

Banking - Switzerland

New FINMA guidance on changes to depositors' protection system

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Introduction

The Swiss Financial Market Supervisory Authority (FINMA) recently circulated a complete draft revision of the Ordinance on the Bankruptcy of Banks and Securities Dealers. The review was deemed necessary as a result of a series of amendments to the Federal Banking Act regarding the protection of depositors.

The amendments to the act were developed in response to the global financial crisis which began in 2008. To this end, immediate measures were adopted by the Federal Parliament in 2008 and extended in 2010. The provisional measures applied from December 20 2008 until the introduction of amendments to the Federal Banking Act in September 2011.

Initially, the new depositors' protection was meant to be part of a new Act on the Guarantee of Bank Deposits. The draft act provided more comprehensive protection for depositors, but during the 2009 consultation process it was rejected by the Swiss banking industry, most of the political parties and the Swiss cantons.

Current situation

The 2011 amendments to the Federal Banking Act implemented five major changes for depositors' protection.

Maximum amounts for preferential deposits

Article 37a(1) of the Federal Banking Act stipulates that deposits of up to Sfr100,000 for each client enjoy preferential treatment. In other words, each client, regardless of the number of deposits, enjoys preferential treatment for up to Sfr100,000. This extends to all client deposits, including those made with foreign branches of Swiss banks or securities dealers (at least for immediate payment, see below).

Coverage of preferential deposits

Banks and securities dealers must permanently hold assets located in Switzerland equal to 125% of all preferential deposits held by the respective bank or securities dealer. However, FINMA can grant, by special request, temporary as well as lasting exceptions to the coverage requirements.

Immediate payment of preferential deposits

In case of bankruptcy, FINMA will define on a case-by-case basis the amount of preferential deposits to be reimbursed immediately without any offsetting of claims and regardless of the ordinary schedule of claims.

Maximum gross amount covered by Deposit Protection Scheme

Banks must contribute up to Sfr6 billion towards the Deposit Protection Scheme. The scheme is intended to compensate preferential deposits which cannot be immediately satisfied by the bank's liquid assets in case of bankruptcy. It functions on an *a posteriori* basis – the financing is provided by other banks only after depositors' claims are made.

Special treatment for pension schemes

Pension scheme accounts are covered by a different system from the privileged deposit system. A client may assert the privileged deposit and his or her rights under the pension scheme, even if the accounts were held at the same bank and thus together exceed the privileged deposit threshold. However, the pension scheme claims are

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privileged only with regard to the bankruptcy of the bank, and do not benefit from deposit protection.

Exclusion of non-nominative deposits from preferential deposits

The 2011 revision introduced an amendment noticed by few banks during the legislative process: preferential deposits include deposits held nominally on behalf of the depositor, but not numbered accounts or bearer deposits.

In 2010 the government explained that this would facilitate the work of the insolvency authorities and avoid duplicate preferential treatment. It considered the identification of creditors of numbered accounts to be complicated and time consuming, while the preferential deposit framework requires deposits to be reimbursed in the shortest possible time. Moreover, the incorrect attribution of deposits may lead to duplicate preferential treatment since the limit of Sfr100,000 applies to each client, rather than to each deposit.

This amendment attracted no special attention during the revision process; its consequences were understood only in December 2011 and surprised the Swiss financial industry.

Revision of Ordinance on the Bankruptcy of Banks and Securities Dealers

The Ordinance on the Bankruptcy of Banks and Securities Dealers is to be renamed the Ordinance on the Insolvency of Banks and Securities Dealers.

The draft confirms the interpretation of the government's Federal Banking Act by providing that claims which do not reveal the beneficiaries' names (in particular, pseudonym and numbered accounts) do not count as deposits and will not be classed as preferential.

In addition, FINMA can inform preferential depositors affected by a bankruptcy through a public announcement, rather than writing to them personally.

Comment

The amendments to the Federal Banking Act do not completely achieve the objective of full protection for depositors set by the government in the wake of the global financial crisis.

In the event of a bank's insolvency, the amended depositor protection buffer of Sfr6 billion is too low. In Switzerland, seven banks already have preferential deposits of more than Sfr6 billion each, and the two largest banks hold preferential deposits in excess of Sfr55 billion.

The exclusion of numbered accounts from preferential deposit status is unjustified. The Anti-money Laundering Act provides that banks must know the beneficial owners of deposits, even those under numbered reference or pseudonym. The risk of duplicate preferential treatment is therefore minute, if not non-existent, as banks possess systems permitting them to make the link between any creditors and clients quickly. The objective of increased depositor protection, as set out by the amended Federal Banking Act, is jeopardised by the unnecessary exclusion of these numbered deposits.

In contrast, the exclusion of bearer deposits from preferential treatment may be justified as banks do not know the identity of their beneficial owners.

In the course of the revision of the Federal Banking Act, a draft Act on the Guarantee of Bank Deposits was prepared, but was shelved after the economic sector reacted with scepticism. However, the draft provided some key measures to re-establish confidence in the financial sector.

The most important measure was the replacement of the *a posteriori* financing of the Deposit Protection Scheme by a two-level guarantee system. The first level was the Deposit Guarantee Fund, which would have been funded by bank contributions and sureties. The fund was intended to reach 3% of the privileged deposits in capital. The second level was an explicit state guarantee or advance, compensated by premiums paid by banks. The state guarantee or advance was intended to ensure payment of preferential deposits in case the fund ever ran out.

Unfortunately, the withdrawal of the draft Act on the Guarantee of Bank Deposits means that the *a posteriori* financing of the Deposit Protection Scheme will continue. This type of financing is particularly vulnerable in the event of a systemic crisis.

It is unlikely that the two-level guarantee system will be reconsidered as part of the 'too big to fail' bill, which amends the Banking Ordinance and the Capital Adequacy Ordinance, implementing the new global regulatory standard of Basel III. However, this option could be reconsidered in the future.

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