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Two messages on the financial system package adopted

Bern, 05.11.2008 - At its meeting today, the Federal Council adopted the dispatch on the package of measures to strengthen the Swiss financial system. It contains the Federal Decree on a loan for the recapitalisation of UBS. In addition, the Federal Council has decided to submit effective measures to Parliament quickly to improve depositor protection. The necessary amendments to the Federal Act on Banks and Savings Banks (Banking Act) are to enter into force immediately after their adoption. Both transactions will be discussed by the Federal Parliament in the coming winter session.

On 15 October 2008, the Federal Council, the Swiss National Bank SNB and the Federal Banking Commission SFBC adopted a package of measures to stabilise the Swiss financial system and sustainably strengthen confidence in the Swiss financial market. The severe turbulence of the global financial markets in Switzerland had mainly affected the two major banks involved in the US market. UBS was hit much harder than Credit Suisse. Towards the end of the 3rd quarter of 2008, UBS's vulnerability manifested itself in a sharply increased outflow of client funds, an unsatisfactory earnings development and, despite countermeasures, still problematically high exposure to illiquid assets.

Since it could not be ruled out that UBS could fall into an intensified crisis of confidence in further deteriorating markets, which could have led to a massive burden on the Swiss financial system, measures were needed to strengthen the overall system. The failure of a major bank could have destabilized Switzerland's liquidity supply and payment system, at least in the short term, which would have had serious, long-lasting economic consequences.

UBS package of measures

The Swiss package of measures addresses where the main problems lie: it supports a systemically important institution by relieving its balance sheet of illiquid assets and at the same time strengthening its own funds. This part of the package consists of two main measures:

- The first measure, which is within the SNB's competence, is the transfer of UBS's illiquid assets to a special purpose vehicle amounting to a maximum of 60 billion. US dollar. This will provide the Bank with additional liquidity. At the same time, it is relieved of risks in this way. The SNB can better bear the risks, as it can wait until the markets have recovered from realising these assets. This support measure is subject to conditions. This includes, among other things, equipping the special purpose vehicle with equity of a maximum of 6 billion. US dollars by UBS.
- With the second measure, UBS's equity base will be strengthened by subscribing to a mandatory convertible bond in the amount of 6 billion euros. Franconia strengthened by the Confederation. This measure is directly linked to the relief of UBS from illiquid assets. It enables the bank to provide the special purpose vehicle with the necessary equity capital without reducing its own capital base. For the Confederation, the mandatory convertible bond has the advantage that the commitment is adequately and securely compensated (coupons of 12.5%) and that the Confederation - at least for the time being - does not become a co-owner of the bank. The Federal Council endeavours to limit the timing of the Confederation's participation.

This requires a clear exit strategy, which includes, among other things, the possibility that the Confederation will divest itself of its exposure during the term of the bond.

The legal basis for the measure to strengthen UBS's own funds base is an ordinance pursuant to Articles 184 (3) and 185 (3) of the Federal Constitution. The Federal Council has thus taken into account the urgency of the capital increase in view of the unfavourable developments on the financial markets. The approval of the necessary loan at the expense of Addendum II to the 2008 estimate was granted with the consent of the financial delegation. With this dispatch, it will be submitted to the Federal Parliament for subsequent approval.

Reinforcement of depositor protection

As a second element of the package of measures to strengthen the financial system, an adjustment of Swiss depositor protection is unavoidable. The revision proposed by the Federal Council consists of five elements:

- The protected deposits are to be increased from CHF 30,000 to CHF 100,000. This would mean that deposit protection in Switzerland would be well above the recently raised minimum limit in the EU.
- Banks will now be obliged to hold domestically backed receivables or other assets located in Switzerland on a permanent basis, depending on the privileged deposits of their customers. This gives customers the certainty that their privileged deposits with any bank in Switzerland are safe. The majority of banks already meet this minimum requirement or will be able to meet it in the near future. The SFBC may grant exceptions in justified cases.
- It also provides for a more generous immediate disbursement of secured deposits from the funds of the troubled bank. The SFBC will determine the amount of the immediate payment on a case-by-case basis. However, the corresponding amount should be several times the current possible 5000 francs.
- The system upper limit of depositor protection is to be set at 4 billion euros from today. Francs to 6 billion Swiss franc.
- Finally, the Federal Council proposes to privilege deposits with pension foundations separately and in addition to the bank deposits already secured today.

The immediate measures must take effect immediately in accordance with their purpose. The necessary amendments to the law should therefore be declared urgent and enter into force immediately after their adoption. The urgent provisions are to apply until 31 December 2010. Until then, depositor protection can be transposed into ordinary law with fundamental improvements.

Further measures

The package of measures to strengthen the financial system contains four further elements:

- The ongoing reform of stock corporation law is to be improved by additional regulations of the compensation systems. At the same time, the SFBC will develop minimum standards for the entire financial sector. UBS will also be obliged to realign its compensation systems for the Board of Directors and management in consultation with the SFBC and in accordance with the established international institutions. The Federal Government's participation is then subject to the condition that UBS implements the Federal Council's requirements in the area of corporate governance. The implementation is reported in the context of the Federal Council's annual report and the state accounts.
- In addition, the SFBC will adopt stricter capital requirements for the two major banks in November 2008. Generous capital buffers strengthen the resilience of the financial system by providing protection against losses that threaten its existence, as if as a shock damper.
- In addition, the Federal Council intends to carry out a fundamental review of the Deposit Guarantee Scheme by spring 2009. The current system can only be expanded to a limited extent, as its financing is increments (i.e. only provided in the event of the insolvency of an institution). This is associated with significant disadvantages (not immediate availability of funds, risk of a chain reaction). In addition, the current depositor protection system is not in a position to fully secure deposits with the larger banks. The system cap cannot be increased arbitrarily, otherwise the other banks would also get into trouble if a ailing bank were rescued. The system must therefore be reviewed in depth in order to permanently improve depositor protection.

Finally, the Federal Council remains prepared to guarantee new medium-term bank liabilities of Swiss banks on the capital market if necessary.

Address for queries

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