Schwanengasse 12
P.O.Box
CH-3001 Berne
Phone +41 31 322 69 11
Fax +41 31 322 69 26
info@ebk.admin.ch
www.sfbc.admin.ch

Eidgenössische Bankenkommission
Commission fédérale des banques
Commissione federale delle banche
Swiss Federal Banking Commission

Swiss Federal Banking Commission media conference, April 29, 2004

Prof. Jean-Baptiste Zufferey, Doctor of Law
Vice-Chairman of the Swiss Federal Banking Commission

Overregulation in banking and finance

Claims of overregulation are nothing new. They crop up now and again, depending on how the economy is faring. If things are going fine, everyone wants a free market. If, on the other hand, scandals are piling up, as we have seen with Enron, WorldCom and more recently Adecco, we hear calls for stronger state regulation. The Swiss Federal Banking Commission is aware of this, and tries to approach the question of what to regulate and when independently of economic trends.

The topic of overregulation in banking and finance has been very fashionable in recent months, the main critics being professional organizations and a few outspoken individuals whose views have been propagated by the media. Far from being confined to the financial sector, however, it appears to be a prime concern for companies in general at the moment[1].

1. The issue

The issue of overregulation is certainly not a new one. It resurfaces at regular intervals in line with the business cycle and economic events. Overregulation was not a word on anyone's lips during the bear market from 2000 to 2002, which brought financial scandals from the likes of Enron, WorldCom, ABB and Parmalat. On the contrary, talk was of more forceful state intervention aimed at putting a stop to dubious practices and protecting investors' interests. Now this period of turbulence seems to be behind us, the banking and finance industry will probably seek a relaxation of the regulatory framework within which it operates. This is part of a natural progression: the industry has been through a bad patch and needs to increase profitability, which it can do most easily by cutting costs; and, while staffing costs have already been slashed, the other costs it has to contend with include those arising from regulation.

[1] cf. Davos Forum discussions at the start of the year

The term "overregulation" is most often used to mean a situation in which a particular sector's growth is hampered by an excessive number of overly stringent standards being imposed on it without any real need, and by the supervisory apparatus and sanctions that go with these standards.

It must be remembered from the outset that the debate has many levels and cannot be reduced to glib statements:

1. It is not accurate to say that the financial sector is more heavily regulated than any other. It is true that it is heavily regulated, but a number of quantitative studies have shown that it is still subject to less strict regulation than other areas such as food, public health, social security, town planning, construction and protection of the environment. Furthermore, all regulation in banking and finance comes from the same legislative source, namely the Confederation, and is thus relatively well coordinated.

2. It is wrong to claim that Switzerland has more onerous regulation than rival countries as far as banking and finance are concerned. In fact, (1) the standards imposed in the EU member states are just as strict and are being added to constantly as part of the ongoing push towards harmonization by the European Commission in Brussels. (2) If we compare the situation in Switzerland with that in the United States (the world's biggest market and the country often cited as a model of liberalism), it is quite clear that it is Switzerland that has the more relaxed regime in terms of regulation and supervision: we have practically no legal constraints for IPOs; our banks can offer all the financial services they want (universal banking system); with only a few exceptions, employees within the supervised institutions are not themselves subject to supervision or authorization; and a number of activities – including non-bank asset management, investment consulting and the distribution of financial information – are not regulated at all. (3) As regards supervision, the Swiss Federal Banking Commission (SFBC) is still a very small authority compared with its counterparts in other countries, given the number and size of the Swiss and foreign banks operating in Switzerland. (4) Where Switzerland really has developed a sophisticated regulatory apparatus over the past few years is in the fight against money laundering, and there is no denying that this has fed through into higher costs for the supervised institutions. However, the latest surveys show that it is precisely this domain in which regulation is perceived as being most important and most helpful. In addition, the Swiss financial sector can only hold onto its bank-client confidentiality rules if it is perceived as exemplary in terms of combating money laundering and the financing of terrorism.

3. These days, it is impossible to dispute the necessity for adequate regulation and supervision. Even the professionals subjected to these constraints have no interest in a "race to the bottom" via blanket deregulation. The financial sector has enjoyed phenomenal growth on the back of the trends towards globalization and

increasing sophistication, and this has inevitably caused the amount of regulation to increase as well.

2. Scope

The legislature and the federal authorities must not be thought of as the only sources of regulation in banking and finance. A number of other factors are responsible for sector professionals feeling that they are overregulated:

1. First of all, there are the professionals themselves: every institution has various internal regulations of its own for organizing processes, managing risks and ensuring good corporate governance.

2. Next are the professional associations, which adopt a range of self-regulation standards, in particular the Swiss Bankers Association, the Swiss Chamber of Certified Accountants and Tax Consultants and the Swiss Funds Association. The financial sector is thus subject to a similar process of standardization to that seen in other sectors of the economy. In some cases, these associations even call on the legislature to grant exemptions and exercise greater lenience, making any new laws all the more complex and difficult to enforce.

3. It must also be borne in mind that providing financial services is a risky business nowadays, given how demanding clients have become. As in many other service professions, banks and other financial intermediaries risk facing complaints and contractual damages claims. They need to develop compliance and documentation systems to protect themselves against these, and this adds to their workload. The SFBC is not party to this trend.

4. The same applies to all standards in other areas, including tax law, competition law, data protection, company law and even consumer protection (personal loans).

3. Measures

The SFBC is nevertheless aware of the burden regulation represents for the institutions it supervises. This is why, before adopting new regulations, it always considers whether it genuinely needs to intervene in order to fulfil the task assigned to it by the legislature – protecting investors and the financial sector as a whole. The principle of proportionality often leads it to make do with an administrative ruling for the institutions concerned or even do nothing in accordance with the *de minimis* principle. Finally, the SFBC always works in concert with the professional organizations.

Specialists are increasingly recommending cost-benefit analyses, and the SFBC intends to use methods of this type in future to assess the impact of plans to intro-

Eidgenössische Bankenkommission
Commission fédérale des banques
Commissione federale delle banche
Swiss Federal Banking Commission

duce new standards. However, we should be under no illusions in this respect. Such analyses are very costly and give extremely incomplete results, especially as regards the benefits a particular regulation might bring for each individual company or the sector in general.

Economic analyses along these lines confirm a fact the SFBC is all too aware of, namely that regulations (particularly new ones) are more costly to implement for small institutions than for big ones. Insofar as the law allows, the SFBC applies the principle of differentiation. Here are some examples: differentiation is at the very heart of Basel II, since most institutions will be able to opt for simplified methods for calculating their capital adequacy requirements; small trading firms are exempt from a number of provisions; investment funds reserved for institutionals also benefit from exemptions; the new MLO-SFBC provides for banks to set their own criteria for defining risky transactions and clients with regard to money laundering via internal directives. Nevertheless, it should not be forgotten that more freedom for professionals means more responsibility, and like as not higher costs.

All forms of self-regulation remain highly pragmatic solutions adapted to suit the Swiss legislative environment. The SFBC will continue to make use of them wherever possible. For their part, the professional associations must guarantee that they will be rigorous, credible and representative both in formulating their standards and in ensuring that their members comply with them.

To conclude, the SFBC is appealing to everyone involved in the Swiss financial sector to promote quality of service and professionalism. Regulation only exists because of the unacceptable behaviour of a small minority, be it insider trading, share-price manipulation or other market abuses. Plans under consideration now include revising the Swiss Code of Obligations to force companies to disclose board members' and directors' pay and the possibility of federal supervision of pension funds.