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Proposal of Federal Law on the Protection of Bank Deposits ("*Bankeinlagensicherungsgesetz*") Limits Application of Termination Close-Out Provision in Bank Restructuring

By proposal of November 5, 2008, the Federal Council introduced several changes to the existing law, aiming at the increase of bank depositors' protection. The Parliament adopted the proposals and implemented the changes by way of an urgent resolution ("*dringlicher Bundesbeschluss*"). The changes introduced by this resolution will expire in December 2010.

Consequently, the Federal Council proposes the introduction of comprehensive changes to the existing law by way of a regular amendment procedure and has submitted a respective proposal on September 11, 2009.¹ Interested parties are invited to submit their comments to the proposal by December 31, 2009.

The draft proposal, however, not only addresses questions of the protection of depositors but also introduces changes to the Banking Act's insolvency provisions, which will, if approved in the current form, severely impact the enforceability of termination close-out provisions of existing agreements in a bank restructuring situation.

In particular, the proposal envisages that a restructuring plan may foresee the continuation of certain of the bank's activities, irrespective of whether or not the bank concerned will survive (see: proposed Art. 30 para. 1 Banking Act). This clause would permit a cherry picking in respect of certain of the bank's activities which could then be transferred to a new bank or a bridge bank.

Art. 31 para. 3 Banking Act as proposed further stipulates that

"[w]here a restructuring results in a change of ownership or in existing contractual relationships being transferred in accordance with Art. 30 [Banking Act], this in itself does not create a termination right in respect of the contracts concerned. Contractual provisions stating otherwise are void."

This proposed change raises the question of the enforceability of termination close-out provisions of existing master agreements in such restructuring situation. It also seems to contradict somewhat Art. 27 para. 3 Banking Act, which states that the enforceability of termination close-out and netting agreements and agreements on private liquidation of collateral remains unaffected by protective measures ordered by the Financial Market Supervisory Authority. These protective measures usually precede a bank insolvency or restructuring.

Moreover, since a restructuring requires the approval of the majority of the bank's creditors (see: Art. 31a Banking Act as proposed), the termination of the agreements would remain suspended, pending creditor approval. This period of uncertainty also appears to be unacceptable for the participants in the market, particularly in the case of a pending bank insolvency, which is most likely to increase volatility in the markets.

¹ <http://www.efd.admin.ch/dokumentation/gesetzgebung/00571/01556/index.html?lang=de>



Given the broad wording of the standard default provisions contained in existing master agreements, it may well be that the master agreements permit the termination of the contractual relationship based upon other clauses. However, the ambiguity created by the most recent proposal to amend Art. 31 para. 3 Banking Act is certainly not in the best interest of the participants in the market and the financial markets in general.

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