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The proposed 'Too Big to Fail' legislation in Switzerland.

As an important financial centre, Switzerland has also been affected by the global financial crises in 2007 and 2008. As a result and in line with global standards, Switzerland has introduced its own 'Too Big to Fail' legislation. This legislation has certain defects, as Lukas Glanzmann and Theodor Härtsch of Baker & McKenzie Zurich highlight below.

The financial crisis of 2007 and 2008 has clearly shown that the failure of one (or even worse, two) of the large Swiss banks would seriously threaten the Swiss economy. Generally, the large Swiss banks are perceived as too big to fail and, at the same time, too big to be rescued. Therefore, the Swiss parliament approved a revision to the Swiss Federal Act on Banks and Savings Institutions on 30 September 2011 with the aim of strengthening the stability of the financial sector.

On 5 December 2011, the Swiss Federal Council published its proposed amendments to the Ordinance on Banks (SBO) and the Capital Requirements Ordinance (CRO), thereby further implementing the 'Too Big to Fail' legislation. Systemically relevant financial intermediaries are subject to specific capital maintenance requirements as set out in arts 123aet seqq of the CRO. Accordingly, they need to have a base capital of 4.5% of their risk-weighted assets (RWA), which shall consist of common equity tier 1, ie, either share capital or retained earnings (CET1). Furthermore, systemically relevant financial intermediaries need to maintain a buffer component of 8.5% of their RWA. At least 5.5% of this buffer component shall again consist of CET1 (art 123f CRO). Up to 3% of the RWA can also be maintained in the form of contingent convertibles (CoCos) subject to the condition that they are converted into CET1 if such CET1 falls below the 7% threshold. This mechanism shall ensure that the CET1 is at all times at least equal to 10% of the RWA, even though CET1 may temporarily fall below such threshold (art 123f para 2 CRO). Furthermore, they are required to build a progressive capital component in the form of CoCos, which are converted into CET1 if and when the CET1 falls below 5% of the RWA (art 123g CRO). Art 123cet seqqCRO set out the conditions to be fulfilled by CoCos and similar instruments in order to count as capital for capital maintenance requirements. In addition, the proposal of the Swiss Federal Council includes a leverage ratio (currently approximately 5% of the unweighted assets) (art 123jet seqqCRO). Finally, art 123m CRO provides for more stringent risk concentration provisions for systemically relevant banks.

In addition to these proposed changes, the draft contains detailed regulations regarding the organisation of systematically relevant financial intermediaries. In particular, they must prepare a contingency plan for the maintenance, without interruption, of systemically relevant functions for the Swiss market in case of an impending insolvency (art 21 SBO). The contingency plan relates only to systemically relevant functions in Switzerland. Each financial intermediary concerned has a certain amount of discretion as to the specific design of its contingency plan. The SBO does not contain any favoured solutions, such as a spin-off of such functions. There are three alternatives, namely: the transfer of such functions into a separate legal entity; the formation of a fully licensed entity, into which such functions shall be transferred if the contingency plan is activated; or, entering into qualified agreements with third parties regarding a takeover of such functions.

The plan must be approved by the Swiss Financial Market Supervisory Authority (FINMA), and FINMA has the right to reject contingency plans it considers ineffective (art 21a SBO). One of the key problems is, however, that FINMA will not be in a position to take into account all obstacles when approving a contingency plan. It will be sufficient if FINMA comes to the conclusion that a contingency plan most likely allows a spin-off of systemically relevant functions without any interruption, thereby creating a certain degree of legal uncertainty among customers and market participants.

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