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Eidgenössische Bankenkommission
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Swiss Federal Banking Commission

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What breed of "watchdog" does Switzerland need?

Anglo-Saxon countries often refer to their regulators as “watchdogs”, a term which expresses respect but also raises expectations. Granting this metaphor, we might then ask what breed of “watchdog” does Switzerland need, what breed does it want and what breed can it afford? This questionning arises today in relation to the SFBC, but it will be no less relevant for the projected financial regulator FINMA. In order to decide upon the convenient breed, one needs to have an understanding of the performances one expects from the “watchdog”. And as a premisse to defining these performances, we need to analyse both the environment and the general set-up.

At the SFBC “watchdog” tasks are fulfilled by a staff of 162 persons – comprising mainly lawyers and economists – filling 153 full-time positions. These people regulate, approve, supervise and carry out procedures. Through its duties in terms of consolidated supervision of world-wide active companies, the SFBC staff is indirectly responsible for about 200,000 bank employees. The aggregate annual cost that SFBC billed to the companies under its supervision was of CHF 30 million. This has to be balanced with the CHF 30 billion of profits earned by the banks alone.

In order to live up with these duties and their order of magnitude, in order, to be recognised as an efficient and competent regulator in national as well as international spheres, it is essential that the SFBC would have at its disposal specialised knowledge in all areas of supervision. Indeed, for the SFBC’s performance is to strengthen the Swiss financial marketplace as well as to contribute to enhance its reputation – in the interests of all. All these requirements have to be filled, precisely in times of an increased competition for talents with the corresponding pressure on salaries it entails, and in times where the market reacts by offering extremely attractive employment conditions. As my German colleague, Jochen Sanio, put it, one could “lapse in euphoria unless one is a regulator".[1]

[1] Comment made at the New Year’s reception of the German Federal Financial Supervisory Authority (BaFin) on 11 January 2007

The Swiss financial sector is thriving

Of course, the economic environment is favourable. Of course, the Swiss financial sector is thriving and has published outstanding results: to start with, UBS AG and Credit Suisse Group have made glimering profits of well over CHF 10 billion. In the past year the two largest Swiss banks alone have withnessed an inflow of nearly CHF 250 billion in net new money. But then, small and medium-sized banks, particularly those active domestically, private banks and foreign wealth management banks, have achieved some of the best results in their history as well. This is good news not only for bank employees and shareholders alike, but also for the tax collector – and for the regulator.

This impressive growth reflects the dynamism of the markets. But this dynamism also leads to more intense competition and forces all players to continuous renewal . New and **innovative business models** are emerging. In some model, for instance, the role of the client relationship manager is repositioned as that of an entrepreneur endowed with extensive freedom of action and decision, with the compensation scheme obtained as a straightforward share in profits. Internal value chains have been optimised through **restructuring** and parts of companies have been split off or sold. Functions are outsourced to other providers, sometimes in completely different geographical locations, as part of co-operation agreements, and services previously carried out in-house are now bought on the market. Cross-border joint ventures create new providers and with them, new perspectives. For the first time, a banking licence has been granted to a Sharia-compliant Islamic bank in Switzerland. The **pace of investment** remains high and may even increase further. This includes investment in information technology, in new trading platforms or in tapping the growth of rapidly expanding markets such as the BRIC states. Individual **product areas** are also growing dynamically, with innovation leading to increasingly complex products (derivatives, structured products, hedge funds).

Risks and opportunities

All the aforementioned developments create new opportunities; they help ensure the continued success of the sector. However, these opportunities entail risks. The offloading of credit risk by means of trading securitized instruments certainly alleviates the banking sector, but it is not clear who will end up bearing that risk in the event of a deterioration in credit quality. The lack of transparency in the rapidly growing sector of private equity and hedge funds, will make it increasingly difficult for banks to assess the risk position of their counterparties. The process of hedging counterparty risk is becoming more and more complex. And thus systemic risks are becoming a key issue. One need only think of the impact a collapse of large hedge funds might have on prime brokers. There has been above-average growth in terms of nominal volume outstanding in credit derivatives ; it now exceeds the volume of outstanding underlying bonds. In the event of an external shock, a sudden sharp contraction of liquidity combined with corresponding value adjustments would be very likely. The proper management of such risks is of crucial importance.

The unrelenting nature of market competition requires a constant adaptability and further growth. Those who do not meet these requirements are ushered out of the market. A growing risk appetite, margin contraction, but also an increased willingness to challenge and try the limits are the consequences of competitiveness. And incidentally the SFBC's Annual Report takes this particular issue up. Moreover, the question of whether we need a regulator can only be a rhetorical one in this context.

The challenges facing the SFBC

The challenges experienced on the market shape and dictate the challenges that the the regulator shall have to face. The regulator has to have forcefulness in performing its duties. It not only has to keep pace with the market's momentum and the associated risks , but must be able to anticipate them. It must remind the limits to those tempted to challenge them, without preventing competition by exerting excessive regulatory activity. The regulator needs both have a stature and stamina to be in the position to set standards in the international area as well – weak structures are prejudicial and impose unwelcome sequels. Last but not least, the regulator must be efficient in performing its duties, be it only in order to meet the range of challenges it faces pragmatically and in due time. The answer to the question what breed of "watchdog" does Switzerland need can only be: the greyhound – because it is slender and athletic, wise in its behaviour but also able to come to grips if required.