avenir suisse essentials
The Facts of the Matter Distilled

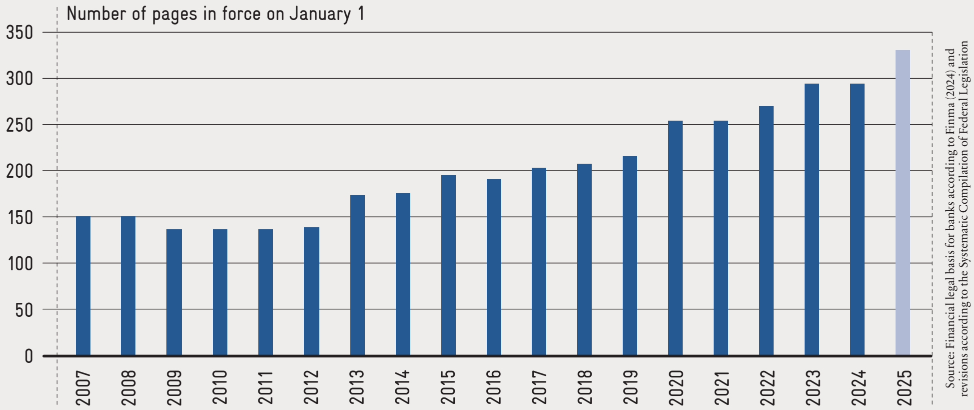
Banking regulation in the digital age

The state has always responded to instability in the banking sector with guarantees and regulations. However, with digitalization, the current regulatory framework has lost much of its effectiveness.

Situation

Loans and money creation are at the center of banking activity. On banks' balance sheets, long-term loans such as mortgages are financed by short-term deposits such as bank accounts. This activity creates risks that materialize in the form of bank runs. These risks are supposed to be controlled by government guarantees and regulations. Despite this, in March 2023 several bank runs took place in the United States and Credit Suisse found itself in difficulty in Switzerland. This major bank merged with UBS thanks to the emergency law and federal guarantees.

Banking regulation in Switzerland has doubled since the financial crisis



When the revised Capital Adequacy and Liquidity Ordinance comes into force next year, 36 pages will be added to banking regulations. This graph does not consider Finma circulars and industry self-regulations, or the countless other financial market regulations that also involve banks.

Facts

3 times faster

Digitalization has speeded up financial transactions enormously. In March 2023, Credit Suisse clients withdrew their deposits three times faster than predicted in the regulatory crisis scenario.

■ **Focus on liquidity and solvency:** There are two main types of regulation. Liquidity regulations aim to make cash outflows bearable, while capital regulations are designed to ensure that banks do not take on too much risk and that losses can be written off.

■ **Digitalization, a turning point:** Information technology is enabling new financial innovations that are undermining the effectiveness of regulation. Assets can be moved from one balance sheet to another, and from one jurisdiction to another, in just a few clicks.

■ **Cat and mouse:** When a regulation is bypassed, new regulations follow. Over the years, this has led to a proliferation of regulations. Guidelines from the Basel Committee on Banking Supervision are now thousands of pages long.

■ **Costs of ineffective regulation:** For the 2008 crisis, the European Central Bank estimated the cost of state rescue measures at around 5% of eurozone GDP. Moreover, in normal times, state guarantees (explicit and implicit) that are not properly remunerated can lead to market distortions.

Recommendations

In the wake of the Credit Suisse crisis, long-held ideas such as the separation of banking activities or the authorization for Finma to impose fines have resurfaced. However, such approaches fail to consider **digitalization:** today, the rules that apply to each financial institution **cannot control systemic risks.**

This calls for a **fundamental rethink** of regulation at international level. On a national level, a **mitigation strategy** is necessary. This involves considerably reinforcing a **bank's liquidation capacity,** to minimize the effects of a systemic crisis on the credit and payment system, as well as on the monetary regime.

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