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The Swiss "too big to fail" regime

The financial crisis of 2007/2008 meant that state intervention was needed in many places around the world to rescue large, interconnected financial institutions. To avoid any future intervention in Switzerland, Parliament has issued specific regulations that are currently being implemented.

At the height of the financial crisis in 2007/2008, state intervention was needed in many countries to rescue large, interconnected financial institutions. The turmoil triggered a chain reaction in certain sections of the financial market and also affected the real economy. The institutions concerned were said to be “too big to fail” (TBTF). In other words, owing to the services they provide that could not be replaced at short notice, the failure of those institutions would be disastrous to the economy. In its efforts to keep the cost to taxpayers as low as possible by minimising the need for governments to bail out systemically important financial institutions, Switzerland has issued specific TBTF regulations.

A host of problems arise when governments are forced to rescue systemically important financial institutions. First, the state guarantee is a form of subsidy, which distorts competition as TBTF institutions have better credit ratings and thus lower financing costs. Second, the prospect of government support can heighten an institution’s risk appetite. Third, the disciplinary effect of the threat of bankruptcy is eliminated. Fourth, taxpayers are exposed to a huge financial risk. Fifth, the state rescue of private companies circumvents market forces.

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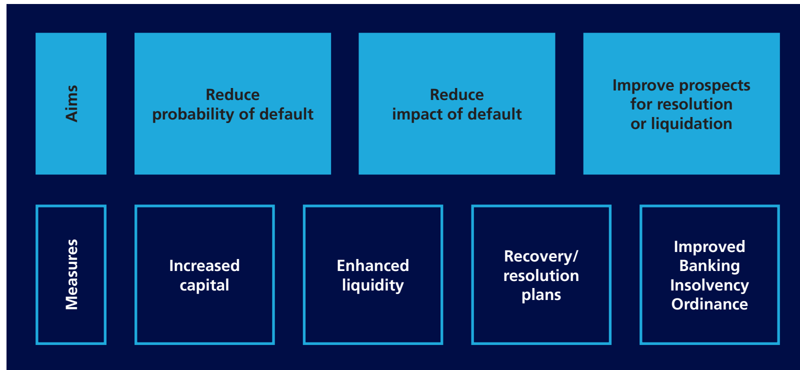
Regulatory response to the “too big to fail” problem

Both internationally and within Switzerland, the experience of the crisis brought about intensive efforts to draft regulatory measures aimed at dealing with the TBTF problem. For instance, criteria were worked out for assessing whether banks are systemically important, and 29 global systemically important banks were identified, among them UBS and Credit Suisse. Minimum requirements for capital adequacy, liquidity and contingency planning were also introduced.

In Switzerland, a commission of experts comprising representatives of the authorities, the private sector and academia presented recommendations for limiting the economic risks attached to large companies in September 2010. These recommendations, mainly concerning large financial institutions, were implemented in acts and ordinances by the end of 2013. The Swiss National Bank is responsible for categorising banks as systemically important. To date, it has done so for the two large banks UBS and Credit Suisse, Zürcher Kantonalbank and the Raiffeisen Group.



"Too big to fail" regime in Switzerland: four core elements

The Swiss TBTF regulations focus on reducing the probability of default and improving prospects for resolution or liquidation. They contain four core elements. First, systemically important banks are required to hold more equity capital to cover losses. This is tied to risk-weighted minimum limits, as well as a maximum level of indebtedness (leverage ratio) to safeguard against risk weightings being too low. The requirements vary depending on the bank's total assets and the market share of the banking services that qualify as systemically important.

Switzerland's TBTF regulations are designed so that individual measures complement and strengthen each other. For example, improved prospects for resolution are rewarded with a discount on capital adequacy requirements.

Second, the bank's resilience to liquidity shocks is improved through a special liquidity regime. Systemically important banks must be able to cover their net cash outflows from their own liquidity buffer for up to 30 days.

Third, preparations for a crisis begin at an early stage. An emergency plan must be in place to ensure that systemically important services can be maintained even if the bank becomes insolvent. In addition, bond creditors are now expected to bear a share of the losses by means of what is termed a "bail-in". The intention here is to avert the need for a bail-out using taxpayers' money. However, creditors' rights must be respected. Losses are borne by shareholders first, then by bondholders. Secured, privileged and offsetable client claims are always exempt.

The fourth element is an amended legal framework for the resolution of financial institutions.

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Implementation status

FINMA is closely monitoring the implementation of these measures. The large banks are working to enhance their ability to absorb losses. They have already implemented the liquidity regime and drawn up recovery plans. FINMA has also completed initial drafts of its institution-specific resolution plans for the large banks, which will be successively updated. Furthermore, both large banks have announced that they are setting up separate legal entities to handle their Swiss business. The Federal Council will review the effectiveness of those measures for the first time in spring 2015 and thereafter every two years.

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