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Swiss bank creditors face bail-in risk

By James Shotter in Zürich

Switzerland's banking watchdog has spelt out how it would deal with the collapse of either of the country's two biggest banks, UBS and Credit Suisse, a move that could present them with a fresh funding challenge.

Since the financial crisis, regulators around the world have been struggling to decide how to protect taxpayers and the wider economy from the failure of large and interconnected international lenders. The topic has particular resonance in Switzerland, where UBS received a $45bn bailout in 2008.

Last month, the Financial Stability Board, which is co-ordinating global financial reform efforts, said that big global banks must choose between two "resolution mechanisms". These dictate how lenders restructure themselves and ensure that crucial banking functions – payment systems, trade finance and deposit taking – can continue, no matter what happens to the larger group.

These are known as the "Single Point of Entry" (SPE), for banks that operate as an integrated group, and the "Multiple Point of Entry" (MPE) method, for banks that operate as locally capitalised subsidiaries. In a position paper released on Wednesday, Finma, the Swiss banking watchdog, said that its preference was for Swiss banks to adopt the SPE approach.

Under this system, creditors of the parent bank would be "bailed-in" if the institution was on the verge of collapse. Finma would have the flexibility to spread out losses over a range of creditors.

Shareholders would be first affected, followed by bondholders – including senior bondholders – and, as a last resort, unsecured depositors. According to Finma, uninsured deposits of about SFr300bn ($326bn) at both big Swiss banks would be affected.

If a bail-in were to prove impossible, however, a failing bank could be broken up, and its assets sold off, wound down or liquidated.

Christopher Wheeler, analyst at Mediobanca, said the threat to senior bondholders posed a challenge for the way Switzerland's two big banks fund themselves.

"[They] face a delicate balance. On the one hand, now that senior bondholders are explicitly at risk of being bailed-in, they need to issue enough low-trigger contingent capital to ensure that their providers of senior funding do not demand a higher coupon."

"But on the other hand, they don't want to issue too many of these instruments, as they will cost a lot more than funding themselves through the broader wholesale markets," he said, pointing out that a 10-year wipeout bond issued last week by Credit Suisse required a coupon of 6.5 per cent to attract investors.

Given the complicated and international nature of Credit Suisse and UBS's businesses, Finma recognises the need for co-operation with other regulators in the event of a crisis. However, it argues that it should take the lead in dealing with the two banks.

UBS and Credit Suisse declined to comment.