making the SNB's toolkit more systematic and flexible and so ensuring the efficient provision of liquidity to all solvent banks when needed, provided those banks meet the necessary preconditions.[2]

*Public liquidity backstop (PLB)*

The SBA supports the introduction of a PLB for systemically important institutions.[3] The PLB supplements the existing range of instruments for protecting system stability. Similar mechanisms have already been implemented in comparable financial centres, form part of the standard range of instruments used internationally, and are recommended by the Financial Stability Board (FSB).

Since the application of a PLB entails extensive privileged status for the SNB in the event of bankruptcy, there is no automatic entitlement to it, and substantial interest and premiums would already be payable to the federal government in the event of a PLB being used, we see no objective justification for an additional "flat fee".

## Capital adequacy

The Swiss capital adequacy requirements for systemically important banks, which are in line with international standards and strict in comparison with relevant financial centres, will be even tighter following the implementation of Basel III Final in 2025. In particular, they are far more rigorous than other countries' regulations with regard to the leverage ratio.

In its most recent TBTF report, the Federal Council also judged the Swiss capital adequacy requirements for systemically important banks to be appropriate. This conclusion is shared by the FDF's Expert Group on Banking Stability. The requirements placed on Switzerland's big banks in terms of Total Loss-Absorbing Capacity (TLAC) are generally higher than those imposed on comparable institutions in the EU, UK and US.

A sizeable capital buffer strengthens the TLAC, reduces the risk of bank runs in cases like this, and provides a more solid basis for resolution or turnaround measures. A solid capital base is therefore essential; it builds trust, provides a buffer and buys time to overcome crises. It can never offer total crisis protection, however, especially if the business model is not sustainable and risk management is not robust.

[2] More details in the separate SBA position paper.
[3] More details in the separate SBA position paper.

From a macroeconomic perspective, it is also important to remember that substantial increases in capital adequacy requirements would have a noticeable impact on the real economy. They could unintentionally lead to a credit crunch by reducing lending volumes and/or increasing costs.

A significant, across-the-board increase in capital adequacy requirements would thus hardly benefit the national economy, especially since it would not address the causes of the crisis being discussed here. Instead, it would curtail the banks' economically vital function as lenders and thus also the real economy, jeopardising the whole country's prosperity. Inevitably, there would also be a risk that some of the banks' business might move to unregulated industries, which could further increase the systemic risks.

In its report entitled "Lessons Learned from the CS Crisis", FINMA notes the weak capital adequacy situation accepted by FINMA at Credit Suisse's parent company (due to the reliefs granted at single entity level). As a result, FINMA is calling for stricter standards at single entity level and the right to impose and disclose additional capital charges where necessary. Any proposals in this area will need to be carefully examined.

## Remuneration and responsibility

It is crucial to a bank's risk management that the responsibilities of decision-makers be clearly defined and their remuneration aligned with the risk policy, the bank's long-term performance, and compliance with codes of conduct. We therefore recommend targeted measures by the legislature:[4]

*Remuneration*: FINMA Circular 2010/1 "Remuneration schemes"[5] already sets out the key principles of a sustainable remuneration policy. To add greater weight to the circular's content and make it more binding, a duty to implement a remuneration policy geared to the long term should be written into law. The details can then be set out in an ordinance.

*Responsibility*: To complement the existing proper business conduct requirements, we support the introduction of an appropriate accountability framework ("senior manager regime"). An accountability framework should be effective but balanced, lean and problem-oriented; the key responsible persons should be identified as is appropriate to the individual bank's complexity and business model, and their specific responsibilities documented. It would explicitly define the responsibilities of decision-makers and establish a link between risk-taking and personal responsibility.

## Supervision

Effective banking supervision is achieved through a combination of a legal basis, specialist expertise, and measured and courageous application. Simply extending or tightening the legal basis cannot make up for deficiencies in the other three requirements.

Effective cooperation between the Federal Department of Finance (FDF), the Swiss National Bank (SNB) and the Swiss Financial Market Supervisory Authority (FINMA) is key. The parliamentary investigation committee is currently evaluating the extent to which this was actually the case.

[4] More details in the separate SBA position paper.
[5] https://www.finma.ch/en/~/media/finma/dokumente/dokumentencenter/myfinma/rundschreiben/finma-rs-2010-01-01-07-2017.pdf?la=en.

In the context of recovery (stabilisation planning) and resolution planning specifically, supervisory approaches need to be analysed and targeted adjustments made where necessary. A greater focus on the practicability of implementing stabilisation and resolution plans in different crisis scenarios would be worth considering, for example.

## Fines and publication of enforcement proceedings

As part of its "Lessons Learned" (report published on 19 December 2023), FINMA is calling for powers to impose fines with the aim of strengthening a bank's governance (p. 48): "In addition to the interventions at the organisational and operational levels, FINMA lacked a repressive tool with which to sanction CS based on fault for the increasing violations and thus send a signal to the bank's management as well as its employees and shareholders."

We would question why existing legislation and the options currently available to FINMA are not sufficient to enable it to, for example, impose fines, send clear messages or take other measures in specific circumstances. An explanation is therefore needed that sets out precisely how imposing fines could have prevented the demise of Credit Suisse.

FINMA is also requesting the ability to publish enforcement proceedings. While we can see the potential benefits of such a measure, we would first want in-depth clarification of why existing proper business conduct requirements and the interventions and communication permitted thereunder are not already sufficient. If the request is pursued, clear rules will be necessary to ensure that any publication of enforcement proceedings is legitimate. Otherwise there is a risk of a loss of trust, prejudgements and arbitrary actions.

## Segregated banking system

The SBA rejects the idea of a segregated banking system, as it does not create any additional stability. Lehman Brothers, for example, was a pure investment bank, while Silicon Valley Bank was a pure commercial bank. Moreover, it was actually investment banking that lent stability to the Swiss universal banks during the banking crisis of the 1990s, when their retail business faltered. The universal banking model creates stability through diversification.

The universal banking model offers a range of advantages in this respect for the benefit of customers. An integrated universal bank can offer companies a broad range of services, including access to the international capital markets via their own bank. In addition, keeping a globally active Swiss universal bank is vital to the international profile and competitiveness of the entire Swiss economy, and also ensures the availability of key services for other banks and their customers. A broad and diversified financial market with a variety of universal bank-style players of different sizes is relevant both for the overall economy and for system stability.

## Finding solutions together

As the umbrella association of banks in Switzerland, the SBA is committed to open and objective debate. It is focused on ensuring proportionality, competitiveness and stability, and will continue to play a constructive role in efforts to evaluate the regulatory framework.