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TECHNICAL NOTE—FINANCIAL SAFETY NET AND CRISIS MANAGEMENT ARRANGEMENTS

This Technical Note on Financial Safety Net and Crisis Management Arrangements for the Switzerland FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in May 2019.

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June 12, 2019

TECHNICAL NOTE

FINANCIAL SAFETY NET AND CRISIS MANAGEMENT ARRANGEMENTS

Prepared By
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Switzerland. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

BA	Federal Act on Banks and Savings Banks
BIO-FINMA	FINMA Ordinance on the Insolvency of Banks and Securities Dealers
BO	Ordinance on Banks and Savings Banks
CAO	Capital Adequacy Ordinance
CS	Credit Suisse
CMG	Crisis Management Group
COAG	Cross-border Cooperation Agreement
CP	Core Principle
DIA	Deposit Insurance Agency
DIS	Deposit Insurance System
EBA	European Banking Authority
ELA	Emergency Liquidity Assistance
FDF	Federal Department of Finance
FINMA	Swiss Financial Market Supervisory Authority
FINMASA	Financial Markets Supervision Act
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
GB-R	FINMA's Recovery and Resolution Division
G-SIB	Global Systemically Important Bank
IADI	International Association of Deposit Insurers
KA	Key Attribute
MOU	Memorandum of Understanding
RAP	FSB Resolvability Assessment Process
RRP	Recovery and Resolution Planning
SIB	Systemically Important Bank
SNB	Swiss National Bank
SPOE	Single Point of Entry
TBTF	Too Big To Fail
TLAC	Total Loss-Absorbing Capacity

EXECUTIVE SUMMARY

While progress has been made in strengthening financial safety net and crisis management arrangements, including for bank resolution, more needs to be done. Since the 2014 FSAP, the authorities have particularly enhanced the arrangements to address a potential failure of the two global systemically important banks (G-SIBs). However, more work needs to be done to finalize (group) resolution plans and to remove impediments to resolvability. Furthermore, the three domestically-focused systemically important banks (SIBs) and the next group of midsized banks, which could be systemic in a system-wide crisis, raise different challenges to resolution. The latter group should be subject to, for example, recovery and resolution planning (RRP), and arrangements should be made to allow them to access emergency liquidity from the Swiss Nation Bank (SNB) on short notice if deemed necessary by the SNB. Moreover, the Swiss deposit insurance system (DIS) is not set up in line with international best practice, preventing it from fully participating in the financial safety net. A thorough reform of the DIS is warranted, including a public deposit insurer, with ex ante DIS funding, and use of DIS funds for resolution funding subject to safeguards.

The early intervention, resolution, and liquidation powers of the Swiss Financial Market Supervisory Authority (FINMA) for banks are closely aligned with the Financial Stability Board (FSB) Key Attributes of Effective Resolution Regimes for Financial Institutions. In response to the 2008 financial crisis, Switzerland introduced a "Too Big To Fail" (TBTF) regime which relies on two components: strict going-concern capital and liquidity requirements; and a framework for the orderly resolution of systemic banks. Several recommendations from the 2014 FSAP have since been implemented resulting in a stronger legal framework. Most striking, however, is the absence of a resolution funding mechanism in the current framework.

An explicit early intervention framework addressing material qualitative supervisory concerns is lacking. While such a framework should not prevent the FINMA from tailoring decisions to individual situations, a written framework would enhance timely interventions, while adhering to the principles of proportionality and equal treatment under the law. Although FINMA's pertinent divisions meet frequently, there is no formal policy in place describing which, when, and how relevant information must be exchanged. The operational modalities for information exchange and cooperation should be documented to enhance timely recovery and resolution interventions.

FINMA has spent considerable resources to operationalize the RRP framework with the focus on the two G-SIBs, but more needs to be done to enhance resolvability. Since 2016, a dedicated Recovery and Resolution Division (GB-R) bundles pertinent expertise that had been scattered among different divisions. The authorities made significant early progress by requiring that the two G-SIBs restructure themselves under non-operating holding companies and issue bail-inable bonds to support a 'single point of entry' (SPOE) resolution strategy. This year, the two G-SIBs will finalize their Swiss emergency plans, and preparations are well advanced to operationalize bail-in. However, FINMA has yet to complete the G-SIBs' (group) resolution plans and remove several critical obstacles to resolvability. The Crisis Management Group's (CMG's) roadmaps to remove resolvability impediments by end-2021 is welcomed and should be accelerated.

RRP requirements need to be intensified for all types of banks. First, as a key part of the forward-looking promotion of resiliency, FINMA will need to do more in-depth work and allocate more resources on recovery planning of the five SIBs. Second, Recovery and Resolution Planning (RRP) requirements should apply to a wider set of banks than the five SIBs that are legally subject to RRP. FINMA has established simplified resolution plan requirements for nine other banks on a particular occasion but those plans were relying on public and supervisory data only and these banks were not subjected to recovery planning. All banks should be required to prepare recovery plans respecting proportionality and based on FINMA guidelines, and FINMA should prepare resolution plans for certain non-SIBs. Priority should be given to start recovery and resolution planning to banks with insured deposits over and above the CHF 6 billion DIS cap. Third, to enhance resolvability, FINMA should have the power to require all banks that are subject to resolution planning to revise their legal and operational structure.

The SNB should issue policies and procedures to provide Emergency Liquidity Assistance (ELA) to any bank that could be deemed systemic under certain circumstances. Currently, hardly any information on ELA requirements and procedures is publicly available; which hampers non-SIB preparation for ELA.

While some improvements are under discussion, the DIS must be thoroughly reformed, including bringing it into the public sector and enhancing its mandate supported by ex-ante funding. The deposit insurer, esisuisse, is a privately run, ex-post funded, narrow pay-box scheme, which is not compliant with international standards. esisuisse cannot be used to fund resolution measures, such as a transfer of deposits to another bank. The authorities should introduce an ex-ante funded DIS with a target level based on a thorough risk-and-financial-needs analysis—the cap of CHF 6 billion should be abolished—complemented by government backstopping. To make the deposit insurer a member of the safety net and national crisis management committee, it should become a statutory public institution without active bankers on its board. The reforms that the authorities are considering will not address these concerns.

The resolution framework should be supported by an ex post resolution funding mechanism. The framework does not foresee resolution funding other than from the firm and its shareholders and creditors. While changing esisuisse's mandate along the lines noted above would provide a new funding source, the funding will be limited, and it will take time to build up the deposit insurance fund. The authorities should therefore establish a funding mechanism, allowing ex post recovery from the banks of temporary public financing to facilitate the resolution of a firm.

Systemwide contingency planning and crisis preparedness must be advanced. A national contingency plan, including crisis communication, is missing. Such a plan should be prepared and updated by the Committee on Financial Crises and be discussed and approved by the members of the Steering Committee. In addition, a crisis communication plan should be drafted to ensure that the agencies speak with "one voice" during the crisis using the same facts and assumptions. The authorities should test their readiness with financial crisis simulation exercises.

Table 1. Switzerland: Main Recommandations

No.	Recommendation	*	**
	Early intervention and recovery planning		
1	Establish an explicit early intervention framework to address material supervisory concerns (FINMA; ¶15)	MT	M
2	Formalize operational modalities for information exchange and cooperation between pertinent divisions (especially for supervision and for recovery and resolution) to ensure advance recovery and resolution preparations (FINMA; ¶15)	ST	M
3	Define formal policies for recovery planning, including proportionality criteria (FINMA; ¶17)	ST	M
4	Require recovery plans from all banks respecting the principle of proportionality, starting with banks which have insured deposits above CHF 6 billion (Federal Department of Finance (FDF)/FINMA; ¶17)	ST	M
5	Prioritize more in-depth work and dedicate more attention and resources to recovery planning, particularly for the banks targeted in recommendation #4 (FINMA; ¶18)	ST	H
	Resolution powers and planning		
6	Formalize the resolution planning requirement for non-SIBs and require them to provide information for the planning process (FDF, FINMA; ¶27)	ST	H
7	Accelerate the resolvability of all five SIBs by identifying and removing impediments to resolution (FINMA; ¶32)	ST	H
8	Empower FINMA to require banks to make changes in their legal and operational structure to enhance their resolvability (FDF; ¶33)	ST	H
9	Strengthen the operational resolution framework with manuals for each resolution power, including the bridge bank tool (FINMA; ¶25)	MT	M
10	Elevate the provisions of the FINMA Ordinance on the Insolvency of Banks and Securities Dealers (BIO-FINMA) into statutory law to enhance legal certainty as currently under discussion (FDF; ¶19)	MT	H
	Deposit insurance and resolution funding		
11	Establish a DIA as a public entity with a statutory mandate, and exclude active bankers from participating in its board (FDF; ¶41)	ST	H
12	Give the DIA a pay box plus mandate, allowing it to fund resolution measures, subject to safeguards (least cost test) (FDF; ¶41)	ST	H

Table 1. Switzerland: Main Recommandations (Concluded)

No.	Recommendation	*	**
	Deposit insurance and resolution funding		
13	Replace the cap of CHF 6 billion and introduce an ex-ante deposit insurance fund with a minimum target level sufficient for simultaneous payouts in case of the failure of several midsize banks, supplemented by back-up funding from the government (FDF; ¶41)	ST	H
14	Prescribe in law a seven-day payout deadline for protected deposits, starting from the closure of the bank (FDF; ¶41)	ST	M
15	Make the two exempted deposit-taking institutions formal DIS members (FDF; ¶41)	ST	M
16	Require banks to produce a single customer view, subject to regular mandatory audits, and regularly test payout capabilities (FDF/FINMA; ¶41)	ST	H
17	Regularly measure public awareness levels of the DIS to assess the effectiveness of public awareness activities, refining these as needed (esisuisse; ¶41)	MT	H
18	Establish a resolution funding mechanism in line with the FSB Key Attributes relying on a pay box plus mandate for the DIA and ex post recovery from the banks of the costs of providing temporary public financing to facilitate bank resolution (FDF; ¶42-43)	ST	H
	Official financial support (including ELA)		
19	Broaden the set of eligible ELA collateral to include other non-marketable instruments (for example, corporate loans), while SNB retains full discretion which collateral to accept (SNB, ¶47)	ST	M
20	Issue guidance on ELA requirements to make ELA available at short notice—and at the SNB's discretion—to other banks than the five SIBs, particularly the banks targeted in recommendation #4 (SNB; ¶47)	ST	M
21	Simulate the SNB's internal procedures and coordination with FINMA for the application and execution of ELA, including to non-SIBs (SNB/FINMA; ¶46)	MT	M
	Contingency planning and crisis management		
22	Under the oversight of the Steering Committee for Crisis Management, advance crisis preparedness with (i) a national contingency plan; (ii) a national crisis communication plan, and (iii) regular multi-agency financial crisis simulation exercises, complemented with cross-border exercises, particularly with CMG members (FINMA/SNB/FDF; ¶50)	ST	M
23	After establishing a public DIA, make it a full member of arrangements and activities for crisis management and preparedness (FINMA/SNB/FDF; ¶51)	MT	H

***** Timing: C: Continuous; I: Immediate (<1 year); ST: Short Term (1–2 years); MT: Medium Term (3–5 years)

****** Priority: H: High; M: Medium; L: Low

INTRODUCTION

1. This note reviews Swiss financial safety net and crisis management arrangements, including bank resolution. It summarizes the findings of the FSAP mission undertaken during January 23 and February 6, 2019.[1] The note focuses on the authorities' ability to deal promptly, efficiently, and effectively with failing and potentially failing banks, and their preparations for financial distress and crisis. The assessment is based on an analysis of existing legislation and documentation relating to the authorities' policies and procedures, the authorities' detailed responses to a questionnaire prepared before the mission, and on discussions with and representations made by the authorities and the private sector. The current framework was reviewed with reference to the FSB Key Attributes and the International Association of Deposit Insurers (IADI) Core Principles for Effective Deposit Insurance Systems (Core Principles). The note does not reflect a detailed, formal assessment of compliance with either standard.

2. This note focuses on the Swiss banking sector. Switzerland has a large and diverse banking sector and hosts two G-SIBs.[2] Total banking assets of CHF 3,300 billion are equivalent to about five times Swiss GDP. Switzerland is a global leader in private wealth management with a market share of more than a quarter of all global cross-border private banking. The two largest banks (Credit Suisse (CS) and UBS)—both designated as G-SIBs by the FSB—together represent 52 percent of total Swiss market share in terms of deposits and combined total global assets of 260 percent of GDP. Due to their international focus, roughly two-thirds of their balance sheet comprises foreign assets. The authorities have designated five SIBs: In addition to CS and UBS, these are PostFinance; Raiffeisen Group; and Zürcher Kantonalbank. The total assets of the three domestic SIBs in aggregate are CHF 513 billion, about 80 percent of Swiss GDP. There are 24 larger regional and cantonal banks, which are significant although not individually systemically important. 259 small regional banks are focusing on traditional retail activities, mostly mortgage finance, within specific geographical regions, as well as private banking and wealth management activities.

3. Since the 2014 FSAP, FINMA initiated ordinary insolvency proceedings against two banks and withdrew another bank's license.[3] It also intervened in three more cases after concluding that the relevant firms were under imminent risk of becoming non-viable and worked with shareholders and management to return the banks to viability.

[1] This note was prepared by Jan Philipp Nolte, IMF senior financial sector expert.

[2] FINMA keeps lists of all authorized institutions in its webpage: https://www.finma.ch/en/finma-public/authorised-institutions-individuals-and-products/. An overview of the structure of the banking sector in Switzerland can be found in this publication of the SNB: 'Banks in Switzerland 2017.'

[3] As the two banks were rather small (with secured deposits of about CHF 20 and 36 million) and their business model not focused on consumers which would have been in immediate need of reimbursement there was no observable negative impact on depositor confidence in the safety net despite long reimbursement processes executed by the two liquidators.

INSTITUTIONAL FRAMEWORK

4. Switzerland's framework for crisis management and financial safety nets comprises four institutions, of which one, esisuisse, plays a very limited role. The SNB, FINMA, and the FDF are official agencies while esisuisse is a self-regulatory body. The institutional arrangements are well established. Roles, responsibilities, accountabilities and information sharing arrangements are generally well defined. The SNB, FINMA, and the FDF have a Memorandum of Understanding (MOU) in place which details information exchange as well as cooperation for crisis management purposes. esisuisse is not incorporated into these system-wide arrangements, but it has a bilateral memorandum with FINMA.

5. The SNB is the monetary authority and lender of last resort. It has an explicit mandate to contribute to financial stability. The SNB, in consultation with FINMA, determines whether a bank is systemically important and for applying to the Federal Council for the countercyclical capital buffer. It also determines and oversees systemic financial market infrastructures (FMIs). SNB does not exercise any bank supervision or resolution functions. It does assess the emergency plans of systemically important banks from the perspective of its lender of last resort function. SNB and FINMA have a bilateral MOU providing for regular meetings and information sharing in the areas of assessment of the soundness of the SIBs and the banking system and to discuss views on regulations that have a major impact on the soundness of banks.

6. FINMA is both supervisory and resolution authority. It is responsible to protect the functioning of financial markets; to supervise the banking, insurance, and securities sectors, using a principles-based approach; and FINMA is also—if not formally designated as such[4]—the resolution authority for licensed entities and systemic FMIs. In 2016, FINMA established a recovery and resolution division, GB-R, pooling pertinent expertise that had been scattered throughout FINMA. The division is responsible for recovery and resolution planning and international cooperation thereof, the approval of emergency plans drawn up by the SIBs. It intervenes and accompanies restructuring efforts of a problem bank, manages resolutions and conducts (or monitors if delegated to a third person) the liquidation of banks under the insolvency law. It is also responsible for all tasks concerning the Swiss DIS. GB-R has a staff of about 25 full time equivalents (FTE) but can draw on support from other divisions (especially banking supervision). The head of the division is a member of the FINMA Executive Board and reports directly to FINMA's CEO.

7. The Federal Department of Finance (FDF) is responsible for financial stability policies and relevant laws and ordinances. The head of the FDF is member of the Swiss Federal Council which can make use of broad emergency powers in a financial crisis. The State Secretariat for International Finance represents Switzerland's interests in financial, monetary and tax matters. The State Secretariat is also responsible for implementing the Federal Council's financial market policy.

[4] Although the FINMASA attributes resolution powers and tools to FINMA, it does not explicitly designate it as resolution authority (see KA 2 and its essential criteria) while it does designate the FINMA as a supervisory authority (for example Art. 4 FINMASA).

8. esisuisse, a self-regulatory body, provides protection for deposits booked in Switzerland up to CHF 100,000 per depositor and per bank. The deposit insurer operates under a narrow pay box mandate and is ex-post financed. It would only become active if the insured depositors cannot be compensated fully out of the remaining liquidity in the failed bank. The payout of insured deposits is not done by esisuisse but executed by the liquidator under supervision of FINMA.

9. Since the Global Financial Crisis, the two G-SIBs have strengthened their resilience by implementing a number of measures under the Swiss "Too big to fail" (TBTF) regime (the regime is outlined in more detail in Appendix 1). The regime consists of two components: First, stricter going-concern capital and liquidity requirements to strengthen resilience of systemically important banks. Second, a resolution framework providing for orderly resolution by giving FINMA resolution powers and tools at hand to deal especially with SIBs. In addition, SIBs are required to have sufficient loss-absorbing capacity in a gone concern perspective. These measures are especially designed with the objective that no public funding is needed in the event of a crisis.

EARLY INTERVENTION AND RECOVERY PLANNING

A. Early Intervention

10. FINMA enjoys a broad range of enforcement and early intervention powers to deal with problem banks. It is empowered to act at an early stage to address unsafe and unsound practices that could pose risks to creditors and the banking system through a range of corrective measures. The tools include ordering action to restore compliance with the law and precautionary measures up to the withdrawal of license, liquidation and bankruptcy. FINMA makes use of these powers as documented, for example, in its public annual enforcement report, which provides insight into its enforcement practice using anonymized case studies.

11. FINMA can act to restore a bank's compliance with supervisory requirements when it becomes aware of a violation or other irregularities (Art. 31 Financial Markets Supervision Act [FINMASA]). It is empowered to issue rulings ordering any proportionate measure necessary to address a problem. The measures are not limited to a defined catalogue and they can be used to address relatively minor noncompliance issues up to serious breaches. FINMA has discretion in deciding which corrective measures are required to restore compliance. Depending on the nature of the violation or irregularity, FINMA can impose conditions on the organization or internal processes of the bank concerned, temporarily or permanently restrict business activities, require capital injections and restrict or suspend payments to shareholders.

12. FINMA can appoint an investigating agent within the institution that breaches the law (Art. 36 FINMASA).[5] The agent is not limited to verify ("investigate") facts but can also be empowered by FINMA to implement and execute FINMA's supervisory measures, to explore

[5] FINMA should be judicious in the use of special agents because of potential contagion and deposit runs if the act has to be publicized.

restructuring options or to replace the management bodies to act on their behalf or the entity. The agent is an external, but suitable qualified person which FINMA chooses from a list of pre-approved candidates. His costs are borne by the supervised entity.

13. FINMA can order protective measures under the BA (Art. 26 BA). The triggers for action include that reasonable grounds exist to expect that (i) the institution is over-indebted; (ii) has serious liquidity problems; or (iii) does not fulfill the capital adequacy requirements after a deadline set by FINMA.[6] As measures, FINMA can (i) issue instructions to the bank's governing bodies; (ii) appoint an investigator; (iii) strip governing bodies of their power to represent the bank and remove them from office; (iv) change the auditor; (v) limit the bank's business activities; (vi) forbid the bank to make or accept payments or undertake securities transactions; (vii) order a determent of payments or payment extension; or (viii) close down the bank. Precautionary measures are enforceable immediately and a court appeal would not suspend their effect.

14. FINMA has an internal escalation mechanism to move the responsibility for a problem bank from the supervision division to GB-R. When regulatory and supervisory non-compliance is discovered, FINMA's Bank Supervision Division addresses these and requests from the Executive Board corrective actions. The supervision division would intensify supervision when the bank enters into a crisis situation. As soon as there is an imminent threat of insolvency or if for a SIB the recovery triggers are met, responsibilities would shift to the recovery and resolution division. A formal decision for this transfer of responsibility is made by a committee of which the FINMA CEO, the responsible division head responsible for the distressed bank, and the head of GB-R are members. After the transfer, GB-R would be responsible to further evaluate the bank's financial status, monitor closely its actual financial and operating figures (e.g., by imposing advance and more frequent reporting duties), and take protective measures. GB-R would also support a bank-led restructuring while internally preparing resolution options, including liquidation. The transfer and the involvement of GB-R usually takes place six months before resolution measures need to be taken.

15. The early intervention process has been used effectively in the past, but an explicit early intervention framework addressing material qualitative supervisory concerns is lacking. While such a framework should not prevent FINMA from tailoring decisions to individual situations, a written framework would enhance and institutionalize timely intervention—independent from the persons that are involved—while adhering to the legal principles of proportionality and equal treatment. The lack of clarity in the law with respect to the triggers and type of measures that supervised entities might be subject to increases the probability of legal challenges in the courts and could also generate supervisory forbearance whereby application of more intrusive measures may be timidly applied or delayed avoiding the inherent legal risks. As far as possible, the law should ensure that some guidance is given regarding two elements: triggers; and type of measures. These should be crafted as flexible as possible, striking a balance between an ample margin of discretion for FINMA in the use of its powers while ensuring legal certainty on the types of measures to be

[6] According to Art. 63 Ordinance on Banks and Saving Banks (BO), this is the case for a systemically important bank if the eligible CET 1 capital falls below 5 percent of the risk weighted positions or if a bank is holding less than the minimum required capital set out in Art. 42 (1) and (2) CAO.

applied and the triggering elements to be used. Furthermore, FINMA's pertinent divisions meet frequently in committees or for bilateral exchanges, but there is no formal policy in place describing which, when, and how relevant information must be exchanged between pertinent divisions. The operational modalities for information exchange and cooperation should be documented to enhance the timeliness of recovery and resolution interventions.

B. Recovery Planning

16. Only the five pre-designated SIBs are required to maintain recovery plans and FINMA has yet to outline its general expectations for recovery planning. GB-R has approved all five plans with the involvement of the supervision division which are now subject to regular annual updates. While for the first assessment of recovery plans, FINMA—as with other aspects of its financial oversight—engaged external audit firms; it now reviews them without external support. The assessment is informed by international guidance (among others, from the FSB, European Banking Authority (EBA), Bank of England). FINMA has issued to each SIB individual guidance for recovery planning, outlining the plans' main components and the bank's governance over the plan. Banks have incorporated the plans in their governance and risk management frameworks. However, it has yet to formalize in a policy document its general recovery planning expectations and requirements.

17. FINMA should define its own recovery plan guidance and ask all banks to prepare plans. The guidance should ensure that the impact of the scenarios for recovery planning is consistent across banks while the scenarios themselves are firm specific. Recovery plans are most useful if they focus on institution-specific tail-risks that threaten the viability of a particular bank. Supervisory guidance should therefore focus on the type of scenarios (market-wide and idiosyncratic; slow-moving and fast-burn etc.) and the severity of their impact, rather than prescribe uniform scenarios across banks. The requirement should be rolled out to all banks, prioritizing banks with insured deposits over and above the CHF 6 billion DIS cap. Recovery planning should respect proportionality criteria, based on banks' size, complexity, and interconnectedness.

18. To enhance the resiliency of the five SIBs, FINMA should do more in-depth work on, and allocate greater resources to recovery planning. To advance the banks' emergency plans and resolution preparedness, FINMA prioritizes resolution planning (with four FTE), while dedicating less than one FTE to recovery planning—out of a total 25 FTE. Recovery plans help to ensure that banks avail themselves of a variety of alternatives to withstand financial distress and have detailed procedures and requirements for triggering recovery measures. Recovery planning and measures are critical in preventing banks from entering resolution; FINMA should dedicate more resources for recovery planning.

RESOLUTION POWERS AND PLANNING

A. Resolution Powers

19. FINMA has a range of bank resolution powers, including liquidation, that are closely aligned with the FSB Key Attributes (KA 3). The resolution framework is established under the BA,

and the Banking Insolvency Ordinance (BIO-FINMA) applies to all banks (systemic and non-systemic) and to group parent companies of a financial group or conglomerates as well as group companies that carry out significant functions. Several recommendations from the 2014 FSAP concerning the legal framework have been implemented resulting in a stronger legal basis for the resolution framework. Further statutory revisions are under discussion, which will enhance legal certainty as provisions will be elevated from a FINMA ordinance to a federal law (Box 1). The revisions are welcomed.

Box 1. Switzerland: Reform of the Bank Resolution Framework since the 2014 FSAP

The authorities have addressed key concerns raised by the 2014 FSAP, including:

- The resolution framework's scope now includes (non-bank) group holding companies as well as non-regulated operational entities.
- Bail-inable bonds are required to be issued in Switzerland and governed by Swiss law.
- FINMA has explicit statutory powers to (i) write down or convert debt in resolution; (ii) to stay early termination rights; and (iii) to exchange information for resolution related purposes with foreign authorities involved in the restructuring and resolution.

The FDF launched a public consultation in March 2019 on further revisions in the BA to strengthen the resolution framework.[1] A key aim is that certain provisions that are currently regulated at ordinance level (BIO-FINMA) are to be incorporated into the BA in order to provide greater legal certainty when implementing resolution measures, including:

- Establishing the sequence of the bail-in measure ("bail-in waterfall") in primary law and regulating the tool in more detail;
- Limiting the rights of new shareholders after a bail-in for a specified amount of time;
- Detailing the content of the restructuring plan;
- Limiting legal action of affected shareholders and creditors against resolution decision,
- Addressing compensation for written-down shareholders in certain cases;
- Giving explicit statutory authority to FINMA to depart from *pari passu* treatment of creditors when exercising resolution powers; and
- Allowing FINMA not to publish protective measures if publication would defeat the purpose of the resolution.

Amendments to the DIS which are discussed later will be part of the same legal package and are expected to enter into force in 2020.

[1] A draft of the consultation document was shared during the mission. A cursory review with the published version did not reveal any differences in the proposed legal amendments.

20. FINMA's GB-R is responsible to assess whether or not the bank is failing, likely to fail, or non-viable (Article 26 BA).[7] The triggers are clearly specified and afford FINMA the ability to initiate resolution when the firm is no longer, or likely to be no longer, viable. However, FINMA should specify the resolution triggers further in internal policy documents to ensure resolution measures are triggered early. FINMA can resolve a bank through a resolution decree, of which the so-called "restructuring plan" is the major part. The plan must be based on a prudent valuation of the bank's assets, loss-absorbency first by shareholders, respect the creditor hierarchy, and aim to ensure that creditors are likely to be better off from the resolution than from liquidation (no-creditor-worse-off principle). Consequently, the bank must comply with all licensing and regulatory requirements after the resolution has been finished. As soon as FINMA approved the plan, it becomes enforceable; no shareholder approval is necessary, and, in the case of systemic banks,[8] the creditors cannot reject the restructuring plan. For non-systemic banks, and when the restructuring plan intervenes with creditor rights, the creditors have the right to reject the plan within a deadline set by FINMA. When a majority of creditors object to the transfer of assets and liabilities or bail-in of creditors under a restructuring plan, the bank would be placed in liquidation. This limitation for the resolution of non-systemic banks is needed to safeguard property rights of the creditors.

21. FINMA can make use of the following resolution powers and tools:

- Remove and replace the governing bodies of the bank or a financial group or issue instructions to these bodies;
- Appoint an administrator ("restructuring agent");
- Impose the continuity of important services on the relevant entities;
- Transfer assets, liabilities and contracts to other legal entities or to a bridge bank;
- Establish a bridge bank;
- Establish a separate asset management vehicle;
- Temporarily stay the exercise of early termination rights; and
- As a last resort to prevent insolvency, order a compulsory conversion or a write-down of debt (bail-in) to ensure that banks can continue to operate and safeguard financial stability.[9]

[7] FINMA may initiate resolution measures against a bank if it finds the bank to be (i) under justified concern of over-indebtedness, (ii) non-compliant, upon prior notice by FINMA, with regulatory capital provisions, or (iii) experiencing severe liquidity problems (Art. 25 BA).

[8] A bank can be determined as being systemic at the time it is likely or likely to fail, but this determination would need to be made by the SNB in consultation with FINMA. Such determination could be made on short notice.

[9] As part of the reform package described in Box 1, it is planned to drop the "last resort" requirement.

22. FINMA's preferred resolution strategy for the two G-SIBs is the single point of entry (SPOE) bail-in at the group holding level. The two G-SIBs are required to hold additional funds in the form of bail-inable bonds to allow for the implementation of the strategy.[10] To count as additional funds the bonds have to be issued by the group holding company, be subject to Swiss law and jurisdiction and be subordinate to the issuer's other liabilities.[11] The strategy for the domestically focused SIBs varies but generally also involves a recapitalization through the conversion of gone concern capital which they have to build up as of 2019.[12] Apart from the general resolution principles mentioned above, a bail-in cannot include secured, privileged (including insured deposits), and off-settable claims. Before any conversion, share capital must be completely written down and CoCos (AT1), T2 debt and total loss-absorbing capacity (TLAC) must be converted or written down as well. FINMA and the two G-SIBs have undertaken preparatory steps to ensure that the bail-in mechanism is operational, for example, through drafting the necessary legal documentation, entering into contracts, and drafting playbooks with central security depositories and the Swiss stock exchange SIX to ensure that bail-in bond holders can be identified, and how old shares can be canceled, and new shares delivered into the accounts. Bail-inable bonds held in the U.S. requires further discussions with the U.S. authorities to understand U.S. processes and requirements in the context of a bail-in ordered by FINMA.

23. FINMA is the sole authority that may initiate liquidation proceedings against a Swiss bank. As one resolution option, FINMA can revoke the license and order liquidation based on modified insolvency procedures set out in BIO-FINMA. When initiating insolvency proceedings, FINMA appoints a liquidator under its supervision to take charge of liquidating the failed bank's assets and pay out its liabilities; FINMA may also carry out—in rare cases—the liquidator's duties itself. Once the liquidator is appointed, FINMA limits its role to their coordination and supervision. The supervision includes on-site visits and audits. FINMA can also give binding orders to the liquidator. FINMA was able in a recent case to sell assets including insured deposits from the liquidation estate to an acquiring bank quickly after the bank was closed.

24. FINMA exercises resolution powers without any ex-ante court involvement. While the approval of the restructuring plan can be challenged in court, this would not suspend resolution measures; courts may only award compensation. The courts cannot suspend, or delay resolution actions taken. However, FINMA's actions are subject to ex post judicial review. The Federal Administrative Court as the competent court of first instance can review both the legal prerequisites and the appropriateness of the decisions taken by FINMA.

25. FINMA should continue to operationalize the resolution framework. Since the 2014 FSAP, FINMA has spent considerable resources to operationalize the resolution framework and to

[10] Both G-SIBs had issued roughly CHF 65 billion in bail-inable bonds by end-2018. The majority (about 90 percent) is issued in USD and to U.S. institutional clients. Only a small part of bonds is sold to Swiss institutional clients thereby likely limiting contagion. Both institutions have an internal policy not to sell these bonds to retail customers.

[11] Art. 126a CAO.

[12] Domestically focused D-SIBs are since 1 January 2019 subject to comparable requirements; but they must only maintain 40 percent of the going concern requirements as additional loss-absorbing capacity.

execute the preferred resolution strategy for the two G-SIBs through a bail-in. FINMA has created playbooks and other documentation, such as a draft restructuring plan as well as templates and timelines for resolution. To strengthen the overall operational resolution framework FINMA should establish manuals for all resolution powers, particularly for the bridge bank tool, which raises questions of governance (ownership) and licensing requirements which should be discussed and decided in advance.

B. Emergency Plans and Resolution Planning

26. FINMA has yet to establish resolution plans for all SIBs which are the only banks subject to this requirement. FINMA has issued individual guidance to banks which specifies the information they have to submit to FINMA for resolution planning. In practice, banks do not only provide information and data but also concrete resolution options and scenarios while FINMA retains full authority about the content of the resolution plan and the incorporation of the information received. FINMA has no internal general policies and guidelines on resolution planning. FINMA is also in charge of the global resolution plans of the two G-SIBs. FINMA has established a first iteration of these plans which need to be completed and operationalized in the next three years. Annually, banks are required to submit information and data for resolution planning, or when requested by FINMA.

27. All banks that could become systemic under particular circumstances should be required to provide FINMA with pertinent resolution planning information. FINMA has drafted simplified resolution plans for nine category-3-banks without being legally required to do so.[13] The plans were drafted as a desk-top exercise, based on public information or supervisory information, without any input from or interaction with the banks. In general, FINMA should further expand resolution planning to banks with insured deposits over and above the CHF 6 billion DIS cap and other banks that could be systemic in a systemic-wide crisis. The resolution planning requirement for these banks should be formalized and they should be legally required to provide FINMA all information for the planning process.

28. The SIBs are required to submit to FINMA so-called emergency plans for their Swiss operations and businesses.[14] The plans lay out how the uninterrupted operation of systemically important functions or entities for Switzerland can be maintained in the event of insolvency.[15] The emergency plans can therefore be seen as a fallback plan, in case the resolution plans fail—the latter aim to prevent insolvency through an orderly resolution. The fact that banks first started to work on these plans made them an important source for FINMA's resolution planning and their

[13] Category 3 comprises of middle-size cantonal banks and larger regional banks, in total 24 banks. Category 1 and 2 comprise of the two G-SIB and the three domestically focused SIBs.

[14] For the two G-SIBs, the requirement only covers the two Swiss banks of the groups (UBS Switzerland AG and Credit Suisse Schweiz AG), which contain the systemically important functions for Switzerland.

[15] The BA gives the SNB the authority to designate not only banks, but also bank functions as systemically important. The identified functions are mainly the domestic deposits and lending activities as well as domestic payment transactions.

implementation also helped increase the groups' resolvability. FINMA is responsible for the definitive assessment and approval of the emergency plans. It examines whether (i) the continuation of the systemically important functions is technically and organizationally ensured, (ii) the legal and financial relations within the group do not obstruct the continuation of these functions, (iii) capital and liquidity planning foresees sufficient capital and liquidity to carry on the functions and implement the plan, (iv) the existence of suitable processes and infrastructure as well as human resources to operate the functions, (v) the intra-group agreements related to the continuation of the functions which have to be recorded, and (vi) if the emergency plan is compliant with relevant foreign laws and regulatory requirements. Emergency plans must be updated annually.

29. None of the five SIBs has an approved emergency plan. A first round of emergency plans from the three domestically focused D-SIBs was reviewed and FINMA asked all three institutions to improve their plans and address deficiencies. When reviewing the draft plans, FINMA concluded that more was needed to ensure the uninterrupted continuation of systemically important functions. The main obstacles for the three domestically focused banks, is the lack of gone concern capital for the resolution strategy set out in the emergency plan. For the two G-SIBs, FINMA found that the strong operational interdependencies and financial ties between Swiss subsidiaries and other group companies complicated the implementation of emergency plans. The emergency plans of the two G-SIBs are required by the BO to be finalized in 2019.

30. FINMA can require banks to make changes in the legal and operational structure based on deficiencies identified in the emergency plan. FINMA undertakes a kind of "resolvability assessment" when assessing the SIBs' emergency plans. When it concludes that a plan is insufficient, FINMA sets a deadline for the bank to remove the impediments before it makes use of its power. These powers include the creation of an independent legal entity in Switzerland to which to transfer the systemically important functions or the adjustment of the bank's legal and operational structure. The bank has a right to appeal against FINMA's decision. So far, FINMA has not made use of its power as SIBs have implemented changes (for example, the establishment of a holding structure) based on supervisory dialogue and the incentives of the TBTF regime's rebates.

C. Resolvability Assessment

31. FINMA has implicitly the power to assess the SIBs' resolvability. Additionally, FINMA conducts resolvability assessments in line with the agreed FSB process for its G-SIBs (Resolvability Assessment Process (RAP)). FINMA applies the FSB Resolvability Assessment template and asks the G-SIBs first to establish a self-assessment. Then, FINMA scrutinizes the self-assessments to inform its own conclusions in preparation of the RAP letters to the FSB chair. Both G-SIB's resolvability has been improved through organizational measures, including a non-operational holding company heading the groups. This structure supports the SPOE resolution strategy. In addition, the two G-SIBs have established separate service companies to ensure that critical services can continue to support critical business activities in resolution and are not impeded by the failure of one or more group entities.

32. Further progress is needed to improve overall resolvability of all five SIBs. For the two G-SIBs, FINMA has agreed with the other CMG members to address the open issues within the next three years based on a roadmap to remove resolvability impediments by end-2021. This work should be accelerated. Outstanding resolvability impediments include the following:

- Resolution funding plans setting out how to deal with the resolution funding needs in a resolution which cannot be covered by shareholders and creditors (bail-in), especially maintaining adequate group liquidity, timely and sufficient liquidity during resolution and the cross-border transferability of surplus liquidity;
- Sufficiency of loss-absorbing including surplus capacity on a stand-alone basis at the level of material group and the parent bank entities (internal TLAC) which perform systemically important functions for the whole group (such as key business operations or central liquidity management);
- The further reduction of financial and operational dependencies within the group;
- The access to FMIs while in resolution;
- Speedy valuation processes and reporting capabilities to determine the no-creditor-worse-off test and capital needs to restructure a bank after a bail-in;
- Resolution challenges rising from the specific legal form of some D-SIBs (the state-owned Zürcher Kantonalbank with an explicit guarantee from the Zurich Canton and the cooperative structure for Raiffeisen including intra-group guarantees); and
- The current lack of gone-concern capital for the three domestically focused D-SIBs which they only must start to build up from this year.

33. Contrary to Swiss emergency plans, there is no explicit power to authorize FINMA to require changes in the legal and business structure or operations of a bank to enhance resolvability. Existing legislation provides FINMA to grant rebates as an incentive to make G-SIBs improve their resolvability. This incentive is the only "soft power" FINMA has to improve resolvability. In line with the KA, FINMA's powers should be strengthened in this respect, authorizing FINMA to adopt appropriate measures to reduce the complexity and costliness of resolution to explicitly enhance resolvability. This power should apply to all banks subject to resolution planning (including the nine-plus category 3 banks).

DEPOSITOR INSURANCE AND RESOLUTION FUNDING

A. Deposit Insurance

34. The Swiss DIS has a unique set-up with a deposit insurance agency (DIA) that lacks critical elements of the IADI Core Principles. The framework to protect deposits is designed to limit the need for a DIA (that is, esisuisse) and rely on its resources for some form of back-up

funding only if the remaining liquidity in a failed bank (which is usually high due to special provisions) is insufficient to reimburse all insured depositors. The reimbursement process itself, which is usually a key competence of any DIA, is carried out by the liquidator who is using the closed bank's employees and infrastructure. esisuisse's role is limited to raising public awareness for the DIS and to collect ex-post contributions from its members as well as to handle information requests from depositors in case of bank failure.

35. esisuisse is a privately-run system operating under a narrow pay box scheme. It cannot be used to finance resolution measures, such as a transfer of deposits to another bank. esisuisse is set up as a Swiss association and is mainly self-regulated with the Banking Act setting out some key parameters such as the level and scope of coverage and a cap of CHF 6 billion. esisuisse's self-regulations are subject to FINMA's approval. All licensed banks and securities dealers (in total 302 members) in Switzerland are esisuisse members,[16] and all deposits of natural persons and legal entities booked in Switzerland up to CHF 100,000 are preferred and insured. There are two non-bank deposit-taking institutions which are not members.[17]

36. esisuisse's Board of Directors comprises mainly active bankers from its member institutions. The Board has 13 non-executive members, of which at least four must be independent individuals (i.e., they must not be employed by, be a board member of, or in any other way be connected to a bank or securities dealer). The board members have contracts of mandate which contain rules that aim to prevent potential conflict of interest. To further reduce any conflicts of interest, FINMA shares the name of a bank that is going to be liquidated, only with the Executive Board, consisting of the CEO and COO. The articles of association of esisuisse, which must be approved by FINMA, prohibit that the Board of Directors is given the name of the bank but is only notified about a possible pay-out case and the size of the contributions expected from esisuisse. Since the 2014 FSAP, esisuisse has been separated from the Swiss Bankers Association and has now its own offices and IT infrastructure; esisuisse has also increased the headcount.

37. esisuisse does not raise ex-ante contributions from its members and banks' overall contribution are subject to a cap of CHF 6 billion. It would only collect the necessary funds to pay out insured depositors if the failed bank's estate would be insufficient. The BA grants priority payment of available funds to insured depositors in liquidation which, in an ideal scenario, might avoid the need for extra funding through esisuisse.[18] To ensure sufficient liquidity, the BA requires banks to hold assets in Switzerland in the amount of 125 percent of the so-called preferred deposits, which include insured deposits.[19] FINMA (or the liquidator appointed by FINMA) is responsible for

[16] This includes 248 banks and 46 securities dealers; 8 members are in the process of discontinuing their business activities (as per 31 December 2018).

[17] COOP, the second largest retailer, and the Federal Employees Savings, which is part of FDF.

[18] Preferential deposits (including insured deposits) are paid out as first creditor class claims in bankruptcy after secured claims (Art 35 BIO-FINMA).

[19] Other preferential deposits which are not insured deposits are, for example, deposits in employee benefits foundations and deposits booked with foreign branches of Swiss banks (Art. 37a (6) BA).

determining and making payouts "immediately," but there is no statutory payout period. In practice, payouts have taken over a month. The BA caps the maximum amount (i.e., the total for all deposit insurance calls) all banks together are obligated to contribute to esisuisse at CHF 6 billion.[20] The system does not have a public backstop. To ensure ex-post funding can be quickly provided, the BA requires esisuisse members to hold ready 50 percent of their maximum contribution obligation as special liquidity; this aims to enable esisuisse to provide the liquidator with funds within the 20 working days.[21] Recovery rates have usually been high.

38. The ex-post funding mechanism, combined with the system-wide cap of CHF 6 billion, and the lack of a formal back-up arrangement could leave doubts that the DIS would always be able to fulfill its mandate. It is uncommon for DIS members' contributions to be capped. A deposit insurance fund must have a target level for the minimum amount of funds to be collected over time from banks. If in a payout case this amount is insufficient, the government usually provides backup funding in form of a loan to the DIS, which is repaid with ex post DIS levies on banks. In Switzerland, however, taxpayers would have to carry the burden of an insufficiently funded DIS, which is against the key principle that the cost of deposit insurance should be borne by its members. It is understood that a DIS cannot deal with systemic banks and system-wide crises, which emphasizes the importance of an effective resolution framework, including resolution planning. Twelve Swiss banks have insured deposits of more than CHF 6 billion. These banks which are "too big to fail" for the DIS should also be subject to regular resolution planning.

39. In March 2019, the Swiss authorities started public consultations of amendments to the BA for DIS reform. The authorities consider the DIS an integrated system including esisuisse, FINMA, and the liquidator, with different members of the safety net being in charge of DIS components. For example, FINMA participating in the crisis management framework and the liquidator reimbursing depositors. According to the authorities' interpretation, IADI CPs, in particular CPs 2, 4, and 6, do not require that the "deposit insurer" be a single authority or entity. Accordingly, the authorities are of the view that the Swiss DIS is in conformity with the IADI Core Principles.

[20] The current ceiling of CHF 6 billion correspond to 1.33 percent of insured deposits. As of 31 December 2017, the total amount of insured deposits was CHF 450 billion. The Federal Council has the power to raise the ceiling if "special circumstances warrant it" (Art. 37h (4) BA).

[21] FINMA monitors if banks fulfill the conditions through the annual auditing process. In addition, members must grant esisuisse a corresponding direct debit authorization.

Box 2. Switzerland: Planned Reform of the Deposit Insurance System

In March 2019, the Swiss authorities started public consultation of amendments to the BA for DIS reform.[1] In 2010 a reform proposal which proposed a nationalized deposit insurance scheme with an ex-ante fund, back-up funding from the government and a target level of CHF 10 billion was withdrawn by the government after the public consultation. The following changes are under discussion:

- Partial ex-ante DIS funding: 50 percent of the banks' maximum contribution would be collateralized by securities or cash held at SIX for esisuisse; the remaining 50 percent would be ex-post financed.
- The CHF 6 billion cap would be replaced by a dynamic cap at 1.6 percent of insured deposits but not less than CHF 6 billion. Because of the growth in insured deposits, the cap's coverage has fallen significantly from 2.4 percent of insured deposits in 2006 to 1.4 percent today.
- A seven-day payout period starting when the liquidator receives payout instructions from the depositor. The liquidator would be required to send notice to all insured depositors "immediately."
- A mandatory single customer view identifying insured deposits, banks would also be required to have the necessary infrastructure and procedures to support the seven-day payout period.
- esisuisse would be required to provide funding (if needed) within 7 days.
- Notably, the proposals do not foresee a change in the mandate and the institutional set-up or the division of labor between esisuisse, FINMA and the liquidator.

While the reforms under consideration would be an improvement, they would not fully align the Swiss DIS with the IADI Core Principles and international best practice:

- Under the new model, the deposit insurance fund would not be fully ex-ante funded and remain without any cash component (Core Principle (CP) 9); it is also debatable if pledged assets which remain in the banks' ownership and control would be perceived from the public as ex-ante funding.
- The Core Principles do not foresee a DIS cap—rather, target levels are a minimum; a cap breaches the principle that banks should bear the funding responsibility for the DIS (CP 9, Essential Criteria 2).
- The proposed payout period and modalities—typically triggered when the bank is closed, and depositors lose access to their deposits (CP 15)—would not be consistent with the Core Principles. Under the proposals, the payout period could take considerably longer than seven days because it would depend on how quickly the liquidator can inform depositors, how quickly the depositors respond to the liquidator, and how quickly the notifications are delivered (postal service).
- Depositors would still not have a legal claim against the DIS to be reimbursed when their bank fails.
- Preparation will be key to meet a short payout deadline. Under the Swiss DIS, esisuisse is the public face without any role in preparing or executing payouts; the liquidator does the payouts but does not regularly monitor banks' payout capabilities in peace time; and FINMA is the only authority to enforce and test banks' payout capabilities. This system will make meeting the new requirements challenging.

[1] A draft of the consultation document was shared during the mission. A cursory review with the published version did not reveal any differences in the proposed legal amendments.

40. While the reforms under consideration would be an improvement, they would not fully align the Swiss DIS with the IADI Core Principles and international best practice (Box 2). Notably, the authorities' proposals do not reform esisuisse's mandate and governance. In an effective and IADI-compliant system, the DIA exercises the deposit insurance functions without dividing these over various agencies.[22] Core Principle 6 also prescribes that the DIA be a full member of crisis management arrangements—irrespective of its mandate—which would give the DIA access to highly confidential information. As esisuisse's private-sector nature and board composition with active bankers prevents it from being included in the Swiss crisis management arrangements, CP6 implies that the Swiss DIA should be a public entity without active bankers on the board. Moreover, the DIA should be allowed to finance resolution measures, for example, a transfer of insured deposits which is more cost effective than a payout and allows depositors to have uninterrupted access to their deposits.

41. The authorities should include the following in the reform proposals:

- The DIA should be established as a public-sector entity, performing a statutory mandate without any active bankers participating in its board;
- The DIA should have a pay box plus mandate, allowing it to fund resolution measures, subject to safeguards (the least-cost test);
- There should be no DIS cap—neither a static (CHF 6 billion), nor a dynamic (1.6 percent) cap;
- Ex-ante funding should be introduced with a target level that would be sufficient to payout insured depositors in the case of a simultaneous failure of several midsize banks,[23] supplemented by back-up funding from the government;
- The law should set the payout deadline at seven working days, triggered by the failure of the bank (inability to repay depositors or license revocation);
- Banks should be required to produce a single customer view (as foreseen under the current proposal), subject to regular audits to ensure compliance and tests to ensure timely payout;
- The two-exempted deposit-taking firms should become regular DIS members; and
- Public awareness levels of the DIS should be regularly assessed by esisuisse and communication campaigns should be undertaken to raise these levels.

[22] IADI CP2, Essential Criteria (EC) 4 states that the DIA's powers should include, among others: (a) assessing and collecting premiums, levies, or other charges; (b) transferring deposits to another bank; (c) reimbursing insured depositors; and (d) obtaining directly from banks timely, accurate, and comprehensive information necessary to fulfil its mandate. esisuisse does none of this.

[23] For purposes of this note, mid-size banks are the 10–15 banks—out of the over 300 banks in Switzerland—just below the level of banks with a SIB designation.

B. Resolution Funding

42. The resolution framework should be supported by an ex post resolution funding mechanism. Switzerland does not have a separate resolution fund or a resolution funding mechanism in place which would cover the cost of resolution or compensation and these funding would therefore need to come from the government as during the last crisis. The authorities advised the FSAP that it is a deliberate policy to reduce moral hazard and rule out bail-outs. The FSB Key Attributes (KA 6.3) call for a resolution funding mechanism which could either be a bank-financed deposit insurance or resolution fund, or a funding mechanism for ex post recovery from the banks of the costs of providing temporary financing to facilitate resolution. While changing esisuisse's mandate and funding models as noted above would provide a new funding source, this would be limited, and it would take time to build up the new ex-ante fund; moreover, DISs are not expected to deal with SIBs or a systemic crisis.

43. An ex-post funding mechanism seems to be therefore the best way to ensure that taxpayers do not have to pay for the costs of a bank resolution and to address moral hazard concerns. Such mechanism would be consistent with the Key Attributes and the Swiss government's policy preferences. An ex post resolution fund would enable the authorities to allocate public funds to resolution and trigger a mechanism to recover those funds from the banks at a later stage. For this approach to work, a few conditions must be met. First, a procedure to determine that failing financial institutions are systemic, and that temporary public funds are needed to preserve financial stability, would have to be established in advance. Second, the mechanism to ensure that public funding becomes available at short notice also would have to be established. And third, there would have to be a legal mechanism linking the temporary support from the authorities to the recoveries from the firms' stakeholders and creditors and, if necessary, from the wider banking complete industry via levies (KA 6.2), phased in as appropriate to mitigate procyclicality. In all cases, the appropriate authority to provide the temporary public funding would be the government, not SNB.

OFFICIAL FINANCIAL SUPPORT (INCLUDING ELA)

A. Official Financial Support

44. The framework does not explicitly establish arrangements for exceptional support, but the Federal Council could use broad emergency powers during a financial crisis. The authorities are of the view that any ex-ante defined government guarantee would distort market incentives and could lead to moral hazard. The Federal Constitution authorizes the Federal Council in exceptional circumstances to issue ordinances for extraordinary measures.[24] These could include official support

[24] The Federal Council can issue ordinances "in order to counter existing or imminent threats of serious disruption to public order or internal or external security" (Art. 184 (3) and Art. 185 (3) of the Federal Constitution).

for banks to avoid a financial crisis and preserve financial stability. During the last financial crisis, the Federal Council made use of these powers in order to recapitalize UBS AG with CHF 6 billion.[25]

B. Emergency Liquidity Assistance

45. The SNB acts also as the lender of last resort.[26] The SNB can—but is not obliged to—provide emergency liquidity assistance (ELA). It can provide ELA for one or more domestic banks if they are no longer able to refinance their operations on the market. The decision is made by the Governing Board of SNB. In order to qualify for ELA, the following conditions must be met:

- The domestic bank or group of banks seeking credit must be important for financial stability.
- The bank seeking credit must be solvent, for which the SNB obtains an opinion from FINMA.[27]
- The liquidity assistance must be fully covered by sufficient collateral at all times. The SNB determines what collateral is sufficient. Eligible collateral are Swiss residential mortgages and securities (both subject to specific eligibility criteria). The ELA has no formal limit regarding its volume, provided that there is sufficient collateral.
- Liquidity can be provided in CHF or main foreign currencies.

46. ELA arrangements are in place with the five banks that the SNB has designated as SIBs. The SNB has undertaken significant preparations together with the five SIBs to enable it to take mortgages as collateral. Annually, the SNB tests their capability to select and transfer eligible collateral to the SNB; the banks test their systems more frequently. Since the 2014 FSAP, SNB has not received any requests for ELA, but once requested ELA could be provided within a day. As bail-in—FINMA's preferred resolution strategy—would aim to restore a bank's solvency, the SNB would be able to provide ELA also to a bank in resolution. SNB should simulate periodically the internal procedures and cooperation with FINMA for the application and execution of ELA.

[25] To rescue UBS, the SNB provided also about CHF 60 billion to move toxic assets from the bank into an SPV.

[26] LOLR/ELA for financial institutions are governed by the Federal Act on the Swiss National Bank. According to the Act, one of SNBs tasks is to contribute to the stability of the financial system (Art. 5). Art. 9 of the Act contains the instruments the SNB may use for fulfilling its tasks. One of these instruments is "credit transactions with banks and other financial market participants on condition that sufficient collateral is provided for the loans." The accompanying Message of the Federal Council on the National Bank (see BBl 2002 6097, 6133) states that the SNB shall act as Lender of Last Resort and for this purpose may provide ELA. See also Section 6, page 6 of SNB's Guidelines on Monetary Policy Instruments for a description of its emergency lending assistance (ELA).

[27] Based on the information available from ongoing supervision such an opinion could be done on a short notice by FINMMA. FINMA can limit its solvency confirmation to a plausibility check on the bank's solvency assessment that it has submitted to SNB, Information exchange and coordination for the purpose of facilitating the provision of ELA are covered by the bilateral MOU between FINMA and SNB.

47. The SNB should issue policies and procedures supporting its authority to provide ELA to any bank that could be deemed systemic under certain circumstances. While no written or formal procedure exists, it appeared from discussions during the mission that SNB is able to do this relatively quickly on a discretionary basis. However, hardly any information on ELA requirements and procedures is publicly available (for example, the types of eligible collateral cannot be found on the SNB webpage), which hampers non-SIBs' preparation for ELA.[28] The SNB should issue guidance on ELA requirements and procedures, allowing non-SIBs to prepare and secure ELA if needed. The granting of ELA should remain at the SNB's full discretion.[29] SNB should broaden the set of eligible ELA collateral to include other non-marketable instruments (for example, corporate loans) and undertake steps to help banks to preposition this kind of collateral, conditional upon the SNB retaining full discretion to decide on a case by case basis which collateral to accept.

CONTINGENCY PLANNING AND CRISIS MANAGEMENT

A. Domestic Arrangements

48. The joint activities between the FDF, the SNB, and FINMA concerning crisis management are governed by a tripartite MOU.[30] This MOU governs the collaboration between the three authorities through the exchange of information on matters relating to financial stability and financial market regulation and cooperation in the event of a financial crisis. The objectives are to improve and strengthen the stability of the Swiss financial system, and to act during a crisis with the intention of taking due consideration of the impact of their actions on the sphere of responsibility of the other parties of the MOU and to coordinate crisis related activities. The MOU also states that the parties shall coordinate their communication during a financial crisis. In general, there are no restrictions on the exchange of information between the SNB, the FDF, and FINMA and various legal provisions require information sharing among them**.** FINMA and the SNB can share non-public information with each other and with the FDF. Other MOUs specify the information sharing. Collaboration between FINMA and the SNB to assesses and discuss the soundness of SIBs and the banking system is governed by a separate bilateral MOU.[31]

[28] An example for transparency on ELA requirements is the Canadian framework which can be found here: https://www.bankofcanada.ca/markets/market-operations-liquidity-provision/framework-market-operations-liquidity-provision/emergency-lending-assistance/

[29] While there is no international consensus on the appropriate communication strategy for ELA operations, it is best practice to disclose any bilateral ELA on an ex post basis. A delay of, for example, one year or more, or as long as necessary until public disclosure would not undermine policy objectives would be appropriate.

[30] MOU in the area of financial stability and the exchange of information on financial market regulation between the FDF, FINMA and SNB (January 2011),

[31] While the MOU from 15 May 2017 also covers contingency and crisis management as a common area of interest, no activities have been undertaken under this arrangement.

49. The tripartite MOU establishes two committees: A high-level Steering Committee and on a working level, the Committee on Financial Crises.

- The Steering Committee is responsible for the strategic coordination of the different authorities during a crisis. It comprises the Head of FDF (chair), the SNB Chairman, and the FINMA Chairman. The Committee does not have decision-making powers and serves as a platform for inter-agency cooperation. Meetings are held whenever necessary; in peacetime, the body is largely dormant.
- The Committee on Financial Crisis is responsible for coordinating preparatory efforts to allow for informed discussion during a crisis. It is chaired by the CEO of FINMA; other members are the State Secretary of the FDF, the Vice Chairman of the SNB, and the Director of the Federal Finance Administration (if, for example, state guarantees are needed during a crisis).[32] In peacetime, the committee meets once or twice a year to exchange information and views on financial stability and discuss issues of current interest in financial market regulation as well as resolution-related matters. Recently, the committee discussed the status of the emergency plans and the resolvability of the two G-SIBs, planned changes to the TBTF-framework, and the general state of the banking sector. The committee also decides if the Steering Committee needs to convene because of an imminent threat to financial stability.

50. Systemwide contingency planning and crisis preparedness must be advanced. While it may be difficult to predict the source of any future crisis, official responses to the crises are typically limited to a defined catalogue of actions, such as early intervention and recovery measures in a SIB, stemming a bank run, providing ELA, and resolution and liquidation. Effective contingency planning for such actions should be supported on a national level requires tools to monitor pertinent developments, awareness of policy and operational choices, and inter-agency cooperative arrangements between domestic and foreign agencies. Contingency planning and business continuity efforts undertaken by the different agencies need to be coordinated and synchronized in an overarching national crisis management plan to ensure complementarity. The plan should be prepared and updated by the Committee on Financial Crisis and be discussed and approved by the members of the Steering Committee. The authorities should make use of simulation exercises to test and enhance contingency plans. These simulations should include top-level staff and executives of the SNB, FINMA, and the FDF, and cover scenarios with institution specific-and systemic crisis elements. As part of the plan, the authorities should prepare a crisis communication plan, that the agencies speak with "one voice" during the crisis thereby using the same facts and assumptions. Contingency planning as well as a crisis communication plan are already foreseen as activities of the Committee on Financial Crisis in its "Organisationsreglement" but have not been put into practice yet; a crisis compendium from 2012 might be a useful basis for this work.

[32] FINMA chairs the committee unless measures under the control of the confederation or the SNB are to be discussed, in which case the FDF or the SNB may chair the committee.

51. When the DIA has become a public entity, it should fully participate in the arrangements and activities for crisis management and preparedness. There is no involvement of esisuisse in the crisis preparedness and management activities of the other safety net participants and the bodies which were set-up under the tripartite MOU. deposit insurer has signed a bilateral MOU with FINMA.[33] FINMA warns esisuisse in a "general nature" about a potential deposit insurance case informing about the number of protected depositors and its estimation of potential funding needs. It does not share information about problem banks or financial stability concerns and the MOU does not foresee any crisis related activities. The DIS needs to be reformed in this aspect, its funding model should be changed, and its mandate be expanded to allow it to provide for resolution funding (see above).

B. Cross-Border Arrangements and Cooperation

52. Crisis Management Groups (CMGs) are in place for both Swiss G-SIBs and are operational. Chaired by FINMA, both CMGs involve the relevant host authorities from U.S. and U.K. and the parties have entered into cross-border cooperation agreements (COAG) detailing the work of the groups.[34] SNB participates in the meetings in its role as lender of last resort. The CMGs prepare group-wide resolution strategies and plans for implementing them, assess impediments to resolvability (FSB Resolvability Assessment Process), and work towards a coordinated resolution. The CMG has prepared playbooks and organized table top exercises, which will be enhanced in the near future and should also include dry-runs going forward. FINMA organizes three multi-day meetings a year, convenes colleges and workshops, and exchanges information with CMG members or meets in a bilateral format under the year. Representatives of the two G-SIBs are also invited to relevant meetings (for example, to discuss the execution of a bail-in). In addition, FINMA exchanges information with authorities (supervision and resolution) from several additional host jurisdictions in the Asia-Pacific region which are not represented in the CMGs, but where the Swiss G-SIBs are not locally systemic, but which are core markets for the G-SIBs. FINMA does not participate as a host authority in other CMGs or non-G-SIBs coordination forums as the Swiss authorities do not consider the operation of such banks as systemically important for Switzerland. For the three domestically focused SIBs no cross-border coordination forums are maintained as their operations are mainly domestic.

53. The legal framework facilitates FINMA to cooperate broadly with foreign resolution authorities, courts and other bodies involved in restructuring and resolution and erects no material barriers to that cooperation. The framework gives FINMA administrative powers to recognize foreign resolution and insolvency measures which, when exercised, make those foreign measures effective in relation to a foreign bank's asset and liabilities in Switzerland without the need for court procedures. GB-R also conducts proceedings to recognize foreign bankruptcy decrees.

[33] MOU in the area of coordination and information exchange between FINMA and esisuisse (June 2017).

[34] In preparation for a potential Brexit, the two G-SIBs plan to move operations and assets from the U.K. to the EU. At least in one case (UBS), this might make the EU operations systemic and therefore subject to SSM supervision and SRB resolution which may have an impact on the membership in the CMG and cross-border cooperation in general.

Appendix I. The Swiss "Too big to Fail" Regime

1. Since the Global Financial Crisis, the two G-SIBs have strengthened their resilience by implementing a number of measures under the Swiss "Too big to fail" (TBTF) regime. The regime consists of two components: First, stricter going-concern capital and liquidity requirements to strengthen resilience of systemically important banks. Second, a resolution framework providing for orderly resolution by giving FINMA resolution powers and tools to deal with SIBs. In addition, SIBs are required to have sufficient loss-absorbing capacity in a gone concern perspective. These measures are especially designed with the objective that no public funding is needed in the event of a crisis.

2. The SNB, in consultation with FINMA, determines whether a bank is systemically important. This is determined by size, interconnectedness with the financial system and the economy and if the institution cannot be substituted at short notice. SNB takes into account various factors of both qualitative and quantitative nature. Among others, it uses criteria such as (i) the market share of systemically important functions; (ii) the amount of secured deposits that exceeds the deposit protection level of CHF 100,000; (iii) the ratio of the bank's total assets to Swiss GDP; and (iv) the bank's risk profile as determined by its business model, balance sheet structure, quality of assets, liquidity and debt-equity ratio. Functions are considered systemically relevant if they are indispensable to the Swiss economy and cannot be substituted at short notice (such as, for example, the domestic deposit and lending businesses).

3. Swiss capital requirements are consistent with Basel III measures and minimum requirements are higher than Basel minima. In 2016, the Swiss Federal Council amended the Capital Adequacy Ordinance (CAO). This amendment set out the new higher capital requirements for SIBs and introduced a new 'gone concern' requirement for G-SIBs in line with G20 standards and the FSB. Minimum going concern capital requirements for the two G-SIBs are 10 percent Common Equity Tier 1 (CET) plus an additional 4.3 percent of tier 1 capital. [1] In addition, the gone concern loss-absorbing capacity (GLAC) capital requirement for G-SIBs is 14.3 percent (before any rebate). Currently – including rebates associated with structural improvements to facilitate a SPOE strategy – the total loss-absorbing capacity (TLAC) requirement is roughly 26 percent. As of January 2019, and in taking into account the rebates granted by FINMA, both banks are already fully compliant with the requirement for gone-concern instruments under the TBTF regime.

4. The TBTF legislation provides for an incentive system in the form of rebates for the two G-SIBs when they improve their overall resolvability. FINMA can announce rebates on the additionally required loss-absorbing funds (as long as international standards and minimum requirements under the law are fulfilled); determined individually for the two G-SIBs in consultation with SNB. The decision is based on the effectiveness of banks' measures to improve the group's

[1] For the three domestically focused SIBs the RWA-requirement is between 12.86 and 13.22 percent.

global resolvability and the interdependencies between the different groups. These can be, for example, structural improvements and the dissolution of complex structures, financial separation to limit contagion, and separation of operational structures in order to secure the continuation of important operational services. The creation of a non-operating holding company for one G-SIB, the transfer of Swiss-based systemically important functions to separate service companies by both large banks and their compliance with loss-absorbing debt capacity requirements in the form of bail-inable bonds resulted in rebates. FINMA assesses the eligibility for rebates every year.

5. The Federal Council is required by law to evaluate the TBTF regime every two years. The evaluation's objective is to examine whether the regime's provisions are in line with the international standards, as well as to compare how the standards have been implemented abroad. The last evaluation report, adopted by the Federal Council in June 2017, concluded that the regulatory model does not need to be fundamentally adapted as it is suitable to reduce the risk of SIBs. However, the report recommended that reduced gone concern capital requirements should be extended to the three domestically focused SIBs.[2] The new rule came in force on 1 January 2019.

[2] The three domestically focused D-SIBs have only to fulfill 40 percent of the gone concern capital requirements applicable to CS and UBS as the authorities deem them to be less interconnected internationally, less complex and therefore less systemically important.