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FSAP on Swiss financial market supervision: Very good marks but no grounds for complacency

The IMF report's overall assessment of the Swiss financial sector and supervisory system is rewarding. As Mr. Villiger, the President of Switzerland, has already emphasised, the report is generally positive. We are all the happier about the outcome because we invested a great deal of time and effort in the IMF's evaluations. From our standpoint, the time and the effort were worth it. We had a unique opportunity to review our supervisory practices and the design of the regulatory system in a dialogue with qualified international experts. For once, Swiss financial supervision was scrutinized from the international perspective rather than a national one, and the view from outside is a valuable one. The IMF experts were distinguished by their great professionalism and expertise, and this is reflected in the report we now have before us.

The report confirms that the Swiss system is in commendably good shape in the opinion of international experts and judged by internationally-recognised yardsticks. The IMF praises our "well-developed and effective system of supervision". Switzerland is "in general fully or largely compliant" with international standards for banking and securities supervision, and this is true for anti-money laundering issues as well.

We are, of course, not perfect in the eyes of the IMF. And the IMF is right in seeing room for improvement in some quarters. But its recommendations come as no surprise, because they mostly concern issues already identified by national expert commissions or working parties, issues which are currently being addressed by way of various regulatory projects. That said, the IMF recommendations buttress our belief that we have recognised the key challenges currently facing financial supervisors and are on the right track with our regulatory efforts.

Let me say a few words about the IMF's key recommendations that are most important to the Swiss Federal Banking Commission (SFBC):

1. Budgetary independence of the supervisory authority

International banking supervision standards call for a supervisory authority that is financially and operationally fully independent. The IMF recognises that the

SFBC is independent in the exercise of its supervisory functions. But it is right when it notes that the SFBC lacks budgetary independence. Administrative independence and sovereignty over its resources are crucial for the quality of supervision. For a supervisory authority to be able to react flexibly to new developments, it has to be able to determine by itself what resources it needs to discharge its functions. Of course, that does not rule out control of the supervisory authority via its accountability to parliament and the public. The SFBC is therefore grateful to the Federal Council for having charged, at the initiative of the Finance Minister, the expert committee chaired by Professor Zimmerli not only with preparing a draft for a fully-integrated financial market regulator but also to grant this new authority financial and administrative independence.

The IMF is just as emphatic in supporting efforts to integrate banking and insurance supervision in a single financial markets supervisory authority, which will have additional tasks as well. As this project will take several years, the IMF recommends that, as an interim step, we place the current cooperation between the SFBC and the Federal Office of Private Insurance on a formal legal footing, particularly with respect to the supervision of financial conglomerates. One of the tools to that end is the pending total reform of insurance supervision legislation: the IMF is correct in calling for faster action on this.

2. Sanctions - market supervision is lagging

The IMF recommends bolstering supervision by expanding the SFBC's sanctioning powers. Currently, the SFBC can reprimand financial intermediaries reporting to it, order the removal of top management or board members and revoke licences in serious cases. But unlike some foreign authorities, the SFBC is not empowered to levy administrative fines, for example. Also unsatisfactory are sanction options for penalizing market abuse, especially with regard to unregulated corporations and individuals.[1] The IMF is right in seeing this as a shortcoming, because an appropriate sanctions catalogue is indispensable for the effective enforcement of supervisory regulations. The groundwork needed to improve sanctions is already underway. This shortcoming, too, is to be remedied at the latest with the advent of the integrated financial market supervisory authority.

3. Quality control of bank auditing

Much time was spent in the consultations on the indirect supervision system. In its final report the IMF acknowledges that the indirect (dualistic) supervisory approach, which is based on external auditors, has served the Swiss system well.

[1] See paper by Franz Stirnimann, Vice-Director of the Secretariat of the Swiss Federal Banking Commission, at the annual media conference on 25 April 2002.

Although most foreign regulators conduct their own examinations in banks, the IMF regards the Swiss method as an effective means of mobilising far more extensive supervisory resources. So the IMF in effect confirms the judgment of the "Expert Commission Nobel" appointed by the SFBC. However, the IMF calls for the introduction of systematic quality control as well as more frequent special audits and joint on-site examinations carried with the SFBC. Work on implementing this recommendation has already begun: the SFBC is creating its own unit geared exclusively to the monitoring of external auditors and will have selected areas of the supervised banks audited periodically by a second independent audit firm or by other specialists (second audit)[2].

4. International administrative assistance

The IMF identifies a particular lacuna in the area of cooperation with foreign securities regulators: it concerns adherence to the standards of the International Organisation of Securities Commissions (IOSCO). IOSCO standards call for cooperation with foreign market regulatory authorities, and this entails the exchange of information necessary to prosecute stock-exchange offences and market abuse. But Swiss laws governing the conditions under which the SFBC may cooperate with foreign securities supervisors not only hamper a rapid two-way information flow but in some cases even render it impossible. Hence the IMF criticism is well-founded, because an international financial centre has to be able to cooperate efficiently at the international level. As announced at the annual media conference in April, the SFBC is currently working intensively on a proposal to amend the relevant law, and the draft is scheduled to be submitted to the Federal Department of Finance in the course of this year.[3]

Conclusion

The final report of the IMF has two main messages for us:

- It emphasises that we are on the right path in our day-to-day supervision. Our supervision of the Swiss financial industry is appropriate and is in line with best international practice. The report attests that the SFBC has the necessary expertise and is capable of meeting the challenges of globalisation and rapid change in the world of finance.

[2] See paper by Jean-Pierre Ghelfi, Vice-Chairman of the Swiss Federal Banking Commission, at the annual media conference on 25 April 2002.
[3] See paper by Dr. Kurt Hauri, Chairman of the Swiss Federal Banking Commission, at the annual media conference on 25 April 2002.

- At the same time, the IMF is also correct to point out the need to further strengthen our supervisory system. The IMF recommendations are to be taken seriously, because a functioning supervisory system is one of the vital prerequisites of a stable financial sector. However, there is no such thing as the ideal system, set in stone for all eternity. Indeed, good supervision is a process which has to adjust to ever-changing market conditions and international trends, re-defining itself as it goes along. This fact is evident from the various regulatory projects under way. The IMF recommendations provide us with welcome support to implement these projects with the priority they deserve.