3rd June 2002

IMF "Financial Sector Assessment Program“ (FSAP): Final report on Swiss participation

The international financial crises at the end of the 1990s brought a new sense of urgency to the need to strengthen the stability of the financial system. The International Monetary Fund was also called onto the scene when in spring 1999, it launched the "Financial Sector Assessment Program" (FSAP) to conduct comprehensive evaluations of regulatory conditions and the crisis resistance of its member countries' financial sectors in collaboration with the World Bank. Switzerland was one of the first industrialised countries to participate in the FSAP, thereby seizing the opportunity to present the quality of regulation and supervision in its internationally exposed financial sector, as well as benefit from the IMF's expertise concerning current proposals for regulatory reform.

1. Background

Financial crises are hardly rare. Since the 1980's they have flared up in almost ¾ of the world's countries, many industrialised nations included. However, the financial crises in Asia in 1997 and in Russia in 1998 heralded a new phase as they were triggered primarily from the private financial sector thereby firmly underlining the importance of sound financial institutions and intact regulatory frameworks in a market environment which is increasingly integrated. For the IMF, whose core mandate is to ensure the stability of the international financial system, there derived an urgent need for action: In May 1999, the "**Financial Sector Assessment Program" (FSAP)** was launched in co-operation with the World Bank. Ultimately, it is a matter recognising at an early stage the regulatory shortcomings and undesirable structural developments in the financial sectors. Although the FSAP is a joint initiative of the IMF and the World Bank, industrialised countries are evaluated exclusively by the IMF. During these evaluations, three approaches are tested simultaneously: macro-prudential analysis serves to capture relevant economic data including aggregated indicators at firm level. Regarding the legal and institutional frameworks, compliance with standards in the five core areas of banking, insurance, securities, payments systems and the transparency practices in monetary and financial policies are also reviewed. Legislation concerning money

Communications
Bundesgasse 3, 3003 Bern
Tel. ++41 31 322 60 33, fax ++41 31 323 38 52
www.efd.admin.ch **www.dff.admin.ch**

laundering also forms part of the evaluation. Lastly, stress tests are conducted using concrete scenario analysis.

2. Switzerland's Financial Sector Assessment

In 2001, Switzerland was one of the first industrialised nations to voluntarily participate in the IMF's FSAP evaluation. For the purposes of the evaluation, an IMF delegation consisting of IMF representatives and external experts visited Switzerland at the beginning of November 2001. During its visit, the delegation conducted discussions with federal agencies (Federal Banking Commission, Federal Office of Private Insurance, Federal Finance Administration, Federal Office of Social Insurance, Swiss National Bank) and over 35 representatives from the private sector. These discussions were open and constructive and enabled the IMF to gain a detailed picture of the Swiss financial system. **Key topics** of the discussions included the system of supervision, crisis prevention instruments and risk management in the public and private sectors as well as compliance with internationally recognised financial sector standards and principles. During the course of the discussions, the economic impact of the September 11th attacks were also raised, which represent a worldwide test for the global financial system. With regard to aspects of combating money laundering, the IMF concentrated on regulation relevant to supervision as well as its implementation. Furthermore, Switzerland's proposals for regulatory reform in the financial sector also featured prominently in the discussion.

3. IMF Assessment

The **general conclusion** of the IMF on the stability of the Swiss financial system is very positive. The Swiss economy is characterised by a high degree of development and a well-established renowned financial sector. Several of the most significant financial institutions worldwide are based here. This international orientation is highly relevant for its stability: On the one hand, domestic shocks can be better balanced thanks to the worldwide diversification possibilities as was the case during the domestic property crisis in the 1990s. On the other hand, there is also a risk that external shocks can be carried over to the domestic market. The outcome is largely dependent on the quality of the regulatory environment, the system of supervision and the risk management of individual institutions. All three control mechanisms are judged to be solid and intact in Switzerland. Today, the greatest uncertainty for the stability of the Swiss financial system lies in deep global economic recession.

The **banking sector** with two large globally oriented banks and the cantonal, regional and Raiffeisen (co-operative) banks presents itself as well-diversified and stable. The large banks are highly capitalised and profitable and prove themselves to be well-equipped for international competition thanks to their highly developed risk management systems. In terms of the regional and Raiffeisen (co-operative) banks, a certain consolidation potential was identified on the basis of the limited prospects for growth in the home market and the pending need for investment in new technologies. They face competition from the cantonal banks, whose preferential regulatory position is noted with reservations. With regard to the structure of supervision, the IMF unreservedly supports the merger of banking and insurance supervision in one integrated supervisory authority in view of the increasing overlapping of their business activities and risks.

The Swiss **insurance sector** can look back upon a long tradition of solid growth, which has not been clouded by a single case of insolvency. The domestic insurance market is practically saturated, a factor which provides incentives to develop international markets. Even in the insurance branch several Swiss companies are among the important *Global Players*. Following the terrorist attacks, a certain fall in the closing accounts of the (re-) insurers must be reckoned with although it should be possible to make up for these losses in the medium-term through higher premium volumes. In contrast the significant correction in the share prices of insurance companies has left its mark and has in turn led to a reappraisal of risk management systems and internal capital guidelines.

The Swiss **securities and derivatives markets** are largely contested by the banks and are processed on three trading platforms: Firstly, Swiss Exchange (SWX) with its electronic and fully integrated trading system; secondly, Eurex, the Germano-Swiss electronic derivatives exchange in Frankfurt, and finally Virt-x, the pan-European blue-chip trading platform initiated by SWX operated in collaboration with Tradepoint in London since this year. All of these projects underline the expansion strategy of the Swiss financial sector and its interest in developing an ever more efficient cross-border trading infrastructure. However, the fact that independent asset managers are not subject to prudential supervision is identified as a point of criticism with a view to client protection and reputation risks.

The **payment system**, Swiss Inter-bank Clearing (SIC), as well as the **securities settlement system** SECOM are very solid in structure and satisfy fully international standards *(CPSS Core Principles for Systemically Important Payment Systems)*. These systems were also put to the test in autumn 2001 and proved their resilience in this situation. The planned transfer to *Continuous Linked Settlement (CLS)* – a system for delivery versus payment processing of currency transactions – also represents a challenge relevant to system stability. The IMF also recommends the careful analysis of structural developments occurring since the introduction of the Euro.

In their role as institutional investors, **pension funds** are important participants in the financial market. These are generally well capitalised pension fund institutions some of which are responsible for managing substantial assets. The provisions laid down in law (4 per cent minimum interest, minimum conversion rate of 7.2 per cent) could however place the long-term financing capability of occupational pension funds in question in light of steadily rising life expectancy and any possible long phases of economic downturn resulting in lower returns from the capital market. A recommendation is made to assess the centralisation of prudential supervision in the area of pension funds.

With the introduction of the Money Laundering Act (MLA) in 1998 significant advances have been achieved in combating abuse in the Swiss financial centre. Today, the Swiss **anti-money laundering strategy** is oriented along the highest international standards. It is worth mentioning that the NBNIFS is subject to the same obligations of due diligence and reporting as were applicable before for prudentially supervised financial intermediaries. It is now a case of driving forward the implementation of the new regulations, above all in the newly incorporated branches.

4. Appraisal

As an open economy, highly integrated internationally, Switzerland has an overwhelming interest in seeing a stable global financial system. Switzerland's participation in the FSAP is evidence that it is willing to make its own contribution in the form of a sustainable monetary policy oriented towards international standards and principles.

Further details: René Weber, Fed. Finance Administration, Tel.: 031 324 75 52

The **stability report of the IMF on Switzerland** (Financial System Stability Assessment, FSSA) is accessible via Internet (**www.imf.org** and **www.efd.admin.ch**).