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Protection of Bank Deposits

Switzerland: Swiss Financial Market Supervisory Authority (FINMA)

Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

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Protection of bank deposits

When a bank faces insolvency and must file for bankruptcy, clients are bound to become anxious about the security of their savings. In Switzerland, clients' deposits are protected by both the depositor protection scheme and the preferential treatment granted in the event of bankruptcy. This reduces the risk of losses suffered.

Protection of bank deposits has two objectives: on the one hand, its aim is to protect depositors from suffering losses. The clients' basis of existence needs to be guaranteed even if 'their' bank goes bankrupt. On the other hand, depositor protection enhances system stability by ideally preventing bank runs and reducing contagion during a banking crisis. In Switzerland, deposits totalling CHF 100,000 per client are regarded as privileged deposits. Deposits held by a Swiss branch of a bank are protected by the depositor protection scheme.

Three-tiered system: bank – depositor protection scheme – bankruptcy assets

Explained simply, depositor protection in Switzerland is based on a three-tiered system. As a first step, privileged deposits are immediately paid out from the remaining liquidity of the failed bank. If the institution's available liquidity does not suffice to cover all privileged bank deposits, the depositor protection scheme is used as a second step to pay out privileged deposits, provided that they were booked in Switzerland (so-called secured deposits). All banks in Switzerland that accept client deposits are obliged to participate in the depositor protection scheme. As a third step, privileged deposits are treated preferentially and are paid out at the same time as other second creditor class claims in the event of bankruptcy.

Unlike cash deposits in bank accounts, assets such as shares, units in collective investment schemes and other securities held in custodial accounts are client property, and in the event of bankruptcy, all such assets are ring-fenced in their entirety and released to clients.

How depositor protection works

When a bank goes bankrupt, privileged bank deposits are paid out immediately from the available liquid assets. FINMA determines the maximum amount of deposits payable immediately. As a result, the largest possible number of retail investors will be paid out before bankruptcy proceedings are instituted. If the amount of liquid assets available is not sufficient to cover the privileged bank deposits, the depositor protection scheme comes into play. As soon as FINMA has declared bankruptcy, it notifies the depositor protection scheme and informs it about the liquidity

Level 1	Level 2	Level 3
Privileged **bank deposits** (excluding retirement savings) of up to CHF 100,000 per client are immediately paid out of the bank's available liquid assets in and outside Switzerland.	**Depositor protection scheme** for privileged bank deposits at a Swiss branch (excluding retirement savings) of up to CHF 100,000 per client.	**Bankruptcy privilege** (second creditor class claims) for bank and retirement savings of each up to CHF 100,000 per client in and outside Switzerland.

required to pay out the secured deposits. The funds required are provided to FINMA or its agent by the other members of the association up to a maximum amount of CHF 6 billion within a period of 20 days. The association members are legally required to keep half of the amount that they are obliged to contribute as additional liquidity. As an additional measure towards achieving full payment of all privileged deposits at the latest during bankruptcy proceedings, such deposits are underpinned with domestically held assets, which FINMA can easily access.

Deposits with pension and vested benefits foundations, in particular vested benefits accounts and pillar 3a pension funds, are privileged separately up to a maximum of CHF 100,000 per client. However, these deposits are not part of the depositor protection scheme and are only paid out during the bankruptcy proceedings through the pension fund (see bankruptcy privilege). In the event of bankruptcy, client deposits and pension savings of over CHF 100,000 per client are regarded as third creditor class claims and are treated equally with the claims of other creditors.

Bankruptcy privilege: In the event of bankruptcy, privileged deposits are allocated to second creditor class and are paid out from the bankruptcy assets once first-class claims (e.g. employee salary and pension fund claims) have been paid out.

The depositor protection system is used only in the event of bankruptcy. The measures described above should not be confused with a bank's restructuring, which takes place at an earlier stage. When a bank is being restructured, privileged deposits – unlike other liabilities of the bank - cannot be compulsorily reduced or converted into equity.

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Origin and reform of depositor protection

Since the 1930s, Switzerland has had a depositor protection scheme with preferential treatment of deposits in the event of bankruptcy. However, there were hardly any bank insolvencies in the post-war period up to the beginning of the 1990s. Therefore, this system has rarely been used.

The lessons learned from the bankruptcy of the Spar und Leihkasse Thun in 1991 resulted in a substantial revision and strengthening of the protection of Swiss depositors. The definition and scope of privileged deposits were expanded. The depositor protection system is based on self-regulation. In 2005, the association "esisuisse" was founded. Its self-regulatory measures are subject to FINMA's approval.

Information on the depositor protection scheme, e.g. what is meant by privileged and secured deposits, can be found on the esisuisse homepage: www.esisuisse.ch.

Some years later, the financial crisis demanded a further reform. This urgent revision comprised five core elements: firstly, the maximum amount for privileged deposits per client and bank was increased from originally CHF 30,000 to CHF 100,000; secondly, banks are obliged to hold domestic assets in the amount of 125% of their privileged deposits in order to ensure that there are enough assets in Switzerland to meet clients' claims; thirdly, immediate payment from the funds available is now more generous and flexible; fourthly, the system's upper limit (maximum amount) of the depositor protection scheme was raised from originally four to currently six billion Swiss francs; and, fifthly, in case of bankruptcy, deposits at pension fund foundations are privileged separately and in addition to privileged bank deposits, also up to the amount of CHF 100,000. These temporary immediate measures were introduced in 2008 at the height of the most recent financial crisis. In 2011, Parliament transposed these measures into ordinary law.