The U.S. Financial Crisis: The Response By Switzerland

James K. Jackson
Specialist in International Trade and Finance

February 5, 2009

Congressional Research Service
7-5700
www.crs.gov
R40200

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

As world financial and economic leaders met January 2009 in Davos, Switzerland for the annual World Economic Forum, Switzerland's renowned flagship banks were being battered by the financial crisis and the country was facing a potentially serious economic downturn. The current financial crisis has demonstrated that financial markets in Switzerland and elsewhere have become highly interdependent and that a crisis in one market can quickly spread to other markets across national borders.

For the United States, Switzerland is important as a member of international fora where the two countries share common interests while Swiss banks also act as competitors in the international financial marketplace. One issue the two countries share concerns the organization of financial markets domestically and abroad to improve supervision and regulation of individual institutions and of international markets. This issue also focuses on developing the organizational structures within national economies that can provide oversight of the different segments of the highly complex financial system. Such oversight is viewed by many as critical, because financial markets are generally considered to play an indispensible role in allocating capital and facilitating economic activity.

In the months ahead, Members of Congress and the Obama administration likely will consider a number of proposals to restructure the supervisory and oversight responsibilities over the broad-based financial sector within the United States and in the broader international financial markets. The Swiss system provides an example of a system that has separated the regulatory and supervisory responsibilities from the monetary policy responsibilities of the Swiss National Bank and consolidated them into a national regulatory body that is subject to the Federal Council, or the executive of the Swiss government.

This report will be updated as events warrant.

Contents

Tables

Contacts

Overview

As world financial and economic leaders met January 2009 in Davos, Switzerland for the annual World Economic Forum, Switzerland's renowned flagship banks were being battered by the financial crisis and the country was facing a potentially serious economic downturn. The current financial crisis has demonstrated that financial markets in Switzerland and elsewhere have become highly interdependent and that a crisis in one market can quickly spread to other markets across national borders. As a result, Switzerland generally attempts to craft economic and financial policies in ways that preserve a careful balance between cooperation and competition with other financial centers in Europe and elsewhere. For the United States, Switzerland is important as a member of international fora where the two countries share common interests while Swiss banks also act as competitors in the international financial marketplace. The Swiss experience with resolution of troubled banks may provide a model for U.S. leaders to consider as they and other policymakers chart a course forward. In addition, Switzerland offers U.S. policymakers an alternative approach to consider in deciding how to regulate and supervise financial markets with the recent reorganization of its financial regulatory structure in a way that centralizes much of these responsibilities in a state body that is independent of Switzerland's central bank.

In terms of the size of its Gross Domestic Product (GDP) Switzerland is one of the six largest advanced economies in Europe and is renowned as an important financial center. The Swiss people have chosen not to belong to the European Union,[1] so Switzerland maintains its own currency and charts independent monetary and exchange rate policies. Many in Switzerland initially viewed the financial crisis as a uniquely American phenomenon, but that view has changed as the Swiss government has had to approve a financial rescue package for the Union Bank of Switzerland (UBS), Switzerland's largest bank, and to move to amend national laws to improve depositor protection. Credit Suisse, Switzerland's second largest bank, so far has refused any funds from the government, but the bank has announced layoffs of more than 5,000 employees. UBS also has placed about $5 billion of its most illiquid loans and bonds into a separate funding facility that it will use to finance bonuses and compensation for its executives. In response to the financial crisis, the Swiss National Bank (SNB), similar to the U.S. Federal Reserve, has undertaken a series of cuts in key interest rates in cooperation with the European Central Bank and the U.S. Federal Reserve.

The recent experiences of Switzerland and other European countries (including Iceland, the United Kingdom, Sweden, and Austria) raise questions about how national governments can effectively supervise large financial firms that operate across national borders. This experience also raises questions about how governments can protect domestic depositors from financial troubles outside their national borders. The financial rescue for UBS also raises questions about the costs and benefits of branch banking across national borders where banks can grow to be so large that disruptions in the financial market can cause defaults that outstrip the resources of national central banks. Also, Switzerland's open economy has become highly intertwined with the broader European economy and its financial system has become highly integrated with the

[1] Members of the European Union are: Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Republic of Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Sweden, and the United Kingdom.

financial systems in Europe and elsewhere. As a result of this high degree of interdependence, the Swiss economy is quickly exposed to adverse economic and financial developments abroad, and it often experiences swings in economic activity that are greater than that experienced by other advanced economies.[2]

Swiss Government and Financial Sector

Switzerland is governed by a Federal Council, a seven-member executive council which constitutes the federal government of Switzerland and serves as the Swiss collective head of state. As such, the Council approves major proposals to consider or to amend laws before the proposals are submitted to the Swiss Parliament. While the entire council is responsible for leading the federal administration of Switzerland, each Councilor heads one of the seven federal executive departments. The current members of the Federal Council are, in order of seniority:

- Moritz Leuenberger (SP), Federal Department of Environment, Transport, Energy and Communications
- Pascal Couchepin (FDP), Federal Department of Home Affairs
- Micheline Calmy-Rey (SP), Federal Department of Foreign Affairs
- Hans-Rudolf Merz (FDP), Federal Department of Finance, President of the Swiss Confederation for 2009
- Doris Leuthard (CVP), Federal Department of Economic Affairs, Vice-President of the Federal Council in 2009
- Eveline Widmer-Schlumpf (BDP).Federal Department of Justice and Police.
- Ueli Maurer (SVP), Federal Department of Defense, Civil Protection and Sports

The financial sector in Switzerland recently initiated a widespread restructuring that centralized the supervisory responsibilities over a broad swath of the financial sector into a regulatory body that is not directly controlled by Switzerland's central bank. Switzerland is not the only country to have such a regulatory structure. For instance, for member of the European Union (EU), supervisory responsibilities range from the central bank being the main supervisory authority with sector-specific institutions sharing some of the supervisory responsibilities to those in which there is a single supervisory authority independent from the central bank and those with a single supervisory authority with involvement by the central bank.[3] Although the Swiss restructuring was not triggered by the current financial crisis, it provides one possible model for other countries that are reconsidering their financial regulatory structure.

Within Switzerland, the financial sector is supervised by the Swiss National Bank (SNB), Switzerland's central bank, the Federal Department of Finance (similar to the U.S. Department of the Treasury) and the newly created Financial Management Authority (FINMA)[4] a state

---

[2] *Switzerland: 2008 Article IV Consultation*, International Monetary Fund, IMF Country Report No. 08/170. May 2008.International Monetary Fund.

[3] Hardy, Daniel, A "European Mandate" for Financial Sector Authorities in the EU, in *Euro Area Policies: Selected Issues*, International Monetary Fund, IMF Country Report No. 08/263, August 2008.

[4] *About FINMA*, FINMA.

regulatory body which began operating January 1, 2009. In clear contrast with the U.S. regulatory structure, FINMA will assume regulatory responsibilities for a large part of the financial sector that is supervised in the United States by the Federal Reserve and the Securities and Exchange Commission. FINMA replaced the Swiss Federal Banking Commission in supervising banks, investment funds, stock exchanges, and securities trading, and the Federal Office of Private Insurance in supervising private insurance, health insurance, life insurance, and insurance brokers. FINMA also replaced the Anti-Money Laundering Control Authority and the Swiss Takeover Board. Under its director, Dr Patrick Raaflaub, FINMA is expected to employ some 320 staff members and spread over seven areas of activity (large banking groups, banks/financial intermediaries, integrated insurance supervision, insurance sectors, markets, legal, enforcement, international relations, and services). The strategic management of FINMA will be in the hands of its Board of Directors, chaired by Dr Eugen Haltiner.

The Swiss National Bank conducts traditional macroeconomic monetary policy with price stability, or a target rate of inflation below 2%, as its chief goal.[5] It implements its monetary policy by targeting the three-month LIBOR rate, rather than the more traditional overnight interbank lending rate, in order to influence money market interest rates. Similar to the U.S. system, the Swiss banking system operates on a reserve basis, where commercial banks are required to satisfy minimum reserve requirements, currently 2.5%, of a bank's short-term liabilities.

The Swiss financial sector, known for its long-standing experience in asset management, performs an important international intermediation function within the global financial system as one of the key players in the international private banking business.[6] Within the Swiss economy, financial services play a large role, accounting for about 12% of GDP and employing about 200,000 people.[7] As **Table 1** indicates, the Swiss financial system is highly developed and diversified. It consists of about 330 banks, a small number of global players in banking and insurance, a large and diversified insurance sector, many pension funds, and two dozen cantonal (state) banks. UBS and Credit Suisse, Switzerland's two largest banks, are complex financial institutions that operate globally and offer a broad range of products and services. The cantonal banks are owned in part or in whole by the cantons, which typically guarantee their liabilities. Regional banks engage exclusively in domestic banking. Raiffeisen banks consist of over 500 credit cooperatives and focus on mortgages in rural areas. The private banks engage primarily in portfolio management for high net worth individuals, and the foreign banks represent subsidiaries of foreign banks that also generally focus on private banking.

Table 1. Switzerland's Financial Sector, Number of Firms by Market

	2005	2006	2007
All Banks	337	331	330
Cantonal banks	24	24	24
Large banks	2	2	2
Regional and savings banks	79	78	76

[5] *The Swiss National Bank in Brief*, Swiss National Bank, August 2007.

[6] *Switzerland: 2008 Article IV Consultation*, p. 3.

[7] *Figures on Switzerland as a Location for Financial Services*, Federal Department of Finance, December 2008.

	2005	2006	2007
Raiffeisen banks	1	1	1
Other banks	189	183	183
Commercial banks	7	7	7
Stock exchange banks	56	52	48
Other banks	4	4	6
Foreign controlled banks	122	120	122
Branches of foreign banks	28	29	30
Private bankers	14	14	14
Insurance companies – life	24	24	24
Insurance companies – general	124	124	124

Source: Swiss National Bank

Switzerland takes an active part in such international organizations as the International Monetary Fund (IMF), the G-10 group of industrialized countries[8], the G-20, the Bank for International Settlements (BIS)[9], the Organization for Economic Cooperation and Development (OECD) [10], the World Trade Organization (WTO), the Financial Stability Forum (FSF)[11], and the United Nations. In addition, Switzerland has been a member of the Financial Action Task Force (FATF)[12] since 1990 and was instrumental in proposing stricter guidelines in 2003 concerning identifying clients and the ultimate beneficial owner of bank accounts.[13]

Recent estimates indicate that Switzerland had a Gross Domestic Product (GDP) in 2008 of about $500 billion and a per capita income of slightly over $42,000, as indicated in **Table 2**. The current

[8] The G-10 group includes Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

[9] The Bank for International Settlements is an international banking organization that was organized in 1930 to foster international monetary and financial cooperation and serves as a bank for central banks. The bank sponsors meetings if central bankers and collects data from central banks and publishes reports and data on the international flows of capital between financial centers. BIS provides a wide range of financial services to central banks to assist them in managing their foreign exchange reserves, extends short-term credits to central banks, and has on occasion extended short-term credits to countries facing financial troubles

[10] The Organization for Economic Cooperation and Development is an international group of 30 advanced economies that provides a structure where governments can compare policy experiences, seek answers to common problems, identify good practices, and coordinate domestic and international policies The member countries include Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, The Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States.

[11] The financial Stability Forum is an international organization that brings together senior representatives of national financial authorities (central banks, supervisory authorities and treasury departments), international financial institutions, international regulatory and supervisory groupings, committees of central bank experts and the European Central Bank. The FSF is serviced by a small secretariat housed at the Bank for International Settlements in Basel, Switzerland.

[12] The Financial Action Task Force on Money Laundering is comprised of 31 member countries and territories and two international organizations. It was organized to develop and promote policies to combat money laundering and terrorist financing.CRS Report RS21904, *The Financial Action Task Force: An Overview*, by James K. Jackson.

[13] *Swiss Financial Centre and Financial Market Policy*, Federal Department of Finance.

financial crisis is taking a toll on the Swiss economy, which is forecast to slow down sharply in 2009, with recovery not expected to come until 2010.[14]

Table 2. Switzerland, Key Economic Indicators

	2007	2008	2009	2010
Nominal GDP ($billions)	426.7	493.4	470.2	473.6
Real GDP growth (%)	3.3	1.8	-1.8	0.3
Population (millions)	7.6	7.7	7.7	7.8
GDP per capita ($)	40,320	42,123	41,736	41,837
Unemployment rate (%)	2.8	2.6	4.1	5.4
General government balance (%of GDP)	2.2	0.9	-1.7	-2.6
Consumer prices (% change)	0.7	2.4	-0.2	0.9
Money market rate (%)	2.5	2.6	0.2	0.3
Current account balance ($billion)	58.0	42.0	37.3	34.8

Source: *Switzerland, Country Report*, Economist Intelligence Unit, January 2009.

Note: Data for 2009 and 2010 are estimates.

Switzerland and the Financial Crisis

Switzerland's efforts to contain the negative effects of the financial crisis initially seemed to be effective,[15] but the spreading crisis and the associated economic downturn are taking a toll on the Swiss economy. The cause and effects of the current financial crisis likely will be debated for years to come. This memorandum does not attempt to provide a complete explanation of the causes of the financial crisis, since other CRS Reports provide such a detailed explanation.[16] While different individuals and organizations will view the crisis from different perspectives, a rough way to view the crisis is as a series of events proceeding through four periods where the policy responses differed.[17] The periods are not necessarily discretely identifiable because they overlap with other periods, but this approach provides a short-hand way of describing the crisis and explaining Switzerland's actions.

[14] *Switzerland, Country Report*, Economist Intelligence Unit, January 2009; and *OECD Economic Outlook,* Switzerland, the Organization for Economic Cooperation and Development.

[15] For information see CRS Report RL34742, *The U.S. Financial Crisis: The Global Dimension with Implications for U.S. Policy,* coordinated by Dick K. Nanto.

[16] See CRS Report RL34182, *Financial Crisis? The Liquidity Crunch of August 2007*, by Darryl E. Getter et al.; CRS Report R40007, *Financial Market Turmoil and U.S. Macroeconomic Performance*, by Craig K. Elwell; CRS Report RL34412, *Containing Financial Crisis*, by Mark Jickling; CRS Report RS22963, *Financial Market Intervention*, by Edward V. Murphy and Baird Webel; and CRS Report RL34742, *The U.S. Financial Crisis: The Global Dimension with Implications for U.S. Policy*, coordinated by Dick K. Nanto.

[17] Fender, Ingo, and Jacob Gyntelberg, Overview: Global Financial Crisis Spurs Unprecedented Policy Actions, *BIS Quarterly Review*, Bank for International Settlements, December 2008.

Phase I: Build-up

In general terms, the financial crisis can be thought of as beginning in August 2007, although the seeds of the crisis likely had been in place for some time. The crisis is identified with a loss of confidence in credit markets that was associated with a downturn in the U.S. sub-prime mortgage market. While a downturn in mortgage markets generally would be expected to have a negative impact on parts of the economy, the crisis quickly evolved into a more general liquidity crunch that spread well beyond the sub-prime mortgage market. Initially, this first period of the crisis appeared to affect highly leveraged banks, investment firms, and other financial services providers, which prompted an ad hoc case-by case response. For instance, the Federal Deposit Insurance Corporation took control of IndyMac Bank, the Federal Reserve arranged for JPMorgan Chase to acquire Bear Sterns, and the British government nationalized housing lender Northern Rock.

Phase II: Liquidity Issues

In the second period, as U.S. mortgage markets continued to deteriorate, the U.S. Treasury announced that it was taking over the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).. Soon after this takeover, Lehman Brothers filed for bankruptcy, which led to a more wide-spread crisis of confidence. This lack of confidence, in turn, was a major factor in causing credit markets to freeze up and it led to a lack of liquidity. In this period, the policy emphasis shifted from rescuing individual banks and institutions to responding to the broader systemic issues that were affecting a wide range of credit markets. The Federal Reserve provided financial assistance to American International Group (AIG) and approved the transformation of Goldman Sachs and Morgan Stanley into bank holding companies. On October 8, 2008, the Federal Reserve, the European Central Bank, the Bank of England and the central banks of Canada, Sweden, Switzerland, the Bank of Japan, and the Chinese central Bank all lowered their lending rates to reduce borrowing costs and to provide liquidity Before the end of the month, the Federal Reserve announced another cut in interest rates, which other central banks followed in November. In addition, various central banks increased guarantees to depositors holders. The International Monetary Fund (IMF) approved a short-term liquidity facility to assist banks facing liquidity problems.

Phase III: Solvency Issues

In the third phase, the lack of confidence in credit markets and a lack of liquidity also sparked concerns over the adequacy of capital provisions of financial institutions and to concerns over the solvency of banks and other financial institutions. During this phase, financial firms attempted to deleverage by reducing the amount of troubled assets on their balance sheets. At the same time, the stocks of most financial firms dropped markedly and the value of their assets continued to decline, which weakened an even larger number of institutions. In this phase, intervention by central banks continued, but national governments also began to intervene, typically through their respective Treasury departments, to take control of insolvent banks or otherwise to provide financial assistance. The U.S. Congress passed the Troubled Assets Relief Program (P.L. 110-343), and the U.K. government provided assistance to the Royal Bank of Scotland, Lloyds TSB, and to Hallifax Bank of Scotland (HBOS). Several European countries, including Germany, France, Italy, Austria, Netherlands, Portugal, Spain, and Norway announced plans to recapitalize banks and to provide government debt guarantees. At a meeting of the G-20, leaders agreed to take steps to stabilize the global financial system.

Phase IV: Fiscal Intervention

In the fourth period, as the problems in credit markets persisted, the financial crisis spread to those activities in the real economy that are highly reliant on credit markets and it reinforced concerns over the adequacy of capital provisions. Furthermore, the slowdown in economic growth weakened the capital position of financial institutions so that the financial crisis and the economic downturn have become negatively reinforcing. Governments have responded in this phase of the crisis by adopting macroeconomic stimulus measures to blunt the effects of the economic recession in addition to providing liquidity, guaranteeing the safety of deposits, and providing funds to improve the capital position of banks and other financial institutions. In February 2008, the U.S. Congress passed P.L. 110-185, the Economic Stimulus Act of 2008 to provide rebates to individual on their income taxes in order to provide a fiscal boost to the U.S. economy.[18] Then in July 2008, the U.S. Congress adopted, and President Bush signed, P.L. 110-289, the Housing and Economic Recovery Act of 2008 to provide an additional fiscal stimulus to the U.S. economy. In February 2009, the Congress is considering H.R. 1 and S. 1, the American Recovery and Reinvestment Act of 2009[19] to provide an additional fiscal stimulus to the U.S. economy. The U.K. government announced a fiscal stimulus package and the EU governments approved a economic stimulus package for its members. in addition, the U.K. government and the German governments have announced additional stimulus packages. Various central banks also announced additional cuts in key interest rates as another measure to stimulate economic growth.

Switzerland's Response

Switzerland has chosen to address the financial crisis in it own distinct way. It has not followed Iceland,[20] which essentially nationalized its troubled banks, or Sweden,[21] which nearly a decade earlier had restructured its troubled banks by creating a separate entity to work out failing loans. As a first step, the Swiss National Bank moved to address concerns over liquidity by engaging in coordinated actions with other leading central banks. It lowered key interest rates on October 8, 2008, November 7, 2008, November 20, 2008, and on December 8, 2008, bringing the key interest rate to 0.5% in December 2008. In addition, in September 2008, the SNB addressed concerns over the capital adequacy of its two largest banks by contributing $15 billion to a $100 billion emergency injection of liquidity. Also in September 2008, the Swiss Government introduced a 900 million Swiss franc-package of measures to stimulate the Swiss economy. Then, in December, 2008, Swiss Economic Minister Doris Leuthard announced that the Swiss government had development a second economic stimulus package that was worth about 650 million Swiss francs-mostly in infrastructure projects to be implemented in 2009, out of concerns that the Swiss economy was headed for its worst recession in nearly 20 years. Reportedly, the Swiss Cabinet is preparing a third package of economic stimulus measures for 2010 should economic conditions in Switzerland continue to deteriorate.

Also, to improve the capital adequacy of Switzerland's largest bank, Switzerland's Federal Council formally adopted on November 5, 2008 a package of measures proposed by the Federal

[18] CRS Report RS22850, *Tax Provisions of the 2008 Economic Stimulus Package*, coordinated by Jane G. Gravelle.

[19] CRS Report R40104, *Economic Stimulus: Issues and Policies*, by Jane G. Gravelle, Thomas L. Hungerford, and Marc Labonte.

[20] CRS Report RS22988, *Iceland's Financial Crisis*, by James K. Jackson.

[21] CRS Report RS22962, *The U.S. Financial Crisis: Lessons From Sweden*, by James K. Jackson.

Council, the Swiss National Bank and the Swiss Federal Banking Commission (now FINMA) to stabilize the Swiss financial system. The Dispatch adopted by the Council provided $60 billion in aid to UBS and a draft of measures to be submitted to parliament to amend Switzerland's Federal Act on Banks and Savings Banks (Banking Act) to strengthen depositor protection.

The Swiss package of measures are aimed both at relieving UBS of illiquid assets and at strengthening the bank's equity capital. UBS, and to a lesser extent Credit Suisse, was exposed in the credit default swap market,[22] and it had a particularly high exposure to U.S. subprime assets that required UBS to write down the value of a substantial part of its portfolio.[23] In addition to these problems in the banking sector, the International Monetary Fund (IMF) concluded in a recent review of Switzerland's economy that the country's insurers derive a large share of their income from overseas business and, therefore they would experience the effects from a slowdown in economic activity both within and outside of Switzerland.[24]

The first part of the Swiss financial package is intended to provide liquid assets through two actions. First is the transfer of up to $60 billion of currently illiquid UBS assets to a special entity that would be operated and overseen by the Swiss National Bank to bring additional liquidity to UBS, while relieving it of risks. UBS is expected to provide this fund with equity capital of up to $6 billion. With a secure loan to fund the new entity, the SNB is then expected to finance up to $54 billion in loans, not with its own capital, but by raising U.S. dollars initially with the U.S. Federal Reserve and later directly in the market. The fund entity is to charge interest commensurate with the risks and is to compensate the SNB for the risks involved.

As collateral, the SNB is to have ownership of the assets and control of the fund entity, as well as the overwhelming share of the equity in the event of positive performance. The assets transferred from UBS consist primarily of loans associated with U.S. and European residential and commercial real estate mortgages. The underwriting price reportedly is to be determined on the basis of the current book value of the assets and on the basis of an independent evaluation. The entity is to pay the lower of the two prices. The transfer of assets to the fund entity and the administration and liquidation of the assets is to be supervised by the SNB.

In the second measure, the capital base of UBS is to be reinforced by the Swiss government subscribing to 6 billion Swiss francs of mandatory convertible notes. This measure is directly connected to relieving UBS of illiquid assets by allowing the bank to fund an entity with the necessary capital, without diminishing its own capital base. For the Swiss government the mandatory convertible notes offer the expectation that the notes are secure and that the government will be commensurately compensated (coupons of 12.5 %) and that the government will not, at least not initially, become a co-owner of the bank. The Federal Council has indicated that it is committed to putting a time limit on the participation of the government.

In addition to the measures to assist UBS, the Federal Council instructed the FDF to improve the Swiss depositor protection system. As an immediate measure, the Federal Council indicated that

[22] Credit default swaps are insurance-like contracts that promise to cover losses on certain securities in the event of a default or other credit event. They typically apply to municipal bonds, corporate debt and mortgage securities and are sold by banks, hedge funds and others. The buyer of the credit default insurance pays premiums over a period of time in return for peace of mind, knowing that losses will be covered if a default happens. They are supposed to work similarly to someone taking out home insurance to protect against losses from fire and theft.

[23] *Switzerland: 2008 Article IV Consultation*, p. 8.

[24] Ibid., p. 17.

it would submit a Dispatch to parliament in the winter session of 2009 to increase depositor protection from 30,000 Swiss francs to 100,000 francs and to increase the system limits from 4 billion francs to 6 billion francs. In a second phase, the Council indicated that it intends to revise completely the current deposit guarantee scheme. The Federal Council has indicated that it expects to see a reform proposal from the FDF by the end of March 2009. The emergency provisions are intended to remain in force until December 31, 2010. By then it is expected that the improved depositor protection proposal will be integrated into standard law.

In addition to the measures outlined above, the Swiss proposal is intended to strengthen the financial system through four other measures:

1. First, current reforms to company law are expected to be amended by adding regulations on executive compensation. At the same time FINMA is expected to draw up minimum standards for the entire financial sector. In addition and after prior consultation with FINMA, UBS will be obliged to submit its compensation for its board of directors and management in line with established international institutions. The involvement of the government after that will be subject to the condition that UBS implements the requirements of the Federal Council in the area of corporate governance. A report on implementation will be provided as part of the Federal Council business report and the federal accounts.
2. Second, by November 2008, the SFBC was required to issue more stringent capital requirements for major banks.
3. Third, by the spring of 2009, the Federal Council intends to conduct a fundamental review of the deposit guarantee system.
4. Finally the Federal Council indicated that it would remain prepared, if necessary, to guarantee new medium-term bank borrowings of Swiss banks in the capital market.

As a final measure, the Federal Council intends to introduce an additional capital buffer to increase the target value for supplementary capital requirements above those of Basel II[25], which the Swiss government hopes will better cover the systemic risks of the big banks. This further tightening of the capital requirements should go beyond the existing Swiss requirements and the planned tightening of conditions of the Basel Committee. FINMA also intends to introduce a leverage ratio. This would act as a buffer against losses resulting from a false assessment of risks and which are not adequately covered by the requirements of Basel II.

The importance of Switzerland's efforts to support UBS and Credit Suisse is clear from the data in **Table 3**. The foreign exposure of Switzerland's banks, in terms of the stock of foreign assets, grew to exceed the size of Switzerland's GDP, which challenges the ability of national central banks to act as a lender of last resort. Often, banks' foreign exposure is analyzed as a way of assessing risks to the financial system and as an early warning of developments that could stress the system. Over 70% of this exposure, both in terms of claims and liabilities, is in interbank activity. As **Table 3** indicates, UBS had assets in 2008 that were nearly five times the size of

[25] Basel II is the second of the Basel Accords, which are recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision. The purpose of Basel II is to create an international standard that banking regulators can use when creating regulations concerning requirements for capital adequacy that banks must meet to guard against the types of financial and operational risks that banks face.

Switzerland's economy, while Credit Suisse had assets that were three times the size of the Swiss economy.

Table 3. Size of Selected European Banks

Country	Bank Name	Total Assets (billions of euros)	Total Assets to GDP (percent of GDP)
Iceland	Kaupthing	53	623
Switzerland	UBS	1,426	484
Iceland	Landsbanki	32	374
Switzerland	Credit Suisse	854	290
Netherlands	ING	1,370	290
Belgium & Lux.	Fortis	886	254
Cyprus	Bank of Cyprus	32	253
Belgium & Lux.	Dexia	605	173
Spain	Santander	913	132
United Kingdom	RBS	2,079	126
Netherlands	Rabobank	571	121
France	BNP Parabas	1,694	104
Ireland	Bank of Ireland	183	102
Belgium & Lux.	KBC	356	102

Source: O'Murchu, Cynthia, and Emma Saunders, Are European Banks Too Big to Fail?, *Financial Times*, September 30, 2008.

Conclusion

The U.S. and Swiss economies and financial systems are markedly different in size and scope. Each country is facing its own set of circumstances and challenges as a result of the financial crisis. These two countries, however, often cooperate in a number of international organizations, while the international scope of their financial activities often cause firms operating in their respective regulatory jurisdictions to compete. One issue the two countries share concerns the organization of financial markets domestically and abroad to improve supervision and regulation of individual institutions and of international markets. This issue also focuses on developing the organizational structures within national economies that can provide oversight of the different segments of the highly complex financial system. Such oversight is viewed by many as critical, because financial markets are generally considered to play an indispensible role in allocating capital and facilitating economic activity. The financial crisis also has revealed extensive interdependency across financial market segments both within many of the advanced national financial markets and across national borders. Some observers have argued that the complexity of the financial system has outstripped the ability of national regulators to oversee effectively.

In the months ahead, Members of Congress and the Obama administration likely will consider a number of proposals to restructure the supervisory and oversight responsibilities over the broad-based financial sector within the United States and in the broader international financial markets. As policymakers address this issue, they likely will assess the costs and benefits of centralizing supervisory responsibilities into a few key entities, such as the Federal Reserve, or dispersed them more widely across a number of different entities. In the United States, the Federal Reserve holds a monopoly over the conduct of monetary policy, mainly as a means of keeping such policy-making independent from political pressure, but has shared regulatory and supervisory responsibilities with a number of different agencies that are more directly accountable to elected officials and are subject to change. The Swiss system provides an example of a system that has separated the regulatory and supervisory responsibilities from the monetary policy responsibilities of the Swiss National Bank and consolidated them into a national regulatory body that is subject to the Federal Council, or the executive of the Swiss government. Since this newly created entity began operating on January 1, 2009, it is still too early to assess the effectiveness of this system, but it may merit watching closely as a possible alternative to the existing U.S. structure.

Author Contact Information

James K. Jackson
Specialist in International Trade and Finance
jjackson@crs.loc.gov, 7-7751