CENTRE DE DROIT
BANCAIRE ET FINANCIER

Additional equity capital

FINMA practice and the judge's power of cognition

Par Vaïk Müller le 8 May 2023

In a ruling dated March 30, 2023 (B-4004_2021), the Federal Administrative Court (FAT) found that the additional capital requirements imposed by FINMA on PostFinance SA (PostFinance) on the basis of art. 131b cum 45 let. b of the Capital Adequacy Ordinance (CAO) and its practice set out in FINMA Circular 2019/2 "Interest rate risks – banks" (the Circular) to address the risk of rising interest rates were in accordance with the law. This ruling follows a previous decision by the Swiss Federal Supreme Court (TF), which had referred the case back to the first-instance authority for a new decision pursuant to art. 9 para. 1 lit. b FINMASA. The initial decision concerning PostFinance had in fact been issued by the FINMA management, which, in the view of the Federal Court, was not competent to do so, as a decision on capital adequacy was a "far-reaching matter" falling within the remit of the FINMA Board of Directors (cf. cdbf.ch/1042/).

In this relatively detailed and technical ruling, PostFinance put forward a number of arguments, including the following :

FINMA failed to demonstrate that PostFinance was an "outsider" within the meaning of Section I of Appendix 1 of the Circular, i.e. in particular an institution with a potentially inappropriate level of interest-rate risk in the banking book (allowing FINMA to require additional capital due to its allegedly particularly high interest-rate risk structure/management), as it had not been classified in an appropriate category, the "retail bank" category being, according to PostFinance, inappropriate in view of the structure of its balance sheet.
FINMA did not base its decision on PostFinance's specific situation by carrying out a "case-by-case" assessment in accordance with section II of Appendix 1 of the Circular, but instead arbitrarily set the rates without demonstrating how PostFinance's empirical measures, which were not disputed by the prudential auditors, were inadequate to cover the institution's risks.
FINMA violated the principle of legality. According to PostFinance, neither the wording of Art. 45 OFR nor any other provision of Swiss law allowed FINMA to prescribe a fixed interest rate determined by supervisory law to measure the "risks incurred".

The TAF rejected PostFinance's arguments one by one, noting that :

The identification of "non-standard" institutions described in the Circular is in line with international standards, and the criteria according to which PostFinance has been classified in the "retail banks" group are derived from the contested decision, if not mentioned in Appendix 1 of the Circular. The criteria used by FINMA are objective criteria that respect equal treatment

between banking institutions, and furthermore PostFinance does not argue why assignment to another group would be more appropriate (e.g. “asset management banks”).
The TAF emphasizes that FINMA cannot rely exclusively on measures internal to the bank in question, but that on the contrary, the supervisory authority must be able to validate internal measures with an objective assessment based on assumptions from other institutions and market factors, in order to be able to make an objective comparison. In this respect, the TAF points out that the setting of standardized interest rates by FINMA mitigates the risks resulting from banks’ internal models and measures, given the external nature of the requirements imposed by FINMA, and helps strengthen banks’ ability to bear losses in the event of unforeseeable events. The TAF also rejected the arbitrary nature of FINMA’s decision, pointing out in passing that the appeal authority may restrict its free power of cognition if the nature of the case justifies or requires this. This is generally the case when the application of the law requires special technical knowledge available to the ruling authority (in this case, FINMA), provided that this authority has examined and taken into account the essential elements of the case. The TAF recalls that FINMA must have a certain margin of technical discretion in determining the “risks incurred” and whether or not the existing equity capital guarantees “sufficient security”, which does not exclude the setting of a rate duration for prudential purposes (cf. TAF B-19/2012).
The TAF, against the opinion of PostFinance, considers that art. 45 let. b OFR constitutes a sufficient legal basis based on a law in the formal sense (art. 4 al. 3 LB). The multi-criteria approach followed by FINMA, the need to model risks and therefore to define rate durations within this framework, as well as the need for a margin of appreciation due to the technical nature of the regulations and the evolution of the international regulatory environment, require a certain latitude which a general and abstract standard such as art. 45 let. b OFR contributes to.

In conclusion, the FAT’s decision reiterates FINMA’s considerable discretionary powers, and the limits of arbitrariness in examining technical standards. The TAF decision also emphasizes that the Swiss regulatory framework complies with international standards, which are of a non-binding nature (soft law) unless transposed into domestic law, which may set higher requirements.
*** Translated with www.DeepL.com/Translator (free version) ***
