FSB FINANCIAL STABILITY BOARD

Press release

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FSB completes peer review of Switzerland

The Financial Stability Board (FSB) published today the report on the peer review of Switzerland. The main purpose of the report is to assess Switzerland's progress in addressing regulatory and supervisory issues raised by the International Monetary Fund (IMF) under the Financial Sector Assessment Program (FSAP) in 2006-07. The report also provides an overview of market and regulatory developments since the FSAP was published.

The response of the Swiss authorities to the problems of one of the two systemically important banks (SIBs) during the financial crisis was swift and effective. Their actions, in combination with strong macroeconomic fundamentals, allowed the economy to recover fairly quickly with very limited fiscal stimulus.

Nevertheless, the crisis did reveal the considerable macroeconomic and financial system risks arising from a SIB's failure and demonstrated that large losses by these institutions were not merely a theoretical possibility. As a result, strengthening their resilience has become a key priority for the authorities. The lynchpin of their response is the recently-approved too-big-to-fail (TBTF) package, which is due to come into force on 1 March. The FSB commends the Swiss authorities for developing this package, particularly in the absence of an internationally agreed framework at the time on how to deal with systemically important firms. The package goes beyond international minimum standards in terms of regulatory capital requirements and has been influential in the international policy debate on this issue.

Implementation issues, such as the use of contingent capital instruments and the application of regulatory capital "rebates" for firms that are able to demonstrate resolvability and resolution beyond minimum requirements, will be important for the success of the TBTF package. However, at least as important is ensuring: (1) a rigorous corporate governance framework in SIBs to ensure that their risks are well-understood and adequately managed internally; and (2) a robust supervisory framework in the prudential authority (FINMA) with sufficient resources and intensive supervision. These two factors are particularly relevant given the size, global reach and business models of the two large banks.

The peer review examined the steps taken by the Swiss authorities to address FSAP recommendations on regulatory and supervisory issues in the following areas: banking and supervisory framework; banking supervision; (re)insurance regulation and supervision; and pension regulation and supervision.

FINMA's operational independence from the federal government has been enhanced compared to its predecessor authorities in areas such as hiring and budget setting. However, the FINMA Act has not been revised (as recommended by the FSAP) to address situations where there are tensions or direct conflicts between prudential and competitiveness objectives or to grant FINMA the powers to impose civil money penalties to enhance its prudential powers. Progress on addressing these issues would be desirable.

FINMA has made good progress in strengthening its resources and headcount as recommended by the FSAP, in spite of difficulties in recruiting specialists. FINMA should continue to increase its resources – both on the banking and on the insurance side – and enhance its in-house expertise to keep pace with market and regulatory developments.

FINMA is making a number of improvements to its supervisory framework, including a new risk-based supervisory approach. However, reliance on these third parties remains strong. While the outsourcing of supervisory functions to third parties is appropriate in certain cases, the FSB encourages the Swiss authorities to continue to enhance FINMA's supervisory capacity and its ability to perform more on-site examinations itself, including with respect to bank risk management practices and internal controls. One important concern with respect to outsourcing is the independence of the work carried out by third parties. In that respect, FINMA is encouraged to continue to improve its oversight of banks' external auditors, as envisaged in its current plans.

Cantonal banks weathered the crisis fairly well and were able to gain market share at the expense of the two large banks; they are also generally well capitalized and have a higher quality of capital than the two SIBs. Cantonal banks are subject to supervision by FINMA and operate under the same corporate governance regulation that applies to private banks. However, some of these banks have their liabilities fully guaranteed by their respective cantons (often for a fee). In order to promote a level playing field, the Swiss authorities should consider eliminating these guarantees.

Significant progress has been made in implementing insurance sector reforms since the FSAP. The Swiss Solvency Test (SST) came into full effect in 2011; FINMA has expanded its supervisory resources and undertakes focused inspections of high risk insurers; there is enhanced data collection for intra-group transactions (IGTs); an internal audit function within FINMA has been established; and quarterly reporting of selected key indicators for insurance companies has been implemented. Looking ahead, FINMA needs to ensure the proper operation of the SST for all relevant (re)insurers and the further development of systems to support in-depth analysis of the use of IGTs. FINMA is also encouraged to take additional steps to expand public disclosure, an issue that it is currently considering.

The impending change in the supervisory structure for pension funds, while falling short of the FSAP's main recommendation, represents a major improvement compared to the current situation. However, it is unclear that the current resources allocated to the central supervisory commission (OAK) will be sufficient to achieve its intended objectives. It is also essential to ensure a clear line of communication and cooperation between OAK and FINMA, given the role of insurance companies in the private pension system.

Significant progress has been achieved in strengthening governance provisions of pension funds following the FSAP. On the other hand, the new legislation does not specifically address other aspects of risk management. The development of supervisory guidelines on risk management should therefore be one of the first priorities of the OAK. The FSAP recommendation on a risk-based solvency test also remains to be implemented.

Notes to editors

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

The peer review of Switzerland is the fifth country peer review conducted under the FSB's *Framework for Strengthening Adherence to International Standards*.[1] The objective of such reviews is to examine the steps taken or planned by national authorities to address IMF-World Bank FSAP recommendations concerning financial regulation and supervision as well as institutional and market infrastructure. FSB member jurisdictions have committed to undergo an FSAP assessment every five years and, to complement that cycle, an FSB peer review two to three years following an FSAP. As part of this commitment, Switzerland volunteered to undergo a peer review in 2011, which follows up on the recommendations of the FSAP undertaken by the IMF in 2006-07. Canada also underwent a peer review recently and its report will be published shortly. South Africa will undergo a peer review in 2012.

A country peer review evaluates the progress made by the jurisdiction in implementing FSAP recommendations against the background of subsequent developments that may have influenced the policy reform agenda. It provides an opportunity for FSB members to engage in dialogue with their peers and to share lessons and experiences. Unlike the FSAP, a peer review does not comprehensively analyse a jurisdiction's financial system structure or policies, nor does it provide an assessment of its conjunctural vulnerabilities or its compliance with international financial standards.

The report published today describes the findings and conclusions of the Switzerland peer review. The draft report for discussion was prepared by a team of experts drawn from FSB member institutions and led by Paul Rochon, Associate Deputy Minister, Department of Finance, Canada. The review benefited from dialogue with the Swiss authorities and from discussion in the FSB Standing Committee on Standards Implementation.

The FSB is chaired by Mark Carney, Governor of the Bank of Canada. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.financialstabilityboard.org.

[1] A note describing the framework is available at http://www.financialstabilityboard.org/publications/r_100109a.pdf.