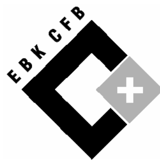


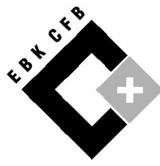
Eidgenössische Bankenkommission
Commission fédérale des banques
Commissione federale delle banche
Swiss Federal Banking Commission

Bank Insolvency

The situation in Switzerland and internationally

A report by the SFBC

January 2008



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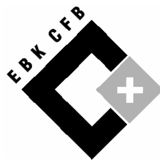


Abbreviations

ACA	Swiss Federal Law on the Federal Administrative Court of 17 June 2005(Federal Administrative Court Act, RS 173.32)
APA	Swiss Federal Law on Administrative Procedure of 20 December 1968 (RS 172.021)
ATF	Decision of the Swiss Federal Supreme Court
BA	Swiss Federal Law on Banks and Savings Banks of 8 November 1934 (RS 952.0)
BBO	Swiss Federal Banking Commission Ordinance on the Bankruptcy of Banks and Securities Dealers of 30 June 2005 (RS 952.812.32).
BO	Swiss Federal Ordinance on Banks and Savings Banks of 17 May 1972 (RS 952.02)
CAO	Swiss Federal Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Dealers of 29 September 2006 (RS 952.03)
CC	Swiss Criminal Code of 21 December 1937 (RS 311.0)
FF	Swiss Federal Official Journal
FLDCB	Swiss Federal Law on Debt Collection and Bankruptcy of 11 April 1889 (RS 281.1)
FSCA	Swiss Federal Law on the Federal Supreme Court of 17 June 2005 (Federal Supreme Court Act, RS 173.110)
IPLA	Swiss Federal Law on International Private Law of 18 December 1987 (RS 291)
RO	Official Compilation of Federal Legislation
RS	Classified Compilation of Federal Law
SESTA	Swiss Federal Law on Stock Exchanges and Securities Trading of 24 March 1995 (RS 954.1)
SESTO	Swiss Federal Ordinance on Stock Exchanges and Securities Trading of 2 December 1996 (RS 954.11)
SESTO-SFBC	Swiss Federal Banking Commission Ordinance on Stock Exchanges and Securities Trading of 25 June 1997 (Banking Commission's Stock Exchange Ordinance, RS 954.193)
SFBC	Swiss Federal Banking Commission
SFBC Circular	Circular issued by the Swiss Federal Banking Commission
SHAB	Swiss Official Commercial Gazette

Key points

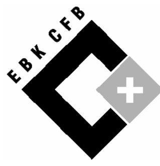
Clear and predictable rules on insolvency are vital and indispensable to any orderly market economy. This also applies to bank insolvencies. In many ways, however, these justify special treatment, as reflected in the new bank insolvency law in Switzerland (Part I). This report presents an overview of experience gathered to date by the Swiss Federal Banking Commission (SFBC) with the new Swiss bank insolvency law that came into force on 1 July 2004 (Part II). It also examines some issues which the SFBC believes are important with respect to international bank insolvencies (Part III).

Under the new Swiss bank insolvency law, the SFBC has exclusive responsibility for insolvency with respect to Swiss banks and securities dealers. This responsibility follows on seamlessly from its supervisory role, and enables it to take specifically tailored measures at a very early stage to protect the interests of creditors. Swiss and foreign creditors are treated equally. In addition to the special rules governing the liquidation of insolvent banks, there is also a far-reaching law on compulsory restructuring (albeit only for authorised institutions), though there has not yet been any opportunity to test this in practice. Where authorised institutions are liquidated under bankruptcy proceedings, the smallest deposits (up to a maximum of 5,000 Swiss francs per customer) are paid out immediately. Privileged deposits (up to a maximum of 30,000 francs per customer) at branches in Switzerland are then reimbursed within three months through a mandatory deposit insurance scheme.

Bank bankruptcy proceedings differ in some respects from those provided for in the Swiss Federal Law on Debt Collection and Bankruptcy. For example, where banks are concerned the SFBC is the only competent bankruptcy authority in Switzerland, and is obliged to implement a single procedure. There are a number of measures to speed up the process: notice to creditors, for instance, is issued as soon as bankruptcy proceedings are opened. Claims that are evident from the books are deemed to have been registered. Creditors outside Switzerland are not obliged to elect domicile within the country. Claims against third parties can be freely sold either individually or bundled together, and need not be assigned to the creditors. This last point has already enabled the SFBC to realise illiquid assets in a number of cases where it would otherwise have been impossible to conduct bankruptcy proceedings.

The SFBC has initiated 113 bankruptcy proceedings since the law came into force in 2004. None of these, however, concerned an authorised bank, and only three related to authorised securities dealers. The remaining 110 concerned institutions acting as banks or securities dealers *without authorisation* from the SFBC. In most cases, the SFBC appointed specialised companies or experts as liquidators, and closely monitors their activities.

International bank insolvencies present major challenges. Regulations, responsibilities and interests differ from country to country. Consolidated supervision in the country of origin is highly restricted in cases of insolvency. The issue needs to be addressed in more detail by international committees, and indeed the SFBC continues to argue the case for this.



I. Introduction

Insolvency law is a key pillar of a properly ordered market economy

Insolvency law is essential to an orderly market economy. It ensures that if a debtor becomes unable to meet payment obligations, the debtor's assets are used as far as possible to satisfy the claims of creditors. Effective insolvency law helps to provide predictability and legal certainty. Market participants want to know in advance what will happen to unfulfilled claims or collateral if an insolvency occurs. The importance of insolvency law extends to all sectors of the economy, including banking.

Banks, too, may become insolvent. It is not the aim of bank supervision to prevent such insolvencies at all costs: this would not make economic sense, and would be impractical without restricting the business activities of the banks in a way that would harm the overall economy. In order to protect the stability of the banking system as a whole, the supervisory authority must be able to close down banks that no longer comply with the licensing requirements and that are not in a position to restore their financial situation. Their continued existence, and the increasing risks that this would entail, could endanger other financial institutions. If a bank no longer possesses the statutory level of equity capital, bank supervision seeks to rectify this shortcoming as soon as possible. This may be achieved either by capital injections or by guarantees given either by existing shareholders or by another entity taking over the bank. State aid, on the other hand, has no place in insolvency law. The option of calling on government funds may tempt a bank's executive bodies to enter into excessive risks. Market discipline is generally less effective if participants know that they can count on support from the state if they encounter problems (the so-called moral hazard). In addition, the need to ensure fair competition makes it impossible to justify state aid. Finally, imposing an additional burden on taxpayers by using government funds to subsidise ailing banks is politically untenable. State intervention must not therefore be used as a way of delaying structural reforms that are economically necessary. All this requires an effective insolvency procedure, and these rules apply to all participants in the economy, including banks.

Special law for banks

Nevertheless, there is an issue about whether banks should be treated differently from other companies in bankruptcy proceedings. There are some features which are particular to banks and therefore justify special treatment. The first is their considerable importance to the economy. In its memorandum on the draft federal law on banks and savings banks of 2 February 1934, the Federal Council argued that regulation was needed because banking was developing into a "public service".[1] Indeed the growth of the economy depends on the banks making capital available for investment. Banks are also responsible for processing payments. Moreover, the Swiss National Bank's tools for implementing its monetary policy are directed towards them.

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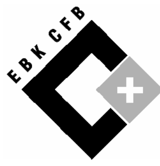
[1] FF 1934 I 171; see CHRISTOPH WINZELER, Das schweizerische Bankwesen - "eine Art öffentlicher Dienst"? [Swiss banking – "a kind of public service"?] in *Zeitschrift für Schweizerisches Recht*, new issue 1999 I, vol. 3, p. 201 ff.



Another special feature of banks is the "maturity transformation" that occurs between the asset and liability sides of the balance sheet – in other words, between loans and deposits. Banking operations are based on the assumption that only a portion of depositors will withdraw their funds at any given time. This frees up part of the available funds to be invested longer term, for example by granting loans. In order to ensure that the bank has the necessary liquid funds available under normal circumstances, the Banking Act contains provisions on liquidity.[2] As soon as a bank faces a loss of confidence, there is a risk that customers will withdraw more of their funds than usual (and indeed, in extreme cases, besiege the bank), tipping it into a crisis and exacerbating its existing difficulties. Banks' heavy dependence on public trust is the reason why they are so vulnerable in a crisis. Because of the large numbers of creditors involved, difficulties at a single bank can trigger a crisis that has implications for the whole economy. This fact necessitates a mechanism that allows intervention to take place very quickly and discreetly.

II. Bank insolvency in Switzerland

1 New bank insolvency law since 2003

The lengthy efforts to revise the regulations on bank bankruptcy and restructuring that began in the 1930s have speeded up considerably in recent years. It had long been evident that there were major gaps in the law on bank bankruptcy and restructuring, and that it was scattered across a large number of different rules and regulations. This resulted in a lack of clarity, and in consecutive or even parallel interventions by different authorities adopting different approaches. In other words, the law on bank bankruptcy and restructuring was no longer up to the task of dealing with the problems that were arising.

The bankruptcy of Spar- und Leihkasse Thun in 1991 and the ensuing chaotic and expensive liquidation proceedings, which took 14 years to complete (see box 1), provoked strong reactions within Switzerland and prompted politicians to address the issue afresh. Finally, in 1999, the Federal Council appointed a group of experts and mandated them with revising the law on bank bankruptcy and restructuring. The group's report and its draft law were well received. In 2003, Parliament unanimously accepted the corresponding amendments, chiefly to the Banking Act[3], and specifically to sections XI[4] *Measures for dealing with the threat of insolvency*, XII *Liquidation of insolvent banks (bank bankruptcy)* and XIII *Deposit insurance*. These amendments came into force on 1 July 2004, one year before the new ordinance on the bankruptcy of banks and

[2] Art. 4 BA in conjunction with Art. 15 ff. BO.

[3] Swiss Federal Law on Banks and Savings Banks of 8 November 1934 (Banking Act, BA; RS 952.0).

[4] The BA comprises a total of 15 sections.

securities dealers itself came into effect on 1 August 2005.[5] Finally, the new provisions of the Banking Ordinance[6] on the deposit insurance system, together with the Swiss banks' and securities dealers' agreement on deposit insurance, came into force on 1 January 2006. Taken together as a coherent whole, these regulations form the legal basis for bank insolvency.

Box 1: ***The closure of Spar- und Leihkasse Thun (1991)***

No bank closure since the 1930s has caused such a sensation as the closure of Spar- und Leihkasse Thun (SLT) on the instructions of the SFBC in 1991. The bank, which adopted an aggressive lending policy and granted risky and poorly processed real estate loans, got into difficulties when interest rates rose and property prices fell for the first time in decades. A relatively small bank with around 46,000 deposit accounts, it had strong ties to its local region. Many private customers and businesses used it to process payments and were therefore hit extremely hard by its closure.

On 3 October 1991, following the failure of informal restructuring efforts and takeover negotiations, the Chairman of the SFBC ordered the temporary closure of the bank. On 18 October 1991, the SFBC revoked the bank's licence (which then as now meant that, under the Banking Act, liquidation was the inevitable consequence) and duly appointed a liquidator. Almost simultaneously, SLT applied to the court that had jurisdiction under the old law for a moratorium on claims against it.

Thereafter, both the liquidator appointed by the SFBC and the "commissioner" or "administrator" appointed by the court overseeing the moratorium and composition proceedings were involved in liquidating the bank. The two sometimes experienced serious difficulties in coordinating their efforts. On the basis of a provisional valuation of the assets and the available liquidity, 45 percent of all deposits were repaid within months of the bank's closure. After that, progress slowed to a crawl. It was not until May 1993, 19 months after the bank was closed, that all the privileged deposits were reimbursed by the deposit insurance scheme then in operation.

After a number of court cases, the liquidation of SLT was not finally completed until 2005. It resulted in a total dividend of 60.7 percent for non-privileged claims. The administration and liquidation costs accounted for over three percent of third-class deposits.

2 Core elements of Swiss bank insolvency law

The new bank insolvency law is specifically tailored to the particular features of the banks, and has the following essential elements:

The SFBC as supervisory authority has exclusive responsibility for bank bankruptcy and restructuring proceedings. It is charged with issuing licences to banks and supervising them on an ongoing basis. It has a wide range of tools at its disposal to enable it to take preventive measures when the requirements of prudent practice are not complied with, and to rectify existing irregularities. In the event of persistent capital inadequacy or liquidity problems, the SFBC can take measures that

[5] Swiss Federal Banking Commission Ordinance on the Bankruptcy of Banks and Securities Dealers of 30 June 2005 (Bank Bankruptcy Ordinance, BBO; RS 952.812.32).

[6] Swiss Federal Ordinance on Banks and Savings Banks of 17 May 1972 (Banking Ordinance, BO; RS 952.02).

may lead to restructuring or bankruptcy proceedings. The fact that sole responsibility lies with the Banking Commission ensures continuity and rapid action, as the Commission knows the bank concerned and already has comprehensive information about it. The SFBC is also solely responsible for the entire bankruptcy and restructuring proceedings. It appoints and oversees the liquidators or those entrusted with the restructuring. When necessary, it can also become involved in the liquidation itself.

Early intervention. The SFBC steps in as soon as a bank is unable to comply with the capital adequacy requirements for an extended period or experiences liquidity problems, or if there are other indications of impending insolvency. No formal evidence of overindebtedness or inability to meet payment obligations is required before restructuring or liquidation proceedings are initiated.

Use of commissioned investigators with executive authority. The SFBC may engage a commissioned investigator who has the authority to act in place of the bank's executive bodies and therefore takes control of the whole bank. The aim is first to establish the financial situation and take measures where necessary to prevent that situation from deteriorating.

Measures to protect the interests of creditors. The SFBC may order further measures instead of or in addition to appointing a commissioned investigator in order to protect the interests of creditors. These may include restricting the bank's business activities, closing it, imposing a moratorium or deferring maturities. These last two measures have no effect on the legally binding nature of netting and security agreements.

Tailor-made solutions. The individual measures can be tailored to the situation at hand, and can be implemented either individually or jointly in restructuring or bankruptcy proceedings. They do not have to be carried out in a particular order. The appointment of a commissioned investigator, for example, is not necessarily linked to a restriction on business activity. The initiation of restructuring proceedings does not necessarily require a moratorium. As long as the interests of its creditors are safeguarded, the bank can remain in business. Moreover, the measures do not need to be made public unless they directly affect the rights of third parties.

Restructuring as an alternative to liquidation. If there is a realistic prospect of success, the SFBC can carry out a restructuring. Decisions taken in a restructuring that fall within the powers of the annual general meeting, such as capital increases, do not require the agreement of the shareholders. The aim of these provisions is to speed up the restructuring proceedings. Only the creditors may reject a restructuring plan, and then only if they represent more than half of the non-privileged claims. In this case, the SFBC will order the bank's liquidation (bank bankruptcy).

Special rules for the liquidation of insolvent banks (bank bankruptcy). General insolvency law does not apply to bank bankruptcy proceedings. The SFBC has enacted special regulations under its power to issue ordinances. These are tailored to the particular circumstances of banks and are more flexible than normal insolvency law. The claims of depositors are automatically registered without them needing to file an

application. The rules on inspection of the schedule of creditors take account of the need to protect the privacy of bank customers.

Rapid repayment of small deposits. Depositors with less than CHF 5,000 deposited at the bank can be reimbursed immediately and ahead of all other creditors. Their claims no longer need to be included in the schedule of creditors.

Recognition of foreign insolvency measures. If a foreign authority takes measures concerning a foreign bank or securities dealer with a branch or assets in Switzerland, the SFBC is responsible for recognising those measures. Once the claims of those creditors whose claims are protected and privileged under Swiss law have been satisfied, the proceeds of the liquidation of assets located in Switzerland are turned over to the foreign proceedings.

Equal treatment of Swiss and foreign creditors. "All creditors of the bank and of its foreign branches shall be entitled to participate in the bank bankruptcy proceedings initiated in Switzerland, and shall be accorded the same privileges."[7] They must, however, allow any sums they have received in foreign proceedings against the bank or its assets to be offset against their entitlement in Switzerland.[8]

Application of bank bankruptcy also extends to financial intermediaries that are unauthorised. The SFBC also applies the bank bankruptcy procedure to financial intermediaries that are subject to compulsory liquidation due to illegal banking or securities dealing activities and that prove to be insolvent. This is by far the most common area in which the procedure is used. The regulations on restructuring and depositor protection do not apply to illegal financial intermediaries.

Obligatory deposit insurance. Deposits of up to CHF 30,000 per depositor are safeguarded by an obligatory deposit insurance scheme. Payments to depositors should be made quickly, and no later than three months after the SFBC informs the scheme of the insured event. The Swiss depositor insurance scheme is financed ex post by the affiliated banks: there is no fund. When a bank insolvency occurs, every bank is obliged to make a contribution towards compensation for the insolvent bank's depositors. The contribution is calculated on the basis of the insured deposits at the individual bank as a proportion of the total insured deposits at Swiss banks. In order to ensure that they are able to make their contribution if an insured event occurs, the banks are obliged to comply with specific additional liquidity requirements at all times. They must report the level of their insured deposits to the SFBC annually. To do this, they need to have implemented organisational measures to ensure that the extent of an individual depositor's claim against the depositor protection scheme can be ascertained. In this way, payments for the protected deposits can be made rapidly if an insured event occurs.

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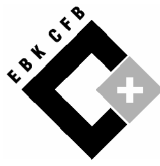
[7] Art. 3 para. 2 BBO.

[8] Art. 37f para. 2 BA.



No offsetting under the deposit insurance scheme. The insured deposits are calculated "gross" for each depositor. Under the scheme, deposits of up to CHF 30,000 may not be offset against the depositor's debts.

3 Companies affected by bank insolvency

The regulations on bank insolvency are directed primarily at banks and securities dealers. However, they apply not only to the financial institutions authorised by the SFBC and subject to its supervision, but also to overindebted companies that engage in banking or securities dealing without a licence from the SFBC.[9] The overwhelming majority of bank insolvency cases concern firms such as these. However, not all the measures to deal with the threat of insolvency will apply to them. Restructuring[10] cannot normally be ordered, as the rules stipulate that due to their unauthorised activities and the impossibility of obtaining a licence from the SFBC,[11] such firms must in all cases be liquidated. The deposit insurance system[12] does not cover any deposits at companies that engage in banking or securities dealing activities without authorisation, since these do not constitute privileged claims.[13]

The fact that the authority which supervises banks and securities dealers also takes responsibility for the liquidation of unauthorised financial intermediaries is without precedent. The SFBC regards this task as a service which it provides to the Swiss financial sector in order to safeguard its good reputation. Inasmuch as the liquidation costs incurred by the SFBC are covered by the assets of the unauthorised companies, it is the latter, rather than the Swiss financial sector as a whole, that bear the lion's share of the cost for this service.

Box 2: ***Statistics (as of 31.12.2007)***

Number of bank bankruptcy proceedings initiated since 2004: **113** (of which 110 involved companies engaged in unauthorised activity, 3 securities dealers and 0 banks).

Numbers of bank bankruptcies per year: 2004 : 5 ; 2005 : 13 ; 2006 : 33 ; 2007 : 62.

Number of bank bankruptcy proceedings completed since 2004: 11.

Number of bank bankruptcy proceedings halted due to lack of assets since 2004: 9.

Average duration of completed liquidations (not including halted bank bankruptcy proceedings): 18 months.

Average of dividends paid out for third-class claims: **29** percent.

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[9] The Federal Supreme Court confirmed this extended application in its judgment in the case of Klaro GmbH dated 24 March 2005 (ATF 131 II 306), which was also published in SFBC Bulletin 47/2005, p. 37 ff.

[10] See Chapter 7 below.

[11] FF 2002 *8085*.

[12] See Chapter 9 below.

[13] Art. 37*b* para. 2 BA.

The relatively high dividends paid to creditors in bank bankruptcies compared with bankruptcies in general (see boxes 2 and 8) are chiefly due to the flexibility in distribution allowed for by the bank bankruptcy procedure. There is, for instance, provision for the transfer of financial products (see box 7). The average dividend of 29 percent paid out in respect of third-class claims could be considerably higher if bank bankruptcy proceedings took account solely of the deposits made by the creditors and did not also include the often unrealistic profit undertakings entered into by unauthorised companies.

4 Interfaces with general supervisory activity

The SFBC my intervene and order measures "in the event of insolvency" if any one of the following conditions is satisfied:[14].

1. no appropriate level of equity capital;
2. reasonable grounds for concern that a bank is overindebted;
3. serious liquidity problems.

All banks are required to maintain an adequate level of **capital** on a consolidated basis.[15] A Federal Council ordinance lays down the elements of the capital that every bank must have available to cover credit risks, market risks, operational risks and risks that are not related to counterparties.[16] Normally, the SFBC is informed of each individual bank's capital adequacy situation on a quarterly basis,[17] though it may even request these figures daily during periods of financial instability. Banks are also obliged to inform the SFBC without delay if the statutory capital adequacy requirements are no longer complied with.[18] If the SFBC establishes that a bank is no longer meeting the statutory capital adequacy requirements, it must set the bank a deadline for bringing this situation back into order. Should the bank be unable to do this, the SFBC will instruct that the necessary insolvency measures be taken. If it is futile to set a deadline because it is clear that the capital adequacy situation will not improve, the SFBC can order insolvency measures directly, in other words without setting a further deadline.[19]

Under the Banking Act, an institution is deemed to be **overindebted** as soon as the valuation of its assets is such as to raise doubts about its ability to meet the claims of its creditors.[20] No formal evidence of overindebtedness is required. The existence of

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[14] Art. 25 BA.

[15] Art. 4 BA.

[16] Swiss Federal Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Dealers of 29 September 2006 (Capital Adequacy Ordinance, CAO; RS 952.03).

[17] Art. 13 CAO.

[18] Art. 33 para. 4 CAO.

[19] SFBC decision of 30 June 2005, published in SFBC Bulletin 48/2006, p. 271 ff.

[20] FF 2002 *7496*.

special circumstances indicative of existing or impending overindebtedness is sufficient.[21]

Ultimately, a bank which is suffering **serious liquidity problems** is no longer in a position to meet its payment obligations. The liquidity available has ceased to be adequate to cover obligations that have already fallen due or which will do so in the near future, and the bank is no longer able to obtain liquid funds at market conditions.

As part of its ongoing supervision of banks, the SFBC learns of the first difficulties faced by a bank, be it in terms of capital adequacy or liquidity, at a very early stage – indeed, before other judicial authorities would be informed on the basis of civil law regulations.[22] It also has the power to intervene and take whatever measures it believes necessary. These measures will be tailored to meet the case in question.[23]

5 Preventive measures

If a bank is experiencing financial difficulties without necessarily meeting one of the prerequisites mentioned in the previous chapter, it will take initial action alone, with the understanding of the SFBC where appropriate. If these measures prove insufficient, the SFBC will take more far-reaching action against the bank, albeit without imposing formal measures. If financial difficulties arise to the extent that formal measures must be taken[24], the SFBC will impose preventive measures[25].

Two types of preventive measures may be taken:

- They may consist in mandatory directives being issued to the executive managers of the bank which partially or even fully rescind their authority, while also placing restrictions on the bank's business operations. This type of measure is generally accompanied by the appointment of an expert investigator to monitor implementation of the preventive measures and to exercise the authority taken from the bank's executive management. At this stage, customers of the bank will not necessarily be informed and the measures cited will generally not be published if these do not have any direct consequences for customers or creditors.

- If the measures imposed by the SFBC could affect depositors, the measures will be made public by the SFBC. However, the situation is a delicate one, as this type of information could hinder the bank's efforts to regain a stable financial footing.

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[21] SFBC decision of 30 June 2005 (point 14), published in SFBC Bulletin 48/2006, p. 271 ff. and FF 2002 *8079*.

[22] See in particular Art. 725 CO relating to the overindebtedness of public limited companies.

[23] See Chapter 5 below.

[24] See Chapter 4 above.

[25] According to Art. 26 BA.

In general, the measures imposed by the SFBC depend on the particularities of each situation. Aside from general administrative principles, in particular the principle of commensurability, the SFBC is not bound to rigid, predetermined rules. It has the latitude to act in favour of the financial system's overall stability as well as in the interests of creditors, though the interests of creditors take precedence over all others in principle.

If the measures imposed by the SFBC lead to the bank's business activities being restricted, that is, if it is prohibited from making or accepting certain payments or executing certain types of securities transactions, or if the measures lead to branches being closed or a stay or postponement of maturities being granted, then new liabilities taken on by the bank since the measures were imposed must be given priority in the event of bankruptcy (see box 3).

The preventive measures are an effective instrument made available by the SFBC to a bank in the event of financial difficulties, but they also serve an additional purpose. If a bank's difficulties are such that a formal restructuring[26] or a bankruptcy[27] must be imposed, the preventive measures may also be applied to supplement these other proceedings[28].

Box 3: Example of preventive measures being imposed[29]

A bank was experiencing serious organisational difficulties, which it attempted to remedy under the oversight of an expert investigator appointed by the SFBC. As part of his mandate, the expert investigator determined that the liquidation balance sheet showed liabilities exceeding assets, while the continuing balance sheet showed a surplus. The SFBC imposed preventive measures which restricted the bank's business operations (Art. 26 para. 1e BA). Based on that fact, the account balances of new customers, new deposits by existing customers as well as other liabilities received by the bank since the imposition of measures would have been accorded priority in the event of a subsequent bankruptcy (Art 37 BA). But since the bank was able to regain a sound financial position (as well as administrative organisation), the preventive measures were subsequently lifted.

6 Experts and liquidators

In the course of carrying out its duties, the SFBC regularly calls upon external experts. They may be mandated with the investigations required by the SFBC or the implementation of measures it imposes such as preventive measures. In the event of a bankruptcy, the SFBC appoints these experts with the task of liquidation under its oversight. As an "extension" of the SFBC they are not themselves authorities with the power to issue orders[30]; this power is invested only in the SFBC.

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[26] See Chapter 7 above.

[27] See Chapter 8 above.

[28] Art. 25 para. 2 BA.

[29] SFBC ruling of 9 November 2005 in SFBC Bulletin 48/2006, p. 306 ff.

[30] As defined by the Federal Act on Administrative Proceedings (Art. 5 APA; RS 172.021).

If an order of bankruptcy is unavoidable, the initial phase is devoted to putting together an overview of assets available for liquidation. Like any other bankruptcy judge, the SFBC may also halt proceedings if assets are lacking to the extent that the liquidation costs are unlikely to be covered. However, in the interests of creditors, the SFBC attempts to keep cases like these to the absolute minimum. In fact, these cases lead to legal uncertainty, as the claims of creditors – particularly depositors – are never formally recognised. Though this type of situation may appear unlikely for a bank approved by the SFBC, in the case of liquidation by a financial intermediary which illegally performs an activity requiring proper authorisation, it may still occur. In the case of very limited assets, the SFBC may defer the appointment of a liquidator and carry out the initial steps in the liquidation itself, primarily as a means of acquiring better insight into existing assets as well as to estimate the probable liquidation costs (see box 6).

In some cases, the expert investigator appointed by the SFBC to investigate the facts of the case or to implement the appropriate measures may be granted control over the assets of the firm which is the focus of the investigation before bankruptcy proceedings are formally initiated or a bankruptcy liquidator is appointed. To the extent that an outside expert is appointed as an executive manager of the company, he can ensure that the company's assets will not be misappropriated, irrespective of whether the assets are located in Switzerland or another country. This anticipated intervention by an SFBC expert can have a decisive impact on the best possible execution of uniform bankruptcy proceedings and the equal treatment of all creditors envisaged.

Box 4: ***The course of "normal" bankruptcy proceedings*** – 6 stages

(***Stages 2,3 and 4 take place simultaneously.)***

1 Ruling Initiation of bankruptcy by the SFBC, appointment of a liquidator and notification of creditors.

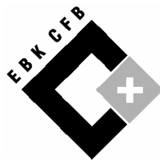
2 Assets Liquidator makes an inventory of available assets. Immediate sale of assets which are exposed to rapid impairment loss, would cause disproportionally high administrative costs, are traded on a representative market (stock exchange) or are not of significant value.

3° Liabilities: Liquidator creates a schedule of creditors (all debts listed in order of importance)..

4° Deposit insurance The liquidator creates a payment plan for the insured deposits. The deposit insurance scheme makes the necessary amount for payment available to the liquidator. Payment must take place within three months.

5° Distribution: As soon as the schedule of creditors enters into force and the assets are liquidated, the liquidator creates a distribution list. With approval from the SFBC, the liquidator distributes the available funds to the creditors.

6° End of proceedings: Upon receiving the final report from the liquidator, the SFBC takes any remaining measures necessary (such as depositing into escrow any undistributed assets) and publicises the end of the bankruptcy proceedings.



7 Restructuring proceedings

Independent restructuring proceedings are designated for banks and securities brokers.[31] The aim of these proceedings is to provide a financially stricken bank with the opportunity to continue its business operations to the best possible satisfaction of its creditors, with the support of measures from the authorities. A positive prognosis by the SFBC stating that the licensing requirements can be met over the long-term following restructuring is absolutely essential for initiating restructuring proceedings. This assessment is based on the current situation on the financial markets in general as well in relation to similar banks. In assessing a bank's prognosis for restructuring, the SFBC is naturally accorded considerable discretion.

Since the new bank insolvency provisions came into force in July 2004, there has not been an opportunity to test out the proceedings. Generally an informal solution would be attempted first. Only once this appears impracticable or other attempts have failed but some likelihood remains of the continued viability of a bank's business operations in future should the possibility of officially mandated restructuring proceedings be considered. In most cases, restructuring proceedings would have to be combined with simultaneous preventive measures[32]. It is also possible that the SFBC would appoint an outside restructuring expert to elaborate a forward-looking restructuring plan as well as an outside investigator to monitor the continuation of business operations. Depending on the duration of the proceedings, the option of dividing these tasks among different persons would need to be examined.

Generally speaking, time is also a critical factor in restructuring proceedings. The accompanying preventive measures[33] could help to contain the situation for at least a few weeks and thus allow a restructuring plan to be formulated. It is conceivable to limit customers' access to their accounts to a certain amount during this stage, as for example by only allowing access to privileged deposits or those covered by deposit insurance[34].

However, there might also be situations in which restructuring would only be successful if the restructuring concept could be presented at the same time that restructuring proceedings were initiated and the need to restructure the bank in question was communicated. In such cases, the SFBC woul communicate the initiation of restructuring proceedings and the restructuring plan simultaneously. In this case, the outside restructuring expert's scope of activity would be limited to implementing the restructuring plan. To the extent that restructuring measures interfere with the rights of creditors, the SFBC can only pre-approve the restructuring plan if the majority of non-privileged creditors do not reject the restructuring plan within the legally defined interval

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[31] Art.28 ff. BA; the probate proceedings described in Art. 293 ff. FLDCB are not applicable (see Art. 25 para. 3 BA)

[32] See Chapter 5 above.

[33] Especially a stay or postponement of maturities, prohibition on transactions and restrictions of business activity (Art. 26 para. 1e BA).

[34] Art. 36b and Art. 37h BA. See Chapter 9 below.

of 20 days. This would result in the immediate initiation of bankruptcy proceedings.[35] In addition, those creditors or shareholders whose rights have been infringed have the option of contesting the restructuring plan with a legal complaint.[36] However, the SFBC can eliminate the delaying effect of a complaint against its approval rulings as far as necessary so that non-deferrable measures can take effect right away.[37]

The contents of a restructuring plan reflect the requirements of the individual case, with organisational and staff-related measures remaining open for discussion. A wide range of measures can be used to remedy financial difficulties. They include recapitalisation by existing shareholders or third parties, payment deferrals, interest waivers, reductions of claims and the conversion of debt into equity. For all measures which interfere with the rights of creditors, however, it must be ensured that – in accordance with the law – the interests of the creditors takes priority over those of the shareholders, and the ranking of of creditors is duly observed.[38]

8 Bank bankruptcy

8.1 Differences to bankruptcy procedures under the FLDCB

In contrast to bankruptcy procedures in accordance with the FLDCB, according to which proceedings are opened at the request of creditors[39], bank bankruptcy is almost always initiated by the SFBC. On the basis of the oversight exercised by the SFBC over banks and securities firms, it regularly initiates proceedings which can result in bank bankruptcy. However, in the case of unauthorised companies involved in banking or securities trading operations, creditors or investors often report possible illegal activity to the SFBC. The SFBC then verifies whether authorisation requirements were violated and, in the case of overindebtedness, begins bankruptcy procedures without requiring any further involvement on the creditor's part.

Bank bankruptcy procedures are modelled on general bankruptcy procedures under the FLDCB, though they take into account the specifics of bank liquidations by allowing for a more for flexible and rapid wind down. The liquidator in a bank bankruptcy is appointed exclusively by the SFBC and is subject to its sole oversight.[40]. The SFBC can determine the makeup of a committee of creditors, in which case it also defines the committee's duties[41]. The effects of a bank bankruptcy are the same as for a general bankruptcy[42], particularly with regard to creation of the bankruptcy estate, automatic stay, revocation of pending debt collection as well as suspension of pending civil and

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[35] Art. 30 BA.

[36] Art. 24 para. 2 BA.

[37] Art. 55 para. 2 APA

[38] Art. 31d BA.

[39] Art. 166 FLDCB.

[40] Art. 33 BA.

[41] Art. 35 BA.

[42] Art. 34 BA and 197-220 FLDCB.

administrative proceedings. Debts become due, interest ceases to accrue, tangible claims are converted into monetary claims with the same value and the priority ranking of claims is set[43].

Bank bankruptcy proceedings are broadly outlined in the Banking Act[44], but are defined in greater detail in the Bank Bankruptcy Ordinance of 30 June 2005. The declared objectives of these bank bankruptcy proceedings are efficiency (the liquidator enjoys substantial discretion; the rights of creditors are limited to the most important), simplicity (the SFBC is the supervisory authority overseeing the bankruptcy liquidation and thus grants any authorisations in connection with it; all creditors are accorded equal treatment regardless of their domicile) and differentiation (the SFBC can decree individually tailored liquidation measures in certain cases). The SFBC devoted a special bulletin in 2006, SFBC Bulletin 48/206, to the subject of bank bankruptcy proceedings and deposit insurance [45].

Box 5: ***Primary differences to bankruptcy under the FLDCB***

Bank Bankruptcy (BA/BBO)	General Bankruptcy (FLDCB)
The SFBC is the authority which decrees and monitors bankruptcy proceedings as well as issues rulings in conjunction with liquidation proceedings.	Depending on the canton, the authority to decree and monitor bankruptcy proceedings as well as to issue rulings in conjunction with liquidation proceedings may be divided among two or three agencies.
There is only one possible type of bankruptcy proceedings, though it may be adjusted in the individual cases of companies to be liquidated.	There are two possible types of proceedings (ordinary or summary), depending on the assets available.
Simultaneous initiation of bankruptcy proceedings and notice to creditors.	Notice to creditors only after assets have been estimated.
Creditors domiciled outside Switzerland are sent notices at their given address.	Creditors domiciled abroad must have a residence in Switzerland in order to receive notices.
Claims evident on the books are automatically included in the schedule of creditors.	All claims must be registered in order to be taken into consideration.
Separation of assets in custody in favour of custody account holders without formal proceedings.	The bankruptcy administrators issue a ruling on the restitution of assets for which a separation request was made.
Bankruptcy privilege of up to CHF 30,000 for depositors and guarantee of the corresponding deposits through deposit insurance.	No privilege for small creditors and no deposit insurance.
Fast payment (apart from schedule of creditors) for depositors with a claim of up to CHF 5,000.	No faster repayment for smaller claims.

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[43] Art. 219 FLDCB and 37*b* BA define the priority.

[44] Twelfth section, Bank Bankruptcy, Art. 33 ff. BA.

[45] SFBC bulletins can be downloaded from the SFBC website (www.ebk.admin.ch) under *Publications/Bulletins*.

Sale by private contract or public auction of assets.	Public auction of assets, sale by private contract is secondary.
Claims to third parties may either be sold or assigned.	Claims to third parties must be assigned and may only be sold as a secondary instance.
With regard to the liquidator's actions, creditors may only contest liquidation actions.	Creditors may contest all actions by the liquidator.

8.2 Taking known claims into consideration

In contrast to a general bankruptcy, the creditors in a bank bankruptcy are not obligated to register their claims. Claims evident from the books, namely those for which creditors were regularly informed through a statement or a certificate of the existence and amount of the claim, are considered to be registered[46]. The domicile of the creditor is immaterial. Creditors belonging to the foreign branches of a Swiss bank are authorised to the same extent and with the same privileges to participate in a bank bankruptcy in Switzerland[47]. This automatism works well.

However, it is possible that creditors outside Switzerland may not be informed of the initiation of certain bankruptcy proceedings, in spite of the simultaneous publication of notice in the Swiss Commercial Gazette and on the website of the SFBC. Since the law takes their claim into consideration, they still participate – though without being aware of it at first – in the proceedings. As a result, they need not bear the consequences of having the proceedings brought to their attention at a later date by a notice from the liquidator or in a publication – as would be the case for a general bankruptcy conducted according to the FLDCB – and are thus relieved from paying additional costs for having their claim taken into consideration with late registration.

8.3 Limited access to bankruptcy documents (professional secrecy)

When creditors are given the opportunity to inspect documents, the liquidator must see to it that privacy is respected (professional secrecy in accordance with Art. 47 BA) [48] However, preservation of privacy, an objective specified by the legislators, should not deter creditors from being able to assert their rights. For this reason, creditors can generally gain access to bankruptcy documents if they can plausibly demonstrate that this access has a bearing on the protection of their own financial interests. Moreover, information received in this way can be used solely for the preservation of those interests (specialty principle). The liquidator can make access to documents dependent on a declaration to this effect and impose penalties in the case of non-compliance[49].

For example, creditors can inspect the schedule of creditors. They are also able to inspect all registered claims and the liquidator's rulings on these claims, as long as

[46] Art. 36 BA and 24 BBO.

[47] With the exception of deposit insurance (see Chapter 9 below).

[48] Art. 36 para. 2 BA and 5 BBO.

[49] Art. 50 BA and 292 CC.

these are claims of creditors of greater or equal priority. They do not, however, have sufficient financial interest to access the claims of subordinate creditors whose recognition by the liquidator has no direct influence on their subsequent claim on dividends.

8.4 Legal status of creditors

In contrast to bankruptcy proceedings under the FLDCB, creditors cannot contest all actions and measures taken by the liquidator, nor can they delay the proceedings to the same extent. In order to increase efficiency, creditors' right to contest has been limited to where it is essential, namely, in realizing proceeds. In this way, creditors' complaints have an influence on the amount that can be distributed at the close of the liquidation proceedings.

A creditor who intends to contest an action or measure taken by the liquidator that is not related to realising proceeds can report the details of their complaint to the SFBC. It is up to the SFBC whether or not to take action[50]. The creditor submitting the report does not have standing in the procedure, and thus is not entitled to be informed of any measures taken[51]. However, if – and only if – the report concerns the realisation of assets, the creditor filing the report can request the SFBC to issue an order that can be challenged in court[52].

Procedures, such as contesting the schedule of creditors or submitting a claim for the segregation of assets, that possible as part of a bankruptcy within the jurisdiction of the civil court are remain possible in bank bankruptcy proceedings. The judge is responsible for following the applicable procedural law for the canton where the bankruptcy proceedings are taking place. In order to avoid any doubts concerning the location where such proceedings are to be held, the SFBC announces a standard bankruptcy forum when it publishes the initial bankruptcy proceedings[53].

8.5 Realisation of assets

The liquidator has significant leeway in realising assets, whether this occurs through sale by private contract or through public auction. However, the liquidator must explain the course of action to be taken in a plan, which is to be presented to creditors on a periodic basis. If the creditors disagree with the methods for realising assets as they are planned, they must request that the SFBC make a ruling on the matter. Any complaints a creditor may present shall be judged by the Federal Administrative Court in the first instance, and then by the Federal Supreme Court in the last instance.

However, certain sales can be made without delay and without being included in the plan for realising assets[54]. This includes assets which are exposed to rapid depreciation

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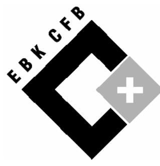
[50] Art. 6 para. 2 BBO.

[51] Art. 6 para. 3 BBO.

[52] See Chapter 8.5 below.

[53] Art. 8 and 11, para. 2c BBO.

[54] Art. 7 para. 2 BBO.



(relative to their value), which cause disproportionately high administrative costs, which are traded on a representative market (stock exchange) or are not of significant value[55]. In general, costs associated with selling the assets are taken into account in order to prevent these costs from exceeding the proceeds of the sale. The expected proceeds determine the way the liquidator will proceed.

In contrast to general bankruptcy proceedings, where unsubmitted claims against third parties are sold to the highest bidder only in a secondary instance, the provisions for bank bankruptcy make it possible to realise these assets in the first instance[56], if no creditor demands that they be assigned[57]. In practice this approach is generally more advantageous for the creditors as a whole than assignment to an individual creditor, where any surpluses are only distributed to the bankruptcy estate after the assignee has been completely covered (see box 6).

Box 6: ***Sale of claims belonging to the bankruptcy estate***

In a recently opened bankruptcy proceeding where the bankruptcy estate had no liquid assets that could be used to conduct a bank insolvency proceeding, the SFBC did not appoint a liquidator. However, the bankruptcy estate had claims against two Italian municipalities amounting to approximately between EUR 0 and EUR 10 million. Before going bankrupt, the company had tried for many years in the Italian courts to order the payment of these contested claims. The proceedings did not go beyond the first stage. Because the bankruptcy estate did not have means available to take the proceedings further, they announced in an Italian newspaper that they would possibly sell the claims to the highest bidder. This announcement attracted so much interest that a private auction was organised, raising more than CHF 2 million for the bankruptcy estate. The SFBC was therefore able to appoint a liquidator, and the bank bankruptcy proceedings could proceed.

Additionally, it is not mandatory to convert assets from a bank bankruptcy into liquid assets in order to distribute them to creditors. Should it prove advantageous for a significant majority of creditors, and if the creditors approve of the move, it is also possible to distribute assets belonging to the bankruptcy estate in whole or in part as with a debt restructuring agreement with assignment of assets (see box 7).

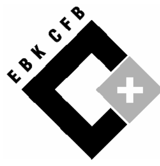
Box 7: ***Distribution of dividends in the form of financial products***

In a bankruptcy case dealing with a foundation that accepted public funds for commercial purposes without authorisation, a pragmatic solution was found for repaying the funds to creditors. Part of the client deposits were invested in a structured financial product with a guaranteed minimum return, which was issued by a accredited and supervised foreign finance company. Early repayment of the financial product was not possible without incurring a significant loss. The two main investors, who were also the closest to the foundation, agreed to accept the financial product, which was purchased at the current rate, as partial payment and take the remainder in liquid form. All other creditors were repaid in liquid form. The financial product that the investors purchased appreciated, and the solution allowed a dividend of 100% to be distributed to creditors.

[55] Art. 29 para. 3 BBO.

[56] Art. 19 para. 6 BBO.

[57] Art. 260 para. 3 FLDCB



8.6 Assets held abroad

The bankruptcy estate includes all of the company's realisable assets at the time the bankruptcy proceedings are opened, regardless of whether they are in Switzerland or abroad[58]. Experience shows that recovering assets held abroad differs greatly according to the country in which they are held, and it depends especially on the whether the bankruptcy decree opened by the SFBC in Switzerland is recognised. In certain countries, such as Germany, the bankruptcy decree is automatically recognised, which enables the liquidator to act without (substantial) hindrances. In specific cases the procedure is the same in the US, where the Swiss bankruptcy liquidator can be recognised as liquidator given certain conditions. In other countries, it is possible to request that assets be released for the benefit of the Swiss bankruptcy estate. Under certain circumstances this is also possible in the Principality of Liechtenstein, once it has been determined in a ruling there that the Swiss bankruptcy proceeding guarantees reciprocity (at least) to the same extent.

Our experience shows that – achieving a standardised liquidation in the interests of all creditors – it is often simpler to rely on company law to control certain assets before bankruptcy proceedings are opened. This makes it possible for the expert investigator appointed by the SFBC (and future liquidators, as the case may be) to act as the governing body of the company that is the object of the SFBC investigation, and in this capacity to control the company's assets without a special recognition process. Once bankruptcy proceedings have been opened, this can occur only by having the bankruptcy decree recognised, which depending on the country can be more or less simple to achieve.

9 Deposit insurance system

The deposit insurance system for banks and securities dealers guarantees all deposits in their Swiss branches up to a maximum amount of CHF 30,000 per creditor[59]. The domicile of the creditor is immaterial. "Deposits" refers to assets in accounts, and not to assets in securities safekeeping accounts whose contents are not included in the liquidation trust but are instead segregated beforehand for the benefit of the depositor[60]. The deposit insurance as a whole is limited to a maximum amount of CHF 4 billion[61]. Deposits at foreign branches of Swiss banks are not covered under the deposit insurance scheme.

In this context, banks and securities dealers have created a SFBC-approved deposit insurance association[62], which guarantees that payment of insured deposits occurs within a period of three months following the opening of bankruptcy proceedings, or that

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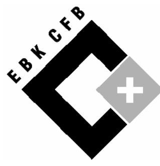
[58] Art. 3 BBO.

[59] This includes medium-term notes deposited at the bank in the depositor's name (Art. 37*b* BA).

[60] Art. 37*d* BA.

[61] Art. 37*h* para. 3b BA.

[62] www.einlagensicherung.ch/



certain protective measures are imposed[63]. The deposit insurance association holds no assets. In addition to legally prescribed liquidity requirements, banks and securities dealers are obliged to hold permanent liquid assets amounting to half of their maximum contribution obligations[64]. Banks and securities dealers report the total of the privileged deposits stated on their balance sheets to the SFBC annually. Based on the information provided, the SFBC calculates the proportion of supplementary liquidity that it is necessary to maintain, and communicates this to the individual banks[65].

In the case of bankruptcy proceedings, the SFBC communicates this ruling to the deposit insurance association and informs them of the total contribution obligations that every bank and every securities dealer must ensure as a proportion, and of the privileged deposits that are to be indicated on the balance sheet of the company that has gone bankrupt[66]. Based on this, the deposit insurance association demands the required contribution obligations from the banks and securities dealers, and then makes the necessary amount available to the liquidator[67]. In parallel to this, the liquidator creates a schedule for payments using claims that qualify as privileged deposits in their bookkeeping[68]. Offsets to privileged claims are not taken into consideration. Except for deposits up to CHF 5,000, which are immediately repaid with assets available (this also excludes offsets), the proceedings must be carried out by the SFBC within three months of when the bankruptcy proceedings are opened with the deposit insurance association. The deposit insurance association enters into the rights of the creditors up to the extent of its payments to them out of the bankruptcy estate.[69] In this way, all creditors whose claims are completely covered within the deposit insurance system are replaced by a single creditor: the deposit insurance association. Small creditors with claims of less than CHF 5,000 whose claim is repaid outside of the schedule of creditors no longer participate at all in the bank bankruptcy proceedings[70].

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[63] Art. 37*h* BA.

[64] Art. 37*h* para. 3c BA.

[65] Art. 19 BO.

[66] Art. 55 BO.

[67] Art. 58 BO.

[68] Art. 57 BO.

[69] Art. 37*i* BA.

[70] Art. 37*a* BA and Art. 25 para. 3 BBO.

Box 8: *The first application of deposit insurance*

The deposit insurance was triggered in response to recently opened bankruptcy proceedings against an approved securities dealer. During the three-month period prescribed by law, an amount of approximately CHF 200,000 was made available to the bank bankruptcy liquidator. However, this money could not immediately be distributed to creditors because certain creditors refused the receipt of payment within their county of domicile. Deposits in accounts up to CHF 5,000 could not be promptly refunded to the creditors in question because all of the company's assets (liquidity) were legally blocked. This kind of blockage also affected the deposit insurance system, which as a result had to indemnify small deposits of less than CHF 5,000 This experience showed for the first time the importance of good communication between all participants in a bankruptcy proceeding, including the deposit insurance association, the liquidator and the penal authorities.

The deposit insurance system makes it possible to repay deposits of up to CHF 30,000 within a period of three months and small deposits of up to CHF 5,000 immediately. However, the system offers customers no direct access to assets amounting to USD/CAD100,000, as in Canada or the US. In this respect, the Swiss deposit insurance system alone probably cannot prevent a surge of customers seeking to recover their assets (*bank run*) in all cases. However, Swiss deposit insurance goes beyond the requirements of European law[71] to the extent that repayments of up to CHF 30,000 are assessed "gross". In other words, any claims the bank has against depositors cannot be validly offset. Also, in contrast to systems in other countries, the Swiss deposit insurance scheme covers deposits in foreign currencies. Further, in contrast to European law, the three-month period cannot be extended.

10 Recognition of foreign bank bankruptcies

Recognition of bankruptcy decrees or liquidation measures issued abroad also fall within the purview of the SFBC[72]. In such cases, the bank bankruptcy proceedings apply also to the realisation of assets in Switzerland as part of an ancillary bankruptcy proceeding[73]. Assets held abroad are not included in these proceedings. This also applies to assets that the Swiss branch of a foreign bank has abroad. While according to general bankruptcy law only secured creditors and privileged creditors with Swiss residency can participate in such proceedings[74], ancillary bank bankruptcy proceedings also allow foreign privileged creditors to participate[75]. This corresponds to the principle of equal treatment for Swiss and foreign creditors as described in Art. 3 para. 2 BBO.

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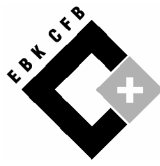
[71] Directive 94/19/EC of the European Parliament and Council of Ministers from 30 May 1994 on deposit insurance schemes.

[72] Art. 37*g* BA.

[73] Art. 10 para. 1 BBO und 170 IPLA.

[74] Art. 172 IPLA.

[75] Art. 37*g* para. 3 BA.



In case ofa branch of a foreign bank in Switzerland and recognition of the foreign bank's bankruptcy in Switzerland, it is possible that two proceedings could occur in parallel: the ancillary bank bankruptcy proceedings that cover all of the assets in Switzerland, and the bankruptcy proceedings for the bank branch[76] that cover all of the branch's assets. In such a case the assets held by the bank branch in Switzerland could fall into two bankruptcy estates. Certain creditors could participate in both of the proceedings in Switzerland, while others could participate in neither. In the interest of efficiency and the equal treatment of all creditors, the SFBC has the authority to coordinate these proceedings in such cases[77]. For example, if it turns out that the creditors are only domiciled abroad the SFBC can suspend any bankruptcy proceedings at the location of the bank branch in Switzerland until the foreign bankruptcy decree has been recognised[78]. However, even in such a case it is not possible under current law to dispense with an ancillary bankruptcy proceeding in Switzerland and to give the foreign liquidator direct access to the assets held in Switzerland. The SFBC must recognise the foreign bank bankruptcy, open ancillary bank bankruptcy proceedings in Switzerland and continue them until settled. Additionally, any remaining amounts cannot simply be handed over to the foreign liquidator. First, the foreign schedule of creditors must be approved. In such cases it would clearly be more efficient – and also in the creditor's interests – if the foreign liquidator could be given access to the assets held in Switzerland at the same time as the foreign bankruptcy is recognised in Switzerland.

11 Group bankruptcy

In Switzerland there is no specific law for group companies, nor is there a corresponding bankruptcy law for them, though at present there are numerous debates on this issue. This is also true of banking law, and the new provisions for bank insolvency have not changed this. Therefore, it is not possible under current law to liquidate all of the companies within a group in a single proceeding. As a consequence, creditors of the various companies of a group which has fallen into bankruptcy find themselves in a different situation. Their prospects of having part of their claim repaid thus depend on the financial situation of the individual companies with which they have a claim.

The SFBC and their liquidators are bound by current law. However, there are two possible ways to compensate for this unequal treatment when a group company is liquidated:

1° The creditors file their claims in the bankruptcy proceedings for all of the companies in the group (joint and several liability). This possibility is appropriate when the company against which the creditor actually has the claim cannot be clearly determined (for example, because all of the companies appeared under the same company name).

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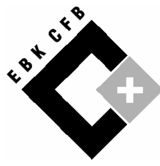
[76] Art. 50 FLDCB establishes a bankruptcy location for the bank branch.

[77] Art. 37*f* para. 1 BA.

[78] FF 2002 *8098*.



2° Each company files a claim in the bankruptcy proceedings of the other companies of the same group for a repayment of payments made prior to the initiation fo bankruptcy. In doing this, it is possible to achieve at least a partial redistribution between the creditors of the different companies.

12 Courts and bank bankruptcy

Of the 113 bankruptcy proceedings that the SFBC has opened since the end of 2004, in 27 cases appeals were brought to the responsible courts (Federal Supreme Court and since 1 January 2001, the Federal Administrative Court) on the issue of the bankruptcy proceedings. To date, no appeal has been approved. The realisation of assets, which creditors can also appeal, has only been contested in a single case. The appeal process is still pending.

Since then, the various courts have generally become aware that the SFBC acts as a judge in bank bankruptcy cases. However, there has not yet been a case where a bankruptcy petition against an unauthorized by the SFBC has been transferred by ordinary courts to the SFBC[79]. This is because it is difficult to judge at the time that bankruptcy proceedings are opened whether a company is operating as a bank or securities dealer without approval. This problem will probably persist for such companies. The significance of this needs to be put in perspective, however. Because the SFBC has not yet decided whether such companies fall within the purview of one of the laws that it monitors, the competency of judges in ordinary courts of law is not in question, barring exceptional cases.

With certain reservations [80], cooperation with the cantonal criminal prosecution authorities is functioning well. In countless cases it has been possible to work out a common strategy based on SFBC information, which allows creditors to recover their assets expeditiously in bank bankruptcy cases and the criminal prosecution authorities to prosecute offending parties effectively.

13 Conclusions

Initial experiences with regard to bankruptcy have been positive. As promised, the procedure has proven itself to be flexible and efficient in the interests of creditors. The SFBC has in fact liquidated mainly unauthorised financial intermediaries since the new system came into force. Aside from the bankruptcies of three small authorised securities dealers, the SFBC has fortunately not had to declare any banks bankrupt to date. However, the experience gained by the SFBC as supervisory authority for the bankruptcy of banks in connection with the liquidation of unauthorised financial

[79] Art. 173*b* FLDCB.

[80] 2006 SFBC Annual Report, p. 45; see also box 8.

intermediaries will be of considerable benefit to it should it ever have to order and supervise the liquidation of a major banking institution.

The system of deposit insurance has only been tested in one (minor) case. It worked well, but its limits are known. While it enables the creditors worst affected by the bankruptcy to be repaid within a reasonable period of time (three months), it does not afford them direct access to their assets. It is therefore not suited to preventing panic among the clients of a bankrupt bank and thus a "run on the bank" in which clients rush to move their money elsewhere. In addition, it must be remembered that the system of deposit insurance and the related privileges put other creditors, especially those in the third class, at a disadvantage[81]. Last but not least, it enables a maximum of CHF 4 billion to be insured, which is sufficient only for small and medium-sized banks. The bankruptcy of a large bank whose privileged assets exceed this amount would stretch the system to its limits and result in a reduction in the amount of insured deposits. Conscious of the limits inherent in any insurance system, the legislator chose to accommodate the financial sector's wish for a solution that is efficient but not costly rather than pursuing a more ambitious system such as a permanent insurance fund.

The bank restructuring procedure has not been used to date. This procedure may be used, however, if there is a possibility that – despite the failure of informal restructuring efforts – the financially embattled financial institution may be able to keep its business going within the constraints of its licence with support from the state. The flexible restructuring procedure, combined with additional protection measures where appropriate, is generally the best way to preserve creditors' interests.

It is likely to be difficult to meet the need for a bankruptcy procedure for group companies. In particular, a solution on an international scale would have to be sought here, since it is often the case that the companies concerned are domiciled in a variety of different countries. On the other hand, in the interests of creditors both in Switzerland and abroad, **a simpler and quicker procedure for recognising foreign bankruptcy declarations**, which would obviate the need for ancillary bankruptcy proceedings, should be looked into.

III. International bank insolvency

14 Challenges posed by international bank insolvency

Substantial challenges arise when a bank with international operations and branches outside Switzerland gets into difficulty. The various regulations and responsibilities, together with the territorial nature of insolvency rules, make it harder to find a solution that preserves value across all parts of the company. International cooperation is only possible to the extent that national laws allow.

[81] SFBC Annual Report 1993, p15ff

Differing national regulations and responsibilities

The spectrum of regulatory approaches ranges from a fully autonomous procedure for dealing with bank insolvency outside the scope of general bankruptcy law – as practised in the US and Switzerland, for example – to jurisdictions such as the UK having no special rules at all for banks but instead applying general bankruptcy law to banks. Depending on the national insolvency rules, various authorities are responsible at the national level. In Switzerland, for instance, the supervisory authority is responsible for restructuring procedures, whereas in other countries a bankruptcy authority or court (e.g. in the UK) or a deposit insurance body (e.g. in the US) is in charge. These significant differences stand in the way of measures being properly coordinated and authorities working together constructively.

Impact on supervisory practice of a mismatch between consolidated supervision and insolvency law

In cases of crisis, internationally active banks are subject to the provisions of national insolvency law. These differs from country to country and do not follow the principles underlying consolidated supervision, according to which the various aspects of an internationally active bank's global business are taken as a whole, and in some cases does not follow it at all. For example, minimum capital adequacy requirements are applied for internationally active banks without the primary focus being on where the assets are held. However, if a bank has a branch in a country that practises a separate procedure for branches, the question of which assets can be ascribed to that branch is of crucial importance in the event of bankruptcy.

Asymmetry of national interests

The various national authorities pursue different interests in accordance with their legislative mandates. As a rule, they are most concerned with protecting domestic creditors. Authorities in a number of countries can impose measures at any time or when there is a threat of insolvency to block assets equal to all or part of the total claims of domestic creditors within their jurisdiction against access from other countries ("asset maintenance").

Territoriality instead of universality

In some countries, authorities can seize assets in order to use them exclusively to cover the claims of domestic creditors ("ring fencing"). In this way, it is possible in some countries for separate proceedings to be initiated against foreign bank branches, even though these form a single legal entity together with the foreign head office.

No automatic recognition abroad

Measures to protect creditors are not automatically recognised in all countries. This can make access to assets of the insolvent bank located abroad in the interest of creditors difficult, especially when foreclosure actions can be undertaken concerning these assets.

Unequal treatment of creditors

Territorially focused insolvency procedures and numerous differences in material rules (e.g. bankruptcy privileges) and appeal processes, as well as differing depositor protection provisions, mean that similar claims against the same institution are not always treated equally. The bankruptcy dividend a bank's creditors receives may differ considerably depending on the country in which they do business with the bank.

15 International initiatives

There are currently no international norms whatsoever regarding how to deal with cross-border bank insolvency. Various international fora and institutions have been looking into this problem since the early 1990s.

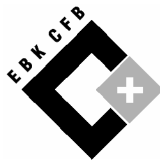
Basel Committee

The Basel Committee on Banking Supervision is an international committee of bank supervisors. Since 1974, it has been contributing in no small measure to the use of internationally aligned principles in bank supervision at the national level. Following the BCCI case, which brought to light the problem of differing national procedures, the Basel Committee set up a working group that published a report in December 1992 entitled "**The Insolvency Liquidation of a Multinational Bank**" [82]. The report acknowledged that there was room for improvement but failed to follow up the issue. The Basel Committee's **Task Force on the Winding Down of Large and Complex Financial Institutions** dealt in 2000/2001 with the problems arising when crisis strikes a major international financial group. The solution approaches proposed in an unpublished report dated 5 March 2001 are limited to strengthening the exchange of information and cooperation. On the initiative of the Financial Stability Forum (FSF), the Basel Committee mandated a further task force in July 2001 to draw up guidance on how to deal with weak banks. In its report (**Supervisory Guidance on Dealing with Weak Banks**: Report of the Task Force on Dealing with Weak Banks, Basel Committee on Banking Supervision, March 2002) [83], the task force discussed early-warning measures for identifying weak banks and the various instruments under supervisory law for supervisory authorities to intervene at an early stage and restructure such banks.

On the initiative of the US banking supervisory authorities, the Basel Committee set up a working group at the end of 2007 to carry out a detailed review of the existing legal frameworks in the individual member states for dealing with financial problems at banks. The working group, chaired by the SFBC and the US Federal Deposit Insurance Corporation (FDIC), will start work in the first quarter of 2008.

[82] http://www.bis.org/publ/bcbs10c.pdf

[83] http://www.bis.org/publ/bcbs88.pdf?noframes=1



Group of Thirty

In 1995, following the Barings case, the Group of Thirty (G30) joined forces with the International Federation of Insolvency Practitioners (INSOL) to form a working group to study the regulatory and financial problems that can arise when an international financial institution collapses. The working group drafted 14 recommendations to strengthen the regulatory framework for dealing with such cases of bank insolvency ("Group of Thirty, International Insolvencies in the Financial Sector, A Study Group Report, 1998")[84]. These recommendations attached the most importance on the one hand to improving cooperation between the relevant domestic and foreign authorities and on the other to creating clear legal principles that ensure netting agreements between market participants are recognised and legally enforceable in cases of insolvency.

G10

The G10 report ("Insolvency Arrangements and Contract Enforceability: Report of the G10 Contact Group on the legal and institutional underpinnings of the international financial system", September 2002)[85] sheds light on the status quo and the legal problems arising from the existing frameworks for dealing with cross-border insolvency in the financial sector, in particular the problems of netting and realising collateral in a cross-border context.

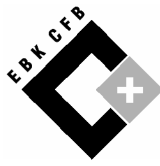
European Union

The only multilateral agreement on dealing with bank insolvency concluded to date is between the EU member states. According to Directive 2001/24/EC on the reorganisation and winding up of credit institutions[86], reorganising and winding up an EU credit institution is the exclusive responsibility of the authorities and courts of the member state in which the institution in question was first licensed to conduct banking business. The decision by this member state to wind up the institution (i.e. to initiate liquidation proceedings) is recognised by the other member states *ipso iure* at the time the proceedings are begun. The effects of reorganisation and liquidation in terms of procedural and material law depend on the home member state's laws. However, the Directive does not harmonise the type and characteristics of measures to be taken, so the individual member states' regulations remain as diverse as ever. The Directive only applies with respect to institutions from Switzerland and other third countries when a Swiss bank operates branches in at least two member states. In this case, the rules set out in the Directive are limited to an obligation on the part of these member states' authorities to work together. As regards third countries, meanwhile, the Directive governs neither the responsibilities nor the effects in terms of recognition.

[84] http://www.group30.org/pubs/pub_0995.htm

[85] http://www.bis.org/publ/gten06.htm

[86] http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&type_doc=Directive&an_doc=2001&nu_doc=24&lg=en



The European Commission conducted a public consultation on the Directive on the reorganisation and winding up of credit institutions in summer 2007[87]. The aim was to examine whether the Directive completely fulfils its purpose, whether its scope of application should be extended to include subsidiaries within the EU and to ensure that banking groups can be dealt with in a standardised procedure, and how obstacles with regard to the transfer of assets within such groups can be overcome. An assessment and a report on the next steps are expected during 2008.

16 SFBC's international involvement

Approaches to solve the clearly recognised **problems of international bank insolvency** are largely limited to recommendations on **information exchange** as well as **cooperation** and **drafting memoranda of understanding (MoUs)** between authorities. However, since legally non-binding "best effort" declarations have no binding effect whatsoever, these initiatives are of little practical help. As a result, the uncertainty persists as to how the foreign authorities affected would behave in such exceptional situations. Constructive improvements would require binding international agreements and also adjustments to national legislation,

The SFBC feels there is a need for action here at the international level. In March 2003, it held a joint conference with the Swiss National Bank (SNB) on the topic of international bank insolvency. Representatives of supervisory authorities, central banks and international organisations attended the seminar, which was aimed at finding ways to achieve improvements.

On the initiative of the SFBC and the US Federal Deposit Insurance Corporation (FDIC), representatives of interested supervisory authorities and central banks met in spring 2007 to look in depth at the existing legal frameworks for dealing with financial problems. One of their objectives was to achieve a better understanding of the crisis resolution frameworks in key home and host jurisdiction in order to improve their own contingency preparedness. The group's work made it clear that a lack of coordination results in conflicts between national measures that make value-preserving solutions impossible. This problem can only be solved through better coordination of national authorities' measures. However, working out agreements to this effect is no easy task. Even before a crisis occurs, therefore, efforts must be made to reach a mutual understanding among the relevant supervisory authorities.

17 SFBC's position

In the SFBC's view, an international bank insolvency can scarcely be handled effectively in a globalised financial world without close coordination between domestic and foreign authorities. Since every banking crisis is different, and since the solution

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[87] http://ec.europa.eu/internal_market/bank/windingup/index_en.htm

depends to a great extent on the causes of the crisis, it is not really possible to draft a script for dealing with future crises. However, rapid action is essential in the case of a bank insolvency more than in insolvency cases outside the financial sector. It is therefore important that the opportunities for and limits on international cooperation are clearly determined at the earliest possible stage.

Maximum coordination can minimise the detrimental effects of a banking crisis on the financial system and serve to maximise value in the interests of creditors. Constructive improvements would require binding international agreements and also adjustments to national legislation, but it is hardly possible for this problem to be solved among banking supervisory authorities, since most countries' supervisory authorities – unlike the SFBC – have no powers in insolvency cases. An international treaty setting out a global standard for bank insolvency law is also unrealistic for the foreseeable future.

Improved coordination between authorities and perhaps also adjustments to national regulations could bring about substantial improvements on the current situation, provided the following conditions are met:

(1) All the authorities concerned should have the flexibility required to coordinate national measures with each other.

(2) The applicable insolvency rules should ensure equal treatment of all creditors and allow domestic and foreign creditors to participate in the insolvency proceedings on the same terms.

(2) Insolvency measures ordered in other countries should be recognised quickly and, wherever possible, automatically.

(3) All the authorities concerned should be allowed to exchange the information required to deal with the insolvency with each other.

The SFBC is committed to improving the frameworks for international bank insolvency at the international level along these lines.