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International Briefings

Switzerland

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The resolution of Swiss systemically important banks

PARADIGM SHIFT FROM THE PROTECTION OF CREDITORS TO THE PRIMACY OF FINANCIAL STABILITY

However assiduously regulators try to prevent financial crises and bank failures, such events are bound to recur. The need for an enhanced bank resolution regime was blatantly demonstrated by the taxpayer-funded bail-outs of financial institutions in the financial crisis of 2007–2009. Against this background, the Financial Stability Board (FSB) spearheaded the development of new resolution tools. In 2011, it published the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes), a standard setting out the core elements of modern bank resolution regimes. The aim of the Key Attributes is to find a third way between the Scylla of a disorderly liquidation of systemically important banks (SIBs) and the Charybdis of an open-ended public financing of bailouts. As a consequence, the shareholders and creditors, instead of the taxpayers, shall foot the bill of bank failures. This amounts to a paradigm shift: while traditional banking regulation aims at protecting creditors, the Key Attributes clearly set out the primacy of financial stability and the protection of taxpayers.

With its two globally active major banks Credit Suisse and UBS and the three domestic systemically important banks PostFinance, Raiffeisen and ZKB, the resolution of banks is a particularly important issue for the relatively small Swiss jurisdiction. In the wake of the 2007–2009 financial crisis, Swiss banking regulation heavily built upon international standards. The Swiss Banking Act obliges the Federal Council (the highest body of the federal government) to periodically review Swiss SIB regulation regarding its compliance with international standards and to provide a report on the need for adjustments. Thus, Swiss banking regulation was elevated to an international level. However, national implementations of resolution planning and resolution tools differ still. The following paragraphs highlight some of the key regulations of the Swiss bank resolution regime.

STABILISATION, RESOLUTION AND EMERGENCY PLANNING

Swiss banking legislation sets out a dichotomy between SIBs and non-SIBs and requires that the systemically important functions of such banks be continued without interruption in a case of crisis. It stipulates the elaboration of the following planning instruments:

- **Recovery plan** (*Stabilisierungsplan*). This is a document drawn up by the concerned bank and approved by the resolution authority. It assumes a going-concern perspective and outlines the options the bank itself may take to ensure that it remains adequately capitalised and liquid without the need for government intervention in a stress scenario.
- **Resolution plan** (*Abwicklungsplan*). In contrast to the recovery plan, the resolution plan is elaborated by the resolution authority. It is concerned with a gone-concern scenario, ie when the bank passes the point of non-viability (PoNV) and enters into resolution proceedings. It contains information on the resolution options, such as a bail-in or a transfer of certain functions, and their implementation.
- **Emergency plan** (*Notfallplan*). The Swiss Banking Act demands that functions that are critical to the Swiss economy can be continued independently of the other parts of a failed bank. The overall aim of the emergency plan is to guarantee the uninterrupted continuity of these functions.

The elaboration of a recovery plan and a resolution plan are requirements in line with international developments. However, the emergency plan is a tool unknown to the Key Attributes or other international standards. Under the emergency planning provisions, the SIB is required to prove to the Swiss Financial Market Supervisory Authority (FINMA) that its structure, infrastructure, management and controlling as well as its intragroup liquidity and capital flows are designed in a way that allows the continuation of the bank's systemically important functions.

FINMA can impose any necessary measures if a systemically important bank fails to provide this proof. In practice, this gives considerable discretion to FINMA to influence a SIB's group structure and even order supervisory measures regarding non-financial entities within the banking group, such as service companies.

The resolution planning instruments described above must not be confused with the restructuring plan (*Sanierungsplan*). The latter is a decree with immediate legal effect upon approval by the resolution authority and implements the restructuring of a failed bank, for instance through a bail-in or break-up of the group.

FINMA'S RESOLUTION POWERS

FINMA acts both as supervisory authority and resolution authority. It can declare the non-viability of a bank in the following events:

- there is justified concern that the bank is over-indebted;
- there is justified concern that the bank has serious liquidity problems; or
- the bank no longer fulfils the capital adequacy provisions and fails to restore adequate capitalisation before the expiry of a deadline set by FINMA.

After FINMA has determined that the bank is non-viable due to one of the above reasons, it has the following procedural options:

- protective measures (such as a deferment of payments or closure of the bank);
- opening of restructuring proceedings and appointment of a restructuring agent; and, if there is no prospect of a successful restructuring,
- opening of bankruptcy.

Protective measures can be ordered independently of the opening of restructuring or bankruptcy proceedings. However, in the case of SIBs, the measures imposed must at least enable the uninterrupted continuance of the Swiss systemically important functions. In addition to protective measures or restructuring proceedings, FINMA can order a resolution stay on the termination of contracts and contractual netting, liquidation and transfer rights for up to two days.

In the event of a restructuring proceeding, FINMA has the power to impose losses on creditors by way of a bail-in. This means that certain liabilities of the bank are written down or converted to equity, subject to the condition that all creditors are better off than in the (hypothetical) immediate opening of bankruptcy proceedings.[1] In contrast to EU law, the old share capital must be fully wiped out and cannot merely be diluted. The Swiss regime excludes the bail-in of secured liabilities, offsettable liabilities, and liabilities privileged in bankruptcy (such as deposits up to CHF 100,000 and claims by employees and social insurances).

The single point of entry (SPoE) bail-in approach, in which only the top-tier non-bank holding company is subjected to restructuring proceedings and bail-in, is the preferred resolution approach for the two globally active Swiss SIBs.[2] In case this approach fails, FINMA has the fallback options of bailing-in creditors of group companies, breaking-up the group, and transferring assets, liabilities and contracts to other legal entities. It can be expected that a bail-in or break-up will be ordered combined with further organisational measures, including a replacement of the group's previous management.

FINMA's resolution powers are thus comparable to the resolution tools under the EU Bank Recovery and Resolution Directive (BRRD, 2014/59/EU), with its four key tools being the sale of business, bridge bank, asset separation and bail-in.[3]

Credit Suisse and UBS made significant efforts to adapt their structure and capitalisation to the SPoE bail-in approach. Both banking groups feature a top-tier non-bank holding company, a universal banking entity and a Swiss banking entity. It is less clear at this time how the domestic Swiss SIBs – each of the three having very distinct structures and properties – would be restructured in the event of their failure.

OPEN ISSUES AND OUTLOOK

One of the main issues of the current Swiss bank resolution regime is that only the most fundamental rules are set out in the Banking Act, while a great number of significant regulations are found on the ordinance level. In particular, the "bail-in cascade", ie the scope, sequence and scale of liabilities subjected to a bail-in, is only set out in the FINMA Bank Insolvency Ordinance. This is not sufficient to meet the requirements of the constitutional principle of legality: severe governmental interventions in private rights must be set out at the federal act level (ie a law enacted by parliament), and a bail-in undoubtedly amounts to such intervention.

Furthermore, the compensation of creditors and shareholders whose rights are unduly affected by resolution action is not entirely clear at present. The law states that these stakeholders may lodge an appeal against the restructuring plan with the federal administrative court and obtain compensation. However, the question of compensation is a difficult one. In contrast to the EU, Switzerland does not have any resolution funding arrangements in place. As the appeal must be taken against the approval of the restructuring plan by FINMA, it would be consistent that FINMA should compensate creditors and shareholders if their rights were unduly affected by the restructuring, eg if a creditor does not fare better than in the bankruptcy counterfactual. However, a liability of FINMA for resolution action would run against the objective of protecting taxpayers. Rather, a compensation of unduly treated creditors or old shareholders would have to be effected by issuing call warrants or other long positions in the restructured bank. This could occur by a court order obliging FINMA to allocate the compensation through an addendum to the restructuring plan. In any case, the grounds of such procedure are shaky under the current rules.

Moreover, Swiss insolvency law sets out a different ranking of liabilities in restructuring proceedings and in bankruptcy proceedings. In particular, uninsured and unprivileged deposits rank higher than senior debt in a bail-in, while they rank as ordinary senior debt in bankruptcy. This asymmetry may lead to difficulties with the "creditors better off" condition if a bail-in is implemented at the level of an operating bank.

A further issue to be resolved is the ranking of bail-in debt. In light of the Total Loss-absorbing Capacity (TLAC) regulations, which aim at pre-positioning loss-absorbency for resolution, Credit Suisse and UBS have issued bail-in bonds (external TLAC) whose claims accrue at the top-tier holding company level in the case of non-viability. Such claims are thus structurally (but not statutorily or contractually) subordinated. In addition, the banking groups have pre-positioned internal TLAC, which allows for a downstreaming of a recapitalisation by bail-in. Currently, TLAC instruments are not subordinated under Swiss law. As in other European jurisdictions, a proposal has been made to introduce a statutory subordination of instruments issued for loss-absorbency in resolution.

An amendment to the Banking Act, which includes a more detailed regulation of the bail-in cascade, the compensation of creditors, and certain other issues, is being prepared for consultation in early 2018. ■

1 This reflects the "no creditors worse off than in liquidation" test set out in the Key Attributes and the BRRD.
2 See the FINMA White Paper "Resolution of global systemically important banks" dated 7 August 2013, available at www.finma.ch.
3 For an in-depth discussion and comparisons of laws, see Yves Mauchle, *Bail-In and Total Loss-Absorbing Capacity (TLAC) – Legal and Economic Perspectives on Bank Resolution with Functional Comparisons of Swiss and EU Law*, Wolters Kluwer International Banking and Finance Law Series, vol. 32, Alphen aan den Rijn 2017.

Denmark

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Third country access

THIRD COUNTRY ACCESS UNDER MIFID II – AN INTRODUCTION

■As a result of harmonised requirements under MiFID, firms established in an EEA country benefit from the passporting regime which will continue under the coming MiFID II. In contrast, since EU regulatory and supervisory requirements do not apply to firms established in a country outside the EU (third country firms), such firms have not been able to benefit from the passporting regime, but have instead been subject to national requirements. To increase harmonisation, third country access under MiFID II is permitted and can be implemented at the discretion of each individual member state. The level of harmonisation depends on the type of client.

For example, third country access has been harmonised in relation to per se professional clients and eligible counterparties. Under MiFIR Art 46, a third country firm will be able to conduct cross-border services into the EU to per se professional clients and eligible counterparties provided that the firm is registered in the register of third-country firms kept by ESMA in accordance with Art 47.

Accordingly, it is also a requirement that the Commission recognises the regulatory and supervisory arrangements of that third country to be of equivalence to certain EU legislation – a so called "equivalence decision".

It is at the discretion of each member state as to whether to adopt national rules requiring third country firms to establish a branch from which the third country firm can provide investment services or activities with or without any ancillary services in the member state's territory to retail clients or elective professional clients in pursuance of MiFID II Art 39.

The following describes national licensing requirements adopted at the discretion of Danish legislators.

NATIONAL REQUIREMENTS ON THIRD COUNTRY ACCESS

Under the applicable s 33 of the Financial Business Act, Consolidation Act No. 174 of 31 January 2017 (in Danish: *Lov om Finansiel Virksomhed*) (Financial Business Act) a foreign credit institution or investment company that has been granted a licence in its home jurisdiction/a non-EEA country is required to obtain a licence from the Danish Financial Supervisory Authority (Danish FSA) to carry out activities or perform services with securities trading in Denmark. The application procedures are set out in Executive Order No. 979 of 4 December 2003. In addition to this, such firms may establish a branch pursuant to Executive Order No. 842 of 6 September 2005.

On 30 May 2017 the Danish Parliament adopted amendments to the Financial Business Act. The purpose of the amendments was, among other things, to implement MiFID II Art 39, as Danish legislators decided to opt in to the provision in order to ensure an appropriate level of protection. The Danish FSA has issued Executive Order No. 918 of 26 June 2017 pursuant to the new s 33(5) of the Financial Business Act.

The amendments to the Financial Business Act and the executive order will enter into force on 3 January 2018, implying that the two executive orders from 2003 and 2005 respectively will be abolished.

Retail clients and elective professional clients

Consequently, a third country firm which provides activities related to securities trading to retail clients and elective professional clients will henceforth be required to establish a branch under the new ss 33(2) and 33a of the Financial Business Act. The requirement is triggered when the firm or any of its personnel approach the respective types of clients in Denmark with a view to offering them investment services and activities.

The application procedure is provided in s 33a(2)–(5). The obligation to provide information and the grant of authorisation represent implementation of the procedures and requirements set out in MiFID II Arts 40 and 41.

The Danish FSA allows six months from submission of a complete application to let applicants know whether or not authorisation has been granted.

Per se professional clients and eligible counterparties

As stated above, MiFIR partly harmonises third country access, and a third country firm may provide cross-border investment services and investment activities into the EU to per se professional clients and eligible counterparties provided that: