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FINMA in 2009 – the Chairman’s review

2009 was a turbulent year – both for the supervised institutions and for the newly created supervisory authority, which began its mandate on 1 January 2009. Continuing uncertainty on the financial markets, negative growth, particularly in the industrialised world, and the consequences of the recession left their mark on the global economy, drastically so for some market participants. There was no significant recovery until the second half of the year, since when results in the financial sector have improved again.

The Swiss financial centre had an additional challenge to face. International pressure over cross-border asset management business, specifically with respect to business practices relating to untaxed assets, required a change of approach. The outcome remains uncertain, but it will undoubtedly have an impact on business models.

Difficult decisions in the first quarter

At the start of the year, FINMA had a number of difficult decisions relating to UBS on its hands. The Swiss Federal Banking Commission (SFBC), as one of FINMA’s predecessor authorities, had carried out preparatory work in this respect, but the newly constituted Board of Directors had to actually take the decisions. One of these decisions concerned the approval of UBS’s variable remuneration for the loss-making year 2008 under the agreement reached as part of the package of measures to strengthen Switzerland’s financial system. The approved remuneration cuts were seen by the general public as not going far enough and came in for some heavy criticism. In actual fact, however, these cuts were very radical and triggered a wave of resignations, which could only be halted by means of higher fixed salaries.

In February, FINMA ordered the disclosure of data on a limited number of UBS clients to the US authorities. This allowed a settlement to be reached, thus averting an impending criminal lawsuit by the US Department of Justice and defusing, before it was too late, a crisis that could have threatened the existence of the bank. FINMA based this order on the protective measures laid down in Art. 25 of the Swiss Banking Act, which grant it wide-ranging powers to be used if it has reasonable grounds to

suspect that an institution is about to become insolvent or illiquid. The Federal Administrative Court ruled on 5 January 2010 that this order was unlawful. FINMA subsequently referred the judgment to Switzerland's Supreme Court, with the intention that the court will pass final judgment on the extent of its legal latitude in crisis situations. We hope that this issue will be clarified quickly.

These two examples show that decisions taken by supervisory authorities are often controversial and difficult to communicate. This is especially the case if they run contrary to public opinion and expectations. However, FINMA's sole duty is to exercise its mandate in accordance with the applicable laws. It exercises this duty by taking independent, circumspect and appropriate decisions. It is often only with hindsight that one can judge whether the decisions taken had the desired effect. FINMA is not afraid of having its measures and decisions critically scrutinised.

Full-scale investigations completed

In February, FINMA published a summary report containing the results of its full-scale investigation into the advisory services provided by UBS to help US clients circumvent their tax obligations. FINMA reprimanded the bank for a severe breach of the provisions of the Swiss Banking Act and the serious shortcomings in the way it deals with legal risks and ordered that corrective measures be taken. Unless a criminal act is committed, such a reprimand is the most serious measure that FINMA can take against supervised institutions, short of withdrawing an institution's licence. However, this investigation did not reveal evidence of criminal activity. The investigation into the Credit Suisse Group for breaching US sanctions with respect to USD payments also resulted in a reprimand being issued.

A number of criminal complaints were filed for breach of disclosure obligations in the Sulzer case. In this respect, FINMA issued reprimands to Zürcher Kantonalbank, the Zurich branch of Deutsche Bank AG and NZB Neue Zürcher Bank for their roles in the undisclosed acquisition of holdings in Sulzer. It also filed criminal complaints with the Federal Department of Finance against foreign investors not under its supervision.

Proceedings were instigated for many more potential breaches of disclosure obligations and are still ongoing.

The Madoff fraud case and the losses suffered by many clients on capital-protected products as a result of the collapse of Lehman Brothers also triggered full-scale investigations. In a recently published report, FINMA identified a need for regulatory action in the advisory business for investment clients; it intends to examine this issue further in a regulatory project, which will focus on improving client protection.

Regulation

FINMA improved client protection by publishing its circular "Guidelines for the recognition of self-regulation in asset management as minimum standard". These guidelines define rules of conduct for independent asset managers to be followed for the purpose of self-regulation by industry organisations. These guidelines must also be critically reassessed in terms of the need for action with respect to client protection in the investment and asset management business.

The “Supplementary social health insurance” circular is aimed at improving protection for insured persons by increasing transparency. The comments received during the consultation period were evaluated, and the circular was revised accordingly. It is due to enter into effect on 1 May 2010.

A consultation period was also opened on the amendments to the Capital Adequacy Ordinance for cantonal and cooperative banks. FINMA campaigned in favour of the abolition of exception rules in the interests of a higher-quality capital base for these banks. The revised Capital Adequacy Ordinance entered into force on 1 January 2010.

The Federal Council and FINMA Collective Investment Schemes Ordinance was brought into line with European law. By abolishing the “Swiss Finish” formal and quantitative requirements, FINMA will have the personnel capacity to conduct and monitor an increasing number of qualitative audits in future.

Finally, the much-anticipated consultation period for the FINMA circular on remuneration schemes opened in June 2009, with the circular itself coming into effect at the start of this year. The Circular aims to ensure that remuneration systems are not structured in such a way that provides incentives to take inappropriate risks that could threaten the stability of financial institutions. It is based on the principles published by the Financial Stability Board (FSB) and codifies these. In particular, it gives greater responsibility for structuring and monitoring the effect of remuneration systems to the boards of directors of financial institutions. FINMA is unable to fulfil more far-reaching expectations to limit the absolute amount of remuneration, as it has no authority to do so.

FINMA as an organisation

The transition from the predecessor authorities to FINMA took place without any operational problems. Following the issue of new employment contracts, the implementation of a new IT infrastructure and the organisation’s move in mid-2009 to new headquarters, FINMA is in a good position to raise efficiency. The mandate conferred on FINMA and the repercussions of the financial crisis require an even greater level of performance and expertise, which FINMA was able to deliver thanks to targeted recruitment and an increase in headcount to the budgeted level of 355 full-time equivalents.

FINMA’s costs are financed via fees and supervision charges. The costs incurred in 2009 were in line with budget at CHF 84.8 million, while the fees and supervision charges received totalled CHF 93.4 million. This surplus is to be used to create the first tranche of a reserve in an amount equivalent to one year’s budget, as specified by the Act on the Swiss Financial Market Supervisory Authority. The full financial statements, which were prepared according to IFRS, will be published on the FINMA website once they have been approved by the Federal Council.

In September, FINMA published its report on the financial market crisis, which contained confirmation of organisational failings in supervisory activities. These shortcomings were addressed through the creation of FINMA and the further streamlining of the organisation over the past year. A well-functioning system of governance also plays a key role in this respect. The Board of Directors of FINMA is of the opinion that the best way to guarantee that the necessary checks and balances are in place between the Executive Board and Board of Directors is to have a strong executive board and via

the current separation of duties, which complies with statutory requirements. All of our experiences, including those from the crisis, have confirmed this view.

Strategic goals of FINMA

At the end of September, the Federal Council approved the strategic goals proposed by FINMA for the period to 2012. These goals, which define FINMA's approach, are divided into seven thematic areas and are supported by key points for implementation, which describe specific initiatives and projects that are underway or yet to be commenced.

The overriding aim of FINMA's strategic goals is to continue to improve client protection. The core role of FINMA is to protect creditors, investors and insured persons, and this forms the basis of its supervisory activities. Accordingly, FINMA's strategic goals focus on limiting systemic risks, client protection in the narrow sense, the thrust of regulation, the further development of supervisory activities, enforcement, international cooperation and recognition of equivalence, and strengthening FINMA as an authority.