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The financial sector is vitally important to our country. It both needs and deserves appropriate regulation and a strong supervisory authority to ensure its international competitiveness. This is an essential prerequisite for the success of Swiss financial service providers abroad. The criticisms of overregulation levelled at the Banking Commission by the financial sector two years ago were set out in less emotional terms in 2005. The Banking Commission sees this as a mandate to continue on its chosen path and focus on defining the priorities of its strategy. It will continue to involve market participants and their representatives in regulation planning and further enhance the dialogue it has with them.

The financial sector and the Banking Commission's strategy

The Banking Commission offers pragmatic solutions wherever possible. For example, it has decided that, on application, it will grant Swiss asset managers who manage foreign collective capital investments a licence to operate as securities dealers, thereby protecting them from the loss of market share that would otherwise have resulted from the implementation of the new European Union Investment Funds Directive.

Pragmatic approach

As regards the incorporation of the Basel II Capital Accord into national law, the differentiated menu concept permits the regulations to be applied at modest cost and in a way which is geared to the individual needs of institutions. Despite the changes, the Swiss banks' tried and tested level of capital underpinning is to be maintained. This objective, though, in no way threatens lending to small and medium-sized companies.

Differentiated, cost-conscious regulation

The auditing reform was largely completed. The aims of strengthening the independence of audit companies and providing more transparent, meaningful and timely reporting were met. Quality controls by the Banking Commission promote the optimal implementation of the risk-oriented approach, thus ensuring a viable basis for the two-tier supervisory system in the future.

Risk-oriented approach

The biggest project aimed at increasing the efficiency of financial market supervision in Switzerland is the merger of the Banking Commission, the Federal Office of Private Insurance and the Money Laundering Control Authority to form the Federal Financial Market Supervisory Authority (FINMA). The SFBC welcomes this project. FINMA consolidates and streamlines the supervisory architecture, creates coherence across the individual areas of supervision and promises to enhance the international standing of the Swiss supervisory system. FINMA will also offer synergy potential in some areas, but a reduction in the cost of supervision is unlikely.

Efficient supervision

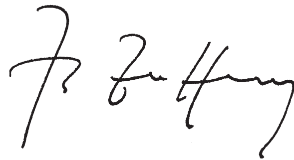
Business ethics are vital

2005 was a boom year for the markets. In an active and positive economic and stock market environment, it is especially important to guarantee the reliability both of the market and of the players within it. This calls for a strong sense of business ethics on the part of all those involved. The Banking Commission is responsible for ensuring that this becomes a reality. In 2006, its activities in this area will focus primarily on market risks and the complexity of new investment products as well as on monitoring and enforcement.

New Chairman of the Banking Commission

Dr. Kurt Hauri stepped down as Chairman of the Banking Commission at the end of September 2005 to begin his retirement. He took this step in the same way as he led the Banking Commission for 20 years, first as its Director and then as its Chairman through some occasionally difficult times – in a no-nonsense and well considered manner. The Banking Commission, the financial sector and Switzerland as a whole owe Kurt Hauri a huge debt of gratitude for his service and contribution. Following the interim chairmanship of Prof. Jean-Baptiste Zufferey, Dr. Eugen Haltiner took up the position of Chairman of the Banking Commission in February 2006.

Jean-Baptiste Zufferey
Chairman



April 2006

1 Implementation of Basel II in Switzerland

The Basel Committee on Banking Supervision signed off the new Capital Accord (Basel II) at the end of June 2004. The regulations contained within the Accord aim to enhance the stability of the global financial system and – by harmonising international capital adequacy requirements – help to provide a level playing field for banks competing in the global marketplace. The capital buffer within the banking system as a whole is essentially to be retained.

Three pillar principle

The mechanism adopted to achieve these goals is based on three pillars. The first sets out the minimum capital requirements for various types of risk. The second requires the supervisory authorities to ensure when conducting their statutory audits that every bank has put in place the necessary internal risk management procedures, and that risks which do not fall within the first pillar are covered. The third pillar seeks, through greater disclosure and transparency, to give market participants a better insight into a bank's risk profile and the adequacy of its capital underpinning. The uniform and more stringent transparency requirements are designed to subject banks to the discipline of the market.

Menu of options

Under Basel I, operational risks were still implicitly contained within the capital adequacy requirements for credit risks; under the new system, they will for the first time be considered separately. To reflect the different types of banks covered by the Accord, Basel II provides a selection – or menu – of approaches for calculating capital adequacy requirements for credit, market and operational risks. The simple, standardised approaches are easier to use and involve less complex calculations, but compensate for their lack of accuracy by generally requiring higher levels of capital than the more sophisticated models tailored to specific institutions. The latter are closer to the internal risk management methods developed by the banks themselves and impose lower capital adequacy requirements on institutions with a favourable risk profile. Their use is subject to stringent approval procedures and is allowed only with the permission of the competent supervisory authority.

Approaches for credit risks

Some of the most significant innovations under Basel II concern the calculation of capital adequacy requirements for credit risks. Here, institutions may choose between a standard approach – similar to that already available under Basel I – and a new, elaborate approach based on internal ratings (IRB). There are two versions of the IRB: a basic version (Foundation IRB, F-IRB), and an advanced alternative (Advanced IRB, A-IRB). The standard approach includes preset risk weighting rates for certain types of credit assets. The creditworthiness assessment is arrived at either through ratings

from external rating agencies – where available – or, as hitherto, via general risk weightings; though here the system is slightly more nuanced than under Basel I. The standard procedure under Basel II permits a broad range of techniques for reducing credit risk, while the institution-specific IRB relies on a debtor rating arrived at using the bank's own internal procedures.

Approaches for operational risks

As regards operational risks, the basic indicator (BIA) and standard approaches are the simple options. Under the BIA, a bank's capital adequacy requirement corresponds to 15 percent of its gross income. The standard approach uses a similar calculation, but gross income is divided up across eight areas of business, each weighted with its own percentage (12, 15 or 18 percent). The institution-specific Advanced Measurement Approach (AMA) gives banks the option to determine their own capital adequacy needs using an internal model for estimating operational risks.

Market risk regulation essentially unchanged

The market risk regulation system, which already allows banks to choose from a range of different approaches tailored to their needs, is essentially unchanged under Basel II. The only adjustments and additions made are in the area of trading activities and the treatment of simultaneous default by debtor and provider of security (double default). The aim here is to ensure that the previous market risk regulation methods can interact smoothly with Basel II. The rules were drawn up by the Basel Committee in conjunction with the International Organization of Securities Commissions (IOSCO).

Reasons for implementation

As a member of the Basel Committee and the location for the head offices of two leading global banks, Switzerland cannot remain aloof from Basel II. If Swiss banks were subject to completely independent regulation that was at odds with the international standard, they would face problems obtaining banking licences in other countries or would in any case be compelled to meet the minimum standards of Basel II if they wished to operate there. The need to simultaneously comply with differing regulatory requirements would be extremely costly and would place the institutions concerned at a clear competitive disadvantage. A failure to implement Basel II would also be difficult to explain internationally, as the Capital Accord makes a major contribution to international financial stability.

Five goals

There are five key goals to be pursued when calculating capital adequacy requirements:

- The cost of the changeover should be kept as low as possible for the many small and medium-sized universal banks active chiefly in the domestic retail sector.

- Banks with an international orientation have until now calculated their capital requirements both under Swiss law and (voluntarily) in accordance with the Basel rules. They should no longer be required to perform this double calculation.
- The complex methods for calculating capital requirements for credit and operational risks (IRB and AMA) are primarily tailored to the internationally active large banks, which also have the resources necessary to implement them.
- The easing of capital adequacy requirements for small and medium-sized companies (SMEs) under Basel II is also to be adopted into Swiss legislation.
- A strong capital underpinning is a vital factor in ensuring the stability of the Swiss financial system and fostering the client confidence so central particularly to asset management. Switzerland's existing capital requirements are to be preserved essentially in their present form, which already places them considerably above the international minimum standard.

Adoption of all menu approaches

In common with all member countries of the Basel Committee (except the USA) and the European Union, Switzerland is adopting all the menu approaches provided for in Basel II and incorporating the three pillars into its regulatory system. The IRB, the approaches for operational risks and the changes for market risks are being adopted unchanged from Basel II.

Bank-specific multiplier for IRB

An additional bank-specific multiplier is provided for IRB in Switzerland with a view to counteracting any erosion of the capital requirements, which would be problematic for systemic reasons – especially for the large banking groups. Apart from a dozen or so foreign banks that have expressed an interest, only the two large banking groups and one cantonal bank are currently planning to use the IRB. Few institutions other than the big two have opted for the AMA. The majority will be using the simple approaches, and for this reason work on implementing Basel II has concentrated on these. Two variants of the standard approach for credit risks are being offered in Switzerland.

Swiss standard approach

The changes introduced by Basel II are being incorporated in their entirety into the Swiss standard approach. Apart from this – in other words, in those areas that are not affected by Basel II – as little change as possible is being made to the tried and tested system that operates throughout Switzerland. The risk weightings for mortgage and corporate lending are essentially in line with the international minimum. Swiss capital requirements for certain commercial mortgages with conservative loan-to-value ratios and for collateral (Lombard) loans are lower than those prescribed by Basel II. They are

much more strict and differentiated, however, when it comes to interbank transactions and assets where no counterparty is involved. The rules in these two areas of business have not been revised under Basel II. The preferential treatment in terms of capital underpinning which Basel II provides for retail and residential construction mortgages, loans to companies with good external ratings and SMEs, is being adopted in full. The risk distribution rules for banks applying the Swiss standard approach will, as before, be linked to the risk weightings for capital underpinning, and for this reason, the workload caused by the changeover should be relatively low.

International standard approach

Many internationally oriented Swiss banks and numerous subsidiaries of foreign banks calculate their capital requirements not only in accordance with Swiss law but also using the Basel rules (BIS ratio). Their aim in doing so is to enhance international comparability. The new regulations aim to dispense with this double calculation by instituting an international standard approach which sets out capital adequacy requirements for straightforward credit risks in accordance with the Basel rules and based on the EU directives. In order to prevent capital arbitrage and distortions of competition against the Swiss standard approach, the capital adequacy requirements of the international standard approach are weighted by means of multipliers to ensure that they are at least as high as under the Swiss standard approach. Where risk distribution rules are concerned, the approach adopted is that applied by the European Union, which – with certain exceptions – provides for monitoring of concentrations of risk using gross positions. The international standard approach is available to all banks that fulfil certain international orientation criteria, though changing over to it is likely to involve a heavy workload.

Continuation of tried and tested practices

The Banking Commission will retain its tried and tested approach of risk-oriented monitoring, and will maintain its individual, in-depth supervision of the big two. The Commission already has the statutory power, in individual cases, to order institutions to set aside extra first pillar capital provisions to reflect their particular risk situation, over and above the normal capital adequacy requirements. In line with existing practice, the Commission expects a capital surplus of at least 20 percent. Although banks are allowed to fall below this target, they will be subjected to closer supervision as a result, and the Commission will take further measures if necessary.

Limitation to the minimum

As far as implementation of the third pillar of Basel II is concerned, Swiss regulation is limited to the minimum necessary. The requirements are even lower for banks using the Swiss standard approach. Private bankers are still

exempt from the obligation to publicly disclose their risks and capital resources.[1]

Capital adequacy and risk distribution ordinance

The implementation of Basel II in Swiss law does not require any amendment to the Banking Act. As before, the Federal Council is to make the fundamental decisions and set the standardised risk weightings and the capital adequacy rate of eight percent in an ordinance. The current Banking Ordinance is already overburdened with the highly detailed capital adequacy and risk distribution regulations, and the incorporation of the entire menu selection would have caused it to collapse under its own weight. For this reason, the Basel II regulations are set out in a separate Capital Adequacy and Risk Distribution Ordinance (CRO) enacted by the Federal Council. The provisions of the Banking Ordinance covering the definition of capital and risk distribution, which are unchanged by Basel II, are also to be removed from the Banking Ordinance and transferred to the CRO. The provisions on supervision of groups and conglomerates within the Banking Act which came into force on 1 January 2006 are codified in the Banking Ordinance simultaneously with the CRO.

Five circulars with technical notes

The technical notes containing the detailed provisions are being published by the Banking Commission in four circulars covering credit risks, market risks, operational risks and capital disclosure. A further circular sets out the rules on risk distribution. For the IRB, the circular on credit risks refers directly to the minimum standards of the Basel Committee and restricts itself to necessary clarifications.

Hearings and consultation with official bodies

The draft ordinances and circulars were prepared by a national working group headed by the Banking Commission which included representatives of all interest groups within the Swiss financial industry that are affected by the new regulations. The Commission signed off the drafts beforehand, with minor amendments, and decided they be submitted for a public hearing and consultation with official bodies. The responses will be evaluated in the first quarter of 2006 and the texts adjusted accordingly.

Quantitative study

To maintain the current capital underpinning in the Swiss system, the risk weightings in the Swiss standard approach will be set definitively in early 2006. Because the international standard approach takes its risk weightings direct from Basel II, they cannot be changed. To reach the capital target here too, the level of capital requirements will be adjusted upward with the aid of

[1] see II/1.8

multipliers. The Banking Commission will determine the final risk weightings and multipliers with the assistance of a study (Quantitative Impact Study Switzerland, QIS-CH) carried out in the fourth quarter at the same time as the hearing and involving 77 institutions and securities dealers selected as being representative of the Swiss banking sector.

Implementation costs

In addition, the Banking Commission intends to carry out an estimation of the costs of implementing Basel II in Switzerland in the first quarter of 2006, in close cooperation with the Swiss Bankers Association. It will require the support of the banks in carrying out its investigations.

Timetable

The simpler approaches (including F-IRB) are scheduled to come into force on 1 January 2007, with the most advanced and institution-specific procedures (A-IRB and AMA) not following until a year later. This two-speed timetable is designed to give those banks which will be operating the institution-specific approach the time they need to prepare for the changeover. The schedule, envisaged by the Basel Committee, is being adopted by both Switzerland and the European Union. The US, however, is experiencing delays. The drafts of the new Capital and Risk Distribution Ordinance and the amended Banking Ordinance will be submitted to the Federal Council early enough to allow Basel II to come into force in Switzerland on 1 January 2007. Once the ordinances have been enacted by the Federal Council, the Banking Commission will approve its own circulars.

Implications for banks

Depending on their risk profile, individual banks may be faced with capital requirements higher or lower than those they are subject to at present. The switch to Basel II will probably result in little change to the average capital requirements for small and medium-sized universal banks. The additional requirements for operational risks are balanced out by slightly lower capital requirements in the Swiss standard approach when calculating capital requirements for credit risks (as with the international standard approach). This means there will be no new, additional capital burdens for the banks.

No risk to SME loans

The banks began implementing internal rating systems in their lending business long before Basel II, and independently of all regulations. The new capital rules of the IRB are therefore nothing more than the codification as regulations of what is already best practice in the banking business. For this reason, Basel II will have no fundamental influence on banks' lending policy. This is especially true for all banks which use a standard approach to calculating capital requirements for their credit risks. Except where external ratings (which are generally only available for larger companies) are used, there is no direct link between capital requirements and changes in the

credit rating of borrowers. In response to the concerns of SMEs, the privileges for this category of client provided for within Basel II are being adopted in full in the Swiss implementation.

Differentiation

The provision of numerous approaches tailored to differing requirements inevitably leads to a substantial increase in the volume of regulations. Only a fraction of these, however, will apply to individual institutions. The differentiated menu concept therefore permits the regulations to be applied at modest cost and in a way which is geared to the individual needs of institutions.

2 Investment funds and structured products

New record for Swiss investment funds

The Banking Commission examined in detail a number of key themes in the area of investment funds. The sharp rise in the number of newly approved funds underlines the significance of this sector. The Banking Commission approved a total of 256 investment funds under Swiss law (compared with 170 in 2004) – a new record. This was despite the growing consolidation of the European investment fund market following the changes to the EU directives and the resulting increase in competitive pressure on the Swiss fund sector. The number of Swiss investment funds approved rose from 500 to 954 within only three years, a growth of 91 percent. The most striking growth was in other funds for institutional investors with professional treasury, with 142 new approvals. Between 2002 (71) and 2005 (306), the number of funds in this category rose by no less than 431 percent, and they now account for around a third of all approved investment funds under Swiss law. More and more institutional investors are preferring fund solutions for their portfolios, partly because of the tax advantages they bring, and partly because of the flexibility of the current Investment Fund Act and its application by the Banking Commission, which enabled granting approval for the first mortgage fund under Swiss law as well as single investor funds for pension institutions and insurance companies active in the life sector.[1]

Favourable environment

The Banking Commission hopes that the attractiveness and competitiveness of Switzerland as a domicile for investment funds will be further enhanced by the complete revision of the Investment Fund Act. A commission of experts headed by Prof. Peter Forstmoser had already prepared a draft federal act on collective capital investments (Collective Investment Act or CIA), and

[1] see III/2.2

the Federal Council approved both the memorandum and the draft in 2005. The CIA aims to bring Swiss legislation back into line with that in Europe, and extend the scope of the Investment Fund Act to other forms of collective capital investment such as SICAFs (investment companies with fixed capital) which until now have been regulated only by stock exchange law. Ultimately, new legal forms such as the SICAV (investment company with variable capital) and the limited partnership for collective capital investment will also be covered. The new forms covered will, like contractually based investment funds today, be exempt from direct taxation. An exception will remain in the case of SICAFs, which will continue to be taxed in the same way as joint stock corporations.[1]

Parliamentary consultations

Rapid parliamentary approval of the CIA will require the support of the sector, which constantly calls on the authorities to offer creative solutions for issues of interest to it. In particular, the sector should rethink the concerns it expressed during the consultation procedure regarding the wide-ranging powers of delegation to the Federal Council and the Banking Commission, and adopt a more open and constructive attitude. This would serve the interest of Switzerland as an attractive and competitive investment fund location. The Federal Council and the Banking Commission have always exercised their existing powers in the interest of the Swiss fund sector.

Independent asset managers

In a pragmatic interpretation of the Stock Exchange Act, the Banking Commission has decided that, on application, it will grant independent Swiss asset managers who manage foreign, eurocompatible investment funds a licence to operate as securities dealers. This solution protects such managers against a potential loss of market share, or even complete exclusion from the European Union funds market, on the basis of EU legislation on investment funds. The latter stipulates that, from February 2007 at the latest, management of the assets of eurocompatible investment funds may only be transferred to companies which are subject to licensing requirements and adequate supervision in their country of origin. In future, the CIA will impose a licensing requirement on the managers of Swiss collective capital investments. Managers of foreign, eurocompatible collective capital investments are to be given the opportunity to place themselves voluntarily under Banking Commission supervision as securities dealers. As a result, the current, provisional solution will be largely superseded when the CIA comes into force.[2]

[1] see III/1.2
[2] see II/1.7

Structured financial instruments

The Banking Commission also devoted considerable attention to the area of structured financial instruments. In view of the radical transformation in these instruments over the last 30 years and their increasing resemblance to investment funds, the Banking Commission drew up a position paper summarising existing practice and establishing criteria for distinguishing financial instruments from investment funds and creating transparency. The distinction proposed in the position paper was also partially incorporated into the draft CIA. Although there was never any intention to subject structured financial instruments to investment fund legislation, the publication of the position paper and the proposed regulations in the collective investments act were met with huge controversy. The Banking Commission responded by reviewing its position with an eye to the parliamentary debates on the CIA.[1]

Transparency in management fees

To enable Swiss investors to obtain an objective picture of the way in which the commissions charged to an investment fund are used, before they purchase fund units, the Swiss Funds Association issued guidelines on transparency with regard to management fees for new funds. The Banking Commission recognised these as a minimum standard for the purposes of supervisory legislation. As a result, all fund management companies and representatives of foreign investment funds in Switzerland will in future be obliged to break their (lump sum) management fee into three components – management, administration and distribution – and disclose the amount of these in their prospectus.[2]

3 Audit reform

Progress of the reform

In its supervision of banks and securities dealers, the Banking Commission is largely dependent on the work of recognised external auditors. The Commission initiated an extensive reform of its rules on auditing in 2000, reflecting the fact that the existing rules do not sufficiently accommodate the changes under way in the work done by auditors and the conditions under which they operate. It set up a commission of experts, headed by Prof. Peter Nobel, to look into the subject of auditing. This commission was tasked with analysing and assessing the dual supervisory system and formulating strategic recommendations. In its concluding report, the commission of experts came out in favour of retaining the current system and made recommendations concerning improved auditing and monitoring of banks and securities

[1] see III/2.1
[2] see III/1.6

dealers.[1] Subsequently a joint working group comprising representatives of banks, securities dealers and auditors and headed by the Banking Commission was charged with implementing the recommendations. The working group developed a set of draft proposals for provisions in acts, ordinances and circulars based on the recommendations, and presented its concluding report to the Banking Commission in autumn 2004. The proposed regulations did not represent a complete upheaval of auditing practice. Instead, they were aimed at modernising the regulations and appropriating them, although they went beyond a mere update.[2]

Central objectives of reform

The central aims formulated for the reform included the codification, in the regulations, of the risk-oriented auditing approach already established in practice; more transparent presentation of the auditors' remit and the way in which they work, provision for meaningful and timely reporting, as well as increased independence and monitoring for auditing companies. Due account was taken of the particular requirements of complex financial groups and conglomerates, and appropriate weight attached to the internal monitoring systems of banks and securities dealers.

Implementation of the reform proposals

The timing and content of implementation of the reform proposals in banking and stock market law and in ordinances had to be coordinated with the regulatory projects concerning financial market supervision[3] as well as group and financial conglomerate supervision.[4] In some cases, this involved feeding the proposals directly into the corresponding projects. Many of the regulation proposals, however, were successfully implemented in a range of circulars.

Audit and audit report circulars

The 'Audit' circular gave practical effect to the risk-oriented auditing approach, with reference to internationally recognised auditing standards, while dividing up the tasks of auditors into accounting audit and supervisory audit resulted in a clearer structure and delimitation. The accounting audit broadly coincides with the remit of auditors in other supervisory systems and in public companies, while the supervisory audit is a particular feature of the Swiss regulatory system which requires a specific auditing approach. Auditors now disclose their risk analysis and the auditing strategy derived from it to the institution they are analysing and to the Banking Commission. This promotes communication between institutions and their auditors and

[1] see Annual Report 2000, p. 46f (German), p. 188 ss (French)
[2] see Annual Report 2004, p. 21ff (German), p. 19 ss (French)
[3] see I/4
[4] see II/1.3

paves the way for an improved understanding of how auditors work and the results of their audits.

The 'Audit Report' circular lays the foundations for meaningful and timely reporting. The separation into accounting audit and supervisory audit logically implies a parallel separation of reporting. Increased flexibility in setting reporting periods also permits more timely reporting. The 'Audit' and 'Audit Report' circulars were put through a test run before they came into force, and some areas were optimised and clarified following analysis of the test results. In general, however, they proved successful.

Further circulars

Other central goals of the auditing reform were implemented in a series of other circulars. The 'Audit Companies' circular updated the independence rules for auditors on the basis of international standards and dealt with the issue of audit supervision. The specific provisions for complex groups and financial conglomerates are restricted to the 'Supervision of Large Banks' circular. The planned circular on internal monitoring and controlling[1] will aim to set out the requirements for the key internal systems and bodies in banks and securities dealers.

Reform largely complete

The auditing reform is therefore largely complete. The Banking Commission last dealt with the issue in detail in summer 2005 when it approved the circulars. Given the important role which auditing companies play in the Swiss supervisory system, however, the matter will remain on the Commission's agenda during the implementation phase.

4 New financial market supervision system

Further in-depth work

In November 2004, the Federal Council requested the Federal Department of Finance to draw up a Memorandum for Parliament concerning a financial market supervision act (FINMAA).[2] FINMAA will incorporate the establishment of a new supervisory authority comprising the Banking Commission, the Federal Office of Private Insurance and the Money Laundering Control Authority. There are no plans to make material changes to the actual supervision regulations. An internal administrative working group headed by the Federal Department of Finance and involving the participation of the Banking Commission drew up a draft for the Memorandum to Parliament. It based its recommendations on two reports from the commission of experts

[1] see II/1.9
[2] see Annual Report 2004, p. 24 (German), p. 23 (French)

headed by Prof. Ulrich Zimmerli on the organisation and instruments of a new federal financial market supervisory system (FINMA) of July 2003 and sanctions in financial market supervision of August 2004.

Strengthening of institutional governance

The Banking Commission believes that the working group's draft based on the Federal Council's prescriptions is a substantial improvement on previous drafts. The Commission's proposals have been incorporated in a number of areas.[1] The Board of FINMA will, for example, have the power to decide on individual issues of broad significance as well as strategic and regulatory matters. This will strengthen FINMA's institutional governance and is in line with current practice in the Banking Commission. It also offers a counterweight to the (rightly) strong position of the Management Board. The draft clearly emphasises the Board of Directors' responsibilities in terms of leadership and supervision, requiring it, for example, to engage an internal auditor and provide for internal controlling.

Independence but accountability

The draft recognises that it is vital for FINMA to carry out its supervisory tasks in an autonomous and independent manner, and accordingly proposes granting it a large measure of organisational freedom. The only organisational requirement to be enshrined in law is that the various specialist areas be adequately represented in the Management Board and the Board of Directors. It is envisaged that the staff of FINMA will be employed under private law, thereby enhancing FINMA's freedom to arrange matters as it sees fit. The flipside of this is increased accountability. For example, FINMA will, for instance, be required to account to the Federal Council and Parliament in its annual report. Moreover, it will be required to meet with the Federal Council at least once a year to discuss its supervisory activities and its strategy. The Federal Council will be able to request additional information at any time. FINMA will be obliged to disclose its medium-term resource planning and justify its implications on costs and its supervisory responsibilities. Particularly when recruiting specialists, FINMA is to be able to pay salaries closer to the market rates. As today, FINMA will be superintended by Parliament and its decisions will remain subject to judicial review.

Broader sanctions

The Federal Council decided that the Zimmerli commission's proposals on sanctions open to the new authority[2] should be incorporated into the draft FINMAA in all essential respects. Although FINMAA still only meets some of the Banking Commission's concerns[3], improvements have been made.

[1] see Annual Report 2004, p. 25f (German), p. 24 (French)
[2] see Annual Report 2004, p. 25 (German), p. 23 (French)
[3] see comments on the SFBC report on sanctions on p. 24 ff (German), p. 22 ss (French) of the 2002 Annual Report

There is, for example, provision for a ban on professional activity in response to serious breaches of supervisory law; this goes beyond the tried and tested practice for ensuring the proper conduct of business affairs which the Commission will continue to apply. Another important aspect is the mechanism for confiscating the profits made on serious breaches of supervisory law.

Improved supervisory repertoire

The draft offers a standardised definition of the tasks of auditing companies. It leaves scope to continue making differing use of auditors, as banking and insurance supervisors have in the past. It is vital, therefore, to ensure appropriate regulation of information activities in a way that accords due importance to the differing interests of the public at large, the financial sector, the supervisory authority and the individual bodies supervised. The passing of information by FINMA to the criminal authorities and other domestic authorities is to be allowed in principle, but there will be provision for limiting this if it would jeopardise internal decision making processes, ongoing proceedings or supervisory activities. Finally, the integrated act permits a harmonisation of all the tools of supervision, such as duties of disclosure, the use of investigative agents and the revocation of licences, across the whole range of financial market legislation.

Streamlining and deregulation

FINMA is to supervise the financial market independently and autonomously in accordance with seven ‘financial market acts’: the Banking Act, the Stock Exchanges and Securities Trading Act, the Investment Fund Act (in future the Collective Investment Act), the Money Laundering Act, the Insurance Supervision Act, the Insurance Contract Act and the Mortgage Bond Act. Everything that is regulated centrally in FINMAA can be deleted from these financial market acts, resulting in a major streamlining of the legislation. At the Banking Commission’s request, FINMAA is also to do away with outdated provisions of the Banking Act, such as the special rules on the reserve requirement, capital repayment and for cooperative banks, as well as the licensing requirement for agencies of foreign banks. In addition, as in the Stock Exchange Act, the examination of reciprocity will, under the Banking Act, no longer be obligatory, but will instead be at the discretion of the Banking Commission.

Preparations for FINMA

The Federal Council is expected to pass its decision on the FINMAA Memorandum to the Federal Assembly in early 2006. Parliamentary consultations are unlikely to be completed before the middle of 2007. FINMAA is expected to come into force at the beginning of 2008. This deadline will, however, require the preparatory work to be taken in hand rapidly under the aegis of a project organisation, with all those concerned playing their full part. The

Banking Commission favours this and supports swift implementation. The merger presents major strategic and operational challenges for the leadership of the three authorities – challenges that must be met without hindering ongoing supervisory activities.

Realistic expectations of FINMA

The Banking Commission supports the FINMAA project in its current form, and once again emphasised this to the Federal Department of Finance during the process of consultation with official bodies. FINMAA makes the right changes in deepening and streamlining the supervisory architecture of the Swiss financial market, and incorporates important improvements in the tools of supervision. Although it is primarily an organisational act, FINMAA should, in the medium term, also enhance the coherence of material supervisory rules and practice. With its decision to separate the supervision of occupational pensions from that of insurance, the Federal Council has also underscored FINMA's character as a specialist authority while at the same time reducing the interfaces to social policy. Although the influence exerted by the Swiss supervisory authority depends not primarily on how far it is integrated, but rather on the quality of its leadership, its perseverance and the long-term credibility of its supervisory activities, FINMAA has the potential to enhance its international standing. The Banking Commission takes the view that expectations of FINMA must remain realistic. It is not in itself a magic solution for all the problems of supervision. Moreover, despite the synergy potential that is there to be exploited in some areas, it is unlikely to lead to an overall reduction in the cost of supervision.

5 Regulation and self-regulation

Dialogue with the affected parties

The Banking Commission believes it is both sensible and necessary to engage in dialogue with all those affected regarding the priorities and strategic objectives of regulation planning.[1] It holds regular meetings with representatives of the professional associations and the SWX Swiss Exchange, notably with a view to discussing current regulatory developments.[2] For selected regulatory initiatives, it also arranges talks at the highest level. The agenda items and the composition of these meetings are fixed specially. However, the aim is also to consider the interests of non-organised affected parties, namely clients. The Commission continued its discussions with bank representatives regarding the implementation of Basel II, and reviewed issues of bank insolvency and accounting. It met with representatives of the

[1] see Annual Report 2004, p. 30 (German/French)
[2] see VII/2

banks and the stock exchange to examine issues of market supervision. The Commission and the Federal Department of Finance also agreed to hold joint talks on financial market regulation every six months.

Guidelines on financial market regulation

Independently of each other, the Federal Department of Finance and the Banking Commission began as far back as 2003 to examine their own regulatory practice with a view to establishing whether common principles could be derived from the individual regulatory initiatives. To increase the coherence and effectiveness of their efforts, the two bodies joined forces in January 2005 and also brought the Federal Office of Private Insurance into their discussions. The aim was to identify shared features of regulatory practice in the three authorities, and ultimately to set out some uniform principles for all levels of financial market regulation (acts, ordinances, circulars, etc.). The work culminated in the Guidelines for Financial Market Regulation[1] which were signed by Federal Councillor Hans-Rudolf Merz and published simultaneously by the three authorities.

Impact of regulation

The guidelines provide a uniform and systematic basis for reasonable, cost-conscious and effective regulation of the Swiss financial market. The assessment matrix consists of ten principles with examples of possible questions. The first five principles deal with the effects of regulation, taking account of issues such as the cost implications in the international environment as well as the innovative and competitive potential of the financial sector. As far as possible, the effects and costs for those affected are to be estimated and weighed against the expected benefit. Regulatory initiatives should be effective and efficient, and should promote the functionality and stability of the financial sector. They should take account of the implications for competition, market structures and market behaviour. The risks of regulation should also be identified and their importance assessed.

Regulation process

The last five principles lay down rules for the regulation process. Both regulatory initiatives and existing regulations must be examined to see whether they are necessary and what alternative measures could be taken. If regulation is the only adequate way to solve a problem, the pros and cons of individual solutions must be weighed up. The legal, economic and international options open should be taken into account. The regulatory authorities are obliged to provide information about planned and pending projects and involve all affected parties to a reasonable extent in the planning and drafting of the regulations. They must ensure coherence between existing and

[1] see http://www.efd.admin.ch/dokumentation/grundlagenpapiere/00818/index.html?lang=en

planned regulatory measures, and set priorities. The implementation of regulations is to be planned and tracked.

Regulatory principles in FINMAA

The legislation on the planned integrated financial market supervisory authority FINMA (FINMAA)[1] is intended to enshrine in law the basic ideas of the regulatory principles. FINMA should regulate only to the extent that this is necessary to fulfil the goals of supervision (protection for creditors, investors and insurance policy holders, safeguarding the operational efficiency of the financial markets and upholding the reputation and competitiveness of the Swiss financial centre). In particular, FINMA should consider the costs and effects of regulation, the various business areas and risks of those it supervises, as well as international minimum standards. It should also ensure that the regulatory process is transparent and that all those affected are given an appropriate say in developments. Guidelines for implementing these principles are provided; these are geared towards the guidelines for financial market regulation.

Application and implementation of the guidelines

The principles formulated in the financial market regulation guidelines are primarily intended to serve as a checklist during regulatory activities and should be included in the regulatory process as early as possible and repeatedly thereafter. By way of experiment, a retrospective test was conducted to establish whether the Money Laundering Ordinance which came into force in 2003 would comply with individual principles.[2] Targeted use may also be made of the guidelines in the context of selected projects, by way of instructions for effect-oriented analyses or as a set of rules for in-depth studies. The principles are flexible, but cannot simply be applied in any fashion desired. The Banking Commission organised a seminar to inform staff about the guidelines, and discussed issues of regulatory methodology and technology. It also integrated the guidelines into its own regulatory process. Where other administrative offices or self-regulatory bodies are responsible for a project, the Banking Commission will do all it can to ensure that the guidelines are taken into account.

Significance of self-regulation

Self-regulation in financial market supervision is well developed by international standards and has a long-standing tradition. It is a crucial and useful component of regulation. It is particularly widespread within banks, investment funds, the stock exchange and the auditing profession as well as in efforts to combat money laundering. It lightens the state regulator's workload, ensures proximity to the market and thus creates a solid foundation for

[1] see 4
[2] see II/1.6

maintaining competitiveness. To underscore its importance, the Banking Commission promulgated the 'Self-Regulation' circular as a minimum standard in 2004.[1] With the backing of auditors, it ensures compliance with the self-regulation norms recognised as a minimum standard.

Requirements for self-regulation

Self-regulation faces the same general problems as every form of regulatory activity. If it is to be a credible alternative to state regulation, the two must be aligned with each other.[2] The Banking Commission should therefore be involved in the development of self-regulation standards from the very start. Planning of regulation should also be coordinated. The self-regulatory process must be designed in such a way that all those affected are involved or at least have the opportunity to voice their opinions. Self-regulation should be transparent and obey the same rules as apply to state regulation. The Banking Commission will remind self-regulatory bodies of this when necessary. The Commission has collated its deliberations in an issue paper which it has distributed to self-regulatory bodies together with an invitation to joint talks.

[1] see Annual Report 2004, p. 32 (German), p. 31 (French)
[2] see Annual Report 2004, p. 32 (German), p. 31 (French)