The Banking Regulation Review: Switzerland

Shelby R du Pasquier, Patrick Hünerwadel, Marcel Tranchet, Valérie Menoud and François Meier
Lenz & Staehelin
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Introduction

The Swiss banking industry has a long tradition and has been internationally focused from the outset. Services offered by Swiss banks comprise all banking services.

Currently, there are 239 licensed banks in Switzerland, of which:

a. four are big banks that are part of two global systemically relevant banking groups (G-SIBs) (UBS AG as well as UBS Switzerland AG and Credit Suisse AG as well as Credit Suisse (Switzerland) Ltd) and three are systemically relevant banks or banking groups (SIBs) (Zurich Cantonal Bank, Raiffeisen Switzerland and PostFinance);
b. 24 are (partly) state-owned cantonal banks;
c. 59 are regional banks or savings banks;
d. 67 are foreign-controlled banks (i.e., controlled by significant foreign shareholders); and
e. 26 are Swiss branch offices of foreign banks.

Current challenges to the Swiss banking industry continue to include the implementation and application of regulatory responses to the 2008 financial crisis. Since 2013, the Swiss legislator and regulatory authorities have reinforced the capital adequacy and liquidity requirements and addressed the 'too big to fail' issue in line with the Basel III standards. The last package of reforms making up Basel III, the final Basel III regulations of 2017 (also referred to as Basel 3.1 or Basel IV), is expected to be implemented and enter into force on 1 January 2025 in Switzerland (see Section VII.ii).

In line with international developments, sustainable finance is increasingly becoming the focus of self-regulation (in particular, the Swiss Bankers Association's (SBA) guidelines on the integration of environmental, social and corporate governance (ESG) preferences and ESG risks into investment advice and portfolio management) and the supervisory practice by the Swiss Financial Market Supervisory Authority (FINMA) (e.g., appropriate management of climate risks). In the near future, Switzerland is further expected to enact legislation on the prevention of greenwashing (see Section VII.ii).

The regulatory regime applicable to banks

i Main statutes

Besides the Financial Market Supervision Act of 2007 (FINMASA) governing the supervisory activities and instruments of FINMA, the main federal statutes governing the Swiss financial markets are:

a. the Banking Act of 1934 (BA);
b. the Financial Market Infrastructures Act of 2015 (FMIA);
c. the Collective Investment Schemes Act of 2006 (CISA);
d. the Mortgage Bond Act of 1930 (MBA);
e. the Anti-Money Laundering Act of 1997 (AMLA);
f. the Financial Services Act of 2020 (FinSA); and
g. the Financial Institutions Act of 2020 (FinIA).

These statutes are supplemented by a number of ordinances enacted either by the Swiss government (i.e., the Federal Council) or, as regards more technical aspects, by FINMA; their practical application is further regulated by FINMA circulars.

ii Banking and securities firms' activities

Under Swiss banking laws, a business entity that solicits or takes deposits from the public (or refinances itself with substantial amounts from other unrelated banks) to provide financing to a large number of persons or entities is considered a bank. The conduct of banking activities in or from Switzerland is subject to a licensing requirement and to supervision by FINMA.

Swiss financial markets law makes no distinction between commercial and investment banks, and banks are not limited in the scope of their activities. FinIA provides for a 'licence cascade', in which the banking licence is considered as the highest ranking licence encompassing the authorisation to operate as a securities firm, manager of collective assets (e.g., funds), portfolio manager or trustee without the need to apply for a separate authorisation. This formal simplification, however, does not exempt a licensed bank from adapting, as the case may be, its capital, liquidity, organisation or internal policies to comply with the specific requirements applicable to the conduct of another category of regulated activities.

The main statutes governing the securities business of both banking and non-banking intermediaries in Switzerland are FinIA and FMIA and their respective implementing ordinances. The activities of a securities firm are defined broadly. They encompass the activities of securities brokers acting for the account of clients (client dealers) provided they hold securities deposits or maintain accounts in their books for more than 20 clients, market makers and own-account dealers provided they are members of a trading venue, operate an organised trading facility (OTF) or execute trades for a total value exceeding 5 billion Swiss francs per year in Switzerland.

As regards cross-border banking and securities activities, the Swiss licensing regime is rather liberal: foreign-regulated entities that operate on a strict cross-border basis (i.e., by offering banking or securities services to Swiss investors without having a business presence in Switzerland) do not need to be authorised by FINMA. If, however, the activities of a foreign bank or securities firm involve a permanent physical presence in Switzerland, this cross-border exemption is not available. In practice, FINMA considers a foreign entity to have a Swiss presence as soon as employees are hired in Switzerland. That said, FINMA may also look at further criteria to determine whether a foreign bank has a Swiss presence, such as the business volume of that bank in Switzerland or the use of teams specifically targeting the Swiss market.

However, the provision of financial services to clients in Switzerland on a cross-border basis falls within the scope of FinSA. The latter imposes a number of point-of-sale obligations and duties on financial services providers (e.g., client segmentation, compliance with rules of conduct and organisational measures, affiliation with an ombudsman and registration in a client advisers register; see Section IV).

The granting of a licence to a foreign bank to establish a Swiss branch or representative office is conditional upon the principle of reciprocity being satisfied. FINMA will deem the reciprocity test met if a Swiss bank is permitted to establish a representative branch, office or agency in the country in which the foreign bank has its registered office without being subject to substantially more restrictive provisions than those imposed in Switzerland.

The granting of a licence to a Swiss bank controlled by foreign shareholders is also made dependent upon the reciprocity requirement by the relevant foreign country of domicile or incorporation of the foreign shareholders (see Section VI.i).

iii Other regulated activities

A Swiss bank may also serve as a custodian for collective investment schemes. This type of activity is subject to the CISA and its implementing ordinances.

FINMA further supervises compliance by banks with due diligence duties under the AMLA and its various implementing ordinances.

In 2019, the BA introduced a simplified authorisation for fintech firms, the activities of which are limited to deposit-taking activities to the exclusion of lending activities involving maturity transformation. This licence entitles to accept and hold public funds up to 100 million Swiss francs without any time limit, provided such deposits do not bear interest and are not used to fund a traditional lending business during this period of custody. Currently, only four Swiss entities have a fintech licence.

iv FINMA

The single integrated financial market supervisory authority, FINMA, is responsible for the supervision of banks, securities firms, stock exchanges, collective investment schemes, managers of collective assets, fund management companies and supervisory organisations that are in charge of the ongoing supervision of portfolio managers and trustees, as well as the private insurance sector. FINMA also directly monitors compliance by certain financial intermediaries such as banks and securities firms with their due diligence duties in relation to anti-money laundering and the financing of terrorism.

FINMA is a public institution with separate legal personality. Although it carries out its supervisory activity independently, FINMA has a reporting duty towards the Federal Council, which approves its strategic objectives, as well as its annual report prior to publication, and appoints FINMA's CEO. Parliament is responsible for overseeing FINMA's activities.

FINMA employs around 530 full-time equivalent staff. Its operating expenses are covered by fees and duties levied from the supervised entities. FINMA is able to carry out its tasks within a relatively modest organisation mainly thanks to the dual supervisory system, which relies strongly on external auditors and self-regulatory organisations. Indeed, external auditors carry out direct supervision and on-site audits, whereas FINMA retains responsibility for the overall supervision and enforcement measures (see Section III).

Regulatory duties are delegated to self-regulatory organisations: the SBA, for instance, issues self-regulatory guidelines to its members, which FINMA recognises as minimum standards that need to be complied with by all Swiss banks. In particular, the SBA's guidelines governing banks' duty of due diligence in identifying the contracting party and the beneficial owner of accounts[2] and the portfolio management guidelines[3] play an important role in practice.

Prudential regulation

i Relationship with the prudential regulator

The Swiss banking supervision system is based on an indirect supervision model. Banks, foreign banks' branches and financial groups (or conglomerates) subject to Swiss supervision must appoint an external audit company licensed by the Federal Audit Oversight Authority. The auditor assists FINMA in its supervisory functions: it examines annual financial statements, and reviews whether regulated entities comply with their by-laws and with Swiss financial markets regulation and self-regulatory provisions. FINMA requires that financial and regulatory audits be conceptually separated and may require, where appropriate, that these two audits be carried out by different audit firms. The results of the financial and regulatory audits are detailed in annual audit reports that are to be handed over to the supervised entity and to FINMA. FINMA exercises its oversight and ascertains whether the various regulatory requirements are complied with, largely based on these reports.

In addition, auditors are obliged to inform FINMA if they suspect any breach of law or uncover other serious irregularities. Supervised entities also have a general duty to inform FINMA of any event or incident that may be of relevance from a supervisory perspective. Furthermore, banks have specific reporting duties: for instance, in cases of changes in the foreign controlling persons (or entities), in the qualified shareholders, and in the status of statutory equity capital, liquidity ratios or risk concentrations. Based on these informational tools, FINMA initiates investigations (if necessary, through an appointed investigator) and, if a breach is ascertained, takes enforcement measures aimed at restoring compliance. In cases of serious breach, FINMA can ultimately withdraw a licence. In the event of serious breach (and, in particular, in the event of violation of market conduct rules), FINMA may also order the disgorgement of illegally generated profits, on the other hand, FINMA has no authority to impose fines. In practice, the most common sanctions that FINMA imposes relate to the forced liquidation of unauthorised securities firms, insolvency procedures and sanctions following non-compliance with Swiss know your customer (KYC) rules.

The intensity of the supervision and the direct involvement of FINMA, in particular as regards qualitative aspects of supervision, depend on the category to which a bank is assigned. In this context, FINMA applies a risk-oriented supervision, classifying regulated banks according to their importance (notably in terms of assets under management, deposits and required equity) and risk profile:

a. Category 1 institutions are extremely large, important and complex market participants, which require intensive and continuous supervision;
b. Category 2 institutions are deemed very important and complex, and require close and continual supervision;
c. Category 3 market participants are large and complex, to which a preventive supervision model is applied; and
d. Category 4 and 5 institutions are small to medium-sized participants, for which event-driven and theme-based supervision is generally deemed sufficient.

In response to the 2008 financial crisis, a more rigorous supervisory regime was put in place for G-SIBs (UBS AG as well as UBS Switzerland AG and Credit Suisse AG as well as Credit Suisse (Switzerland) Ltd) and SIBs, as they raise systemic risks. Accordingly, FINMA does not rely exclusively on the reports of the banks' auditors but carries out its own investigations and maintains close contact with the two banking groups.

FINMA supervises G-SIBs and SIBs in an intensive and continuous manner in accordance with a risk-based approach. For several years FINMA has carried out extensive stress tests at Credit Suisse and UBS to periodically and systemically assess their resilience against sharp deteriorations in economic conditions. Systemic banks are subject to a specific regime in terms of capital adequacy (see Section III.iii) and crisis resistance. In this context, they are required to establish detailed recovery and resolution plans, as well as to implement specific corresponding organisational measures. As an example, both Credit Suisse AG and UBS AG have set up a non-operating holding company as group parent (Credit Suisse Group AG and UBS Group AG), and they have transferred Swiss-based systemically important functions to separate subsidiaries (Credit Suisse (Switzerland) Ltd and UBS Switzerland AG). Within FINMA, a specific division, the Recovery and Resolution Division, which is in charge of crisis restructuring and insolvency proceedings, monitors and coordinates these emergency and resolution planning efforts.

In 2020, FINMA introduced a specific regime for small banks (supervisory categories 4 and 5). This regime aims at reducing the regulatory burden on small, particularly liquid and well-capitalised institutions. Banks eligible to participate in the small banks regime may benefit from a significantly less complex regulatory regime under the Capital Adequacy Ordinance (CAO) that allows them to, for example, waive the requirements with respect to the calculation of risk-weighted assets. Likewise, the Liquidity Ordinance (LO) provides for a relaxation of the applicable liquidity coverage ratio (LCR) requirements for these institutions.

ii Management of banks

The granting of a banking licence is conditional upon the fulfilment of certain organisational requirements. In particular, the articles of incorporation and internal regulations of a bank must define the exact scope of business and the internal organisation, which must be adequate for the activities of the bank. As a general rule, two separate corporate bodies must be in place:

a. a board of directors that is primarily in charge of the strategic management of the bank, and the establishment, maintenance, monitoring and control of the bank's internal organisation. The board must comprise at least three members who meet professional qualifications, enjoy a good reputation and offer every guarantee of proper business conduct. Depending on the size, complexity and risk profile of the bank, FINMA may require that the board comprises more than three members. In addition, FINMA expects, as a rule, that a substantial number of the board members have a close relationship to Switzerland in terms of residence, career or education. In practice, FINMA requires at the very least that the chair or vice chair of the board be domiciled in Switzerland. As a matter of principle, the board must be free of any conflicts of interest with the management or with the bank itself. By law, the board of directors of a Swiss bank is non-executive, with a strict prohibition of a double mandate both as director and manager; and
b. the executive management, which also implements the instructions of the board of directors. Its members must meet the various professional qualifications and fit and proper tests. As a rule, FINMA requires that a Swiss bank be managed from Switzerland, and senior managers are typically expected to be domiciled in Switzerland.

Under FINMA practice, the strategic management, supervision and control by the board of directors, the central management tasks of the management, and decisions concerning the establishment or discontinuation of business relationships may not be delegated to another affiliated or non-affiliated entity. As a result, a Swiss bank that is a subsidiary of a foreign group must be granted a certain degree of independence in its decision-making process. General instructions and decisions from a foreign parent entity are permitted, however. For the rest, as a general rule, outsourcing of other functions within a Swiss bank to affiliated or non-affiliated service providers both in Switzerland and abroad is generally permitted, subject to the satisfaction of certain requirements, in particular in relation to Swiss banking secrecy and data protection rules. FINMA Circular 2018/3 governs outsourcing solutions at banks in a principle-based and technology-neutral manner. It imposes, inter alia, the following rules:

a. banks must maintain an up-to-date inventory of all outsourced services, including information regarding the outsourced services, the service provider, the service recipient and the responsible unit within the financial institution;
b. in the case of outsourcing outside Switzerland, banks have to make sure that all necessary data for reorganisation, resolution and liquidation purposes remain accessible in Switzerland at all times;
c. the requirements provided by the Circular are to be complied with regardless of whether outsourcing is within a group, although the intra-group nature of an outsourcing may be taken into account for risk assessment purposes; and
d. banks are required to assess compliance with requirements for data protection and banking secrecy, separately, in light of the relevant applicable statutes.

FINMA Circular 2018/3 applies to all outsourcing arrangements. That being said, outsourcing arrangements that were in place before 1 April 2018 benefit from a transition period until 1 April 2023 to adapt to the new regulatory requirements.

Specific constraints and requirements regarding the organisation of a Swiss bank (e.g., with respect to internal audit, controls, compliance and reporting, segregation between trading, asset management and execution function) vary depending on the actual business and size of the bank.

In this context, FINMA Circular 2010/1 on remuneration schemes, the purpose of which is to increase the transparency and risk orientation of compensation schemes in the financial sector, provides for 10 principles that certain financial institutions must observe. Although these rules do not impose any absolute or relative cap on remuneration, FINMA requires that variable compensations (i.e., any part of the remuneration that is at the discretion of the employer or contingent upon performance criteria) be dependent on long-term sustainable business performance, taking into account assumed risks and costs of capital. FINMA thus expects a significant portion of the remuneration to be payable under deferral arrangements. Furthermore, the compensation policy is to be disclosed annually to FINMA. These rules are notably mandatory for banks and financial groups (or conglomerates) with capital requirements in excess of 10 billion Swiss francs. In practice, this concerns UBS and Credit Suisse. For other financial institutions, the Circular represents guidelines for adequate remuneration policies. FINMA can, however, deviate from this and require, where appropriate, a determined institution to comply with some or all of the provisions of Circular 2010/1.

Finally, FINMA Circular 2017/1 on corporate governance and revised Circular 2008/21 on operational risks integrate the key principles of corporate governance and risk management issued by the Banking Committee on Banking Supervision into Swiss regulation. Of note, FINMA published the final version of the Circular 2023/01 on operational risks and resilience on 13 December 2022, which will replace Circular 2008/21 as of 1 January 2024. The fully revised Circular reflects new technological developments and implements the principles for operational resilience published by the Basel Committee on Banking Supervision in March 2021.

iii Regulatory capital and liquidity

Since 2013, the Swiss legislator and FINMA have gradually introduced the Basel III standards into Swiss law (i.e., rules on eligible capital, on the amount of capital required to absorb losses, risk diversification, liquidity and disclosure). Indeed, the capital adequacy and liquidity requirements are set out in the CAO and the LO in line with the applicable Basel III standards. The Swiss implementation of the last package of Basel III (i.e., the final Basel III standards (also referred to as Basel 3.1 or Basel IV)) that notably seeks to increase credibility in the calculation of risk-weighted assets (RWA), is expected to enter into force on 1 January 2025 (see Section VII.ii).

As the Basel III capital requirements are minimum requirements and Switzerland has a tradition of imposing more stringent capital requirements on its banks, the CAO provides for an additional layer of capital (additional capital), which requires Swiss banks to have additional capital based on the size and specificities of their business.

Compared to Basel III, the CAO provides for:

a. the possibility of a direct deduction from Common Equity Tier 1 capital as an alternative to a risk-weighting of an asset; and
b. the application of requirements on a stand-alone basis for which Basel III does not make any recommendations.

Calculation of capital requirements

As regards credit risks, Swiss banks can choose between the standard approach (international standard SA-BIS) and an internal ratings-based approach (IRB) in its two variations: foundation IRB or advanced IRB.

As regards operational risks, Swiss banks can choose between the basic indicator and the standard approach as simple methods. A Swiss bank having the necessary resources may also choose the advanced measurement approach and thereby use a tailor-made proprietary risk model approved by FINMA.

As regards market risks, the CAO implements the respective rules developed by the Basel Committee in cooperation with the International Organization of Securities Commissions. Capital requirements must be met both at the level of the individual institution and at the level of the financial group or conglomerate. Stand-alone reporting is required on a quarterly basis and consolidated reporting on a semi-annual basis.

The required capital is as follows.

Minimum capital requirements

The minimum capital requirements (after application of regulatory adjustments) call at all times for an aggregate (Tier 1 and Tier 2) capital ratio of 8 per cent of a bank's risk-weighted assets, with a minimum Common Equity Tier 1 capital ratio of 4.5 per cent and a minimum Tier 1 capital ratio of 6 per cent of such risk-weighted assets.[4] In this context, banks' assets are notably weighted against credit risk, non-counterparty-related risks, market risks, operational risks, risks under guarantees for central counterparties and value adjustment risks in connection with derivative counterparty credit risks.

Capital buffer

Banks must have a capital buffer up to the amount of the total capital ratio in accordance with requirements specified in the CAO for each bank category. If the minimum ratio is not met because of unforeseeable events, such as a crisis within the international or Swiss financial system, this does not amount to a breach of the capital requirements, but a deadline will be set by FINMA for replenishing the capital buffer.

Countercyclical buffer

The Swiss National Bank (SNB) can request the Federal Council to order that banks must maintain a countercyclical buffer of up to 2.5 per cent of all or certain categories of their risk-weighted assets in Switzerland in the form of Common Equity Tier 1 capital if this is deemed necessary to back the resiliency of the banking sector with respect to risks of excessive credit expansion or to counter an excessive credit expansion. Following its deactivation at the outset of the covid-19 pandemic in March 2020, the Federal Council reactivated the countercyclical buffer of 2.5 per cent applicable to loans secured by Swiss residential property as of 30 September 2022.

Extended countercyclical buffer

Banks with total assets of at least 250 billion Swiss francs, of which the total foreign commitment amounts to at least 10 billion Swiss francs, or with a total foreign commitment of at least 25 billion Swiss francs, are further required to maintain an extended countercyclical buffer in the form of Common Equity Tier 1 capital. An extended countercyclical buffer is calculated on the basis of foreign private sector credit exposures, including non-bank financial sector exposures.

Additional capital requirements

In special circumstances and on a case-by-case basis, FINMA may demand that certain banks maintain additional capital, notably to respond to risks that FINMA deems not adequately covered by the minimal capital requirements. The additional capital requirements, with the capital buffer, primarily aim at ensuring that the minimum capital requirements can also be met under adverse conditions.

Qualifying capital

To qualify under the capital requirements, equity must be fully paid in or have been generated by the bank. As a rule, it cannot be directly or indirectly financed by the bank, set off against claims of the bank or secured by assets of the bank. All qualifying capital must be subordinated to all unsubordinated claims of creditors in the case of liquidation, bankruptcy or restructuring of the bank. Capital instruments that are not only convertible, or subject to a conditional waiver in the case of an imminent insolvency of a bank, are qualified based on their respective terms prior to conversion or reduction, other than in the context of the requirements for additional capital or convertible instruments of systemic banks.

The capital qualifying under the above general requirements is divided into Tier 1 capital and Tier 2 capital. Tier 1 capital is, in turn, subdivided into:

a. Common Equity Tier 1 capital, which consists of the paid-in capital, disclosed reserves, reserves for general banking risks (after deduction of latent taxes unless provided for) and profits carried forward and, with certain limitations, profits for the current business year as shown on audited interim financial statements reviewed in accordance with FINMA guidelines; and
b. Additional Tier 1 capital, which consists of perpetual equity or debt instruments with restricted optional repayments and discretionary distributions providing for a conversion into Common Equity Tier 1 instruments (or, in the case of equity instruments without a conversion feature, a waiver of any privilege over Common Equity Tier 1 instruments), or a reduction and write-off to contribute to the restructuring of a bank in the case of its threatened insolvency (point of non-viability (PONV)). The conversion or reduction must take place no later than at the acceptance of public aid or when ordered by FINMA to avoid insolvency in the case of equity instruments, whereas an additional trigger of breaching a minimum threshold of 5.125 per cent of Common Equity Tier 1 capital is required for debt instruments. Debt instruments with capital reduction may provide for a conditional participation in the benefits of a subsequent recovery of the bank's financial situation. Additional Tier 1 capital issued by a special purpose vehicle, the proceeds of which are immediately and without restrictions passed on to the ultimate holding company or an operative company of the group in the same or higher quality, qualifies as Additional Tier 1 capital on a consolidated basis.

Tier 2 capital consists of equity or debt instruments with a minimum term of five years with restricted optional repayments and discretionary distributions providing for their conversion or reduction at such time as the bank reaches the PONV as for Additional Tier 1 capital. During the five years before final maturity, the amount of such instruments that qualify is reduced by 20 per cent of their nominal amount for each year.

Regulatory deductions

Banks must apply full or threshold deductions to the above capital elements to account for various items, such as losses, unfunded valuation adjustments, goodwill, deferred tax assets and defined benefit pension fund assets in line with the Basel minimum standards.

Leverage ratio

Based on the LO, which implements a leverage ratio in line with Basel III, FINMA Circular 2015/3, 'Leverage ratio – banks' defines the methodology for calculating the leverage ratio in line with the Basel III methodology.

In accordance with Basel III requirements, the CAO requires a risk-weighted capital ratio as well as an unweighted capital adequacy requirement for all non-systemic banks. A safety net in the form of a leverage ratio has been implemented and provides for a minimum core capital (Tier 1) to a total exposure ratio of 3 per cent for all non-systemic banks. The FINMA Circular 2015/3 enables banks to also apply the Basel III standard approach for derivatives when calculating the leverage ratio.

Risk diversification rules

The maximum risk concentration permissible is 25 per cent of the overall required capital (after application of required deductions). The CAO provides that risk concentrations are to be measured only against core capital (Tier 1), meaning that supplementary capital (Tier 2) is generally not taken into account. Moreover, banks are allowed only very restricted use of models for determining their risk concentrations, as modelling errors have a major impact when calculating these risks. The risk diversification provisions in the CAO are supplemented by FINMA Circular 2019/1, 'Risk diversification – banks'.

Compliance with capital adequacy requirements has to be reported to the SNB on a quarterly basis and is one of the topics addressed in the long-form reports issued by banks' external auditors on a yearly basis.

Liquidity requirements

The LO sets out the quantitative and qualitative requirements for the minimum liquidity for banks. Although FINMA is in charge of the implementation and enforcement of the LO, it must consult with the SNB on any questions relating to its implementation.

The LO implements the quantitative elements required by the Basel III framework for the LCR. The implementation of the net stable funding ratio (NSFR), which was postponed owing to delays in the introduction of the NSFR on the EU and US financial markets, was implemented in July 2021 (along with the revised FINMA Circular 2015/2 on the liquidity risks for banks), in line with the implementation in the EU and US. As mentioned in Section III.i, reduced LCR requirements apply to small banks, which are further detailed in FINMA Circular 2015/2.

Banks have to report their LCR at each month end to the SNB. Banks that hold privileged deposits must maintain additional liquid assets to cover their respective obligations, as set by FINMA, based on the amount of privileged deposits reported annually by the bank.

Specific regime applicable to systemic banks: capital, liquidity and risk diversification

The CAO sets out the specific capital requirements for SIBs and G-SIBs in line with G20 standards.

SIBs must have sufficient capital to ensure continuity of their service at times of stress and to avoid state intervention, restructuring or winding up by FINMA (i.e., going concern capital requirement). The going concern requirement consists of a basic and a progressive component and is set with respect to both the bank's leverage ratio and its risk-weighted assets.

The progressive component is calculated based on the degree of systemic importance of a bank, such as its size and market share. The basic going concern capital requirement of a SIB consists of a base requirement of 4.5 per cent leverage ratio and a 12.86 per cent risk-weighted assets ratio, and a surcharge. With the inclusion of the surcharge, Credit Suisse has for instance to comply with a 5 per cent leverage ratio and a 14.3 per cent risk-weighted assets ratio. The size of the surcharge is set with respect to the degree of systemic importance (i.e., the total exposure and the market share of the relevant SIB). The going concern requirement is further split into a minimum requirement component of a 3 per cent leverage ratio and an 8 per cent risk-weighted assets ratio that a SIB has to maintain at all times, and a buffer component by which a SIB may temporarily fall short (e.g., in the case of losses and under strict conditions).

Systemic banks operating at an international level are further subject to an additional capital requirement to guarantee their recovery or the continuation of their systemic functions in an operating unit while liquidating other units without support from the public (i.e., gone concern requirement). By analogy, the gone concern requirement of a G-SIB quantitatively corresponds to its total going concern capital requirement: that is, a minimum 4.5 per cent leverage ratio and a minimum 12.86 per cent risk-weighted assets ratio, plus any surcharges applicable to the relevant G-SIB, to the exclusion of countercyclical buffers. After consultation with the SNB, FINMA may lower the level of those requirements, based on the effectiveness of measures taken to improve the global resolvability of the relevant G-SIB group and in consideration with other factors. However, the gone concern requirement must not fall below a 3.75 per cent leverage ratio or a 10 per cent risk-weighted assets ratio. The gone concern requirement is complied with, as a general rule, by means of bail-in instruments such as bonds with conversion rights, subject to the regulator's decision. Following the introduction of gone concern capital requirements for the G-SIBs (UBS and Credit Suisse) in 2016, these now also apply to the SIBs. The CAO also provides for specific rules for the treatment of systemically important banks' stakes in their subsidiaries (see below). Further amendments to the CAO were introduced in January 2020 to ensure that the parent entities of systemically important financial institutions are sufficiently well capitalised in the event of a crisis. In particular, certain group entities of SIB, such as their parents or Swiss units performing systemically important functions, will need to fulfil, both at group level and on a stand-alone basis, the specific requirements with which systemic banks have to comply.

Systemic banks also must satisfy the countercyclical buffer and extended countercyclical buffer requirements. Capital requirements apply both on a stand-alone and consolidated basis. Finally, FINMA may, in extraordinary circumstances, require a SIB to hold additional capital or demand that the going concern capital requirement is fulfilled with higher-quality capital.

In addition, SIBs are subject to more stringent liquidity requirements both on a stand-alone and a consolidated basis, which take into account extraordinary stress scenarios. Indeed, the LO sets forth additional liquidity requirements that SIBs must meet and ensures that SIBs hold sufficient liquidity to absorb liquidity shocks and cover their needs in the event of restructuring or liquidation. In particular, SIBs need to hold sufficient liquidity to confront a 90-day liquidity crisis as opposed to 30 days for non-SIBs. Further, FINMA may require additional liquidity requirements at entity level. These new liquidity requirements entered into force on 1 July 2022 with an 18-month transitory period for SIBs.

As regards risk diversification, the maximum risk concentration permissible for systemic banks is 25 per cent (or, in the case of exposure to another systemic bank, 15 per cent) of the Common Equity Tier 1 capital (other than Common Equity Tier 1 capital constituting the progressive element) only. The CAO provides for specific rules for the treatment of systemically important banks' stakes in their subsidiaries. The same regime applies to SIBs and G-SIBs. This regime provides, inter alia, for an abolition of the full deduction of parent companies' positions held in subsidiaries from core equity capital and of the accompanying relief measures allowed for these two large banks and for replacement thereof, after a transition period, by a risk weighting of up to 250 per cent with respect to positions in Swiss-based subsidiaries and 400 per cent with respect to positions in foreign subsidiaries of these two large banks. These requirements relate to parent companies' stand-alone capital ratios, but not the consolidated ratios.

iv Recovery and resolution

The provisions of the BA dealing with insolvent banks aim at streamlining reorganisation procedures, ensuring prompt repayment of preferential deposits and the continuity of basic banking services. These provisions enhance the flexibility of such proceedings and confer additional instruments and powers to FINMA with a view to increasing the likelihood of a successful reorganisation. FINMA is, for instance, empowered to order a transfer of all or part of a failing bank's activities to a bridge bank, the conversion of certain convertible debt instruments issued by the bank (CoCos or convertibles), the reduction or cancellation of the bank's equity capital and the conversion of the bank's obligations into equity. The FINMA Banking Insolvency Ordinance details the reorganisation and bankruptcy proceedings set forth in the BA.

On 17 December 2021, the Parliament passed amendments to the BA to enshrine in the law itself the reorganisation measures such as capital measures (e.g., a bail-in) that may affect the rights of a bank's owners and creditors, something that was previously only provided for in the FINMA Banking Insolvency Ordinance. In particular, detailed rules with regard to the claims that qualify for bail-in measures and the order of priority of such claims were now introduced in the BA. They allow FINMA to order the conversion of the bank's obligations (third-party funding) into equity capital, with the exception of certain limited claims that would be ranked in privileged classes in the event of a liquidation procedure. This measure could also potentially concern clients' deposits that do not qualify as preferential deposits (being defined as cash deposits of up to 100,000 Swiss francs whose payment would be secured within liquidation proceedings). Furthermore, the amendments to the BA specify the content of the restructuring plan and replace the requirement that a restructuring plan needs to put creditors in a better position than liquidation by the more usual 'no-creditor-worse-off-than-in-liquidation' requirement. Further, the available capital measures (cancellation of existing equity and the write-down or conversion of debt into equity) are addressed in more detail. Indeed, conversion of debt into equity is no longer an ultima ratio measure but may be ordered by FINMA if it is deemed to be the most appropriate measure. Further amendments to the BA strengthen the deposit protection scheme (see Section VII.i). These amendments to the BA entered into force on 1 January 2023.

Under the BA, FINMA may further order a stay of early termination rights (and, as a result, netting, private realisation of collateral and porting) with any of the protective or reorganisation measures it may take in the event of insolvency risk and in relation to any contractual agreement with the bank. Where agreements subject to termination rights in the case of protective or reorganisation measures are governed by non-Swiss law or non-Swiss jurisdiction clauses, the Banking Ordinance (BO) generally requires, for enforceability purposes, that Swiss banks and securities firms only enter into new agreements or agree to the amendment of agreements, provided the counterparty contractually acknowledges and consents to a stay of the termination right.

In line with international standards, systemic banks must have both a recovery plan and a resolution plan for identifying risks to the stability of the financial system as a result of their systemically important nature, and to determine viable ways of dealing with the effects of a crisis. Pursuant to the BO, a systemic bank has to establish a recovery plan that contains the measures that it would implement in the event of a crisis and that would allow it to pursue its activity without requiring government funds. Responsibility for drafting and regularly updating the recovery plan lies at executive board level of the systemic bank and must be embedded in a viable corporate governance framework. The recovery plan and any amendments thereto are subject to FINMA's approval. On 24 March 2022, FINMA confirmed that the recovery and resolutions plans of

Credit Suisse and UBS (G-SIBs), as well as the recovery plans of Zurich Cantonal Bank, Raiffeisen Switzerland and PostFinance (SIBs) were in place, while noting that the resolutions plans of Zurich Cantonal Bank, Raiffeisen Switzerland and PostFinance were still subject to improvement.

Conduct of Business

The obligations ordained by the anti-money laundering regulations have a material effect on how banks conduct their activities. Financial intermediaries are required to verify the identity of their contracting partners and the beneficial owner of accounts as well as to periodically review this information and monitor high-risk transactions.

If reasons for suspicion of money laundering exist, banks must notify the Money Laundering Reporting Office Switzerland (MROS) by filing a suspicious activity report (SAR). In this context, a two-step process applies. First, banks must monitor the account during the review of the case by the MROS (with the aim of blocking any transaction that may result in preventing or complicating the confiscation of the concerned assets). As of 1 January 2023, the Swiss legislator has suppressed the 20-day statutory period for the MROS to conduct its review. However, in case the MROS does not inform the bank within 40 days that it transmits the SAR to a prosecution authority, the bank is free to terminate the relationship. In such a case, it is required to keep a paper trail following any withdrawal and to inform MROS of the termination of the business relationship and the date on which it occurred. As a second step, if the MROS informs the bank that it transmits the SAR to a prosecution authority, the bank must implement a full freeze on the account for up to five working days until a decision to maintain the freeze is rendered by the criminal authority.

An immediate freezing of assets is, however, required for assets connected to persons whose details have been transmitted to the financial intermediary by FINMA, the Federal Gaming Board or a self-regulatory organisation because of a suspicion of such persons being involved with or supporting terroristic activities. The MROS is vested with powers regarding requests for information from the Swiss financial intermediaries and the exchange of information with foreign financial intelligence units (FIUs). The rules of conduct of Swiss banks in relation to the prevention of money laundering and terrorism financing are further detailed by the Agreement on the Swiss banks' code of conduct with regard to the exercise of due diligence 2020 (CDB), which represents mandatory minimum standards for all banks. A breach by a bank of its duty to communicate is subject to a fine of up to 500,000 Swiss francs. In addition, certain behaviours may constitute a criminal offence of money laundering, as the case may be, by negligence.

With respect to its customer relationships, a bank is primarily bound by the duties and obligations stated in the relevant contractual documentation. In addition, FinSA governs the provision of financial services, whether provided in Switzerland or to Swiss clients. FinSA is complemented by an implementing ordinance, namely the Financial Services Ordinance. FinSA is inspired by the EU financial markets and services legal acts (the Markets in Financial Instruments Directive, the Prospectus Directive and the Packaged Retail and Insurance-based Investment Products Regulation). FinSA notably introduces the following requirements, including for non-Swiss financial service providers acting in Switzerland on a cross-border basis (unless the financial service is the result of a reverse-solicitation situation expressly excluded from the scope of FinSA):

a. to classify clients according to new client categories (private, professional and institutional);
b. compliance with certain organisational measures and rules of conduct (e.g., information duties, including in relation to conflicts of interest, suitability and appropriateness tests, documentation requirement, reporting duties, duty of care);
c. a duty for client advisers to register in a client adviser register. In this respect, an exemption is available for foreign financial service providers that are subject to prudential supervision in their home jurisdiction, provided they only offer their services to institutional and per se professional clients in Switzerland; and
d. to be affiliated with an ombudsman's office (except for institutions that exclusively provide financial services to institutional or per se professional clients).

A breach of the duties of information, diligence and loyalty may give rise to civil liability as well as regulatory consequences to the extent that FINMA is of the view that a bank no longer meets the requirements of good reputation and proper business conduct.

A Swiss bank is bound by a statutory duty of confidentiality towards its clients. A breach of that duty is considered to also be a breach of the client–bank contractual relationship and may give rise to civil and criminal liability. As a general rule, any disclosure of client data to a third party, including the parent company, its supervisory authority or an affiliated entity, is prohibited. Exceptions apply under certain circumstances, such as in the context of consolidated supervision, or following a request for international judicial or administrative assistance issued by a public authority (including FIUs for anti-money laundering purposes), or if a client has consented to a disclosure. In recent years, the importance and scope of Swiss banking secrecy has been the subject of intense discussion in Switzerland following pressure from other countries, and the situation significantly changed with the implementation of the automatic exchange of information.

Funding

The main funding sources for Swiss banks are money market instruments, interbank funding, customer savings accounts, other customers' deposits, cash bonds and bonds.

Control of banks and transfers of banking business

i Control regime

For purposes of the BA, a participation is deemed to be qualified if it amounts to at least 10 per cent of the capital or voting rights of a bank, or if the holder of the participation is otherwise in a position to significantly influence the business activities of the bank (a qualified participation). In practice, FINMA requires disclosure of participations of 5 per cent or more for its assessment of whether the requirements of a banking licence are continuously being met.

The BA does not set any restrictions on the type of entities or individuals holding a controlling stake in a bank. However, one of the general licensing conditions is that individuals or legal entities that directly or indirectly hold a qualified participation in a bank must ensure that their influence will not have a negative impact on the prudent and reliable business activities of the bank. Thus, the bank's shareholders and their activities may be of relevance for the granting and maintenance of a banking licence. Shareholders with a qualified participation may be deemed to have a negative influence on the bank; for example, in cases of a lack of transparency, unclear organisation or financial difficulties of financial groups or conglomerates, and influence of a criminal organisation on the shareholders. Should FINMA take the view that the conditions for the banking licence are no longer being met because of a shareholder with a qualified participation, it may suspend the voting rights in relation to that qualified participation or, if appropriate and as a last measure, withdraw the licence.

If foreign nationals with a qualified participation directly or indirectly hold more than half the voting rights of, or otherwise have a controlling influence on, a bank incorporated under the laws of Switzerland, the granting of the banking licence is subject to additional requirements. In particular, the corporate name of a foreign-controlled Swiss bank must not indicate or suggest that the bank is controlled by Swiss individuals or entities, and the countries where the owners of a qualified participation in a bank have their registered office or their domicile must grant reciprocity (i.e., it must be possible for Swiss residents and Swiss entities to operate a bank in the respective country, and the banks operated by Swiss residents must not subject to more restrictive provisions than foreign banks in Switzerland). In practice, the reciprocity requirement no longer applies as regards foreign holders of qualified participations domiciled or incorporated in Member States of the World Trade Organization (WTO).

Furthermore, FINMA may request that a bank is subject to adequate consolidated supervision by a foreign supervisory authority if the bank forms part of a financial group or conglomerate.

If a Swiss bank falls under foreign control, as described above, or if a foreign-controlled bank experiences changes in its foreign shareholders directly or indirectly holding a qualified participation, an additional special licence for foreign-controlled banks must be obtained prior to such events. Under the BA, a foreigner is (1) an individual who is not a Swiss citizen and has no permanent residence permit for Switzerland or (2) a legal entity or partnership that has its registered office outside Switzerland or, if it has its registered office within Switzerland, is controlled by individuals as defined in (1).

According to Swiss law, there are no restrictions regarding the business activities of the entities holding qualified participations in a bank as long as the conditions for granting and maintaining the licence are complied with. Generally, transactions between the (controlling) shareholders of a bank and the bank itself may be subject to specific requirements (e.g., the granting of loans to significant shareholders must be in compliance with generally recognised banking principles).

Each controlling shareholder has the duty to notify about an acquisition or disposal of a qualified participation, as well as the fact that its participation reaches, exceeds or falls below certain thresholds. Further, the holder of a qualified participation is required not to negatively influence the prudent and reliable business activities of the bank.

Even though the acquisition of a qualified participation in a bank by a Swiss individual or a Swiss entity in theory only triggers notification obligations, it is necessary to seek a letter of no objection from FINMA for the account of the bank prior to an envisaged transfer of a controlling stake in a Swiss bank, as FINMA controls the continuing compliance with the conditions of a banking licence. FINMA will examine whether the influence of the new shareholder with a qualified participation would be detrimental to the prudent and reliable business activities of the bank.

ii Transfers of banking business

Historically, the vast majority of acquisition transactions in the Swiss banking industry were structured as share deals. Over the course of the past few years, a number of transactions have been structured as asset deals.

The year in review

i Regulatory developments

In addition to the issues addressed in the foregoing sections, the following regulatory developments can be outlined.

Financial technology

In recent years, FINMA has focused on adapting the regulatory framework to the needs of the fintech sector and has put in place a special fintech desk to efficiently address key issues arising in this sector. In past years, various amendments of the BA and the BO have also been put forward and adopted with the aim of reducing market entry barriers for fintech firms. This resulted, in particular, in the adoption of a new lighter licensing regime for fintech firms (see Section II.iii). Separately, in September 2020 the Swiss Parliament adopted the Federal Act on the Adaptation of Federal Law to Developments in Distributed Ledger Technology (DLT). This blanket act aims at adapting various federal laws to develop the blockchain and DLT area in Switzerland. These new provisions entered into force in 2021 and generally enabled the introduction of ledger-based securities that are represented in a blockchain.

Deposit protection and bank insolvency

Amendments to the BA came into force on 1 January 2023, which further strengthen depositor protection and banking insolvency rules. The deposit protection scheme is improved in three ways: the first is to require the deposit protection scheme (i.e., esisuisse) to pay out protected cash deposits within seven business days of the bank's bankruptcy (instead of 20 days, as was previously the case), which is in line with international standards. Further, banks do no longer need to secure half of their obligatory deposit insurance contributions in the form of additional liquidity but are to deposit High Quality Liquid Assets (HQLA) or Swiss francs in cash with a reliable custodian. Finally, the maximum payment commitment of previously 6 billion Swiss francs is raised to (a fluctuating) 1.6 per cent of the total amount of secured deposits (i.e., currently approximately 8 billion Swiss francs), with a minimum of 6 billion Swiss francs. The amendments to the BA further anchor certain insolvency provisions at the legislative level rather than only in the FINMA Banking Insolvency Ordinance (see Section III.iv).

In this context, the Federal Act on Intermediated Securities (FISA) was also amended as of 1 January 2023. It now provides that custodians are obliged to segregate their own securities from those of clients.

Amendments to the anti-money laundering regulations

Taking into account the FATF 2016 mutual evaluation report on Switzerland, amendments to the AMLA and the anti-money laundering ordinance (AMLO) that strengthen the Swiss anti-money laundering framework entered into force on 1 January 2023. They focus on the definition of the reasonable grounds that trigger the duty to file a SAR, the formal anchoring into the AMLA of a duty to verify the beneficial owner and the requirement to periodically review the KYC information provided by clients according to a risk-based approach. Further, the revised AMLA removed the 20-day period during which the MROS is to review the SAR made by the financial intermediary (see Section IV).

ii Future changes

National implementation of the final Basel III post-crisis reforms

As described above (see Section III.iii) the CAO provides for the minimum standards as regards capital requirements for banks, which implements the Basel III standards.

In order to implement the last package of Basel III (i.e., the final Basel III standards (also referred to as Basel 3.1 or Basel IV)), the Federal Council intents to adapt the CAO. The purpose of the new rules is to improve transparency and comparability of banks' capital ratios, in particular by reducing the variability in the calculation of risk-weighted assets (RWA) and increasing the risk sensitivity of the capital requirements. The provisions will amend the rules for calculating capital requirements, notably for credit, market and operational risks. In this context, the risk sensitivity of the standardised approaches for credit and operation risks will be enhanced, the use of internal model approaches to calculate capital requirements for credit and market risks will be constrained and the existing Basel II output floor will be replaced by a more robust risk-sensitive floor. In addition, the Federal Council plans to enshrine various Basel III regulations that are currently implemented at FINMA Circular level in the CAO. In parallel, FINMA contemplates to adopt five new implementing ordinances (i.e., the (1) Ordinance on the Trading Book and Banking Book and Eligible Capital; (2) Ordinance on the Leverage Ratio and Operational Risks; (3) Ordinance on Credit Risks; (4) Ordinance on Market Risks; and (5) Ordinance on the Disclosure of Risks and Capital Requirements and the Principles of Corporate Governance) and to repeal five existing FINMA circulars (i.e., the (1) Circular 2013/1 on eligible capital; (2) Circular 2015/3 on leverage ratio; (3) Circular 2017/7 on credit risks; (4) Circular 2008/20 on market risks; and (5) Circular 2016/1 on disclosure). It is expected that the new rules will enter into force on 1 January 2025.

The New Federal Act on Data Protection

In its session in the autumn of 2020, the Parliament passed the new Act on Federal Data Protection (nFADP) which will come into effect on 1 September 2023. In particular, one of the main goals of this new Act is to ensure that the EU continues to recognise Switzerland as a country offering an adequate level of data protection and that cross-border data transfers between the EU and Switzerland remain possible in the future without further hurdles. The nFADP will strengthen the Swiss data protection framework.

Developments in sustainable finance and the prevention of greenwashing

While Switzerland's approach in connection with sustainable finance is generally more liberal than the one in the EU, sustainability in the financial sector is becoming an increasingly important theme in Switzerland. On 16 December 2022, the Federal Council published a report drawing on previous publications that lays down the Swiss strategy in the area of sustainable finance for 2022 to 2025. This report sets out 15 measures built on four areas of action: (1) sustainability data from all sectors of the economy; (2) transparency in the financial sector; (3) impact investments and green bonds; as well as (4) pricing of pollution.

On the same date, the Federal Council defined its position on the prevention of greenwashing in the financial sector. The Federal Council intends to introduce binding and enforceable legislation across the financial market dealing with this matter. It is expected to publish a legislative proposal by 30 September 2023. Currently, initiatives in relation to the prevention of greenwashing come mainly from the industry. On 16 June 2022, the SBA adopted guidelines on the integration of ESG preferences and ESG risks into investment advice and portfolio management applicable to banks that are SBA members at the point of sale. These guidelines entered into force on 1 January 2023, but provide for transitional periods. The Asset Management Association (AMAS) has further issued voluntary self-regulation on transparency and disclosures for manufacturing and managing sustainable collective investment schemes.

Simultaneously, FINMA has been active in this field. In November 2021, FINMA issued Guidance 05/2021 on preventing and combating greenwashing in relation to sustainability-linked funds. Moreover, the Swiss regulator has repeatedly stressed that financial risks arising from climate change are among the most important long-term risks for Swiss banks and the Swiss financial centre. In May 2021, FINMA amended its circular on disclosure to require large banks to provide qualitative and quantitative information on climate-related financial risks. The circular requires, in particular, disclosure of the process applied for identifying, assessing and managing climate-related financial risks (risk management) as well as quantitative information (including a description of the applied methodology) on climate-related financial risks. In addition, in January 2023 FINMA reiterated the importance of an appropriate management of climate risks by banks in its Guidance 01/2023.

Outlook and conclusions

The 2008 financial crisis brought up many regulatory topics that have been examined by the supervisory authority and extensively discussed within the banking industry, such as the effects of a high density of regulations for certain sectors, and governmental influence on and support of financial institutions. In line with international developments and discussions, as measures that aim to refine and strengthen capital adequacy and liquidity requirements have been formally enacted, FINMA continues to focus closely on systemic risk issues. The Swiss regulatory framework is further progressively converging from a principle-based to a rule-based approach, with a particular focus on systemically important financial institutions, in accordance with FINMA's risk-based approach.

Every three years, FINMA publishes its strategic goals and priorities for the next three-year period. For the period from 2021 to 2024, FINMA has updated its strategic goals to the following main policy challenges:

a. safeguarding the stability of supervised financial institutions;
b. sustaining positive impact on their conduct;
c. ensuring that supervised financial institutions promote responsible corporate governance and maintain the highest risk management standards;
d. providing long-term mitigation of the 'too big to fail' risk;
e. ensuring that the financial system remains robust in light of forthcoming structural changes and that clients are able to benefit from new opportunities without being exposed to additional risks;
f. promoting innovation in the Swiss financial sector;
g. contributing to the sustainable development of the Swiss financial centre by taking into account climate-related risks; and
h. ensuring that Swiss financial regulation is in line with international standards.

In addition, in recent years, FINMA has continuously increased its enforcement action and, consequently, the resources dedicated to it. While FINMA's enforcement practice generally remains focused on financial entities, the regulator has increased its targeted actions against individuals responsible for serious violations of supervisory law with, as the case may be, a professional ban imposed on such individuals and publication of the relevant decisions. In this context, FINMA has repeatedly announced that it particularly focuses on risk management and compliance with anti-money laundering obligations by regulated financial intermediaries.

One of the main current regulatory challenges is linked to the implementation of the new legislation on financial services and financial institutions, which entered into force on 1 January 2020. The growth of the Swiss fintech sector and the continued emergence of innovative business models will undoubtedly also represent an important challenge for both the Swiss legislator and regulator in the years to come. To this end, the Swiss regulator engaged with a number of international bodies to establish a framework aimed at promoting innovation, as well as the protection of customers and investors in this area.

Finally, a new area of concern and supervisory focus has emerged: climate change. Greenwashing will undoubtedly remain at the top of the regulator's agenda and will likely lead to a number of regulatory enforcement actions in the future. The Swiss government is currently working on proposals to amend financial market legislation to further foster sustainable finance while mitigating greenwashing risks (see Section VII.ii).

Footnotes

[1] Shelby R du Pasquier, Patrick Hünerwadel, Marcel Tranchet and Valérie Menoud are partners and François Meier is an associate at Lenz & Staehelin.

[2] Agreement on the Swiss banks' code of conduct with regard to the exercise of due diligence of July 2018 (CDB 20).

[3] Portfolio Management Guidelines of November 2020.

[4] These requirements form the first pillar of a bank's regulatory capital base.

Shelby R du Pasquier

Author

shelby.dupasquier@lenzstaehelin.com

Patrick Hünerwadel

Author

patrick.hunerwadel@lenzstaehelin.com

Marcel Tranchet

Author

marcel.tranchet@lenzstaehelin.com

Valérie Menoud

Author

valerie.menoud@lenzstaehelin.com

François Meier

Author

francois.meier@lenzstaehelin.com

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Slaughter and May

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Janne Lauha, Hannu Huotilainen and Heidi Lumme
Castrén & Snellman

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Didier Martin, Samuel Pariente, Jessica Chartier, Béna Mara and Gaël Rivière
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Sven H Schneider and Jan L Steffen
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Advokatfirmaet BAHR AS

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Morales & Justiniano

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Vinge

Switzerland

Shelby R du Pasquier, Patrick Hünerwadel, Marcel Tranchet, Valérie Menoud and François Meier

Lenz & Staehelin

Taiwan

James C C Huang and Maggie Huang
Lee and Li Attorneys at Law

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