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Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
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To all:

- Banks
- Securities dealers
- Auditors
- Insurance Institutions Subject to FINMA Supervision

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Overhaul of FINMA's supervisory approach

Ladies and Gentlemen

In line with its strategic goals approved by the Federal Council, FINMA aims at achieving effective and efficient regulation. To realise this core objective, FINMA has started working on optimising and redirecting its supervisory approach, also referred to as the FINMA supervisory concept, to the respective regulatory areas.

Considering the diverse range of assignments that fall under FINMA's remit and the high demands made in many regulatory areas, its staff resources are sparse. This in turn requires prudent handling of funding to allow FINMA to concentrate its resources on assignments involving underlying risks that call for heightened attention. Furthermore, it entails consistently adopting a risk-based approach to all regulatory areas under FINMA's purview. In this context, the various supervisory laws give FINMA room for manoeuvre in prioritising the extent of its supervision of the individual institutions. This latitude is to be more rigorously exploited in the future, taking into account the risks posed by the institutions.

Against this backdrop, FINMA has divided all supervised institutions into six supervisory categories. Allocation has been based on the risks posed to creditors, investors and policy holders, as well as to the entire system, and to Switzerland's reputation as a financial centre. The supervised institutions in category 1 are characterised by their size and global relevance, and the associated significant risks posed at various levels. In the other categories, the institutions' risk potential decreases incrementally down to category 5, while the market players in category 6 are not subject to prudential supervision.

Reference:

In addition to dividing the institutions into risk categories, each of them is given a rating that represents FINMA's assessment of its current state. On the basis of these two parameters – category classification and institutional rating - the regulatory concepts, extent of supervision, deployment of supervisory instruments, interaction between direct supervision by FINMA and the assignment of audit firms are determined for the individual institutions.

By adopting this regulatory approach, FINMA aims at attaining further differentiation in its supervision and at managing its supervisory resources more efficiently.

1 Risk-based regulatory approach to insurance supervision

Insurance companies subject to supervision are allocated to supervisory categories 2 to 5. Classification mainly depends on the required amount of tied assets or balance sheet total in the case of reinsurers. Presently, 5 insurance companies are in category 2, 30 in category 3, 49 in category 4, and 172 in category 5. The aggregate balance sheet total of the 35 companies in categories 2 and 3 accounts for almost 90% of the balance sheet total of all supervised institutions.

Each insurance company is given an internal rating based on criteria relating to areas such as the quality of corporate governance and risk management, adequacy of provisions and the solvency of the insurance company.

The extent of supervision will be a function of the insurance company's risk category and rating. The regulatory processes applicable to the four supervisory categories differ by virtue of the supervisory instruments deployed as well as the extent and frequency of auditing. The higher the risk category, the more intensive the supervision. Where certain rating parameters within a category result in negative values for a company, the standard supervisory process for this company is stepped up in the area concerned, which results in "differentiated heightened supervision".

Another development of the new regulatory approach is the increased assignment of audit firms, which are progressively being charged with supervisory tasks. Resources for direct supervision are primarily deployed for risk categories 2 and 3 and for companies warranting FINMA's heightened attention on account of their current risk situation.

2 Risk-based regulatory approach to banking supervision

Banking institutions subject to supervision are allocated to categories 1 – 5. In line with the criteria applied, the two large banking groups are currently in category 1, another 2 institutions in category 2, approx. 25 in category 3, approx. 70 in category 4, and approx. 270 in category 5. When measured in terms of their balance sheet total or portfolio volume, 85% – 90% of the volume falls to categories 1 – 3, which means that these institutions or financial groups are allocated the most supervisory resources.

Reference:

The risk-oriented monitoring approach applied to banking supervision for some years now is gradually being improved, with a number of new measures and the enhancement of existing supervisory instruments. Particularly worthy of mention at present are two instruments: assessment letters and supervisory reviews.

Since the existing regulatory approach foresees sending annual assessment letters only to the two large banking groups, FINMA will now extend this assessment to institutions in categories 2 (annually) and 3 (at least every two years). The purpose of an assessment letter is to provide the supervised institutions with an evaluation directly from the supervisory authority, notifying them formally of their risk assessment, any weaknesses identified and any ensuing need for action. The institutions have the possibility to respond to the assessment in writing.

To further enhance the dual supervisory regime, more on-the-spot audits, i.e. supervisory reviews, will be conducted in the future. Until now, such reviews have been conducted regularly at both of the large banking groups and at the banks of the Raiffeisen Group. They are considered to be a limited complementary supervisory instrument that enables FINMA to get an immediate overview of a business or risk area. Issues relevant to a bank’s daily operations or in-depth analyses of specific topics important to regulation may justify a supervisory review. If such a review is conducted at different banks on the same topic, it allows for benchmarking and any shortcomings detected in the process to be tackled systematically.

3 Adjustments to the dual supervisory system

By strengthening the risk-oriented supervisory approach, a number of adjustments are being made to the dual supervisory system and, consequently, the roles assumed by FINMA and the audit firms as its extended arm. On the one hand, the following immediate measures are foreseen: systematic requirements for risk analysis/audit strategy for supervised institutions in categories 2 and 3, and, in case of high risk assessment, also for supervised institutions in categories 4 and 5 to impact audit planning at an early stage and, if necessary, to have additional areas undergo audit. On the other hand, the increased use of third parties is planned to provide systematic clarification of specific issues independently of the regulatory auditors. This resulted in FINMA Newsletter 12 of 23 July 2010 being amended so that the practice allowed by FINMA of changing the supervisory audit firm retrospectively is no longer possible and to introduce new regulations for audit firms in the licensing procedure. Finally, the strategic direction for reforming auditing in the financial sector, still to be communicated, constitutes a further component - the strengthening and harmonising of the roles adopted by the regulator, supervised institutions and audit firms.

Reference:

The supervisory instruments will undergo further development. Any changes that occur will be communicated to the supervised institutions.

Yours sincerely

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