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Bank stability

Federal Council report impressive but still too vague

Par Rashid Bahar le 3 May 2024

Since the adoption of the too-big-to-fail regime in 2011, article 52 BL stipulates that the Federal Council must examine the provisions of articles 7 to 14b BL three years after the system comes into force and then every two years, compare them with the corresponding international standards abroad and report back to the Federal Assembly, if necessary with proposals for amendments to the law or ordinances. In its report on systemically important banks of 4 June 2021 (FF 2021 1487), the Federal Council concluded : “The Swiss approach to defusing the problem of systemically important banks, which combines various measures and has developed over the years, is proving adequate by international comparison. There is therefore no need for a fundamental reorientation of this policy”. The proposals were modest, calling for an improvement in overall liquidation capacity and a revision of the OLiq. Less than 24 months later, he had to resort to the emergency clause to facilitate the merger between Credit Suisse and UBS.

On 10 April 2024, the Federal Council published its first report under Art. 52 BL since the crisis. The report is 341 pages long, compared with 18 pages in the 2021 report, and examines a package of 37 measures in six fields of action based on three priorities : strengthening prevention, reinforcing liquidity and broadening the instruments for combating the crisis. It selected 22 measures for implementation and suggested that seven others be examined in greater depth. These include the public liquidity backstop implemented as part of the Credit Suisse crisis and already presented to parliament.

The main field of action covers measures to improve corporate governance and supervision. These include, as expected, the introduction of a senior managers’ regime based on the UK model, whereby responsibility for specific issues is assigned to specific individuals at board, executive or senior management level. It also proposes more restrictive regulations on remuneration, with the possibility of intervening in the area of blocking periods, linking remuneration to sustainable economic results and making it possible to demand the return of remuneration if it proves to be unjustified by means of claw-back clauses, without proposing to cap variable or total remuneration. We will have to wait for the concrete proposals to see whether these measures will simply enshrine in law the principles set out by FINMA in its Circular 2010/01 “Remuneration systems” or go further. Other measures are more vague and it remains to be seen what they mean in concrete terms : this is true of the desire to create responsibilities in terms of corporate culture, which will be difficult to regulate and monitor. In part, FINMA could already have exercised a number of these powers on the basis of general clauses and its broad discretionary powers. The Federal Council’s proposals are therefore

aimed more at raising questions than at overhauling the system.

In terms of supervision, the Federal Council intends to strengthen FINMA's right to information under Art. 29 FINMASA so that it can address not only supervised persons and their bodies but also third parties, in particular employees, outside formal administrative procedures. It is also envisaged that FINMA will be able to inform the public about ongoing proceedings independently of the conditions set out in Art. 22 para. 2 FINMASA or the measures set out in Art. 34 FINMASA. In order to speed up proceedings, the Federal Council is also considering withdrawing the possibility of appealing to the Federal Supreme Court against decisions initially taken by FINMA.

However, the biggest surprise concerns administrative fines : the Federal Council is not proposing to give FINMA the power to impose administrative fines. It merely calls for a more detailed examination of the issue with regard to supervised persons and refrains from examining the question of whether it would be appropriate to be able to impose sanctions on natural persons, e.g. directors or employees of supervised persons, over and above the severe sanction of a ban on exercising a profession or practice under Articles 33 and 33a FINMASA. Instead, it plans to align the prohibition on exercising one's profession or office (Art. 33 FINMASA) with the prohibition on practising one's profession or office for employees responsible for trading in financial instruments or advising clients (Art. 33a FINMASA), so that measures can be taken against the former not only when they have violated supervisory law but also when they have violated internal rules. After a brief excursus on the subject, the bill also refrains from amending the rules governing the civil liability of supervisory bodies. At the same time, the system of measures against individuals will be strengthened, since the Federal Council is proposing to extend the measure of confiscation of illegal gains (Art. 35 FINMASA) to persons other than supervised persons and their governing bodies.

We will not go into further detail on the package of measures applicable to capital, liquidity and liquidity guarantees other than to note that the Federal Council does not intend to abolish the use of hybrid capital instruments such as the amortised AT1s in the case of Credit Suisse, but rather proposes to clarify the terms of the bail-in and to take measures against double leverage within banking groups. Similarly, the Federal Council intends to examine the possibility of improving the guarantee of liquidity through the use of other forms of collateral and by strengthening the possibility of transferring liquidity within the same banking group, without actually proposing any measures, since this decision is the responsibility of the Swiss National Bank.

The Federal Council's proposals do not envisage more fundamental structural measures : the Swiss deposit guarantee system based on an insurance mechanism anchored in self-regulation will remain in place, which is consistent with the solution adopted by parliament in 2021. Similarly, the Federal Council has no plans to create a liquidation fund or to enshrine in law a temporary public ownership mechanism, which means that we must expect the emergency law to be invoked again if a crisis were to recur, which may be right from a pragmatic point of view, but is disappointing in a state governed by the rule of law.

Overall, the package of measures proposed by the Federal Council is aimed primarily at systemically important banks, but some of them will have a broader scope. This applies in particular to the measures relating to FINMA's enforcement powers and, to a lesser extent, to corporate governance. In addition, it is to be expected that certain measures, although not

directly applicable to other banks and financial institutions, will affect them indirectly.

Finally, there is one area where the Bank Stability Report remains particularly timid, if not silent : the ability of financial market supervisors to adequately and effectively oversee systemically important banks. In quantitative terms, of the 37 measures examined, most are aimed at strengthening corporate governance and supervisory instruments (13, of which 8 have been retained and 5 are to be examined), capital instruments (8, of which 5 have been retained), liquidity guarantees (7, of which 4 have been retained and one is to be examined) and liquidation planning tools (6, of which 3 have been retained). Only one measure, which was not retained but only classified for review, concerns the organisation and coordination of authorities. It would have been important to determine whether FINMA had really exhausted the supervisory instruments at its disposal. More fundamentally, it would also have been appropriate to examine the appropriateness of the bipolar system of prudential supervision with FINMA, on the one hand responsible for microprudential supervision, and the Swiss National Bank, responsible for macroprudential supervision and, more generally, for contributing to the stability of the financial system, at a time when, increasingly following the financial crisis, models consisting of entrusting prudential supervision to an authority belonging to the central bank seem to be gaining ground. The Federal Council may have preferred to wait for the outcome of the CEP before examining this question, but even if the economic responsibility for the crisis lies primarily with the bank, its governing bodies, its board of directors and then its shareholders, the supervisory system also failed in its mission, by not preventing and then not acting until it was too late.

In short, the Federal Council is proposing a seemingly impressive catalogue of measures. At the same time, it has to be said that the report is still vague, even timid, when it comes to concrete measures : it gives a general description of the measures envisaged, but we will have to wait for the preliminary drafts of laws and ordinances to see what they entail in concrete terms. This is also the first stage in the legislative process : in accordance with art. 52 BL, the Federal Council is formulating proposals which it will then have to implement as part of the process of revising the BL and its implementing ordinances. It is to be expected that the industry and the institutions concerned will respond critically (see SBA press release). At the same time, this report is part of a complex political choreography in the wake of the Credit Suisse crisis : it follows on from the FINMA report (Liegeois, cdbf.ch/1315) and aims to anticipate the outcome of the CEP, without making any institutional concessions. In any case, one thing is certain : this crisis will leave its mark on Swiss banking supervision law : “you never want a serious crisis to go to waste” said Rahm Emmanuel in 2009 following the Lehmann bankruptcy and the sub-prime crisis. This strategy is still valid today.

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