Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

Annual Media Conference, 23 March 2010

Dr Patrick Raaflaub
CEO

Ensuring stability – and with it Switzerland's attractiveness as a business location – requires an extension of the legislative framework

I would like to concentrate today on two key topics: the "too-big-to-fail" issue and the forthcoming implementation of the Swiss Solvency Test (SST) in the insurance sector. These two very different topics are both concerned with the same basic issue – one that is a central objective of financial market supervision – namely ensuring the stability of the Swiss financial sector.

The regulatory activities and tools of the financial market supervisory authority are to a large extent determined by legislation. The legislative bodies still have key decisions to take on the subject of banks being too big to fail. In relation to the insurance industry, Parliament has already taken a major step towards securing the stability of the system with the Insurance Supervision Act, which entered into force in 2006. The Swiss Solvency Test (SST), introduced nearly five years ago, will shortly come into force: its rollout is scheduled for 1 January 2011. The timing for introducing a modern, comprehensive, risk-based solvency test for insurance companies could not be better.

Insurance: Swiss Solvency Test (SST) is a sign of strength for the Swiss financial centre

The lessons of the financial crisis have shown that those purchasing insurance products seek stability and transparency with regard to the risks involved. The need for a contractual partner to demonstrate a strong balance sheet on a long-term basis has become a prominent concern. It is therefore in the interests of the insurance companies to meet clients' high expectations in this respect, thereby securing a competitive advantage for themselves. The lead that Switzerland has over the EU, for example, in introducing its risk-based solvency system is certainly not a disadvantage but rather an advantage for us as a business location. A strong capital base does not just mean security for clients of insurance companies, but is also in the interests of the insurance companies themselves. For these reasons, FINMA is not prepared to make concessions to those seeking to postpone the launch of the SST.

The SST is a risk-based solvency system, much like the EU's Solvency II requirements, due to enter into effect in 2012. This means that a company's capital adequacy is determined on the basis of the actual risks entered into. When the SST comes into effect on 1 January 2011, we will have a modern solvency supervision instrument that is able to gauge the financial solidity of insurance companies based on an overall view of their balance sheet and using market-based valuations. This takes into account all relevant micro-prudential risks on an integrated basis, unlike the old Solvency I regime. A solvency system that realistically reflects the risks will provide certainty for insurance clients, and we aim to create the greatest possible level of certainty with the new system.

The SST will be fully implemented in 2011, following a long introductory and transitional period. The first field tests in conjunction with the industry took place back in 2004 and 2005. The corresponding legal provisions then entered into force on 1 January 2006. This means that insurance companies have had five years, from finalisation of the provisions until their introduction in 2011, in which to reduce their risk or build up their capital as appropriate.

FINMA evaluated some 140 SST reports for the reporting year 2009, in which the insurance companies outlined their underlying assumptions, methodology and results of calculations. Life insurance companies reported significantly worse SST results for 2009 than for 2008, which is not surprising given the interest rate situation for life insurers. However, the SST now provides the opportunity to influence the capital management of insurance companies in good time and to lay down capital requirements that are commensurate with the risks.

FINMA’s role is to protect insured parties against the risk of insolvency of their insurer. The Swiss solvency test is an effective instrument for achieving this.

FINMA’s thinking about banks of systemic relevance being too big to fail

Our objective is to ensure a competitive, high-quality Swiss financial services industry, based on stability and sustainability, that also includes banks with successful international operations. We are confident that clients and investors share these expectations. Greater stability, in all likelihood, involves costs, but these higher costs are, in our opinion, justifiable because stability is an indispensable attribute for a leading international wealth management centre like Switzerland is today, and wishes to remain in future.

There is a fundamental problem to be resolved before this can be achieved: The problem is that the government is at present effectively obliged to bail out any bank of systemic relevance, either with financial support or by means of factual acts. This results in a situation where one of the main mechanisms of the free market system has ceased to function, and competition is distorted. This is not an acceptable state of affairs, and the issue is particularly acute in the case of Switzerland, given the scale of the total assets of the two big banks relative to the country’s GDP. In extremis, the necessity to bail out banks could overtax the state’s resources, with dire consequences for the Swiss economy. This must be avoided.

Measures are needed that will protect the national and international financial system and the Swiss economy against the impact of systemically relevant banks failing, eliminating as far as possible the necessity for state bailouts.

We considered whether the current legislative framework is adequate and concluded that it is not. The situation is as follows:

- FINMA already has a statutory basis for raising the capital and liquidity requirements for banks of systemic relevance. In the case of capital, FINMA's predecessor authority, the SFBC, did so in November 2008. Action in respect of liquidity will follow in the coming weeks.
- With good reason, the expectation today is that tougher requirements will not only be possible (as they currently are for capital and liquidity) but will in fact become mandatory under legislation.
- The legal basis for measures in relation to group structures and intra-group capital transactions also needs strengthening.
- Ultimately, it appears in view of the risks for the state that criteria need to be defined at the legislative level that determine a bank's systemic significance.

The experiences of the crisis have shown quite plainly that internationally active large banks are interdependent to such an extent that crisis situations are very hard to manage. We want to tackle this issue and improve the conditions for effective crisis management – be that via the companies themselves or through official intervention. This may require changes to the structure of groups or tougher regulation on intra-group capital flows.

- The reinforcement of the statutory framework under the Swiss Banking Act must be drawn up swiftly. The details will need to be enacted by the Federal Council in the form of ordinances. In collaboration with the SNB, FINMA's thinking is as follows:
- The systemic significance of a bank is determined not by just its size but also on the basis of its systemically relevant role, the lack of substitutability, and the level of national and international interdependence.
- The additional requirements in terms of capital and liquidity need to be adjusted to the degree of systemic relevance, in a mandatory but gradual fashion.
- A clear legal framework must be created in terms of the organisation of and crisis management at financial institutions of systemic relevance, providing for measures in respect of corporate governance, the simplified disposal or separation of group entities in a crisis situation, and limits on capital flows and contingent liabilities within a group.

In collaboration with the expert commission on limiting economic risks caused by large companies, FINMA seeks to advance the work along these lines so that legislative proposals can soon be submitted to the Federal Council.

If Switzerland is serious about tackling the problem of institutions being too big to fail, then radical changes are required. The Federal Council and Parliament need to take responsibility for this.