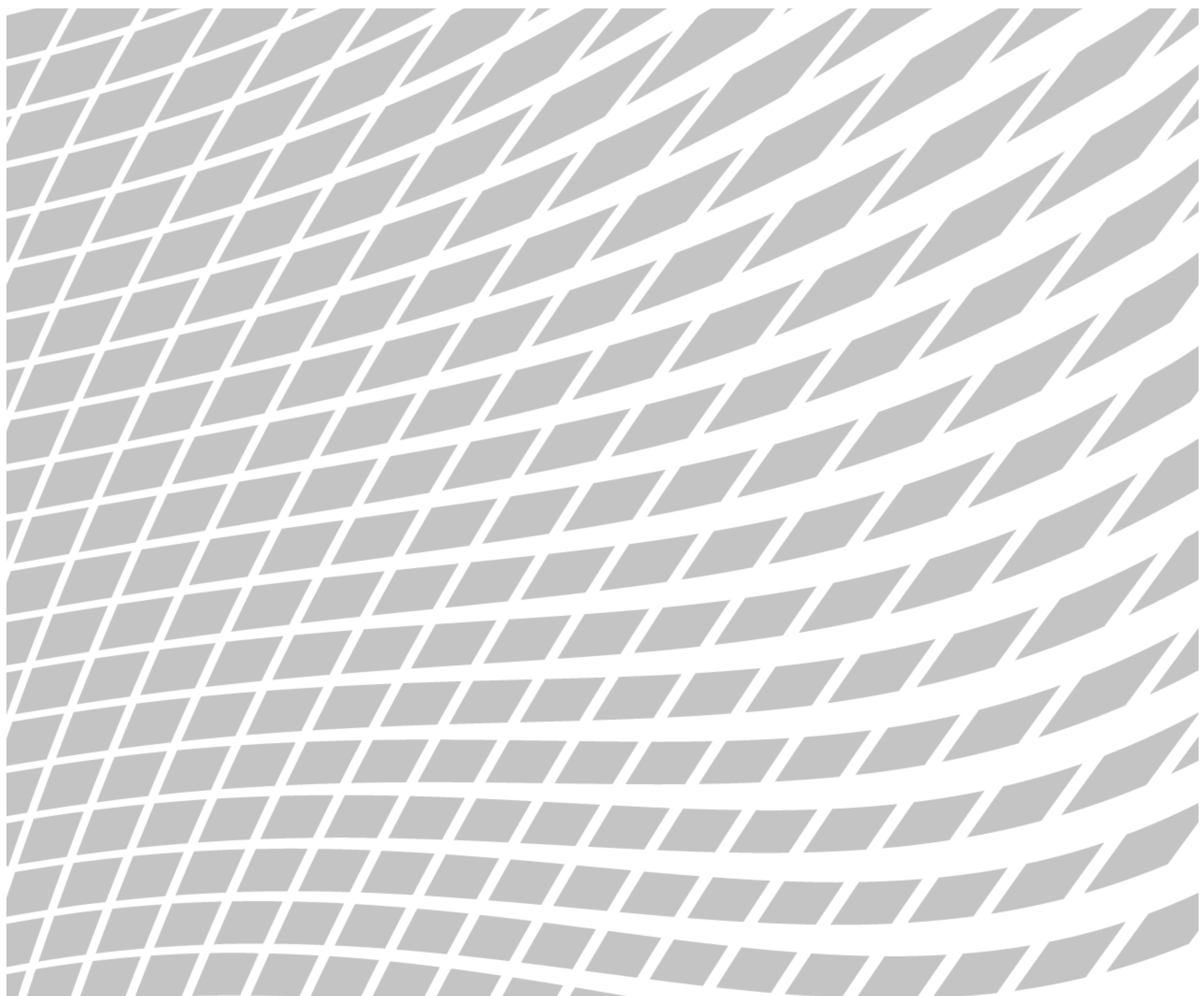
Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

21 April 2011

Effectiveness and efficiency in supervision

Supervisory instruments, working processes and organisation at FINMA



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Key points

- The **strategic goals of FINMA** as approved by the Federal Council on 30 September 2009 set out the authority's main focus for a three-year period, in terms of both fulfilment of its statutory mandate and the further development of its operations. FINMA enjoys a large measure of decision-making autonomy in these areas and is able to effect real change. Today, FINMA stands at the **mid-point of the three-year strategy implementation process**, and is already in a position to report on **results**.
- As part of its commitment to the goal of "Increasing the effectiveness and efficiency of supervision", FINMA has **developed a new supervisory approach**. This approach is based on the risks emanating from the institutions under FINMA's supervision, having regard to the protective function of financial market supervision. FINMA has allocated all the institutions it supervises to one of six categories according to their risk impact on creditors, investors, policy holders and the system as a whole, as well as the reputation of the Swiss financial sector. In addition to being allocated to a risk category, each institution receives a rating corresponding to FINMA's assessment of its current state. On the basis of these two parameters – **categorisation and institution rating** – the supervisory approach stipulates the extent of supervision, the use of supervisory instruments and the interaction between direct supervision by FINMA and the assignment of audit firms for the individual institutions. All these measures result in a **more systematic risk orientation of supervisory activities** and a closer involvement with the institutions that are relevant from a risk perspective.
- The latter translates into an emphasis on the **increased use of on-site visits and FINMA's own inquiries and analyses** for the larger and more complex supervised institutions. Direct reviews are currently being carried out on a regular basis at the large banking groups, and selectively at other banks and among insurance companies. Where it identifies potential sources of risk, FINMA also carries out rapid and comprehensive, cross-sector surveys or comparisons.
- Only two of the institutions under FINMA's supervision have been allocated to **category 1**. They are the two **big banks**, which are regarded as systemically important. There are no insurance companies or collective investment schemes in this category. The Capital Markets group has systematically built up specialist banking supervisory expertise to enable the professional supervision of investment banking – the area of business with which the greatest number of risks are associated.
- A massive increase in the frequency with which institutions provide information, combined with a higher intensity of analysis by FINMA, has an impact on the **quality of the interaction with the supervised institutions**. The enhanced level of banking supervision is also reflected in the number of supervisory reviews – special, on-the-spot audits of supervised institutions on specific topics carried out by FINMA. In 2011, FINMA will be carrying out around 20 supervisory reviews of the major banking groups and 20 more of the remaining banks. This compares with just two such reviews in 2007 and 2008, which were discussed with the banks concerned but did not result in any

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follow-up. The reviews carried out today contain recommendations by FINMA to which the banks are required to respond. The analyses may also require the banks to take action where necessary.

- FINMA's risk-based supervisory approach also requires the **responsible deployment of the human and financial resources** at the authority's disposal. Its supervisory capacities are directed precisely towards supervised institutions which, owing to the risks underlying them, demand greater attention.
- FINMA does not set out to expand its human resources before giving the matter careful consideration. It has instead begun by examining ways of improving the effectiveness of its supervisory instruments and those of the audit firms. It has therefore concentrated first on making better use of the **available potential** in terms of human resources, before taking **precisely targeted action to acquire additional know-how in certain areas**. Despite fierce competition and the constraints of salary ceilings, it has succeeded in motivating specialists to work for FINMA.
- Enhancement of the risk-oriented supervisory approach will also result in certain changes to the assignment of audit firms. The main driver of the **necessary reorientation of FINMA's audit-related activities** was the substantial differences in the content and aims of the existing audit prescribed by the Swiss Code of Obligations on the one hand, and the regulatory audit under supervisory law on the other. Unlike the regulatory audit, the audit prescribed by the Code of Obligations takes a mainly historical approach. The regulatory audit, meanwhile, essentially looks into compliance with licensing regulations and other requirements imposed under supervisory law. A further fundamental difference from the audit prescribed by the Code of Obligations is that the audit firm is obliged to carry out its mandate as the **"extended arm" of FINMA**.
- Under the current system, audit firms in principle wear "two hats"; yet among the supervised institutions and throughout the market as a whole, they still tend to be perceived mainly as mere "auditors of the accounts".
- As a response to this issue, FINMA now aims **to separate completely the audits prescribed by the Swiss Code of Obligations from the regulatory audits**, **in terms of approach and organisation,** for both banks and insurance companies. It will also be submitting proposals for enhancing its influence over the work of audit firms in regulatory audits.

1 Background

FINMA, the new Swiss Financial Market Supervisory Authority, commenced operations on 1 January 2009, in the midst of the financial crisis. As with all supervisory authorities around the world, its most urgent task was the management of that crisis. Simultaneously, it began working to build an integrated financial market supervisory organisation combining all three of its predecessor authorities. It was seen as vital for the new authority to make responsible use of the freedom granted to it by the legislature to fulfil its mandate effectively as a public law institution. This work, coupled with the lessons which FINMA had learnt from the crisis itself and published under the title 'Financial market crisis and financial market supervision', were key factors in the formulation of its strategic goals. Those goals were approved by the Federal Council on 30 September 2009. Today, FINMA stands at the mid-point of the three-year strategy implementation process, and is already in a position to report on results.

The strategic goals set out FINMA's main focus for a number of years, in terms of both fulfilment of its statutory mandate and the further development of its operations. FINMA enjoys a large measure of decision-making autonomy in these areas and is able to effect real change. It has readily accepted this responsibility and, during the two years of its existence, developed into a modern supervisory organisation. Targeted measures were first taken to build on the knowledge already available within the organisation's existing staff, and it was only after careful analysis that additional know-how was brought in to cover the few areas where it was lacking. Today, internal and external supervisory resources are deployed where risks have been systematically located in advance. All these measures have brought about a transformation of the supervisory culture. The emphasis now is not on sitting at a desk ploughing through lengthy reports, but rather on meticulously prepared on-site activities at the premises of supervised institutions.

Reporting on the implementation of the strategic goals takes place as part of FINMA's annual meeting with the Federal Council. However, FINMA also announced its intention to produce a report on supervisory instruments, working processes and organisation in connection with recommendations 3 and 6 made by the CC in their examination of the conduct of the authorities during the financial crisis. It is for that purpose that this report has been compiled.

Since the assignment of audit firms and the supervision of large banking groups have been prominent aspects of the lessons drawn from the crisis, this report focuses on those two issues.

2 Supervisory approach

FINMA has made increasing the effectiveness and efficiency of supervision one of its strategic goals. One important element of this is the systematic adoption of a risk-based approach in all areas of supervision. Comprehensive risk identification gives supervisory activity the necessary effect by enabling the targeted monitoring and enforcement of supervisory rules. Based on a categorisation of supervised institutions and a rating for each, the supervisory approach stipulates the extent of supervision and the graded use of supervisory instruments.

As a new, integrated supervisory authority resulting from the merger of three predecessor organisations, FINMA has focused its efforts to improve effectiveness and efficiency on harmonising supervisory processes across supervisory areas wherever it was sensible to do so, and making more uniform use of the supervisory instruments at its disposal. Where expedient, the instruments employed by FINMA's predecessor authorities have been adapted to suit the needs of relevant supervised sectors such as banking and insurance, thus enabling them to be deployed across a number of areas. Responsible use of the human and financial resources available to FINMA also means targeting the existing supervisory capacities more precisely on the supervised institutions which, because of their underlying risks, require closer attention.

The various supervisory laws grant FINMA a degree of flexibility in terms of the extent to which it supervises individual institutions. FINMA's new supervisory approach makes use of this freedom for manoeuvre.

2.1 Categorisation and rating

FINMA's supervisory approach is based on the risks emanating from the institutions under its supervision, having regard to the protective function of financial market supervision. All such institutions are allocated to one of six categories according to their risk impact on creditors, investors, policy holders and the system as a whole, as well as the reputation of the Swiss financial sector. The institutions in category 1 are those that are of major and even global relevance, and therefore pose correspondingly significant risks at various levels. The risk potential of the institutions in the remaining categories decreases progressively down to category 5; market participants in category 6 are not subject to prudential supervision. This division of supervised institutions into categories was one of the first building blocks of a supervisory system more differentiated than that operated by FINMA's predecessor organisations.

As well as being allocated to a risk category, each institution receives a rating corresponding to FINMA's assessment of its current state. On the basis of these two parameters – categorisation and institution rating – the supervisory approach stipulates the extent of supervision, the use of supervisory

instruments and the interaction between direct supervision by FINMA and the assignment of audit firms for the individual institutions.

All these measures result in a more systematic risk orientation of supervisory activities and a closer involvement with the institutions that are relevant from a risk perspective. The risk-based approach is consistently applied in all areas of FINMA’s supervisory activity. The requirements and differentiations, as well as the monitoring and intervention tools used, may differ between individual areas of supervision, but the conceptual approach remains the same.

2.1.1 Banking supervision

The institutions subject to banking supervision are divided between categories 1 to 5. On the basis of the criteria laid down, the two large banking groups are currently assigned to category 1, a further two institutions to category 2, around 25 to category 3, some 70 to category 4 and approximately 270 to category 5. In terms of balance sheet total or volume of deposits, 85 to 90 percent are to be found within categories 1 to 3, and accordingly it is to these institutions and financial groups that the most supervisory resources are allocated. For the purposes of banking supervision, the risk-based supervisory approach is supplemented by certain new elements or enhanced using existing supervisory instruments.

Overview of categorisation of banks:

Categories / Criteria	**1** Extremely large, important and complex institutions / very high risk	**2** Very important, complex market participants / high risk	**3** Large and complex market participants / significant risk	**4** Medium-sized market participants / average risk	**5** Small market participants / low risk	**6** Market participants not subject to prudential supervision
Specific Criteria (3 out of 4 must be fulfilled)	Balance sheet total ≥ 500 bn. Aum ≥ 1000 bn. Priv. deposits ≥ 30 bn. Reg capital ≥ 20 bn.	Balance sheet total ≥ 100 bn. Aum. ≥ 500 bn. Priv. deposits ≥ 20 bn. Reg capital ≥ 2 bn.	Balance sheet total ≥ 15 bn. Aum. ≥ 20 bn. Priv. deposits ≥ 0,5 bn. Reg capital ≥ 0,25 bn.	Balance sheet total ≥ 1 bn. Aum. ≥ 2 bn. Priv. deposits ≥ 0,1 bn. Reg capital ≥ 0,05 bn.	Balance sheet total < 1 bn. Aum. < 2 bn. Priv. deposits < 0,1 bn. Reg capital < 0,05 bn.	n.a.
Number of supervised institutions in this category	2	2	25	70 banks	270 banks/ securities dealers	n.a.

2.1.2 Insurance supervision

The companies subject to insurance supervision are assigned to supervisory categories 2 to 5, primarily on the basis of the debit amount of the tied assets or, in the case of the reinsurers, balance sheet total. At present, five insurance companies are assigned to category 2, 30 to category 3, 49 to category 4 and 172 to category 5. Taken together, the 35 companies in categories 2 and 3 have total assets that account for almost 90 percent of the balance sheet total for all the supervised companies. The internal ratings of insurance companies are based on criteria such as quality of corporate governance and risk management, adequacy of provisions, and solvency.

Overview of categorisation of insurance companies:

Categories / Criteria	1 Extremely large, important and complex institutions / very high risk	2 Very important, complex market participants / high risk	3 Large and complex market participants / significant risk	4 Medium-sized market participants / average risk	5 Small market participants / low risk	6 Market participants not subject to prudential supervision
Specific Criteria (3 out of 4 must be fulfilled)		Balance sheet total ≥ 100 bn or market share > 20% in sociopolitically sensitive area (BVG) plus qualitative criteria: complexity, organisational structure	Non-life, life: debit amount of tiedassets > CHF 1bn Reinsurance: total assets > CHF 1bn qualitative criteria: complexity, organisational structure	Non-life, life: debit amount of tiedassets > CHF 0.1bn Reinsurance: total assets > CHF 0.1bn qualitative criteria: complexity, organisational structure	Non-life, life: debit amount of tiedassets < CHF 0.1bn Reinsurance: total assets < CHF 0.1bn qualitative criteria: complexity, organisational structure	
Number of supervised institutions in this category		5	30	49	172	

While the new supervisory approach was being developed, it became evident that the insurance supervision process generates a particularly large volume of data and information, not all of which can be systematically processed. Reporting is now being streamlined. In particular, the existing reports are being examined in order to establish how far they are necessary and whether the process of evaluating them can be simplified.

2.1.3 Supervision of collective investment schemes

The risk-based audit approach applied to collective investment schemes encompasses all fund management companies, SICAVs, SICAFs, limited partnerships for collective investment, representatives and custodian banks, including their products. The supervisory approach for asset managers of collective investment schemes is currently under development and will be integrated into the existing approach at a later date.

An examination of the risk impact of the products and licence holders covered by the Collective Investment Schemes Act, based on the principles of monitoring and the systematic approach of the Act, reveals that Swiss retail funds present the greatest risk. Where foreign collective investment schemes are concerned, FINMA is not the primary supervisory authority. Accordingly it monitors only the distribution of such schemes, even when they are also offered to the public.

Because Swiss retail funds present the greatest risk, they have been allocated to categories which entail closer monitoring than funds for qualified investors. Publicly offered products have been allocated to categories 3 and 4, products for qualified investors to category 5. Representatives of foreign products also fall within category 5.

Since SICAVs, SICAFs and limited partnerships for collective investment are fund products in the form of a company, it is impossible to distinguish between the product and the institution for categorisation purposes. With regard to contractual investment funds, although such a distinction can be made, the decision was taken to categorise the products together with the fund management company, since monitoring is geared to the product.

Retail funds in the form of companies and their fund management companies were allocated to categories 3 and 4, the criteria being the size and complexity of the licence holders. Large licence holders with retail funds accounting for more than two percent of the Swiss market were allocated to category 3, as were those that are active internationally and are subject to consolidated supervision by FINMA.

Past experience has shown that the activities of a custodian bank entail a substantial risk effect for investors and also reputational risks for the financial sector as a whole. However, since the banks as such are already subject to supervision by FINMA's Banks division, the decision was taken, adopting a risk-based approach, to allocate monitoring of custodian bank activities by the Markets division to category 5.

On the basis of the criteria set out above, nine institutions are currently assigned to category 3, 41 to category 4 and 160 to category 5. The monitoring processes that underpin these three categories differ in terms of the monitoring effort involved. The higher the risk category, the more intensive the monitoring. Any weaknesses identified are discussed with the supervised institutions at regular meetings, and any actions required subsequently communicated in writing.

2.1.4 Monitoring of the parabanking sector in respect of combating money laundering

The parabanking sector comprises independent asset managers, fiduciary companies, companies involved in payment services, lawyers and notaries, financing companies, bureaux de change and money transmitters. This sector is not subject to prudential supervision by FINMA and is therefore normally allocated to category 6 under the supervisory approach. However, supervision is carried out with a view to combating money laundering.

Under the Anti-Money Laundering Act (AMLA), financial intermediaries in the parabanking sector are permitted to decide for themselves whether they wish to join a self-regulatory organisation (SRO) or subject themselves to direct supervision by FINMA. Article 14 AMLA stipulates that all financial intermediaries which are not affiliated to an SRO must obtain a licence from FINMA to carry on their business. Of the 6,892 financial intermediaries active in the parabanking sector at the end of 2010, 412 are currently subject to direct supervision by FINMA.

The vast majority, therefore, are monitored by the eleven SROs recognised by FINMA. FINMA subjects the SROs to constant supervision, and its approval is required for any changes to their regulations or responsible officers. FINMA receives a report from each SRO every year detailing its activities and providing information on problems the SRO has experienced with its members. FINMA also carries out an on-site inspection of the SRO every year. The only exception is the SRO for lawyers and notaries: here, the law requires the inspection to be carried out by an audit firm owing to the duties of confidentiality to which the profession is bound.

Financial intermediaries affiliated to an SRO are generally obliged to commission an audit firm approved by the SRO to carry out the AMLA inspection. The SRO reviews the audit reports. Where there are serious breaches of due diligence obligations, the SRO will initiate sanction proceedings and appoint an agent to investigate the financial intermediary. The initiation of such proceedings is reported to FINMA. The proceedings may lead to a reprimand, a fine or even the exclusion of the

financial intermediary. All exclusions of financial intermediaries are reported to FINMA, which can then take any steps necessary. Inspections by SROs are normally carried out once a year. However, a member may apply to the SRO for an extension of the interval between inspections, up to a maximum of three years. In deciding whether to grant this extension, the SRO will consider the level of the money laundering risk involved in the financial intermediary's activities and whether the last two annual inspections of that intermediary have revealed serious breaches of due diligence obligations.

The 412 financial intermediaries subject to direct supervision by FINMA (DSFIs) are required to undergo an audit by an audit firm licensed by FINMA (Art. 19a and 19b AMLA). The audit is carried out annually, with the option to apply for an extension of the interval between audits. The specific details of the audit approach have been set out in a number of circulars.

2.2 Review of the use of audit firms

Enhancement of the risk-oriented supervisory approach will also result in certain changes to the assignment of audit firms. Work on the redesign has already been initiated as part of the strategic goal of increasing the effectiveness and efficiency of supervision. A request contained in the CC report also calls for "the role of audit firms in audits of large banking groups, as defined by law" to be reviewed and for "a report to be made into possible statutory or other measures to enhance the role of audit firms for the benefit of banking supervision." FINMA has now reviewed the role of audit firms not only in relation to the large banking groups, but also in respect of all supervised institutions.

The revisions to the assignment of audit firms drawn up by FINMA will, as far as possible, be regulated by FINMA circulars within the scope of the existing legislation. At the same time, FINMA is assessing whether amendments to laws or ordinances are required to enable optimum fulfilment of the mandate for regulatory audits.

2.2.1 Differences between audit mandates under the Swiss Code of Obligations and regulatory audits

There are considerable differences in the content and objectives of audits prescribed by the Swiss Code of Obligations on the one hand, and regulatory audits under supervisory law on the other.

Unlike the regulatory audit, the audit prescribed by the Code of Obligations takes a mainly historical approach. Its chief aim is to assess whether business events in the reporting year are presented fully and correctly, and whether the company's continued existence as a going concern is safeguarded. Accordingly, the mandate of an audit firm carrying out an audit under the Code of Obligations consists predominantly in examining quantitative aspects of the supervised institution's operations; application of, and compliance with, defined, nationally and internationally recognised auditing standards is both possible and indeed required. Pursuant to the statutory mandate, findings are reported to the annual general meeting (attestation) and to the board of directors (comprehensive report).

The regulatory audit, meanwhile, essentially considers whether the supervised institution is complying with the regulations governing its licence. This includes a wide range of issues which must be consid-

ered individually and assessed in relation to the institution's business model. The assessment covers the company's entire internal organisation, internal controlling and reporting mechanisms and their operation; the practicality of its strategies, including the resources that are required and available; and the assurance of proper business conduct, including the integrity of the individuals responsible for the company's management. In an audit of this type, the mandate of the audit firm is to obtain a comprehensive, qualitative and forward-looking picture of the supervised institution. A further fundamental difference from the audit prescribed by the Swiss Code of Obligations is that the audit firm is obliged to carry out its mandate as the "extended arm" of FINMA.

Under the current system, audit firms in principle wear "two hats"; yet among the supervised institutions and throughout the market as a whole, they still tend to be perceived mainly as mere "auditors of the accounts". As a response to the issue, FINMA now aims completely to separate the audits prescribed by the Swiss Code of Obligations and regulatory audits, in terms of approach and organisation, for both banks and insurance companies. It is also examining proposals for enhancing its influence over the work of audit firms in regulatory audits where they act as the "extended arm" of FINMA.

2.2.2 Measures to strengthen the mutual independence of the parties involved

FINMA has also examined the repeated problem of insufficient mutual independence between audit firms and supervised institutions, and will be setting out rules in this area. The independence of the regulatory audit carried out by an audit firm must be enhanced by ensuring that FINMA can intervene if it identifies shortcomings in the audit.

2.2.3 Optimisation of the rules for regulatory audits

Stricter rules will be applied, in particular regarding the licensing of lead auditors for the regulatory audit, responsibilities to FINMA in respect of reporting, and the quality controls carried out by FINMA.

The regulatory audits carried out hitherto in the various areas supervised by FINMA – banks, insurance companies and collective investment schemes – will be harmonised as far as possible, and the requirements concerning reporting of regulatory audits will be revised. New audit strategies will be developed in line with the supervisory categories set out by FINMA, containing standardised FINMA audit mandates for particular types of institution as well as the prescribed audit depth and annual audit calendar. In addition there will be irregular and ad hoc audit mandates from FINMA. An in-depth study is currently under way into a strategy for banking supervision that, by restricting the compulsory annual audit areas and embedding them in an audit plan covering a number of years based on a risk-oriented approach, is designed to ensure the more targeted deployment of audit resources and thus an increase in the value added by the audit in the areas examined.

2.3 Optimisation of internal processes

The strategic goals are being implemented in the form of projects or line mandates. Success also depends on putting in place the necessary structures. In 2010, FINMA launched a wide-ranging programme to improve its internal processes by aligning and running them in accordance with predefined

management, core and support processes. Efficiency gains are to be achieved through improved process discipline and IT support.

However, the aim is not to create a FINMA that is entirely driven by or organised around processes. Instead, the existing organisational model, based on market segments and cross-divisional functions, will essentially be maintained. Where tasks are already performed using standardised processes, these will be maintained; where an improvement could be achieved through enhanced process logic, this will be introduced.

3 Supervisory instruments

At present, the type and use of supervisory instruments is primarily dictated by the categorisation of the supervised institutions. Assessment letters, for example, (see 3.1.2) are used only for categories 1 to 3, but not categories 4 and 5. The second consideration is the institution's rating. Investigating agents, for example, can be used in all categories.

Generally speaking, where larger and more complex supervised institutions are concerned, increasing emphasis is placed on inquiries and analyses carried out by FINMA. Where it identifies potential sources of risk, FINMA also carries out rapid and comprehensive, cross-sector surveys or comparisons. Direct reviews are currently being conducted on a regular basis at the large banking groups, and selectively at other banks and among insurance companies. Greater use of such reviews is planned, especially in categories 1 to 3.

On-site inspections are to be carried out by FINMA monitors. This requires a well-structured approach for direct reviews (planning, conduct, documentation, reporting).

3.1 Banking supervision: far-reaching change

The philosophy of the supervisory approach, with each supervised institution being allocated to a risk category and assigned a rating, and the intensity of supervision derived from these in terms of both on-site inspections and the assignment of audit firms, also underpins the structure of banking supervision. Additionally, there are far-reaching changes to the organisation and the supervisory instruments, as well as their use.

3.1.1 Organisation of banking supervision

All activities related to banking supervision, for both the large banking groups and others, are currently concentrated within a single division. In contrast to the previous system, whereby the big banks and the others were assigned to separate areas which therefore provided two members of the Executive Board, this structure enables better interaction between the various supervisory and cross-divisional functions.

The supervisory teams covering UBS, Credit Suisse and the other two groups of banks now report directly to the Head of Banking. Flat hierarchies enable timely escalation of any irregularities that occur, and facilitate the management of the division, involving all relevant decision makers.

Today, banking supervisory activities are managed in a coordinated and risk-based manner. Institutionalised meetings take place in a variety of configurations, attended by the supervisory and cross-divisional functions. For example, regular meetings take place between the heads of supervision of the two big banks and their colleagues from the cross-divisional Risk Management function. Discussions with Risk Management and all banking supervisors are held in a different configuration. This enables cross-divisional comparisons to be made and supervisory issues to be addressed in greater detail.

The banking supervisory teams have been put together to reflect not only the size of the supervised institutions, but also their business activities. Supervision of asset management banks, for example, is in the hands of a different team from supervision of retail banks. This permits more focused supervision of the various banking activities and also facilitates targeted cross-sector comparisons.

The cross-divisional Risk Management function, which is divided up into Market and Credit Risks, Aggregate Risks and Scenario Analysis, Supervisory Risk Review and, in particular, Capital Markets (see organisation chart above) plays a key part in the integrated approach adopted by the Banks division. The Capital Markets group, set up in 2009, has enabled FINMA to focus on building up specialist knowledge of investment banking. This know-how is exploited by the Banks division and, where appropriate, also by the Insurance division.

Broad engagement with topical issues is also supported by the knowledge management specifically built up in the banking area. Attendance at monthly briefings is specifically encouraged. The topics are drawn from across the division and prioritised by a team. They range from new developments in accounting, through the specific problems associated with a given bank, to general discussions of a particular review result.

The flow of information has increased sharply, not only within FINMA but also externally – to and from the supervised institutions. For example, FINMA receives certain data on a daily basis, and other information weekly. Each month, FINMA draws up a highly detailed, comparative risk report on the big banks. Using the know-how accumulated in the area of capital markets, some of FINMA's analyses drill down as far as individual banking transactions.

This massive rise in the frequency of information, combined with a higher intensity of analysis by FINMA, has an impact on the quality of the interaction with supervised institutions. Generally speaking, FINMA now maintains a stronger direct presence at the supervised institutions in the higher categories. It increasingly carries out on-site inspections concerning individual issues, or commissions third parties to investigate the facts. The analyses also require the banks to take action where necessary.

FINMA's enhanced on-site presence also requires critical monitoring of its own independence from the institutions it supervises. To ensure that its supervisors act impartially, FINMA has begun putting in place a system of rotating responsibility for certain supervised institutions (what are termed 'key account manager functions'). In addition, the plausibility of information supplied by supervised institutions is critically examined.

To enable more efficient checks into the activities of the two big banks on foreign markets, there are regular exchanges with the supervisory authorities in the UK and US. These may be expanded in future, for example in the form of joint audit activities in those countries.

The integrated and risk-based supervisory approach adopted by the Banks division is backed up by a range of specific instruments.

3.1.2 Assessment letters and supervisory reviews

The aim of the assessment letter is for the supervisory authority to provide a regular evaluation of a supervised institution. It formally notifies the institution of its risk categorisation under the supervisory approach together with any shortcomings identified and the actions required to address them. The institution then has the opportunity to comment in writing.

The previous supervisory approach envisaged assessment letters only for the two big banks, but since 2010 this has been extended to institutions in categories 2 (annually) and 3 (at least every two years).

The assessment letters set out clear requirements and may lead to further investigations as part of supervisory reviews.

Supervisory reviews are on-site inspections that enable FINMA rapidly to form a picture of a business area or risk area. They may cover current issues arising out of daily business or involve in-depth analyses of specific topics. Supervisory reviews are not a new instrument, but they are now being used in larger numbers and go into greater detail than was the case in the past. Increasingly, the results give rise to expectations on FINMA's part concerning the institution involved. FINMA monitors closely the implementation of any measures required.

Supervisory reviews are also frequently used to examine the same issue at a number of banks. This permits benchmarking and enables shortcomings to be addressed promptly. Comparative supervisory reviews covering macroeconomic topics such as interest rate risks are now carried out systematically. The review teams are drawn from the various areas of the division and put together by the cross-divisional Risk Management function, which also organises the risk assessments in which all parties involved from the supervisory and cross-divisional functions take part.

3.1.3 Capital planning

Monitoring of capital planning is an integral component of the ongoing supervision of all banks. It has been greatly expanded as part of the reorganisation of banking supervision. Analyses of the capital situation of the two big banks are carried out monthly. These examine, for example, the impact of the new capital adequacy requirements on the banks' capital situation. Earnings forecasts are also critically examined. Regular assessments are made as to whether the banks would be able to absorb a stress loss (specified by FINMA on the basis of the risks to which they are exposed) without compromising their capitalisation.

In a further application of its risk-oriented supervisory approach, on 31 January 2011 FINMA sent for consultation its circular entitled 'Capital buffer and capital planning – banks'. This circular will not apply to the big banks. A special capital adequacy regime was established for them under a decree issued in November 2008 as an immediate response to the financial crisis. Under the circular, FINMA aims to amend the practice adopted from its predecessor of imposing an overall capital buffer on all banks and securities dealers. Under Pillar 2, a capital buffer involving an equity surplus of at least 20 percent of the Pillar 1 requirements is now applied. In line with the risk-based supervisory approach, FINMA believes it is necessary to replace this overall 20 percent buffer for all institutions with a more differentiated system. In future, the additional capital requirements under Pillar 2 are to be set in accordance with objective factors that reflect a financial institution's size, complexity and operations. In accordance with the FINMA categorisation system, larger and more complex institutions will be required to maintain a higher capital buffer than their smaller and less complex counterparts.

The consultation on the 'Capital buffer and capital planning – banks' circular ran until 14 March 2011, and FINMA is currently evaluating the results. The circular is set to come into force on 1 July 2011. A transitional period extending until 31 December 2016 has been allowed for institutions that do not meet the capital adequacy targets on that date.

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3.1.4 Loss potential analysis

Quarterly loss potential analyses at the two big banks are an important complement to the supervisory repertoire. They examine whether the banks are in a position to absorb a given loss scenario without falling below the minimum regulatory requirements, and provide a better appreciation of their vulnerability in respect of individual portfolios.

During these regular analyses, staff from Risk Management and relevant supervisory teams work together, bundling their knowledge of the market environment and individual institutions as well as their quantitative risk assessment to arrive at a comprehensive risk appraisal. The aim is to obtain a perspective that is as independent as possible of the supervised institution concerned, which is then compared with the institution's own assessment. This leads to a valuable and intensive dialogue with the institution. Where there are substantial differences in the assessment of the loss potential attached to specific portfolios, FINMA imposes additional capital requirements that remain in place until the institution is able to demonstrate that its analysis is appropriate or amends it accordingly. Where necessary, measures to adjust risk measurement or reduce risks are agreed.

FINMA will be extending its loss potential analyses to cover supervised institutions other than the two big banks.

3.1.5 Liquidity management

In mid-June 2010, new liquidity requirements based on scenario observations were introduced for the two big banks, supplemented by monthly reporting. The objective of this regime is to ensure that the institutions remain able to meet their payment obligations over a period of at least 30 days even in the event of a very serious liquidity stress affecting both the system as a whole and the institution concerned. FINMA and the institution jointly assess the latter's liquidity situation at least once a month, based on both the regulatory reporting and the institution's own internal information. From mid-2011, liquidity monitoring at the level of the Swiss headquarters will be introduced to complement the monitoring at group level. Currency matching of liquidity flows and dependence on functioning currency markets will also be monitored. Finally, the institution's longer term financial planning, under both normal and stressed scenarios, will be reviewed as part of the ongoing monitoring process.

3.1.6 Orderly resolution of systemically important banks – a realistic course of action in a crisis

The recent financial crisis demonstrated both in Switzerland and internationally that a combination of inadequate capitalisation, the structure of the big banks and their complex interrelationships both within the financial system and with the real economy rendered orderly liquidation virtually impossible, thus necessitating government intervention. Accordingly, one of the recommendations made in the final report by the Commission of Experts on limiting the economic risks posed by large companies focused on improving the resolvability of large institutions, alongside higher capital adequacy and more stringent liquidity requirements.

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In parallel with the legislative activities now under way in response to the Commission's recommendations and the Federal Council dispatch based on them, FINMA is currently working on the specifics of implementing those recommendations which affect its supervisory work.

The principal emphasis is on preparations for the recovery and – if this fails – orderly resolution of a bank. The draft law obliges the banks to draw up recovery plans containing effective measures to ensure their survival even in phases of serious stress. FINMA will be required to assess these plans where necessary.

In addition, the systemically important banks will be expected to implement measures to improve their resolvability and safeguard the continued operation of the functions deemed systemically important to the Swiss economy even in an emergency. The draft law will offer the banks an economic incentive to prepare themselves accordingly, by holding out the possibility of an equity capital discount if they make a fundamental improvement to the resolvability of their Swiss and international business operations. Systemically important banks must demonstrate that their systemically important functions can be maintained if they face the threat of insolvency. If they fail to do so, FINMA will be obliged to impose the requisite measures.

One factor that especially complicates the orderly resolution of a major institution is its international orientation. Such institutions are subject to differing and in some cases contradictory bankruptcy regimes, responsibility for which lies with more than one bankruptcy authority. For this reason, international coordination is particularly important.

FINMA is addressing the international dimension by means of two main strategies. First, it is organising crisis management colleges for all the big Swiss institutions, attended by the relevant supervisory authorities of the countries in which those institutions have significant business operations. The aim of these colleges is to prepare for and (where necessary) implement crisis management, including the orderly resolution of an institution. Second, FINMA is involved in the international authorities relevant to this issue, namely the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision, and is actively contributing to the preparation of internationally applicable recommendations.

3.2 Insurance supervision: risk-based solvency system now in force

The fully revised Insurance Supervision Act came into force on 1 January 2006, bringing with it a vital new tool of insurance supervision: the Swiss Solvency Test (SST). The major insurance companies have been implementing the SST in the form of field tests since 2006. A five-year transitional period was established for compliance with the capital adequacy requirements under the SST, which came to an end on 1 January 2011. Since that date the SST has been compulsory, obliging insurance companies to cover the required capital (target capital) calculated under the SST with available capital (risk-bearing capital). Because the SST is based on market valuations and risk-based capital requirements, it gives a much more accurate picture of an insurance company's risk situation than the conventional Solvency I, which imposes solvency requirements geared mainly to the scope of business and disregards risks.

With the SST being mandatory since 1 January 2011, most insurance companies with insufficient coverage based on SST 2010 have adopted capital and risk measures to improve their ratio of available capital to target capital. In particular, various life insurers have received capital increases and, in many cases, guarantees from group companies or have issued new hybrid bonds. Individual companies have reduced their exposure to certain business segments or decreased their risk by introducing better asset and liability matching. Overall, this has led to a substantial improvement in their SST ratio and with it their financial stability.

Alongside the work on designing and implementing the new supervisory approach, the introduction of the SST has been one of the priority tasks of insurance supervision over recent years. Work is not yet complete. Experience has shown that developing an internal model is an extremely time-consuming and labour-intensive operation. The approval process for the internal models has also proved more difficult than initially assumed. While some modules of internal models were approved by the end of the transitional period, others had to be rejected. Delays also occurred because numerous models are still under development; the model documentation submitted by some companies was of insufficient quality and had to be sent back for improvement.

Instruments such as assessment letters and supervisory intervention teams will be extended to the insurance sector in future, in collaboration with the Banks division.

3.3 Instruments for early risk identification

Instruments for early risk identification highlight the impact of the macroeconomic environment on individual institutions, the interdependencies between institutions, and any feedback effects to the real economy. FINMA is already deploying some of these instruments and is working to optimise them.

The principal focus is on further development of the monitoring already used so as to improve the capture and limitation of systemic risks. Monitoring permits a comparative assessment to be made of individual sectors, segments or investment instruments, taking account of the macroeconomic environment. Interdependencies between supervised institutions and the risks arising out of their collective behaviour which could lead to widespread disruption can thus be flagged up at an early stage.

Macro-supervision is not limited to banks. Insurance companies are linked to the rest of the financial sector via a substantial volume of investments and are therefore inevitably exposed to the risk of contagion. Risk monitoring must therefore be seen in a broader context, so that potential system-wide shocks and also long-term trends can be identified in good time and the need for action pinpointed.

FINMA is already employing considerably more sophisticated supervisory instruments to identify risks at an early stage in the two big banks. These include stress tests, sensitivity analyses (building block analysis, BBA) and loss potential analyses (LPA). They model the impact of macroeconomic changes on the situation of the banks. Stress testing is soon to be deployed at medium-sized banks too. The target is to carry out comprehensive scenario analyses with a macroeconomic background for between ten and fifteen institutions per year.

Certain aspects of the SST, such as scenario analyses, could also prove to be very useful macroprudential instruments for the insurance sector. The systemic risks identified in the insurance sector during work on the “too big to fail” issue both by FINMA and in numerous analyses by other experts necessitate a system of risk limitation that takes account of interdependencies, especially in a crisis situation, resulting from the liquidity risks or capital market activities of insurance companies. FINMA is already exercising a degree of macroprudential supervision of the insurance industry via the regular collection of cross-sector data on specific risk areas, such as PIIGS exposure.

4 Organisation

4.1 Strengthening FINMA as an authority

Increasing the effectiveness and efficiency of supervision is a priority issue for FINMA in connection with another of its strategic goals, namely “Strengthening FINMA as an authority”. A professional approach to effective and efficient supervision is the foundation stone of FINMA’s reputation. The aim is to enhance the authority’s reputation, and therefore confidence in its ability to fulfil its mandate, by demonstrating professionalism. The new supervisory approach and the work on process optimisation therefore contribute to enhancing FINMA’s reputation as a competent authority.

A key element in the fulfilment of FINMA’s mandate is its organisation. Since March 2011 this has encompassed six divisions, with the heads of each, plus the CEO, forming the Executive Board. The structure under which all banks are supervised by a dedicated division and all insurance companies by another has proved its worth. One innovation is the Markets division, which focuses on its core areas. This will be vital to FINMA’s preparedness for future challenges such as the supervision of independent asset managers or enhanced stock exchange oversight. The profile of enforcement has also been raised by the creation of a separate division. The fifth division, Strategic and Central Services, has now been joined by a sixth, namely Operations.

The aim in creating the new Operations division is to drive forward FINMA’s operational development. One focal point is processes and IT. The growth of FINMA and greater internal and external demands in terms of efficient and secure processes pose major challenges for the authority in this field. A further key area will be strategic human resources management. This is designed to ensure that FINMA is able to foster the development of its existing staff and also recruit highly qualified new personnel for financial market supervision.

4.2 Requirements in terms of staff and salaries

In 2010, FINMA employed an average of 405 staff across 371 full-time equivalent positions. The increase of 25 in the number of full-time equivalents was implemented with the particular aim of expanding and strengthening core functions in supervision. However, FINMA does not set out to expand its human resources without first giving the matter careful consideration, but begins instead by investigat-

ing the potential for improving the effectiveness of its supervisory instruments and those of the audit firms. Increases in staff numbers are always targeted and aligned with the strategic goals.

Professional, committed and confident staff are FINMA's most important resource. It has therefore risen with some success to the challenge of recruiting competent people by offering an interesting and varied working environment rather than through high salaries.

Targeted expansion of personnel focuses on senior and middle management. FINMA is on the lookout for individuals with many years of broad-based industry experience. Due to the limitations on salary levels, fewer candidates with the required profile are applying for positions at FINMA. For applicants with senior profiles, where FINMA is unable to compete purely in terms of remuneration, it has therefore focused on making a convincing case for working at the authority. The breadth of FINMA's activities, coupled with the opportunity to effect genuine change and gain experience in an international environment, have enabled the successful recruitment of several new staff members. This has permitted the authority to build up know-how in selected areas and, in particular, fill certain management positions with high-profile personalities – an especially important factor in dealings with supervised institutions. This is vital to the effective conduct of on-site supervisory activities.

However, one effect of the successful recruitment drive is that starting salaries for new employees now tend to be higher on average, and this is adding to overall pressure on the wage bill by exerting an inflationary impact on existing salaries. It remains difficult to recruit personnel with certain professional profiles.

Approximately 70 positions were advertised outside FINMA in 2010. Of these, 15 had to be advertised more than once. There are currently three vacancies that have still not been filled after more than half a year, despite being advertised repeatedly. The most difficult positions to fill remain those for actuaries and analysts as well as specialists in quantitative risk management.

The critical issues that hinder staff acquisition are salary levels and location. Experience has shown that most of the sought-after specialists have to be recruited from the Zurich area. The issue of location is frequently discussed both in job interviews and with existing staff, and has a tangible effect in terms of willingness or otherwise to join FINMA.

4.3 FINMA as an employer

FINMA aims to be an attractive employer for qualified staff and to retain them once they have joined. In a move to create more opportunities and flexibility in staff recruitment and development by focusing on relations with the private sector, FINMA has introduced the concept of specialist careers. These enjoy the same status within FINMA as management careers. FINMA's specialist career model offers staff with outstanding specialist skills an alternative to a career in management that is equivalent in terms of salary and status. Promotion within this career path is tied to specialist criteria and requires a substantial increase in specialist expertise.

At the same time, staff development has been better structured and a systematic process introduced. To ensure that the best possible use is made of existing potential, a pilot project was launched in the

Banks division that drew up three-year staff development action plans based on systematic assessments of the potential of around 20 individuals. These individuals will receive targeted additional training both internally and, where appropriate, externally. They will also be assigned a further mentor within FINMA in addition to their line manager.

5 Outlook

FINMA has substantially restructured its organisation, supervisory instruments and processes. It has made considerable progress towards the achievement of its three-year strategic goals. It is using the freedom granted it by the legislature to structure its supervisory activity in an effective and efficient manner.

Another key issue affecting the quality of supervisory activity is the legal framework within which FINMA is obliged to operate. FINMA is therefore involved in certain legislative projects, and offers its own input from a specialist perspective. However, if we are really to learn the lessons from the crisis and prevent the state having to support banks, measures are needed not only in terms of capital adequacy and liquidity, but also with regard to the organisation of the systemically important banks. It is the responsibility of the legislature to address this issue.