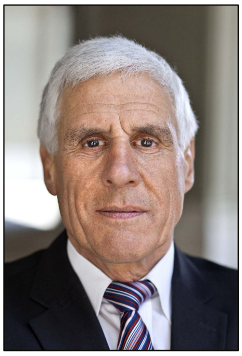
# UBS – state guarantee encourages risk-taking and speculation

## New statutory guarantees planned by the federal government

*by Rudolf Strahm**



Rudolf Strahm. (Picture rudolfstrahm.ch)

*(CH-S) In the spring session (3–21 March 2025), new legislation is to be introduced to regulate state aid for large, systemically important banks. Since 2008, there has been no effective legal regulation in place to protect taxpayers from the enormous financial consequences of a bank collapse. There is still no talk of a clear separation between speculative and business activities.*

*In a guest article, former federal price supervisor and former SP National Councillor Rudolf Strahm explains the problems with the current legislative proposal. What measures are planned, and how should the new statutory liquidity guarantee of the federal government work with the so-called "Public Liquidity Backstop" (PLB)?*

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In October 2008, UBS had to be temporarily saved from collapse with the help of the *Swiss National Bank* and the federal government, with around CHF 72 billion.

In March 2023, the federal government had to enable UBS to be taken over overnight by means of temporary loan loss guarantees in favour of the National Bank liquidity loans to *Credit Suisse* in the amount of 200 or 250 billion Swiss francs.

Why do big banks, of all things, need such state crutches in the event of their failure? This is a preview of the debate on the "Public Liquidity Backstop" in the upcoming March session.

The four major banks UBS, *Zürcher Kantonalbank, Postfinance* and *Raiffeisen* (formerly also *Credit Suisse* CS) are considered "systemically important". They are "too big to fail". They are considered systemically important because they manage tens of thousands of customer and business accounts. The collapse of a major bank of this size could plunge the entire financial system of the Swiss economy and, beyond that, the international financial system into crisis.

### Insufficient equity capital

The most important safeguard against crises, alongside solid bank management, would be a sufficiently large share of risk-bearing equity capital – i.e. share capital, the bank's own reserves and, to a limited extent, convertible bonds that can be converted into share capital in an emergency.

The largest banks do not have enough of this capital: the big banks, *Credit Suisse* and UBS, had and have only about 4 to 5 per cent of their balance sheet total in (unweighted) equity. In other words, for every 100 francs of deposits they receive, they lend out around 95 francs. In the event of major losses or massive capital withdrawals, this margin and the limited equity as a buffer will not be enough, and there is also the threat of a liquidity squeeze, as we experienced in 2008 and even more so in 2023.

The Cantonal Banks and Raiffeisen are better capitalised with equity ratios of 7 to 9 per cent. By comparison, commercial and industrial manufacturing companies have 30, 50 or more per cent equity in relation to their total assets. Therefore, large banks with such a narrow equity base are most at risk of crashing and would have to be bailed out in an emergency. UBS, of all companies, with a balance sheet total that is currently twice as high as Switzerland's gross domestic product, is currently aggressively defending itself with a power play against the increase in equity capital envisaged by the Federal Council, using all the PR tricks in the book.

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## What would happen if a major bank were to crash? Methods of rescuing a bank

1. *Another, larger bank takes over the crisis-stricken bank.*
   This option is ruled out in the case of the collapse of the major bank UBS today because, since its takeover of CS, it is by far the largest bank in Switzerland.
2. *The ailing major bank is "wound up".*
   This means that the international parts and the "unnecessary" banking parts in Switzerland are split off and sold or sent into bankruptcy. At the same time, the important, systemically important banking functions in Switzerland are separated and saved (by the state). This scenario, with "predetermined breaking points", devised from an academic desk by Prof. *Aymo Brunetti,* among others, was envisaged in the "too big to fail" legislation.
   - This intention with a liquidation of foreign bank subsidiaries proved to be unworkable because the foreign financial centres and their governments (USA, GB, EU, Singapore) did not tolerate this for fear of a conflagration in the global financial system. It was a kind of Swiss "geranium solution". "Are you crazy?" the American Secretary of the Treasury, *Janet Yellen,* is said to have shouted down the phone to Federal Councillor *Karin Keller-Sutter* in March 2023 when she proposed this option.
   - The Brunetti solution was cleverly thought out but proved to be inapplicable and is likely to be even less realistic in the future.
3. *In the event of a bank crash, the state temporarily takes over this big bank.*
   The federal government immediately blocks all cash withdrawals and sells the bank after restructuring (*temporary public ownership,* TPO).
   - This option is frowned upon in terms of economic policy, but it is the most likely faute-de-mieux scenario in Switzerland in the future.
4. *The state provides liquidity assistance to the ailing bank as a preventive measure.*
   The SNB and the Confederation provide a default guarantee for the SNB loans (*public liquidity backstop,* or PLB).
   - This is the option under discussion here. It shall now to be enshrined in law.

### State guarantee encourages risk-taking and speculation

This *public liquidity backstop* (PLB), in the form of a state credit default guarantee in favour of the SNB's liquidity loans, is ultimately financed by the Federal Treasury. It acts as an advance insurance. This visible state guarantee is coveted by systemically important banks because it offers the following advantages:

1. The PLB as a state counter-guarantee in favour of the SNB's liquidity assistance to the ailing bank serves to restore investor confidence in the bank.
2. The state counter-guarantee allows the beneficiary bank to borrow capital at lower interest rates, thus benefiting from lower refinancing costs. (This annoys other banks because of the distortion of competition.)
3. The state guarantee allows the bank to take on larger risks and more daring speculative transactions because the bank management counts on this de facto state guarantee. This is referred to as the "moral hazard effect."

More equity (more share capital and more reserves) could also have the effect of reducing risk. But the big banks' lobby claims to the media that this is expensive and puts them at an international competitive disadvantage, although it cannot prove this.

The PLB state guarantee acts as advance insurance in the event of a crisis. Therefore, an annual risk allowance is requested from the four systemically important banks, like a kind of "insurance premium". The lenient Federal Council initially did not want such a remuneration, but in the consultation process it was demanded by broad circles. The dispute in parliament about the PLB bill will be about the following: How much annual risk lump sum do systemically important banks have to pay to the federal government for the PLB system protection? And under what additional conditions is the PLB granted?

### How high will the insurance premium be?

- The Federal Council is being terribly lenient and would like to charge a flat risk rate of just CHF 70 to 210 million per year for all four systemically important banks. That is only 0.005 to 0.015 per cent of the risk-important capital sum or just 0.6 to 1.8 per cent of the cumulative group profits.
- At a symposium on financial market stability, Corinne Zellweger-Gutknecht, a professor of financial law at the University of Basel, described this gift as a cheap "goodie" with advantages for the "insured" bank.
- A team of economists from the University of Bern, led by Professor *Dirk Niepelt* (formerly head of the *Swiss National Bank research centre*), calculated that UBS is effectively being "subsidized" to the tune of at least 2.6 billion Swiss francs a year with such state guarantees.

This is ten times more than the flat-rate fee that the bank would have to pay to the government.
- The risk calculation and the determination of the costs for the state and the benefit for the beneficiary bank through the PLB and other de facto state guarantees is in any case based on a political judgement.

**Banks don't want a "corset"**

Another point of contention in parliament will be the question of what conditions and requirements a systemically important bank that is in distress or has to be saved from a crash has to fulfil. The parliamentary investigation committee (PUK) has developed numerous proposals in this regard. The big bank naturally wants to comply with little "corset" and little "Swiss Finish" (which is a dirty word in banking).

The most important conditions in the Federal Council's PLB bill are as follows:

**Conditions for the PLB credit risk insurance**

1. The amount and duration of the PLB credit default insurance with the federal guarantee is in principle unlimited. It can amount to hundreds of billions of francs. (By way of comparison: the federal government's expenditure budget is around 90 billion francs).
2. The PLB federal guarantee covers those SNB liquidity loans for which the SNB does not receive "sufficient collateral" (in the form of first-class securities, bonds or mortgage loans) from the ailing bank. Any amount that the SNB deems to be unsecured is to be covered by the PLB default guarantee.
3. The liquidity assistance provided by the National Bank and the PLB default guarantees provided by the federal government enjoy bankruptcy privileges, i.e. in the event of the bank being wound up, they are the first to be reimbursed.
4. If a PLB becomes necessary or likely for the federal government, the ailing bank is not allowed to pay out any dividends or bonuses, nor can it buy back any of its own shares.
5. In such a case, the Swiss Financial Market Supervisory Authority FINMA can intervene in the bank's organisation, for example by ordering the dismissal of senior managers. The triggering of a PLB credit default guarantee from the federal government can be implemented immediately under emergency law. However, it is subject to the spending cap in the event of legal (subsequent) approval by parliament. (Which, however, will be ineffective in the usual cases if approved retrospectively.)

*(This is a non-exhaustive list by way of example.)*

**In the end, four politically controversial questions remain**

*1) Adopt the PLB this year or later?*

SVP Councillor of States *Hannes Germann* has called on the *Economic Commission* (WAK-S) not to adopt the PLB bill in advance in 2025, but only later in connection with the further regulatory demands of the PUK and the Federal Council. He received support from SP Councillor of States *Eva Herzog*, among others. The PLB is coveted as a "goodie" by systemically important banks (even if they publicly deny it) because it gives them a competitive advantage. The PLB should therefore serve as a bargaining chip for further demands that the banks are fighting, such as more equity capital, fines, sanctions and accountability of bank executives. Once the PLB, which the banks want, is in place, the big bank lobby will later play for time and fight all the more vigorously against the other, stricter supervisory rules. But prevention is better than rescue. That is why preventive regulatory measures, as envisaged by the PUK and the Federal Council, are more important.

*2) Can/should we do without the PLB?*

An institutionalised PLB for financial market stabilisation has been called for by the Basel Committee on Banking Supervision since 2016. It is now in force in all major international financial centres. International Swiss banks cannot escape it. The Federal Council waited too long and only adopted a message six months after the CS crash. There was speculation as to whether SNB Chairman *Thomas Jordan* or Federal Councillor *Ueli Maurer* was more responsible for these delays. FINMA had already demanded the PLB from the SNB.

*3) Who should define the collateral to be deposited by the bank?*

In the event of a crisis, the SNB decides on the timing and amount of the liquidity assistance required. This is undisputed. But the assessment of what collateral should be deposited also concerns the federal government: after all, the federal government only takes over the PLB at the expense of the federal treasury to the extent that the National Bank does not receive sufficient collateral from the bank for its liquidity assistance. Should or may the federal government have a say in defining the collateral? After all, it is also affected.

*4) How high should the annual PLB risk flat rate be set for the four banks?*

As explained above, the amount of the PLB's "insurance premium" is a political judgement call. The flat-rate premium proposed by the Federal Council is clearly set too low by a multiple.

**Conclusion:
A preliminary assessment of the PLB bill**

*1) From an economic history perspective, the PLB bill opens a new chapter of state guarantees to the private financial sector.*

While the federal government and the conservative world are constantly fighting against so-called "industrial policy" (temporary subsidies to industries), they are now accepting a much higher, quasi-automated state guarantee for banks with the legal anchoring of the PLB. This is a new quality of economic policy!

*2) Parliament should at least not finally adopt the PLB bill until the most important regulatory proposals of the PUK for the prevention of banking crises are in place.*

The PLB should only come into force once the Federal Council has pushed through its planned capital adequacy ordinance, specifically: when all of UBS's foreign bank subsidiaries have also been allocated equity capital in accordance with the new *Basel standard* (currently, FINMA only requires 60 per cent of the equity capital for the UBS subsidiaries with the so-called "buffer").

*3) At present, UBS CEO Sergio Ermotti is publicly opposing the Federal Council's intention to implement this announced new capital adequacy requirement, which will require UBS to have an additional 15 to 25 billion francs in equity capital.*

Rather, according to the statement of intent at the balance sheet presentation, UBS wants to initially give shareholders an additional 3 billion through share buybacks and increase the return on equity from 15 to 18 per cent over the next two years. UBS is also threatening again to look at "alternative locations". It would be a declaration of bankruptcy by the Federal Council and parliament if they were to give in to Ermotti's power play.

*4) The annual flat rate as an "insurance premium" for the PLB must, as shown above, be raised to a realistic, actuarially fair level.*

*5) The liquidity crisis at CS, which quickly became apparent, was triggered by the digital bank run via internet withdrawal requests – an unprecedented event in financial history.*

Why is no one talking about a requirement for large banks to offer investment forms with time-limited capital withdrawal (fixed-term deposit model)? The time factor for withdrawals would reduce the risk of government liquidity loans.

*Source: https://www.infosperber.ch/politik/ubs-staatsgarantie-foerdert-risikobereitschaft-und-spekulation/, 25 February 2025*

*(Translation "Swiss Standpoint")*

*First published: https://direkt-magazin.ch/meinung/kkrft/rudolf-strahm-diese-garantieleistungen-des-staates-erlauben-der-bank-die-uebernahme-groesserer-risiken-und-gewagterer-spekulationsgeschaefte/, 13 February 2025*