Media release:

Expert Group on Banking Stability publishes a report titled “The need for reform after the demise of Credit Suisse”

Recommendations to address gaps in the too-big-to-fail regime

The state-sponsored acquisition of Credit Suisse by UBS in March 2023 quickly rectified a precarious situation, underlining Switzerland’s contribution to financial stability. Nevertheless, it has raised questions on the viability of the too-big-to-fail regime. The report of the Expert Group on Banking Stability discusses lessons and makes recommendations to address gaps in the regime.

Bern, 1 September 2023.

The Swiss Federal Council announced a comprehensive review of the too-big-to-fail (TBTF) regime in March and as part of this, an external and independent “Expert Group on Banking Stability” was established in mid-May. It was tasked with presenting strategic recommendations on the role of banks and the framework governing their activities, with the primary objective of enhancing the stability of the Swiss financial centre. Notably, the mandate of the expert group did not cover the investigation of past events surrounding the takeover of Credit Suisse by UBS. The report focuses on financial market and stability concerns, assesses the TBTF regime, and offers recommendations in four areas.

Recommendations in four areas

The report observes that significant progress has been made within the TBTF regime since the global financial crisis of 2007–08. Stronger capital and liquidity requirements have been beneficial. Nonetheless, the resolution of a global systemically important bank, a key component of the TBTF regime, remains untested.

Should the need for UBS’s resolution arise, the option of merging with another large Swiss bank is no longer available. Consequently, resolution must be both feasible and effective. Thus, it becomes imperative to review the TBTF regime for potential gaps and to address them.

The expert report provides insights and actionable suggestions to enhance the current TBTF framework in the following four areas: crisis management, liquidity, supervision, and capital adequacy.

1. *Enhancements in crisis management preparedness will be crucial*

The Financial Market Supervisory Authority (FINMA), the Swiss National Bank (SNB) and the Federal Department of Finance (FDF) should jointly monitor, evaluate and communicate the viability of the resolution of (global and domestic) systemically significant banks on a continuous basis.

FINMA should prepare resolution options by considering various scenarios as part of the resolution planning process. A resolution plan based on a bridge bank should be considered as one of the options. FINMA should have the power to instruct systemically important banks to make organisational changes to enhance their resolvability.

In addition, it is important to address legal risks that the conversion of bail-in bonds into shares during a resolution process may pose in the United States and other countries at the international level.

The FDF should explore ways to enhance cooperation among FINMA, the SNB, and the FDF in preparing for and managing crises. To ensure the effective management of crises, these authorities should periodically test their preparedness in crisis simulations.

In order to enhance trust in the current resolution tools, FDF, SNB and FINMA ought to explain in detail the reasoning behind their decision to endorse the acquisition of Credit Suisse by UBS, instead of executing the prepared resolution plan.

2. *Gaps in access to liquidity*

To address gaps in the liquidity mechanisms, SNB should widen the scope of acceptable collateral for the provision of extraordinary liquidity assistance (ELA). In particular, the SNB should also accept non-marketable and highly illiquid collateral, and limit haircuts.

The SNB should tackle stigma with respect to ELA and to this end consider the strategies of the Bank of England and other central banks in this area.

The "public liquidity backstop" (PLB), as proposed by the Federal Council, must be introduced expeditiously. Its adoption is critical to guarantee access to funding in the resolution of for a systemically significant bank.

3. *Additional and more effective instruments for FINMA*

FINMA should be able to instruct systematically significant banks to deposit sufficient collateral with the SNB and foreign central banks to ensure satisfactory access to liquidity. The FDF needs to augment FINMA's supervisory tools to allow for more effective handling of systematically significant banks. Among other suggestions, the experts recommend measures to support the swift enforcement of supervisory actions and a broadening of FINMA's powers to publicly disclose ongoing enforcement measures (known as "naming and shaming").

Moreover, FINMA ought to have the ability to intervene at an earlier stage. This can be achieved by implementing precautionary measures before a bank reaches the point of non-viability. Further, the FDF should consider whether the legal framework for FINMA's assessment of the bank's point of non-viability can be enhanced by allowing FINMA to take into account market information and other alternative data sources into account.

4. Enhanced transparency in the quality of capital

With the implementation of "Basel III final" in Switzerland, major banks will be subject to more stringent capital adequacy requirements. There is no need to increase the Swiss capital adequacy requirements beyond that.

However, the quality of capital can be enhanced: FINMA should publicly disclose any relief granted and transitional agreements for capital adequacy demands, as well as the level of “double leverage” employed by banks.

Finally, the Swiss AT1 market has suffered damage. The FDF, alongside FINMA and the industry, should investigate methods to revive the Swiss market for AT1 instruments.

Further information:
Yvan Lengwiler, Chairman of the Expert Group on Banking Stability, +41 79 128 2182

Media contact:
Michael Schoenenberger, Partner Hirzel.Neef.Schmid.Konsulenten, +41 76 433 8102

The report of the Expert Group on Banking Stability is available digitally at:
www.too-big-to-fail.ch

Mandate of the Expert Group on Banking Stability

Following the takeover of Credit Suisse by UBS, the Federal Council decided on 29 March 2023 to review the events and conduct a comprehensive evaluation of the too-big-to-fail regime. This involved external expert opinions. As a result of this decision, the Federal Department of Finance (FDF) set up the Expert Group on Banking Stability on 17 May 2023, with the task of submitting to the FDF by mid-August 2023 strategic considerations, independent of the authorities, on the role of the banks and the state framework with a view to the stability of the Swiss financial centre. The report was completed on 14 August 2023. The Federal Council took note of the report on 30 August 2023.

In accordance with the FDF's directive, the specialist team focused on financial market and stability concerns (excluding state and competition law matters), and established its own agenda when selecting subjects.

In this report, the expert group presents the findings from these discussions and the group's internal reflections. The group derives recommendations from these discussions, which serve as food for thought. These recommendations are intended to contribute to the evaluation and further development of the too-big-to-fail regime. The report does not contain a detailed, backward-looking review of what happened. A parliamentary commission of inquiry (PUK) has been appointed for this purpose.

Members of the Expert Group on Banking Stability

Yvan Lengwiler (Chairman) – Professor of Economics, University of Basel, specialised in financial market regulation and monetary policy, and former member of the Board of Directors of FINMA.

Mirjam Eggen – Professor of Private Law, University of Bern and President of the Takeover Commission.

Hans Gersbach – Professor of Macroeconomics, ETH Zurich, Co-Director KOF, Member and former Chairman of the Scientific Advisory Board of the Federal Ministry of Economics and Climate Protection Germany.

Eva Hüpkes – Head of Regulatory and Supervisory Policies, Financial Stability Board (until 31 July 2023), Secretary General of the International Association of Deposit Insurers (from 1 August 2023), and Lecturer in International Business Law, University of Zurich.

Eva Jaisli – CEO of PB Swiss Tools AG, Vice President Swissmem and member of the Board Committee, economiesuisse.

Renaud de Planta – Senior Partner and Chairman of the Group Executive Committee, Pictet Group and member of the Board Committee of Swissbanking.

Rudolf Sigg – Chairman of the Board of esisuisse, former Chief Financial Officer and member of the General Management of Zürcher Kantonalbank.

Beatrice Weder di Mauro – Professor of International Economics, Geneva Graduate Institute (IHEID), Visiting Professor, INSEAD and President of the Centre for Economic Policy Research (CEPR).

Glossary

Resolution plan – a resolution plan shows how the bank would be reorganised or partially liquidated. The aim is to ensure the continuation of its systemically important functions and financial stability. The public purse is to be burdened as little as possible.

Resolution – the resolution of a systemically important bank aims to maintain the continuity of its operations or at least of its critical banking services. The aim is not to preserve the bank, but to maintain the continuity of particularly important parts of its activities. The aim is to maintain financial stability and avert a destructive liquidation and or costly public bailout.

Emergency liquidity assistance (ELA) – the Swiss National Bank, as lender of last resort, can provide liquidity to one or more domestic banks under the ELA scheme if these institutions can no longer refinance themselves on the market.

Public liquidity backstop (PLB) – a government default guarantee for a central bank that provides liquidity to a bank in need. It is not an instance of the state intervening in a bank's capital, but a loan that must be remunerated and repaid through commitment and risk premiums as well as interest.

Bail-in – a form of creditor participation. It is a process that recapitalises a bank and is used in the resolution of all systemically important banks.