Progress on resolving the "too big to fail" issue

Further key measures to improve the resolvability of global systemically important banks were launched internationally in 2014. Credit Suisse Group and UBS are adjusting their group structures accordingly.

In addition to stricter prudential requirements, stronger supervision and an effective resolution mechanism for large and complex institutions, there have been calls from outside Switzerland for structural reforms. These led to regulatory initiatives in the US (Volcker Rule), the UK (Vickers Commission) and the EU (Liikanen group of experts). The proposals that emerged are currently at various stages of implementation. All of them aim to introduce legislation requiring banks to separate some of their activities. The European approach is primarily geared to improving resolvability by outsourcing deposit-taking to a subsidiary and thus keeping it apart from the more volatile and riskier forms of bank business.

The two Swiss big banks intend bundling their domestic business and systemically important functions within separate Swiss legal entities, as provided for in the Swiss emergency plan. This achieves the desired improvement in resolvability without structural measures mandated by the legislature, through the functional separation of commercial banking from riskier investment banking.

FINMA's preferred resolution strategy involves recapitalisation of the group by bailing in[21] existing liabilities. To support this strategy, the two Swiss big banks will begin issuing their medium- and long-term refinancing instruments through a non-operational holding company. This structure is the best way to ensure that the subsidiaries can maintain operations while the group is in resolution. UBS launched the transition to a holding structure in September 2014 with a share exchange offer. Credit Suisse Group already has a holding structure in place.

Total loss-absorbing capacity requirements for global systemically important banks
In November 2014, the Financial Stability Board (FSB) presented a proposal[22] to secure an appropriate level of loss-absorbing capacity for global systemically important banks in resolution, complementing the existing minimum requirements under Basel III Pillar 1.[23] A public consultation on the proposal was initiated.

Adequate loss-absorbing capacity is necessary in a going-concern scenario and in resolution for the following reasons:

– to secure a high probability that the home supervisory authority can resolve a global systemically important bank or, if this is impossible, wind it down in an orderly manner;
– to strengthen the confidence of the host supervisory authorities that a global systemically important bank can be successfully resolved or wound down in an orderly manner without adverse impact on the host countries; and
– to send a clear signal to all financial market players that a global systemically important institution is far more likely to be resolvable without taxpayer support if it meets the total loss-absorbing capacity requirements.

[21] See Glossary, p. 113.

[22] See "At a glance: the TLAC concept" chart, p. 28.

[23] For details on the three pillars of Basel III, see Glossary, p. 113.

The total loss-absorbing capacity (TLAC) concept is designed to allow for recapitalisation during resolution without government support. The TLAC requirement for global systemically important banks will apply in parallel to the existing Basel III capital requirements. The key elements of the FSB proposal are:

– the TLAC as a requirement that is to be met at all times and that corresponds conceptually to a Basel III Pillar 1 minimum requirement;
– the establishment of TLAC eligibility criteria for a financial institution's liabilities; and
– rules on the location of the TLAC within group structures.

The FSB proposals will be validated in 2015 as part of a comprehensive quantitative impact study. The TLAC standard is likely to be adopted at the end of 2015.

Recognition of cross-border resolution action

Resolution of a global systemically important bank can only be credible if resolution action in the home jurisdiction is recognised by the other jurisdictions in which the bank operates. Two elements are particularly important: cross-border recognition of legal "stays"[24] or other postponements of termination rights in financial contracts (such as derivatives); and the write-down or conversion of debt instruments issued under foreign law in accordance with the bail-in powers of the home resolution authority.

The FSB envisages the following measures in this area:

– an additional protocol[25] to the Master Agreement of the International Swaps and Derivatives Association (ISDA), under which global systemically important banks (G-SIBs) undertake to waive their termination and close-out rights in respect of cross-border transactions in a crisis and to recognise the counterparty's resolution regime;
– a commitment on the part of national authorities to make the additional protocol compulsory for market participants; and
– a requirement for national supervisory authorities to create the legal basis for cross-border recognition of resolution action.[26]

Both the TLAC concept and the removal of obstacles to successful resolution are key components of a solution to the "too big to fail" issue.

FSB Resolvability Assessment Process carried out for the first time

The Resolvability Assessment Process (RAP) for each G-SIB is carried out by senior policymakers from the authorities represented in the Crisis Management Group (CMG) concerned. The steps needed to improve resolvability are then agreed, and the results of the assessment formally communicated to the chair of the FSB. This gives the FSB an overview of the resolvability status of all 29 G-SIBs and enables it to monitor progress in resolving the "too big to fail" issue.

[24] Ordered by the authority, a stay is the postponement of an early termination right linked to the occurrence of a resolution event.

[25] In a bank initiative in October 2014, 18 G-SIBs agreed to sign the additional protocol; see ISDA media release dated 11 October 2014 (http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol).

[26] See FSB press release dated 29 September 2014 (http://www.financialstabilityboard.org/press/pr_140929.htm) and the FSB consultation paper "Cross-border recognition of resolution action" (http://www.financialstabilityboard.org/publications/c_140929.pdf).

FINMA completed the RAP for UBS and Credit Suisse Group on 30 September 2014. The senior policymakers, consisting of representatives from the Board of Governors of the Federal Reserve System (the Fed), the Federal Reserve Bank of New York (New York Fed), the Federal Deposit Insurance Corporation (FDIC), the Bank of England and the Prudential Regulation Authority (PRA), confirmed the bail-in strategy set out in the FINMA position paper on resolution of G-SIBs[27] of 7 August 2013 as the preferred resolution strategy for UBS and the Credit Suisse Group. They also gave a positive overall assessment of the efforts already made by Switzerland's two big banks to improve their resolvability. The RAP will be carried out annually from now on.

Cooperation agreements for crisis situations

The RAP demonstrated that successful resolution crucially depends on clearly regulated cooperation with the members of the CMG and other relevant host supervisory authorities. This is to be achieved by means of international cooperation agreements chiefly covering information exchange and organisational matters. Rapid progress was made on drafting these agreements, as a result of the preparatory work carried out in the CMG. Conclusion of the agreements for UBS and Credit Suisse Group is planned for 2015.

[27] See FINMA position paper "Resolution of global systemically important banks" of 7 August 2013 (http://www.finma.ch/e/finma/publikationen/Documents/pos-sanierung-abwicklung-20130807-e.pdf).