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Crisis Preparation and Optionality – Switzerland's TBTF and resolution regime

Key Points:

1. The Swiss Federal Council's report on the TBTF regulation and FINMA's report on the CS crisis underline that resolution was indeed prepared and considered as a viable option. However, the merger was associated with fewer risks. The resolution planning in accordance with the TBTF regulation gave the authorities a choice in finding a solution.
2. FINMA is calling for additional powers similar to those already available to other authorities in the US, the UK and the EU. These include early intervention powers, intensified direct supervision, a senior managers regime, naming and shaming, fines and resolvability.
3. It is key to focus on how to reduce the impact of a crisis, especially in systemically significant banks, and to contain a wider systemic risk and moral hazard. To this end, it is important to strengthen financial resilience for periods of stress, including recoverability and to enhance resolution planning.
4. In the future the central element of resolution planning will be to enhance "optionality". FINMA will require the bank to prepare for a range of options for different scenarios. While the "SPE-Strategy" remains the preferred solution, which could be implemented now, if need be, a "Market Exit" as well as a "Sale/Merger" must also be planned for. They both need clear legal basis, as proposed by the Federal Council.
5. A clear and concise legal framework is necessary to ensure legal certainty of resolution measures. While the preferred strategy is already well embedded in the Swiss Banking Act, "Market Exit" and "Sale/Merger" are yet to be introduced. Such legislation would allow for additional powers for the preparation of the resolvability, the way bail-in and transfer powers can be combined and finally, a strong liquidity support in the form of a Public Liquidity Backstop.
6. International cooperation is key to improving effectiveness of G-SIB resolution and promoting a wider public understanding for crisis preparation and optionality.

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Ladies and gentlemen, good morning.

Thank you for inviting me to participate in this roundtable discussion on banking resolution. It's a pleasure to be here among such esteemed colleagues. Today, I will provide an update on what we have been doing in Switzerland on the topic of crisis preparation and resolvability.

But first let me start with a short retrospective on the Swiss TBTF regime. Key cornerstones of an effective TBTF framework have been in place for a number of years in Switzerland. In the years following the GFC, Swiss authorities required our two G-SIBs, UBS and Credit Suisse, to implement a clean holding structure, bankruptcy-remote corporate services entities, separate Swiss entities to safeguard the Swiss systemic economic functions and, last but not least, sufficient external and internal loss-absorbing capacity – totalling CHF 111 billion at Credit Suisse in March 2023. And thanks to additional TBTF liquidity requirements, Credit Suisse was able to withstand the first wave of deposit withdrawals in October 2022.

In my view, it is because of these preparatory efforts that the Swiss authorities were able to choose between two options on 19 March 2023.

1. The single point of entry (SPoE) bail-in, combined with a restructuring of Credit Suisse's business model in accordance with FINMA's resolution plan, was ready to implement. This was also thanks to the strong collaboration and preparation efforts with the members of the Crisis Management Group. Many of your staff were also involved in this process and I would like to thank you for the excellent collaboration.

2. A takeover of CS by UBS after private negotiations between the two banks and with the support of the Swiss authorities.

The authorities chose not to impose resolution as the facilitated takeover was clearly the less risky option. It offered better prospects for immediate market stability, legal certainty, and long-term economic value conservation.

It is important to add that both options required a public liquidity backstop, which was introduced using the emergency legislative powers of the Swiss Federal Council, since at the time – and this is still the case – no such instrument had been introduced into Swiss legislation.

Since then, FINMA and the Swiss Federal Council have released their respective reports on the Credit Suisse failure and the current Swiss TBTF framework. They have identified lessons learned and areas for further development which I will touch on shortly.

In the remainder of my remarks, I will elaborate on three topics:

- First, efforts to reduce the probability of a crisis.
- Second, efforts to reduce the impact of a crisis, which include improved readiness for and optionality in resolution.
- And finally, improving international cooperation and coordination.

Reducing the probability of a crisis

I think we can all agree that, at best, an emerging crisis is stopped at an early stage. Alongside capable and responsible bank leadership, we need enhanced supervisory powers. We are also continuing our efforts to strengthen forward-looking, effective supervision.

To increase its supervisory impact, FINMA is calling for additional powers similar to those already available to authorities in the US, the UK and the EU:

1. **Early intervention powers:** We need to have the legal powers to apply the full toolkit of supervisory measures in an appropriate and proportionate manner in the going concern phase. We have learned from past crises that problems start with weaknesses in governance and risk culture, which in turn result in weaknesses in business models. Only later do we observe losses in areas like market and credit risk or due to misconduct and reputational risk. Ultimately these may result in breaches in minimum capital or liquidity requirements, but as the CS case showed, an institution may hit the point of non-viability before prudential minima are reached.
2. **Intensified direct supervision:** We need to increase our own on-site inspections to gain deeper first-hand insights into banks' operations and to reduce excessive reliance on external auditors. This also needs to be accompanied by changes in legislation.
3. **Senior managers regime:** We want to introduce a senior managers regime to hold individuals accountable for their actions and behaviour and thus increase incentives for good governance and risk management.
4. **Naming and shaming:** We want to be able to publish finalised enforcement actions to deter future misconduct.
5. **Fines:** We want to be able to sanction misconduct by institutions with appropriate fines.
6. **Resolvability:** We need to have the power to require changes in business models during the going concern phase if they stand in conflict with effective recoverability or resolvability.

These powers are covered in the TBTF Report published by the Swiss Federal Council on 10 April 2024 (TBTF Report) and it is important that they are implemented as soon as possible.

Moreover, we are also enhancing our supervisory methodologies, tools and processes in areas such as:

1. **Governance:** Improving our ability to identify and respond to weaknesses in risk governance.
2. **Risk culture:** Promoting a culture of risk awareness and responsible behaviour within financial institutions.
3. **Business models:** Evaluating the sustainability of banks' business models.

Finally, we have substantially increased the resources devoted to the supervision of the merged UBS and Credit Suisse.

I am convinced that these powers, areas of deepened supervisory focus, and additional resources will help reduce the probability of a crisis emerging in the first place.

Now to the second part:

Reducing the impact of a crisis

Since we cannot reduce the probability of bank failures to zero, we also need to focus on how to reduce the impact of a problem, especially at systemically important banks, and thus contain wider systemic risk and moral hazard. In Switzerland we are talking about one global systemically important bank, namely UBS, and three additional domestic systemically important institutions.

One approach is to strengthen the financial resilience for periods of stress, including recoverability:

- In the case of UBS, the systemic add-on will increase as a result of the merger. In addition, we believe the bank needs to fully capitalise the investments in its main subsidiaries as the CS failure demonstrated how pro-cyclical a risk-weighted approach can be when these subsidiaries drop in market value. The same goes for other non-loss-absorbing assets such as software.
- In addition, liquidity requirements and LCR parameters should be updated to better reflect the types of outflows observed at CS and during the US banking crisis factoring in new developments such as digitalisation and social media. This is a topic to be taken up at the level of the Basel Committee.
- We are strengthening recovery plans for systemic institutions to ensure that they are even more relevant and capable of being implemented in periods of stress.

We are also focusing on enhancing the resolution plan for UBS. The bank is now very large compared to every Swiss economic metric. And in the event of failure there isn't another Swiss G-SIB available to acquire it.

The **SPE strategy** remains robust, continues to be the preferred resolution strategy, and based on our assessment, it could be implemented now if need be. It is best suited to addressing a GFC-type scenario with expected losses. This means continuation of the bank with certain adaptations to the business model and changes in governance. Through its integration process, UBS needs to mitigate the remaining hurdles to the SPE approach. In particular, the bank needs to consistently integrate the Credit Suisse activities and make sure that its resolution capabilities – especially its valuation in resolution process – are brought up to date, meaning that they are redeployed and tested again for the combined institutions. This will also improve the soundness of the data for navigating the resolution process. In the meantime, the bank has deployed interim measures to help enhance workability during the integration process.

At the same time, we are working to develop a **"market exit" scenario** as an additional option for resolution. This type of wind-down scenario would be most relevant when there is a fundamental loss of confidence in the business model and irreparable damage to the reputation of the institution. In this scenario we envisage that we could employ our transfer powers to sell healthy segments of the bank while keeping problematic parts on the balance sheet for a pre-planned solvent wind-down.

A final option is the **sale/merger of the bank in resolution**, an option that would only be available at the global level.

The TBTF Report sets out how to strengthen the foundation for the above initiatives. In particular, we are working with the Federal Department of Finance and the Swiss National Bank on the necessary legal language to implement the latter two additional approaches in the Swiss Banking Act. For example, the market exit scenario would require additional legislative powers for the preparation of the resolvability of the parent bank. The same can be said for a sale/merger of the whole bank in

resolution. For example, the way bail-in and transfer powers can be combined in this context need to be clearly stated.

Based on clear additional legislation, there could also be variants of how bail-in, wind-down, and merger/sale are combined together depending on the actual situation at hand.

All options, in order to be executable, would require strong liquidity support in the form of a Public Liquidity Backstop. Such a tool needs to be introduced as soon as possible to make resolution a more implementable option in Switzerland.

Moreover, more options in the resolution strategy also require greater flexibility in their implementation. For example, the clean holding company makes the use of a bridge bank in theory unnecessary. That being said, in a crisis of confidence situation, a bridge bank may prove useful to separate losses from viable portfolios and, especially, provide more time to execute resolution. To increase the viability of a bridge bank option, it would be important to clarify in legislation the scope, extent and FINMA's mandate with regard to the bridge bank approach.

Conclusion – international collaboration

I would like to close my remarks with some thoughts on international cooperation. As I said at the beginning, the collaboration of my colleagues at FINMA with the CMG authorities for Credit Suisse was a key success factor in having a credible and implementable resolution option ready on time in March 2023.

With one G-SIB left, we would like to increase our cooperation with our partner jurisdictions in the UBS CMG and beyond. This also includes strengthening cross-border legal certainty for bail-in instruments. We're enhancing our crisis simulation capabilities to conduct and orchestrate a UBS-specific cross-border crisis exercise soon.

We're hoping to join Crisis Management Groups for other G-SIBs in an observer role to leverage on best practices and benchmarking exercises. And it goes without saying that we will continue to engage in the FSB working groups to share our experiences and to advance wider public understanding about the lessons learned and contribute to making resolution even more implementable.

Many thanks for listening. I look forward to our discussion.