

Banking - Switzerland

Protection of deposits with banks and savings banks

Contributed by [Meyerlustenberger Lachenal](#)

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Introduction

The recently published position paper by the Swiss Financial Market Supervisory Authority (FINMA) regarding the resolution of global systemically important banks⁽¹⁾ and setting forth FINMA's strategy of a single point of entry bail-in for large Swiss banks in financial distress has raised some concerns among the public (mainly in online forums and blogs) about the potential impact of a single point of entry bail-in on deposits held with affected banks. However, these concerns are not well founded since there is no negative impact - in particular, not for small savers - by a potential bail-in.

First, in a bail-in the hierarchy of creditors must be observed. A bail-in requires the prior cancellation of existing shares and other regulatory capital, including that obtained through the conversion of contingent capital instruments. Subordinated claims follow, then all other claims; only as a last resort are unsubordinated and unsecured claims converted into new equity capital of the affected bank. Conversely, deposits with preferential treatment – deposits in the name of the investor (including medium-term notes) – to an amount not exceeding Sfr100,000, as well as certain deposits by vested benefits foundations, also up to a maximum of Sfr100,000 per creditor, are explicitly excluded from a bail-in.

Second, deposits in the name of the investor (including medium-term notes) to an amount not exceeding Sfr100,000, as well as certain deposits by vested benefits foundations, also up to a maximum of Sfr100,000 per creditor, are protected by the Swiss deposit protection system, aiming to protect small depositors in order to omit a bank run. This deposit protection system will remain applicable.

Deposit protection system

Based on Article 37a and following of the Federal Act on Banks and Savings Banks, Swiss law has implemented a privately operated deposit protection system based on three pillars. When protective measures (pursuant to Article 26(1)e to h) or a liquidation procedure (pursuant to Articles 33 to 37g) are ordered against a bank, savings bank, stock exchange or Swiss securities dealer is started, the three pillars are:

- preferential treatment;
- accelerated pay-out; and
- guarantee by the deposit protection scheme.

Preferential treatment

Pursuant to Article 37a, deposits in the name of the investor (including medium-term notes) that are deposited with the affected bank (held with branches of the affected bank in or outside Switzerland) in the name of the investor to an amount not exceeding Sfr100,000, as well as certain deposits with the affected bank by vested benefits foundations, also up to a maximum of Sfr100,000 per creditor, are treated preferentially.

Preferential treatment means that the respective deposits will be allocated to the second class of the schedule of claims pursuant to Article 219(4) of the Debt Enforcement and Bankruptcy Act and thus ranked by law above all other unsecured (and unsubordinated) claims against the affected bank, which is advantageous.

Such deposits with preferential treatment are deemed to be:

Authors

[Christophe Rapin](#)



[Alexander Vogel](#)



[Christophe Pétermann](#)



- balances on accounts held in the name of the affected bank's clients;
- medium-term notes held in the name of the bearer at the issuing bank;
- restricted pension deposits;
- contributions of vested benefits foundations; and
- deposits held at foreign branches of the affected bank.

Based on Article 37a(6) of the Federal Act on Banks and Savings Banks, banks must permanently hold domestically backed claims or other assets located in Switzerland to an amount of 125% of their deposits with preferential treatment. Due to the 125% rule, all deposits with preferential treatment must be covered by assets held in Switzerland. This aims to ensure that there is sufficient asset coverage for the claims of all creditors in the first and second class of the schedule of claims (see Article 219 of the Debt Enforcement and Bankruptcy Act). It also means that assets must be held in Switzerland that are equivalent to the deposits of the clients holding deposits with preferential treatment in Switzerland with the institution in question (plus a reserve of 25%).

Accelerated pay-out

Based on Article 37b, deposits with preferential treatment in accordance with Article 37a (1) – deposits in the name of the client (including medium-term notes) not exceeding Sfr100,000 per client (held with branches of the affected bank in or outside of Switzerland) – are further protected by an accelerated pay-out mechanism.

Provided that the estate of the affected bank has sufficient liquid assets, which should in most cases be ensured due to the 125% rule, the accelerated pay-out deposits held at branches in or outside Switzerland will be paid out immediately, without any offsetting of claims and before the ordinary schedule of claims has been established.

Guarantee by deposit protection scheme

In the event that accelerated pay-out deposits cannot be paid out immediately by the affected bank due to a lack of available liquid funds, the deposit protection scheme implemented through the Swiss Banks' and Securities Dealers' Depositor Protection Association, operating under the name esisuisse, kicks in and guarantees accelerated pay-out deposits held with branches of the affected bank in Switzerland to the extent the affected bank's immediately available liquid assets fall short of the aggregate amount of all accelerated pay-out deposits, provided that the maximum amount to be covered by the deposit protection scheme for affected banks is Sfr6 billion.

Accordingly, the following deposits are guaranteed by esisuisse up to a maximum of Sfr100,000:

- balances of private individuals, commercial enterprises and institutions of public law (eg, personal accounts, savings accounts, investment accounts, salary accounts, deposit accounts and current accounts in Swiss francs or another currency); and
- medium-term notes held in the name of the bearer at the affected bank.

These guaranteed deposits are treated the same – there is no preference amount of the various types of deposit. However, the deposit protection scheme covers deposits held only at branches in Switzerland of any affected bank. Further, deposits which are not held in the name of the investor are not guaranteed, even if the affected bank knows the identity of the investor.

Self-regulation

esisuisse

In accordance with Article 37h of the Federal Act on Banks and Savings Banks, banks with guaranteed deposits are required to be a member of the system of self-regulation of banks in order to ensure the repayment of guaranteed deposits within 20 working days of the introduction of measures pursuant to Article 26(1)(e-h) of the act or the start of an involuntary liquidation procedure pursuant to Articles 33 to 37g. Based on this provision of the act, the Swiss Banks' and Securities Dealers' Depositor Protection Association, an association based on Swiss law, was founded by bank and securities dealers in Basel in 2005 with the aim of implementing the self-regulation measures laid down in Article 37h.

The association operated under the brand esisuisse in 2012. All banks (including foreign banks) that have a branch in Switzerland are required by law to participate in the self-regulating deposit protection scheme. The same applies to securities dealers, provided that they are headquartered or have a branch in Switzerland.

Guarantee mechanism

If a bank or securities dealer in Switzerland becomes insolvent, the other participating members of esisuisse will immediately provide the required funds to cover any shortfall in an affected bank's liquid assets available to satisfy the aggregate amount of all accelerated pay-out deposits up to a maximum of Sfr6 billion. This collective scheme

ensures that the clients of such an affected bank have their guaranteed deposits paid out to them within one month (subject to the maximum amount of the guaranteed shortfall of Sfr6 billion).

However, esisuisse does not have funds of Sfr6 billion permanently available. It must request and collect contributions from its participating members based on the concluded agreement with all participating members. This agreement ensures payment within 20 working days after receiving notification from FINMA pursuant to Article 37i. Based on this agreement, esisuisse is entitled to order from its participating members the amounts (up to a total of Sfr6 billion) that they must pay after receiving notification based on Article 37i. This system ceiling of Sfr6 billion means that contributions by participating members (excluding interest) will at no point exceed the specified limit. The system ceiling thus does not apply per claim, per affected bank or for a particular time period, but is the maximum amount guaranteed by participating members. This amount decreases as the banks and securities dealers make payments and then increases again when the assets realised as part of the bankruptcy proceedings are returned to the banks and securities dealers or as these claims have to be written off after an affected bank has been fully liquidated.

Where payments are made under the deposit protection scheme, the claims of the clients resulting from guaranteed deposits are assigned by operation of law to esisuisse, including the privileged ranking in the schedule of claims. The participating members are entitled to reimbursement of their contributions at a later date when the affected bank's liquidation proceeds are distributed. esisuisse is obliged – based on the contract with its participating members – to transfer all proceeds out of the estate of the affected bank to the participating members and thus repay the contributions made by the participating members.

State guarantee

Swiss law does not provide a state guarantee for the deposit protection system or the deposit protection scheme managed by esisuisse. However, participating members are obliged by law to hold, at any given time, sufficient liquid assets to cover half of their maximum contribution obligations (for all participating members, a total of Sfr3 billion) in addition to the minimum level of liquidity prescribed by law. This amounts effectively to a *de facto* credit balance of the corresponding volume for the deposit protection scheme held by its members.

In the event that more than Sfr3 billion in contributions to esisuisse are required, the participating members must provide such liquid amounts using other funds. FINMA monitors on a regular basis whether the participating members are in a position to comply with any such contribution requests by esisuisse. In addition, 22 of the 24 cantonal banks (also participating members) benefiting from a direct state guarantee (unlimited in the case of 21 of the banks) so that their contributions to esisuisse and clients' deposits are secured (or partially secured) by the state.

For further information on this topic please contact [Christophe Rapin](#), [Alexander Vogel](#) or [Christophe Pétermann](#) at Meyerlustenberger Lachenal by telephone (+41 44 396 91 91), fax (+41 44 396 91 92) or email (christophe.rapin@mll-legal.com, alexander.vogel@mll-legal.com or christophe.petermann@mll-legal.com).

Endnotes

(1) See www.finma.ch/e/aktuell/pages/mm-pos-sanierung-abwicklung-20130807.aspx.

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