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Insolvency & Restructuring - Switzerland

Swiss Financial Market Insolvency Regulation revised

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Introduction

Switzerland has recently revised its Financial Market Insolvency Regulation. The Swiss Financial Market Supervisory Authority (FINMA) is responsible not only for commencing and conducting protective measures, but also for restructuring and bankruptcy proceedings relating to individuals and legal entities carrying out business as a bank or securities dealer, for which a licence is required. FINMA is also responsible for the recognition of foreign bankruptcy decrees and restructuring measures concerning banks and securities dealers.

With regard to global systemically important banks, special regulations (regarding capital and liquidity requirements in particular), risk allocation and mandatory emergency plans apply. In August 2013 FINMA published a position paper explaining its resolution strategy regarding cooperation with foreign supervisory and resolution authorities.

Regulation

The new Swiss banking insolvency regulation entered into force at staggered intervals and has strengthened the role of FINMA. In particular, the new FINMA Banking Insolvency Ordinance, which came into force on November 1 2012, implemented appropriate and efficient restructuring proceedings considering the particularities of each bank in the event of a crisis. The main emphasis was on detailed regulation of insolvency proceedings, as well as the instrument of a restructuring plan.

For efficient proceedings, FINMA is competent to order restructuring proceedings and draw up a restructuring plan that can be approved immediately, or can approve an existing restructuring plan. It is no longer mandatory to appoint a restructuring agent. Creditors need not be informed directly. In urgent cases FINMA may inform the public by an announcement on its website and in the *Swiss Official Gazette of Commerce*. In this context, courts have an independent function insofar as creditors can challenge FINMA decisions. In insolvency proceedings regarding systemically important banks, this right is limited.

In restructuring proceedings FINMA is authorised to dispose a moratorium for interest payments, payment extensions and waiver of claims or to take capital-related measures if the threat of insolvency is prevailing, if the bank experiences serious liquidity problems or if the bank fails to meet its capital adequacy requirements within a specified timeframe. Corporate actions (eg, bail-ins) are a core feature of restructuring. Executing a bail-in means issuing compulsory instructions to convert debt into equity capital, thereby turning creditors into shareholders. There is also the option to oblige creditors to bear a share of losses (ie, requiring them to waive some or all of their claims – known as a haircut). Such bail-in measures complement contingent convertible capital, of which the systemically important banks are obliged to hold a considerable amount. However, all privileged claims under regular bankruptcy law (eg, the claims of employees in particular) and client deposits up to the limit of the guarantee of Sfr100,000 per depositor are excluded from such measures. Secured claims and claims subject to offset (eg, the Master Netting Agreements) are neither convertible nor subject to a haircut – they remain unaffected by respective order by FINMA.

As a novelty, restructuring proceedings do not require that an entire bank be subject to restructuring proceedings. FINMA can also require and ensure that particular essential banking services be transferred to other legal entities (eg, to another bank or a bridge

bank). Again, secured claims can be transferred to another entity only together with the collateral. The same applies to claims subject to offset.

Banks are implementing the new banking insolvency provisions, including the higher capital requirements. In addition, systemically important banks are putting in place viable resolution plans setting out the maintenance of systemically important functions (eg, payment transactions) in the event of a crisis. In this context, Swiss law provides for the possibility of a limited reduction of capital requirements for systemically important banks that adopt measures to reduce resolvability risk beyond what is legally required.

In view of this, the Swiss systemically important bank UBS announced in its third quarterly report of 2013 that it intends to establish a new banking subsidiary in Switzerland for its retail and corporate business division. The scope of this potential future subsidiary's business has not yet been decided – but it is conceivable that this approach could be seen in light of the ongoing discussion of the resolution of systemically important banks.

One year after implementation of the new banking insolvency rules, no restructuring or bankruptcy proceeding of a FINMA-licensed financial institution had been carried out (since the prior revision of the Banking Act in 2004, 11 bankruptcy proceedings of FINMA licensed financial institutions were carried out). It remains to be seen whether the new system will function adequately in an emergency.

Foreign bankruptcy decrees

FINMA has a great deal of experience regarding the recognition of foreign bankruptcy decrees and liquidation restructuring measures concerning banks and securities dealers. By the end of August 2013, FINMA had recognised 19 foreign bankruptcy decrees.

Based on the principle of territoriality, foreign bankruptcy estates may not realise their assets located in Switzerland without formal recognition proceedings. As a rule, recognition will be granted only if the general requirements of recognition under the Swiss Private International Law (in particular, the principle of reciprocity) are met. In contrast to this rule, in the new FINMA Banking Insolvency Ordinance, FINMA can waive the principle of reciprocity if it is in the interests of the creditors.

The Swiss Supreme Court has repeatedly confirmed that there is no exception to the requirement of the principle of reciprocity. In particular, the court dismissed the application for recognition of the Curaçao bankruptcy decree regarding the bankruptcy of Lehman Brothers Securities NV, due to lack of reciprocity. In its decision, the court made clear that the principle of reciprocity is binding and can be lifted only through a change in legislation based on an ordinary legislative procedure. Contrary to this statement, FINMA issued the new Banking Insolvency Ordinance, where the competence of waiving the reciprocity principle was granted to FINMA through an administrative act and not an ordinary legislation process. This led to the controversial result that in a parallel proceeding, FINMA had to decide on the recognition of the same bankruptcy decree regarding Lehman Brothers Securities NV, and subsequently approved the request of recognition using its competence to waive the principle of reciprocity.

It is doubtful whether this approach is compatible with the rule of law. Otherwise, pursuing an efficient and coherent process regarding cross-border bank insolvency proceedings, the practice-oriented result of FINMA's recognition practice is welcome.

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