



Regulatory Innovations

Deep Dive - Parent Bank Resolution Planning

I. Introduction

On April 10, 2024, the Swiss Federal Council published its report on banking stability (the **Report**). The report provides for a wide-ranging assessment and evaluation of the Swiss too-big-to-fail regime in relation to the circumstances surrounding the crisis that led to the takeover of Credit Suisse by UBS in March 2023.

The Federal Council aims to increase financial stability by implementing 22 regulatory measures under the Swiss banking supervisory regime in the following six fields of action: (i) Corporate Governance and Prudential Supervision, (ii) Capital Requirements, (iii) Early Intervention and Recovery, (iv) Ensuring Liquidity in a Crisis, (v) Resolution Planning and (vi) Crisis Organization and Cooperation between Authorities.

This Homburger Deep Dive provides an assessment of the measures suggested by the Federal Council in relation to the introduction of a resolution planning requirement for parent banks of internationally active systemically important banks (**G-SIBs**).

II. Swiss TBTF-Regime

Did Switzerland "botch[] its own banking rules"?¹

Whether the trade-offs inherent in Switzerland's "Too Big to Fail" (**TBTF**) regime created or exacerbated a weak link in the parent banks of Swiss G-SIBs² is one of the main themes running through the Report.

Under the current TBTF regime, the parent banks of a Swiss G-SIB may come under pressure as a result of any or a combination of (i) operating a global bank, (ii) holding shares in the group's Swiss (systemically important) bank and the group's other operations abroad (in the form of branches or subsidiaries), and/or (iii) acting as the group's central treasury.

Even before the Credit Suisse crisis, incremental changes to the TBTF regime were aimed specifically at strengthening parent banks. But after March 2023, early post-mortems quickly pointed to Credit Suisse AG, the parent bank of Credit Suisse, as the source of the bank's weakness.

While some of the pressures on parent banks may reflect the inherent tensions between achieving the economies of scale and portfolio/diversification benefits of an integrated global business (with central treasury at the core of the parent bank) and meeting local requirements that may deprive the bank of such benefits (and increasingly so in times of crisis), the Report also raises the question of whether the current Swiss TBTF framework and its impact on the position of the parent bank represents a satisfactory approach to managing these tensions or, worse, exacerbates them.

¹ Margot Patrick, "How a Banking Capital of the World Botched Its Own Banking Rules", [WSJ.com](https://www.wsj.com), November 8, 2023.

² A "G-SIB" is a Global Systemically Important Bank as designated by the Financial Stability Board. The Swiss regulations refer to these banking groups as internationally active systemically important banks and broadly take their cues from the Financial Stability Board's G-SIB designation (cf. article 124a of the Swiss Capital Adequacy Ordinance). For ease of reference, only the term "G-SIB" is used in this Deep Dive. We are using the broader term "SIB" to denote not only such G-SIBs but also banking groups that are systemically important under Swiss law but do not count as a G-SIB.

Among the reported symptoms of stress, the notions of not enough of the group's consolidated capital being available at the level of the parent bank³ or the group's liquid assets and assets eligible as collateral for emergency liquidity assistance becoming trapped in foreign subsidiaries and branches as well as the Swiss domestically important subsidiary⁴ have received much of the attention so far.

By contrast, this Deep Dive focuses on the dog that did not bark: the resolution plan that was not triggered.

From the outset, the Swiss TBTF regime has taken a two-pronged approach to creating conditions that would allow SIBs to fail while minimizing the impact of such an event on Swiss financial stability: (1) a fallback requirement that certain functions designated as systemically important to Switzerland can be continued in such a scenario (which the SIB must formalize through a Swiss emergency plan) and, (2) mainly for G-SIBs, requirements to ensure global resolvability of the entire bank (i.e., minimizing the negative impact of a failure on the financial system if the G-SIB were to be placed in resolution) as a first line of defense (with the Swiss Financial Market Supervisory Authority FINMA (**FINMA**) being subject the statutory obligation to prepare and implement a global resolution plan). The requirements for the Swiss emergency plan are much more stringent, but with the Swiss systemically important functions ring-fenced in a dedicated subsidiary, the activation of the Swiss emergency plan would likely lead to the bankruptcy of the parent bank.

In March 2023, the Swiss authorities decided against both putting Credit Suisse into resolution (the first line of defense) and activating the Swiss emergency plan (as a fallback). Thus, the current TBTF framework did not seem to offer an obvious pre-planned alternative to relieve the pressure on the parent bank.

In response, the Report proposes the introduction of a parent bank resolution plan, which, despite its name, appears to be modeled on the Swiss emergency plan currently implemented for the Swiss systemically important bank rather than the existing global resolution plan.

Because the Report relies heavily on the current requirements for emergency and global resolution planning and otherwise provides little detail on the proposed new parent bank resolution plan, this Deep Dive first provides a summary of the current requirements before setting out an initial assessment of what the new proposal might entail.

III. The current framework

A. The global resolution plan as first line of defense⁵

The Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions call on jurisdictions to assess the resolvability of G-SIBs and to establish an ongoing resolution planning process to promote the resolvability of G-SIBs as part of the overall

³ Which is proposed to be remedied either by deducting holdings in foreign entities from the parent bank's capital or by increasing the risk weights to be applied to such holdings.

⁴ The latest revision to the Liquidity Ordinance that entered into force prior to the crisis at Credit Suisse but subject to phase-in provisions already sought to address some of these concerns.

⁵ The respective requirements are contained primarily in articles 64-65b and 66 Banking Ordinance.

supervisory process. A G-SIB is considered "resolvable" if it is feasible and credible for resolution authorities to "resolve" the G-SIB (i.e., allocate losses from the G-SIB's operations to the G-SIB's shareholders and creditors) in a manner that protects systemically important functions without severe systemic disruption and without exposing taxpayers to losses.⁶

Switzerland has implemented this standard with an obligation for G-SIBs to ensure and maintain global resolvability and with an annual resolvability assessment by FINMA based on certain criteria (e.g. organizational structure, operational continuity). The applicable resolvability criteria are intended to ensure the viability of the global resolution plan to be drawn up by FINMA. FINMA may set a deadline for the removal of any impediments identified in this process and, if the bank fails to comply, impose additional total loss absorbing capacity (TLAC) requirements and/or liquidity requirements at the level of the top or intermediate holding company or any entity that is material to the financial group due to its core function or relative size. The system of imposing surcharges for resolvability deficiencies was adopted only recently, replacing a system under which G-SIBs could obtain rebates on the applicable TLAC requirements by improving their resolvability.

The global resolution plan sets out how a restructuring or liquidation of the G-SIB - if ordered by FINMA - could be carried out. FINMA has expressed a preference for a "single point of entry" (SPoE) bail-in. This means that FINMA would attempt to restructure the G-SIB by "bailing in" the external debt issued at the level of the group holding company, with other group entities channeling losses through the parent bank to the group holding company (via the write-down of dedicated group-internal loss-absorbing instruments), but not becoming subject to restructuring or liquidation proceedings themselves. It was hoped that this structural subordination of loss-absorbing instruments issued by the holding company would insulate the operating entities of the G-SIBs to some extent from the adverse effects of such restructuring (such as the triggering of cross-default clauses) and limit the plan's reliance on the cooperation of foreign authorities.

The SPoE bail-in approach, and any global resolution plan based on such an approach, inevitably takes a group-wide perspective. The Report also points out that the regulatory requirements for global resolvability are less stringent than those for the emergency plan described below, and that FINMA cannot take far-reaching measures to improve the resolvability of parent banks. As a result, although the parent bank is included in the global resolution plan, no specific strategy is defined for the orderly resolution of the parent bank, which would therefore be placed into bankruptcy if the SPoE bail-in fails to resolve the parent bank's distress.

B. The fallback option: Swiss emergency plan⁷

The activation of the Swiss emergency plan is treated as a last resort, to be considered only if the primary strategy of an SPoE bail-in under the global resolution plan fails.

While the resolvability and resolution planning requirements described above relate to international standards aimed at ensuring that losses can be absorbed by the G-SIB's shareholders and creditors in an orderly manner that does not jeopardize financial stability and thus does not

⁶ Key Attributes 10-11 and I-Annex 3-4.

⁷ The respective requirements are contained primarily in article 9 para. 2 let. d and article 10 paras. 2 et seqq. Banking Act and articles 60-63 and 66 Banking Ordinance.

require the authorities to cover such losses in order to protect the public interest, the Swiss emergency plan has a far narrower focus: ensuring the continuation of certain pre-defined functions that are deemed to be systemically important to the Swiss economy, in particular by reducing the interdependencies between the provision of these functions and the G-SIB's other activities. Systemically important functions include domestic deposit-taking, lending and payments activities.

The measures, structures and arrangements to be implemented to achieve this objective must be formalized by the G-SIB under a Swiss emergency plan, which must be submitted to FINMA for approval. For the G-SIBs (historically UBS and Credit Suisse), creating the structural conditions for their emergency plans to work meant spinning off their domestic systemically important functions from the global operations of the parent bank into a separate Swiss legal entity. The objective of the emergency plan is to enable the Swiss entity to continue to operate during the crisis, independently of the other group entities that may need to be resolved. The emergency plans must therefore show how the dependencies of the Swiss entities on the parent company and the rest of the group can be reduced or eliminated.

As a result, the Swiss emergency plan focuses on the Swiss systemically important bank subsidiary and certain service companies, but not on the parent bank or even the G-SIB as a whole: As the Report notes, activating the Swiss emergency plan would likely have triggered bankruptcy proceedings for the parent bank and the immediate withdrawal of the parent bank's license. Conversely, the global resolvability of the G-SIB is only part of FINMA's assessment of the Swiss emergency plan to the extent that the emergency plan is based on certain resolvability assumptions.

If FINMA deems the Swiss emergency plan to be inadequate and this is not remedied by the SIB, it may order the bank to establish independent entities that are prepared to host the Swiss systemically important functions and/or the supporting internal services and infrastructure in the event of activation of the emergency plan and to remove other potential impediments to the viability of the Swiss emergency plan. FINMA's remedial powers in the event of the emergency plan therefore exceed its powers in relation to the global resolution plan and global resolvability.

However, the purpose of the Swiss emergency plan is also limited in what it seeks to achieve - not only in scope (in that it only covers Swiss systemically important functions), but also in that, as the Report notes, it considers the impact of specific stress scenarios on these functions and does not provide a blueprint for the indefinite continuation of the Swiss systemically important entity as a stand-alone entity.

IV. Proposal for a resolution planning requirement at the level of the parent bank

In the case of Credit Suisse, the authorities determined that proceeding with the SPoE bail-in under the global resolution plan would not have provided sufficient mitigation (at least relative to the potential adverse effects).

At that point, the separation of the Swiss systemically important functions from the rest of the G-SIB's business that had been implemented in preparation for the Swiss emergency plan did not appear to adequately address financial stability concerns:

- The crisis at the parent bank appears to have become a focal point for clients and counterparties of the (supposedly ring-fenced) Swiss systemically important bank, causing a significant outflow of liquidity, possibly in excess of its liquidity reserves.
- More generally, the continued existence of the Swiss systemically important subsidiary (beyond the immediate continuation of systemically important functions as provided for in the Swiss emergency plan) in the event of the bankruptcy of the parent bank (as would likely have occurred following the activation of the Swiss emergency plan at the level of the Swiss subsidiary) was considered questionable.
- In addition, even with the Swiss systemically important functions ring-fenced in the Swiss subsidiary, the Report notes that due to the size and interconnectedness of the parent bank (including as the central treasury function), the bankruptcy of the parent bank itself would have posed a threat to financial stability in Switzerland.

According to the Report, the Federal Council intends to introduce a requirement for G-SIBs to prepare a resolution plan at the level of the parent bank. The parent bank resolution plan would have to demonstrate how the parent bank could be resolved over a period of one to two years. Currently, only UBS would be subject to such a requirement.

The parent bank resolution plan would therefore bridge the (to some extent intentional) gap between the two objectives of reducing risks to financial stability and maintaining the continuity of systemically important functions. The resolution of the parent bank on a stand-alone basis would not involve the initiation of bankruptcy proceedings (which would entail the immediate withdrawal of the parent bank's license), nor would it involve a restructuring aimed at restoring the parent bank's viability. Instead, the parent bank's business would be wound down in a controlled manner over a period of time until it no longer poses a threat to financial stability.

As with the existing Swiss emergency plan for the systemically important Swiss subsidiary, the bank would have to demonstrate in the parent bank resolution plan that the financial and organizational interdependencies with other parts of the G-SIB do not pose an obstacle to resolution. This could also help achieve a clean holding company (i.e. a top-level entity without financial obligations that present an obstacle to resolution), which the Report considers important for resolution. In addition, criteria for the review of the resolution plan by FINMA would have to be defined and FINMA would have to be empowered to take certain measures along the lines of the powers it currently has in connection with the Swiss emergency plan, such as hiving off the investment bank, if deficiencies in the plan are not remedied.

Notably, these additional powers comport with the Financial Stability Board's recommendation in the report accompanying its latest peer review of Switzerland (report dated February 29, 2024) that "[t]he authorities should strengthen the legal basis for FINMA, as part of resolution planning, to require identified G-SIBs to adopt changes to their business practices, structure or organisation to address a material impediment to resolvability" (recommendation 5), as well as earlier recommendations to that effect by the International Monetary Fund.⁸

⁸ See IMF (2019), Switzerland: FSAP Technical Note – Financial safety net and crisis management, *IMF Country Report 19/191*, para. 33. Both the Financial Stability Board and the International Monetary Fund made reference to the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions, Key Attribute 10.5, pursuant to which "supervisory authorities or resolution authorities should have powers to require,

V. Assessment

The Report provides little detail as to the specifics of the resolution planning requirement for parent banks. However, as the Report explicitly states ("In the case of UBS Group AG, preparing and implementing this resolution plan will be a big undertaking."; p. 140), the repercussions of such a requirement could prove considerable.

First, despite the term "resolution plan," what is envisaged in the Report appears to go far beyond the existing global resolution plans (which are to be prepared by FINMA) and bears a striking resemblance to the current Swiss emergency plan for the Swiss systemically important banks, not least in that this new parent bank resolution plan is to be prepared by the G-SIB and may be accompanied by far-reaching enforcement tools for FINMA. Whilst the current emergency plans only cover the Swiss systemically important functions, the new parent bank resolution plan would have to be applied on a much broader scale.

Second, the Report makes clear that structural measures that the Report does not recommend for implementation at the general level can still be expected to be imposed by FINMA as part of ensuring the viability of this new resolution plan. Given that the Swiss systemically important functions were spun off from the global bank in order to make the current Swiss emergency plans viable, the implementation of the new parent bank resolution plans could be used by FINMA to impose significant structural changes.

It is also noteworthy that whilst the Report does not recommend the introduction of a formal temporary public ownership (**TPO**) instrument, it does stipulate that TPO would have to be limited to the systemically important functions of the Swiss subsidiary and would be conditional on the existence of a viable resolution plan for the other parts of the G-SIB (notably the parent bank). A resolution plan for the parent bank could serve as a basis for options that are not considered desirable *ex ante*.

Somewhat ironically, then, the call for a new "plan" may express a much deeper lesson from Credit Suisse: a crisis may not follow pre-planned scenarios, but planning for a crisis creates options that can be combined in novel and *ad hoc* ways to meet the needs of the moment ("it is clear that the more flexible and varied the strategies prepared, the more comprehensive the toolkit, and the more unambiguously the remaining obstacles are eliminated, the greater the chances of a successful resolution"; p. 139).

This is also consistent with the spirit in which the report assesses the performance of the Swiss TBTF regime in the Credit Suisse crisis: while the specific crisis could not be addressed as planned, the measures taken to implement those plans nevertheless helped prevent a much worse outcome. The possibility that a plan (or even the law) might turn out to have been botched thus becomes part of the equation.

where necessary, the adoption of appropriate measures, such as changes to a firm's business practices, structure or organisation, to reduce the complexity and costliness of resolution".

Legal Note

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