



Annual Report 2017



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FINMA's mandate

The Swiss Financial Market Supervisory Authority FINMA is an independent, public law institution. Its legal mandate is to protect creditors, investors and policyholders and ensure the proper functioning of the financial markets.

FINMA is mandated to protect individual financial market clients against unfair business practices and unequal treatment of market participants and to ensure that the financial institutions it supervises remain solvent. By securing the way in which the financial markets function, FINMA safeguards and enhances the stability of the Swiss financial system which in turn contributes to the competitiveness and reputation of Switzerland's financial centre.

FINMA supervises banks, securities dealers, insurance companies, financial market infrastructures and insurance intermediaries, in addition to products and institutions under the Collective Investment Schemes Act. It licenses companies operating in the sectors it supervises and monitors their permanent compliance with statutory regulations and licensing requirements. FINMA cooperates with foreign regulators; it is responsible for combating money laundering, taking enforcement measures and, where necessary, conducting restructuring and bankruptcy proceedings.

FINMA is also tasked with supervising the disclosure of shareholdings at listed companies, conducting enforcement proceedings, issuing rulings to restore compliance with the law and, where wrongdoing is suspected, filing criminal complaints with the competent criminal authorities. In addition, FINMA supervises public takeover bids under the Financial Market Infrastructure Act (FMIA) and is the body to which appeals against decisions of the Swiss Takeover Board (TOB) may be brought.

Finally, FINMA participates in the legislative process and, where it is authorised to do so, issues its own ordinances. It also publishes circulars detailing the interpretation and application of financial market law and is responsible for the recognition of self-regulatory standards.

On-site supervisory reviews in figures

On-site supervisory reviews are one of FINMA's key supervisory tools. These reviews provide FINMA with a deeper insight into the institutions it supervises and also encourage an objective and open dialogue with licence holders. This ultimately helps FINMA to identify potential risks. By comparing the results of individual reviews and assessing quantitative and qualitative aspects, FINMA also gains a broader overview of the market as a whole.

JAN.



The automatic exchange of information (AEOI) enters into force in the first wave of countries.

FEB.

p. 18
FINMA sanctions Coutts for serious deficiencies in the bank's anti-money laundering processes associated with the alleged corruption scandal involving the Malaysian sovereign wealth fund 1MDB.

MAY

p. 38
FINMA organises a roundtable discussion for market participants and experts interested in blockchain technology.

JUNE

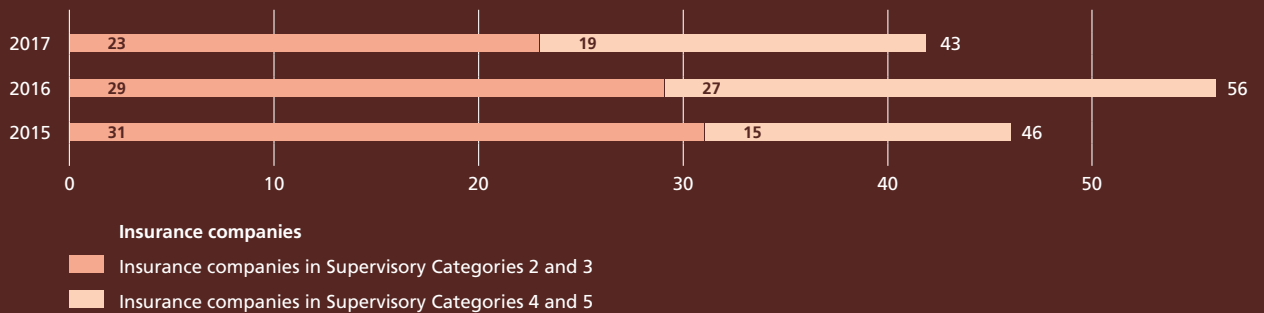
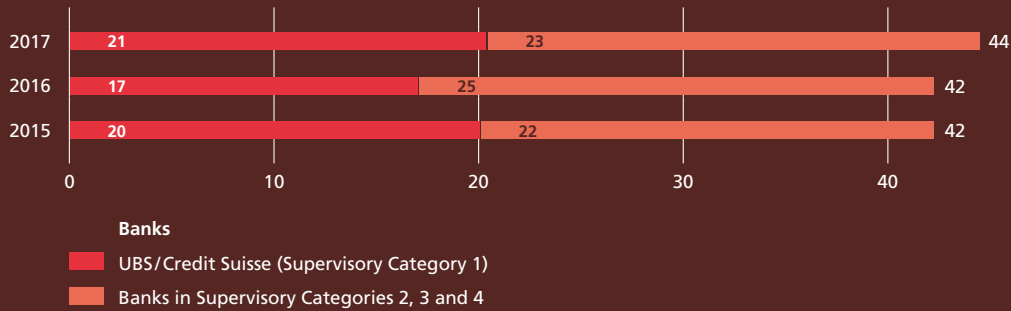


The global ransomware cyber attack WannaCry spreads to thousands of computers and demands ransom for the decryption key.

p. 18
FINMA imposes sanctions for insider trading and market manipulation.

p. 78
FINMA approves the first Hong Kong fund.

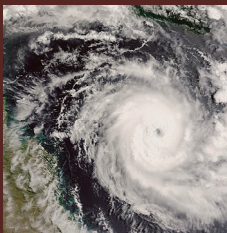
On-site supervisory reviews: banks and insurance companies



In 2017, the Banks division concentrated its on-site supervisory reviews on lending (including mortgages), anti-money laundering, operational risks and wealth management. While no on-site supervisory reviews were carried out at Supervisory Category 5 institutions, they were subjected to brief, but intensive, on-site deployments (deep dives), which provided a better overview of specific topics.

Topics targeted by the Insurance division in its on-site supervisory reviews were corporate governance and internal control systems. It also focused on reinsurance programmes, tied assets, variable annuities and closed portfolios.

AUG.



Hurricane Harvey is the costliest tropical cyclone since Hurricane Katrina (2005).

p. 38
New FinTech regulations enter into force.

SEPT.

p. 88
FINMA closes down coin providers and issues warning about fake cryptocurrencies.

OCT.

p. 45
At its Small Bank symposium, FINMA presents its ideas on simplifying regulations for financial institutions.

p. 75
FINMA organises the first Asset Management symposium.

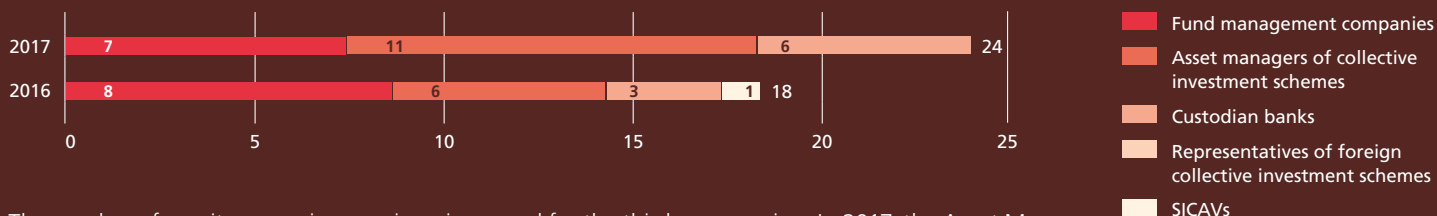
On-site supervisory reviews: directly subordinated financial intermediaries and self-regulatory organisations



On-site supervisory reviews carried out at directly subordinated financial intermediaries (DSFIs) aim to restore compliance with regulatory law where necessary. During the period under review, these audits involved asset managers and financial intermediaries carrying out fiduciary activities. The topics addressed were organisational measures such as an appropriately designed risk management system and compliance with the due diligence requirements for the prevention of money laundering and financing terrorism.

FINMA also performs risk-based audits under the Anti-Money Laundering Act (AMLA) at self-regulatory organisations (SROs). The audit content is redefined annually. In 2017, SRO-specific audit topics included recommendations made by the Financial Action Task Force (FATF) in its fourth country report on Switzerland regarding the prevention of money laundering and financing terrorism. FINMA also concentrated on the SROs' penalty and reporting systems. Where shortcomings are brought to light, FINMA imposes measures to restore compliance with regulatory law and monitors their implementation.

On-site supervisory reviews: institutions under the Collective Investment Schemes Act

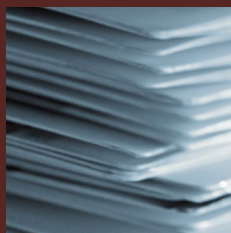


The number of on-site supervisory reviews increased for the third year running. In 2017, the Asset Management division focused on market integrity, auditing business conduct rules, the suitability of products and services and the prevention of money laundering. Risk management and the safekeeping of fund assets were other areas reviewed on site.

p. 25

The Financial Stability Board (FSB) appoints Mark Branson as Chair of its Resolution Steering Group.

NOV.



Millions of confidential documents at Appleby law firm and other locations are leaked to the public (Paradise Papers).

p. 34

FINMA runs a hearing on redesigning the role of audit firms.

DEC.

p. 19

The Group of Central Bank Governors and Heads of Supervision (GHOS) of the Basel Committee on Banking Supervision (BCBS) finalised the Basel reform agenda (Basel III).

p. 50

FINMA publishes the fully revised version of the circular on outsourcing.



The EU recognises the equivalence of the Swiss legal and supervisory framework for stock exchanges – however, for a period of one year for political reasons.

Heightened resilience and greater proportionality – the way forward

Ten years ago, the financial system stood on the brink of collapse. Since then, much has been undertaken and achieved to place financial institutions and markets on a firmer footing. One such achievement is the Basel III standards, which were finalised in 2017.

It was in 2007 that the initial fault lines in the financial system started appearing. The rifts that followed almost led to the collapse of financial markets and national economies. A key lesson from the crisis is that financial institutions were inadequately capitalised. Since then, the capital position of banks – especially that of global players – has been strengthened considerably. An important milestone was reached in 2017 when the Basel III reforms were finalised, thus essentially completing the global regulatory response to the financial crisis of 2007 and 2008.

Institutions need this heightened resilience because significant risks continue to surround the financial

industry. Our duty as supervisor is to identify these risks and limit any fallout they may have on clients and the functioning of the financial markets.

The Swiss property market is a particular source of risk at the moment, especially in the investment property segment, as a consequence of its unbroken growth. Persistently low interest rates are driving an increasing number of investors into this market segment in search of better returns. Whether the pace of growth can continue is doubtful. The prices of buy-to-let properties recently spiked to another all-time high. The combination of increasing prices, falling rents, rising vacancy rates and decreasing immigration is concern-



ing. We are closely monitoring the market developments and the potential need for action here.

Outside prudential supervision, we focused strongly on conduct issues again last year, especially those pertaining to market integrity. In 2017, we dealt with several serious cases of market manipulation and insider trading. Financial market integrity is essential for accurate price formation, an efficient allocation of resources and public trust. Price manipulation cannot be tolerated.

The same goes for money laundering. Last year, we initiated several enforcement actions in response to breaches of anti-money laundering regulations. Swiss financial institutions found themselves linked to major corruption scandals in Asia and South America. Switzerland's reputation as a financial centre can be tarnished by the misconduct of a few, even though the vast majority of its financial institutions behave properly. We are therefore very focused on enforcing these regulations, in particular the need to report suspicious transactions. We see encouraging signs that financial institutions are also now increasingly thinking along these lines and handling these risks more effectively.

In the insurance industry, a focal point of our supervisory activity was supplementary healthcare policies. We have a legal duty here to ensure that insurers

do not overcharge on premiums and hence earn unfairly high margins. In 2017, we imposed reductions in 28 of the 160 tariff adjustment applications.

Looking at regulation, proportionality is one of our guiding principles. Last year, for example, we proposed regulatory relaxations, both quantitative and qualitative requirements, for smaller financial institutions with a low risk profile. Requiring small institutions to follow the same complex rules as the large global banks can be disproportionate and excessive. We have therefore launched an initiative that aims to reduce complexity and lighten the administrative burden on small banks. A second initiative will refocus regulatory auditing so that audit firms – working on our behalf – can operate in a more targeted, risk-oriented manner. Our goal in both cases is to increase the efficiency of the supervisory system and reduce unnecessary bureaucracy.

We see this greater emphasis on proportionality as the right response to the danger of unnecessary and unintended complexity resulting from regulatory developments since the financial crisis.

That said, the bigger safety buffers brought about by stricter capital and liquidity requirements have been a critical step forward. Resilience is a central component of a sustainably prosperous financial industry.



Dr Thomas Bauer
Chair



Mark Branson
CEO

December 2017

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ORGANISATION AND STAFF

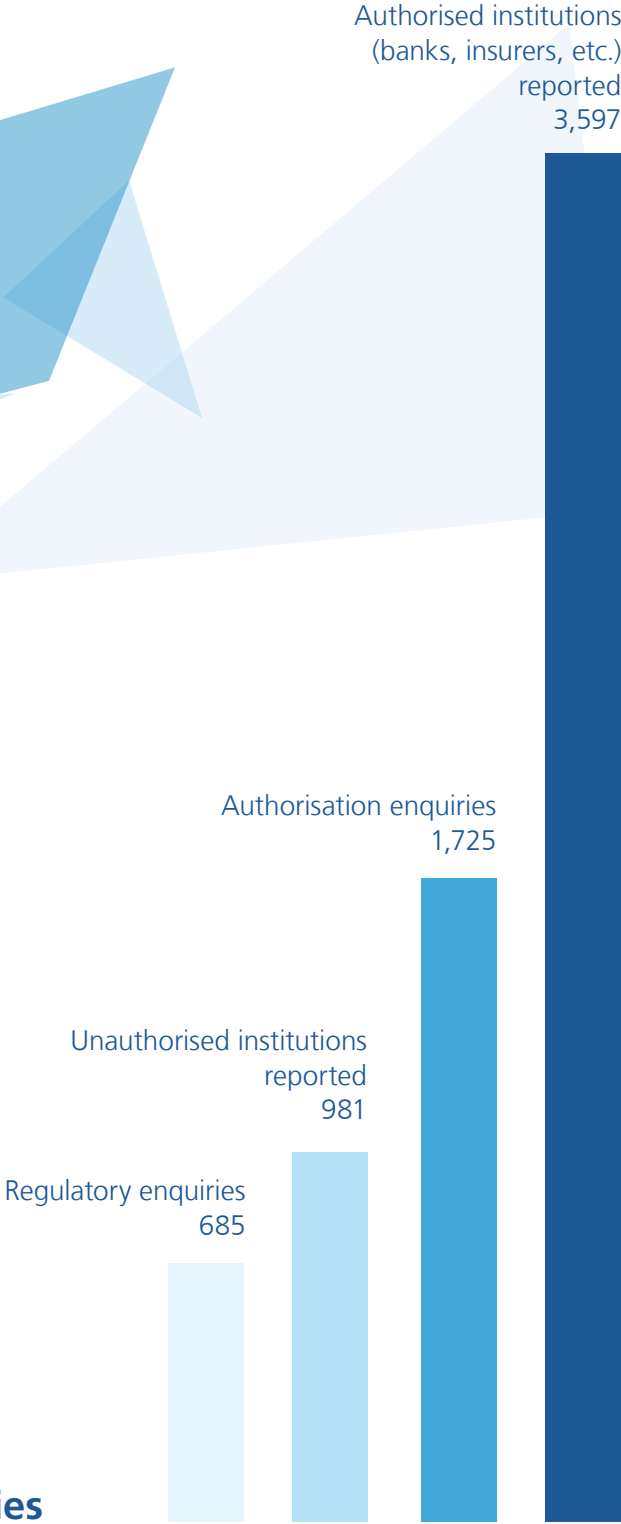
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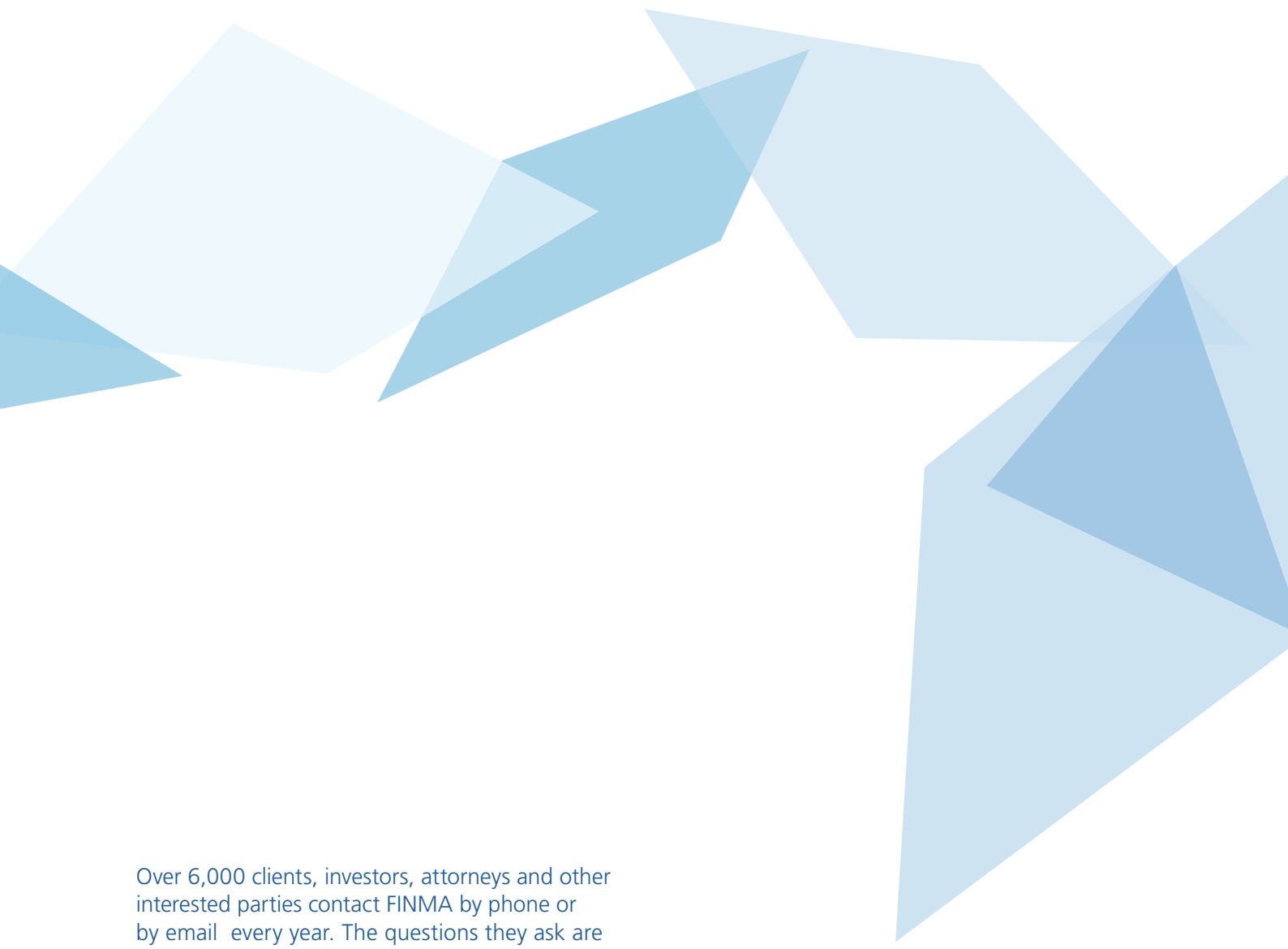
Wide public interest in FINMA's work

6,988 enquiries



FINMA: an overview

- 12** FINMA's core tasks: proportionality in supervision and regulation
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Over 6,000 clients, investors, attorneys and other interested parties contact FINMA by phone or by email every year. The questions they ask are generally about their bank or insurance policies, unauthorised financial market players, and licensing and regulatory issues. These contacts provide FINMA with valuable information for its supervisory activities and the action it takes against unauthorised providers.

FINMA's core tasks: proportionality in supervision and regulation

The Swiss financial industry is a blend of large, globally active banking and insurance groups and smaller niche firms. Because of this diversity, risk profiles vary considerably, which in turn calls for a proportionate approach to financial market regulation and supervision.

Proportionality is a constitutional principle in Switzerland together with equality under the law. Regulation and supervision must therefore also be proportionate. FINMA's approach to supervision is shaped by the risks to the functioning and reputation of the financial market posed by supervised institutions, and the protection of creditors, investors and policyholders. It also adopts the same approach when defining the regulations that fall within its remit. Moreover, FINMA is committed to seeing a fuller application of the principle of proportionality in both supervisory and regulatory issues.

Supervision and regulation in connection with specific risks

FINMA tailors its supervisory and regulatory duties to the specific risks posed by supervised institutions. When doing so, FINMA – as a state authority – fulfils those duties in accordance with the constitutional principles of proportionality and legal equality.

FINMA assigns financial institutions to six supervisory categories according to the risks they pose to the financial market, based on objective criteria such as total assets. Each institution is also assigned a rating representing FINMA's current assessment of their risk status. This is determined using qualitative criteria. Combining categories and ratings determines the intensity of supervision and the type of supervisory instruments that is used for each institution. This approach has proven successful, allowing for a targeted, risk-oriented use of the resources available to FINMA and the participating audit firms.¹

Federal authorities similarly apply the principle of proportionality in the fulfilment of their regulatory duties. Switzerland's banking industry is hetero-

geneous. The smallest bank has total assets of over CHF 24 million, while the largest single entity (Credit Suisse AG) reports a sum of over CHF 488 billion and the major banking group (UBS AG) almost CHF 900 billion. Statutory minimum requirements function as the basis for regulating 24 mid-sized banks in Category 3, which though influential, are not considered to be systemically important banks. This category includes several large cantonal banks that are an important part of their respective regional economies, and global wealth managers servicing clients outside Switzerland. Many of these banks have total deposits that exceed the rescue capability of the Swiss depositor protection scheme.

Logically, the requirements placed on systemically important banks (Categories 1 and 2) are far more stringent than for other banks. The Banking Act stipulates that tougher conditions must be imposed on these banks in terms of capital, liquidity and risk diversification. It also requires these banks to draw up an emergency plan to be used in the event of insolvency, and prepare extensively for possible stress scenarios. The opposite applies to small and micro-banks in Categories 4 and 5, which given the low level of risk, are regularly exempted from the basic requirements. Selective relaxed requirements are also granted to Category 3 banks if specific risks are deemed insignificant.

Likewise for insurers, the choice of supervisory instrument and intensity of supervision are determined by companies' risk exposures. The same benchmarks are used for insurers as for banks, namely risk categories based on objective criteria and a supervisory rating. There are no systemically important institu-

¹ See section on "Supervisory categories" in the Appendix.

Supervisory categories reflect the diversity of the banks and insurers FINMA supervises

The Swiss financial industry comprises a broad range of diverse companies. The majority of banks and insurers, which are often small or very small institutions, are assigned to Categories 4 and 5. In contrast, only the two systemically important global banks are in Category 1.

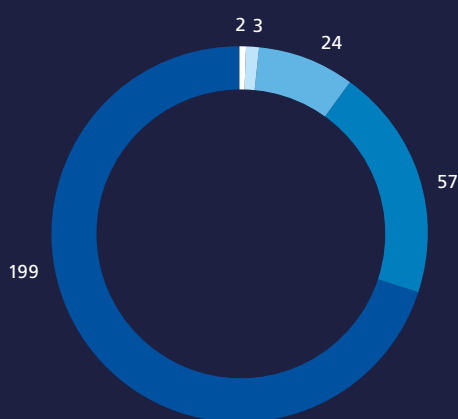
Small banks and insurers are a fundamental part of the Swiss financial industry. In total, 85% of the approximately 300 banks in operation and 80% of the roughly 200 insurers are small institutions assigned to Categories 4 and 5.² Regulation and supervision of these institutions is less intensive than for larger institutions whose risk profiles are higher.

Two banks – the two systemically important global majors – are assigned to Category 1 and three others – the three systemically important domestic banks – are in Category 2. Some 25 banks with total assets exceeding CHF 15 billion are in Category 3 (see Banking Ordinance, Appendix 3, Bank categories). These institutions – many of which are cantonal banks – are important to their regional economies in Switzerland. Conversely, the approximately 260 institutions – the small banks – in Categories 4 and 5 are generally quite diversified market players. Of this number, some 200 institutions (Category 5) have total assets of less than CHF 1 billion.

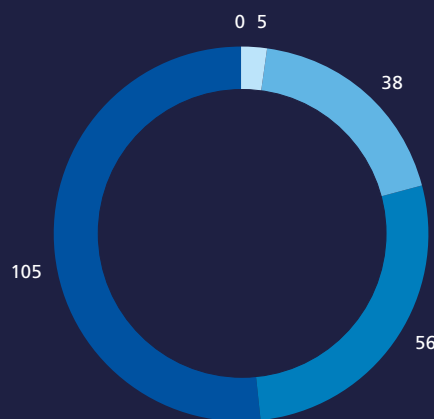
No Swiss insurance companies are to be found in Category 1. The five insurers that make up Category 2 are primarily large, internationally active groups. Category 3 brings together a varied cluster of 38 mid-sized insurers, which – with the exception of reinsurers – are generally focused on the Swiss market. The 161 companies included in Categories 4 and 5 are very small companies. Many are subsidiaries of non-Swiss insurers.

² See section on "Supervisory categories" in the Appendix.

Banks



Insurance companies



- Category 1
- Category 2
- Category 3
- Category 4
- Category 5

tions (Category 1) in the Swiss insurance industry. The five insurers that make up Category 2 are primarily large, internationally active groups that, in some instances, must comply with enhanced requirements. As with banking regulation, FINMA is also attentive to ensuring that proportionate rules apply to insurance companies as well. For example, various circulars allow relaxed requirements for companies that fall into Categories 4 and 5.

The proportionate design of Swiss regulations and supervisory activities was recently documented in a report by the Financial Stability Institute of the Basel Committee on Banking Supervision. In a comparison of six different jurisdictions (Brazil, the EU, Hong Kong, Japan, Switzerland and the US), it was shown that proportionality was most extensively developed in the Swiss system.³

Ten years after the onset of the financial crisis: additional regulatory relief for small banks

Essential reforms were carried out in the wake of the financial crisis of 2007 and 2008 to overcome the weaknesses in financial market regulations that came to light. Key measures have been stricter capital requirements which are aimed at protecting financial institutions from unexpected losses and heightening their stress resilience. In addition, disclosure requirements were introduced or redesigned to enhance transparency of an institution's financial condition. In some instances, these essential reforms have led

to a high degree of complexity. This can be particularly challenging for small institutions because the implementation costs cannot be offset through economies of scale. Additionally, many of these small banks implement narrow or niche business models, with the result that some of the regulatory building blocks designed by the Basel Committee may be irrelevant to them. A distortion of competitive conditions owing to regulatory complexity that places small banks at a disadvantage is an unintended consequence of the enhanced banking regulations. In the interests of proportionality, FINMA is seeking to lighten the administrative burden on small banks either through exemptions or by simplifying criteria, so long as this does not undermine the stability of these institutions. FINMA has developed ideas for what it refers to as a small bank regime, which is due to be tested as early as 2018 and subsequently fine-tuned before full implementation (see p. 45).

Risk-based differentiation also for the insurance sector

There is also scope for differentiation in the area of insurance supervision. Plans exist in the current revision of the Insurance Supervision Act (ISA) to align intensity of supervision more closely with client protection needs. Customer-oriented supervision as a concept is based on the premise that contracts entered into by professional counterparties require less regulatory protection than mass-market contracts involving retail or commercial customers.

³ Bank for International Settlements, Financial Stability Institute: Proportionality in banking regulation – a cross-country comparison, August 2017.

Zero tolerance of improper business conduct

FINMA does not tolerate any departures from standards of conduct. Unlike prudential supervision, the same rules apply to participants regardless of size, simply because the risks are the same, however large or small an institution is. A breach of anti-money laundering and market conduct requirements can take on another dimension even amongst the smallest of institutions. The problem with misconduct is that it not only tarnishes the reputation of (or in the worst cases, destabilises) the institution in question; rather, the whole financial industry is affected.

Financial market regulations and differentiation

Both financial market law and FINMA's own regulations already contain many examples of differentiated regulations that are applicable to banks and insurers.

Banks	
Capital requirements	Banks in Category 5 must have a capital ratio of no less than 10.5%. For Categories 4 and 3, the capital ratio must be 11.2% and 12.0% respectively. Systemically important banks need to meet capital ratios of between 18.1% and 28.6%, including loss-absorbing capital.
Liquidity risk management	<p>Small banks (Categories 4 and 5) are fully exempted from various qualitative requirements, for example the obligation to manage intraday liquidity risks in cases where substantial risks in intraday payment transactions do not exist.</p> <p>Systemically important banks must also fulfil requirements over and above the short-term liquidity coverage ratio (LCR).</p>
Emergency and recovery planning	Category 1 and 2 banks must draw up an emergency plan ensuring that systemically important functions continue to operate in cases of impending insolvency. They must also have recovery plans containing measures to counter stress events.
Qualitative requirements for operational risks	Category 4 and 5 banks are substantively exempted from qualitative implementing provisions. Category 3 banks can request proportionate treatment, which is examined on a case-by-case basis.
Remuneration	FINMA Circular 2010/1 "Minimum standards for remuneration schemes of financial institutions" is only applicable to institutions with required capital of CHF 10 billion or more (currently the two large banks).
Corporate governance	Banks in Categories 1 to 3 require a risk control and compliance function acting in an independent supervisory capacity. At systemically important banks, the chief risk officer (CRO) must be a member of the executive board. Banks in Categories 4 and 5 do not have to appoint a CRO.
Disclosure	Even now, disclosure requirements applicable to Category 4 and 5 banks are far less extensive than for banks in Categories 1, 2 or 3. Category 3 banks also enjoy some relaxed disclosure requirements. In the future, Category 3 banks that do not have special disclosure requirements may opt out of publishing ad hoc information provided that they deem such information to be insignificant.

Insurance companies	
Remuneration	FINMA Circular 2010/1 "Minimum standards for remuneration schemes of financial institutions" is mandatory only for insurance companies with required capital of CHF 10 billion or more.
Corporate governance	Insurers in Categories 2 and 3 must set up an audit and a risk committee. Those in Category 3 may form a joint body covering both these functions. No such requirements exist for companies in Categories 4 and 5.
Disclosure	Insurers meeting specific requirements can be exempted from disclosure obligations, for example companies with gross written premiums (based on total business) below CHF 10 million or gross technical provisions (based on total business) below CHF 50 million. FINMA may grant further exemptions on a case-by-case basis.
Own Risk and Solvency Assessment (ORSA)	Category 4 and 5 insurers and reinsurance captives are exempted from Own Risk and Solvency Assessment (ORSA) reporting obligations to FINMA until further notice.

2017 in milestones

From international cooperation to outsourcing, 2017 brought diversity and challenges. Quarter by quarter, the key milestones are outlined below.

First quarter

First submission of ORSA by insurance companies

On 31 January 2017, insurance companies in Supervisory Categories 2 and 3 presented their first Own Risk and Solvency Assessment (ORSA). ORSA gives an integrated evaluation of a company's overall risk profile and the associated capital requirements based on a forward-looking perspective including the current year and at least two additional years.

Digital delivery platform reduces cost of applications

Since the end of 2016, supervised institutions and audit firms have been able to send documents to FINMA with a legally binding signature via a secure and user-friendly electronic channel. This reduces the administrative burden and therefore lowers fees.

Proceedings against Coutts & Co Ltd in 1MDB case

In January 2017, FINMA concluded extensive enforcement proceedings against Coutts & Co Ltd. The outcome was that the bank was in serious breach of anti-money laundering regulations by failing to carry out adequate background checks into business relationships and transactions associated with the Malaysian sovereign wealth fund 1MDB. FINMA ordered the bank to disgorge unlawfully generated profits of CHF 6.5 million.

Second quarter

Approval of the first Hong Kong fund for distribution to public investors in Switzerland

On 20 June 2017, FINMA approved the first fund issued under Hong Kong law for distribution to public investors in Switzerland, on the basis of the Memorandum of Understanding (MoU) signed with the Securities & Futures Commission of Hong Kong in December 2016.

FINMA imposes sanctions for insider trading and market manipulation

In June 2017, FINMA concluded enforcement proceedings in two separate cases of market abuse. In the first case, it found that a former board member of a number of Swiss industrial concerns had engaged in insider trading. In the second, a securities trading company and three of its traders were found

to have been manipulating the market. FINMA ordered the disgorgement of several million Swiss francs in unlawfully generated profits and imposed long-term industry and activity bans.

Proceedings against J.P. Morgan (Switzerland) Ltd

In late June 2017, FINMA concluded its enforcement proceedings against J.P. Morgan (Switzerland) Ltd. The proceedings revealed that the bank had seriously breached anti-money laundering regulations by failing to screen adequately transactions and business relationships booked in Switzerland associated with the Malaysian sovereign wealth fund 1MDB and one of its business partners. FINMA ordered an in-depth review of the bank's anti-money laundering controls.

Third quarter

FINMA sets interest rate curve for five years

In view of the persistently low interest rate situation, FINMA amended the interest rate curves in the Swiss Solvency Test (SST) for Swiss francs, US dollars, euros and pounds sterling. The risk-free interest rate curve in Swiss francs is based on government bond yields for a maturity of up to 15 years (last liquid point, LLP). This value is then extrapolated to a long-term interest rate. The long-term interest rate of 2.7% in 2017 will be lowered by 15 basis points annually over the next five years until 2022. An interest rate curve with an ultimate forward rate (UFR) of 2.55% will thus be applied in 2018. The local interest rate curve in the relevant currency can be used for foreign subsidiaries.

FINMA takes action against fake cryptocurrencies

In September 2017, FINMA closed down the unauthorised providers of the fake cryptocurrency "E-Coins". They had accepted several million Swiss francs in public deposits without holding the required banking licence. FINMA has also launched bankruptcy proceedings against the companies involved.

Dispatch of first electronic ruling

FINMA's first electronic ruling was sent out in July. The digitally transferred documents were signed by qualified electronic signature (QeS). This is a step towards paperless correspondence and reducing administration and media disruptions, which is also to the benefit of the supervised institutions.

Fourth quarter

FINMA introduces OPA insurance model

In the second half of 2016, FINMA started to develop two standard models for the occupational pensions business in cooperation with the insurance sector. It performed two field tests during the year under review. The results of these tests were stable and satisfactory for the insurance model that is based on a run-off view. FINMA will release this standard model for the Swiss Solvency Test (SST) starting in 2018.

FINMA publishes new circular on outsourcing for banks and insurers

FINMA revised and further specified its supervisory requirements relating to outsourcing procedures for banks and insurers in a circular covering both sectors. The circular enters into force on 1 April 2018. It applies principle-based regulation and enhances regulatory requirements in the context of market developments, particularly as regards materiality, the treatment of groups and requirements for outsourcing activities outside Switzerland.

Small Bank symposium

On 2 October 2017, 190 representatives of small banks gathered in Bern for the Small Bank symposium. FINMA presented its initial thoughts on how to simplify small bank regulation as a basis for discussion. Moreover, FINMA explained its supervisory priorities and discussed cyber risks with the head of the Reporting and Analysis Centre for Information Assurance (MELANI). The symposium aims to initiate institutionalised exchange in the form of a small bank expert panel.

First Asset Management symposium

On 4 October 2017, FINMA held its first Asset Management symposium. Some 150 representatives of fund management companies and asset managers of collective investment schemes discussed the international positioning of Swiss asset management as well as the challenges and opportunities of digitalisation. The event was positively received and will be repeated.

Finalisation of the Basel reform amendments package

On 7 December 2017, the Group of Central Bank Governors and Heads of Supervision (GHOS) of the Basel Committee on Banking Supervision finalised the Basel reform agenda. The

focus of the concluding work was on reducing the variability of risk-weighted assets (RWA). FINMA welcomes the conclusion of the comprehensive reform package and will work towards its implementation in cooperation with the other relevant authorities.

FINMA reports annually to the Federal Council, to which it is accountable, and answers questions from the parliamentary committees. Key topics in 2017 were the analysis of the Swiss anti-money laundering system and the supervisory structure for independent asset managers set out in the proposed Financial Institutions Act.

As in past years, FINMA held an information event on a current topic of financial market supervision for interested members of the Federal Assembly. Members of the supervisory committees and the expert committees of both councils were invited.

Information event on combating money laundering

The Chairman of the Board of Directors, Chief Executive Officer and responsible Executive Board member from FINMA reported on their findings and experience from their supervisory work in combating money laundering. They also explained their focus and FINMA's aims in this area. In addition, the results of last year's mutual evaluation report by the working group on combating money laundering and the financing of terrorism (Financial Action Task Force, FATF) were discussed, as was the current money-laundering risk landscape.

Expert input provided to the parliamentary committees

Besides commenting on the FATF mutual evaluation report, FINMA was asked to provide input on the Financial Services Act (FinSA) and Financial Institutions Act (FinIA), particularly with reference to the supervisory architecture for independent asset managers stipulated in FinIA.

Annual accountability

When the FINMA Annual Report is published, the Chairman of the Board of Directors and Chief Executive Officer meet the parliamentary supervisory committee, the Control Committee of the Council of States (CC-CS), for a question and answer session. In 2017, the second supervisory committee, the Finance Committee, also decided to conduct these annual consultations.

The annual session with the Federal Council, as required by the Financial Market Supervision Act (FINMASA), was held in the autumn. The discussion included the strategic direction of FINMA's supervisory activities and financial market policy.

Political initiatives involving FINMA

Following a tightening of the regulatory framework, political initiatives involving FINMA increased at the end of 2016 and particularly at the start of 2017. They mainly concerned issues relating to competence and the extent of financial market regulation such as the implementation of international standards at national level and the cost-benefit ratio of more stringent financial market regulation, also in relation to other jurisdictions.

Third parties commissioned by FINMA

FINMA relies on significant support from third parties in all aspects of its supervisory work. It is committed to using these third-party resources effectively and efficiently and ensuring a fair and transparent mandate assignment process.

FINMA is a lean organisation by international standards, considering the size of the Swiss financial centre. This is partly due to the fact that FINMA commissions support from third parties in every aspect of its supervisory remit. FINMA appoints audit firms to extend its reach in its supervisory activities. It can also commission mandataries for specific cases relating to aspects of ongoing supervision, enforcement or restructuring and liquidation proceedings.

Auditors assume a key role

The auditors issue an annual risk analysis and audit strategy for their assigned financial institution. FINMA can amend the audit strategy if necessary. There are exceptions in the insurance sector and for directly supervised financial intermediaries (DSFIs). In both instances, FINMA defines the audit strategy and audit programme. Moreover, the auditor is not required to perform a risk analysis for DSFIs. Audit firms report their findings to FINMA. They must adopt a critical approach and guarantee an objective assessment. To this end, the auditor needs to comply with statutory requirements in terms of organisation and employee education and training, as well as independence. The Federal Audit Oversight Authority (FAOA) issues regulatory auditor authorisations.⁴

The costs incurred by audit firms in conducting regulatory audits are covered directly by the supervised institutions. Audit firms report the fees they invoice to FINMA every year. The average hourly rate for a regulatory audit is CHF 218 and CHF 145 for a financial audit. In 2017, audit costs accounted for 43% of the cumulative supervisory costs spread over the Swiss financial market. The extent to which audit firms are used in the Swiss financial market varies considerably. Audit fees account for over 60% of banking supervision costs, compared to just 11% in the insurance sector, where FINMA performs most of the supervision. Audit fees for regulatory audits

conducted by audit firms amounted to CHF 116.4 million in 2017 and thus remained stable.

Fees charged by audit firms for regulatory audits

Annual fees per supervisory area (in CHF millions) ⁵	2017	2016	2015	2014
Asset management	12.6	12.7	11.8	12.0
Banks and securities dealers	94.5	93.7	89.8	95.8
Markets ⁶	2.4	1.7	1.9	2.0
Insurance companies	6.9	7.6	5.5	6.0
Total	116.4	115.7	109.0	115.8

FINMA is committed to Switzerland's unique supervisory system, which comprises FINMA's supervisory work and the audits conducted by audit firms. There is a need, however, to improve the cost-benefit ratio for audits. This will be achieved mainly by focusing more on key risks and should result in a cost reduction (see p. 34).

FINMA mandataries: an important instrument for specific supervisory and enforcement issues

Mandataries are an important supervisory instrument for FINMA and they can be deployed across the full range of FINMA's supervisory activities. As opposed to auditing, mandataries are not usually commissioned for a recurring audit with a predefined audit agenda; instead they are used for specific issues related to supervision and enforcement. FINMA's mandates are as varied as the areas they cover and thus require different types of specialisation. Audit firms serve as mandataries, as do other organisations. Their costs are borne by the supervised institutions. The following are the five types of mandatory and the areas they operate in:

⁴ There are currently eight companies with authorisation to conduct regulatory audits of banks, stock exchanges and securities dealers; seven for insurance companies; nine under the Collective Investment Schemes Act and 14 for financial intermediaries directly subordinated to FINMA.

⁵ The figures for each year (year in which the audit was conducted) apply to audits conducted in the previous financial year. Regulatory audit costs include the basic audit and any additional audits.

⁶ Includes costs for regulatory audits of financial market infrastructures and AMLA audits of DSFIs.

- audit mandataries: authorised financial intermediaries;
- investigating agents: authorised financial intermediaries;
- investigating agents: unauthorised activities;
- restructuring agents and crisis managers: authorised financial intermediaries;
- bankruptcy and liquidation mandataries.

assignment given to a FINMA mandatary results in a ruling on the supervised institution or unauthorised financial intermediary. Costs for FINMA mandataries commissioned in 2017 came to CHF 15.7 million.

FINMA maintains a list of suitable mandataries whom it can deploy quickly in specific instances.⁷ The mandataries listed must have knowledge and experience of similar mandates and have an adequate infrastructure. Where there is no suitable mandatary available, FINMA may commission an expert not on the list. The mandataries must always be independent of the supervised institutions. The list maintained by FINMA comprises a total of 75 mandataries. In 2017, FINMA assigned 25 mandates; individual mandataries received a maximum of three mandates. FINMA monitors the status and completion of mandates at all times and controls the proportionality of the costs borne by the supervised institutions in question. Each

⁷ The lists of mandataries for the various types of mandate are posted on FINMA's website: www.finma.ch/en/finma/finma-mandataries/.

⁸ Costs for insolvency proceedings in particular can vary year on year depending on the complexity or status of the proceedings.

⁹ Invoices received as of 15 February 2018.

¹⁰ This exceptionally high fee is due to several extensive and complex bankruptcy/liquidation proceedings.

Costs for FINMA mandataries and number of mandates granted⁸

Annual fee volume per mandate type (in CHF millions)	2017 ⁹	Number of mandates granted	2016	Number of mandates granted	2015	Number of mandates granted
Auditing of authorised financial intermediaries	1.3	6	4.2	9	7.7	19
Investigations of authorised financial intermediaries	8.2	2	13.0	13	2.5	4
Investigations of unauthorised activities	0.4	7	1.1	8	3.5	15
Liquidation proceedings	0.4	0	0.8	4	0.7	4
Bankruptcy/liquidation proceedings	5.4	10	24.2	15	46.6	8
Total	15.7	25	43.3	49	61.0¹⁰	50

FINMA interacts regularly with many national institutions and associations. In compliance with the legal framework, FINMA maintains an open and transparent information policy towards supervised institutions, other stakeholder groups and the public.

FINMA interacts with almost 100 institutions and associations, including the umbrella associations of supervised institutions, supervisory and criminal authorities as well as other authorities and federal offices. Its contacts with business, professional and staff associations, consumer protection organisations and ombudspersons in various supervisory areas are equally important. FINMA actively cultivates a dialogue with its stakeholder groups to improve their understanding of supervisory and regulatory issues.

Expert panels

Since 2015, the dialogue with the supervised institutions has expanded to include subject-specific expert panels comprising high-level representatives of the supervisory and private sectors. The panels enable a direct and open exchange between the parties responsible for making decisions at the supervisory and financial market level. They discuss specific supervisory and regulatory issues as well as the current market situation. The expert panels quickly proved their worth in banking (asset management, retail banking, capital markets and private banking), leading FINMA to establish similar committees for insurance (non-life, life and health insurance). Moreover, an expert panel for small banks will be established in 2018, following positive initial experiences and the small banks regime project.

Symposia and roundtables with industry

FINMA also promotes broader-based exchanges on selected topics. For example, there was another symposium on combating money laundering during the reporting year. FINMA also held its first Asset Management symposium. These events provided a platform for dialogue on industry developments and any matters of importance to FINMA and key financial market players. Both symposia met with considerable interest.

In addition, FINMA hosted two events focusing on innovation. There was a roundtable discussion on blockchain during which interested market participants and FINMA experts shed light on the implications of new technology from a regulatory perspective. In addition, some initial thoughts on simplifying the regulatory regime for small banks were presented for further discussion at the Small Bank symposium.

Dialogue on consumer protection

In 2017, FINMA invited stakeholders engaged in consumer protection to a roundtable discussion. Consumer protection organisations, the Health Insurance Ombuds Office, the Private Insurance Ombuds Office, the Swiss accident insurer (Suva) and the price supervisor took part in the debate. Various themes relating to supplementary health insurance were addressed, for example the tariff audits scheduled for 2018, the cost coverage of different service providers (e.g. hospitals, doctors) through basic and supplementary insurance, and measures to protect policyholders.

FINMA in dialogue with academia

FINMA regularly invites academics and financial experts to seminars so they can present the results of their latest research. The aim of these events is to promote open discussion on the latest research.

Key topics discussed with important stakeholder groups

FINMA conducts annual or semi-annual discussions with key associations and stakeholder groups of supervised institutions. The main topics covered in 2017 are listed below.

BANKS

Swiss Bankers Association (SBA)

- Real estate market developments
- Introduction of AEOI and implementation status in the banking sector
- Market access
- Measures to optimise the cost-benefit ratio for auditing
- Financial Services Act and Financial Institutions Act
- Follow-up to the FATF country report on Switzerland
- FINMA regulation and competitiveness
- Setting international standards (incl. finalisation of Basel III)

INSURANCE COMPANIES

Swiss Insurance Association (SIA)

- Development of new SST standard models for group life insurance, reinsurance and health insurance
- Revision of the Insurance Supervision Act, particularly regarding restructuring regulation, a supervisory approach based on client protection, and rules on offering financial services
- Health insurance developments, including prices charged by service providers and the restriction of compulsory tariff approval

COLLECTIVE INVESTMENT SCHEMES

Swiss Funds & Asset Management Association (SFAMA)

- Financial Services Act, Financial Institutions Act and other regulatory developments
- Brexit and developments in market access
- Questionnaire on the ongoing regulatory monitoring of distributors
- Progress made by IOSCO and FSB on liquidity risk management

AUDIT FIRMS

EXPERTsuisse

- Improvement of the cost-benefit ratio in regulatory auditing and partial revision of FINMA Circular 2013/3 “Auditing”¹¹
- Exchange of experiences regarding audit programmes for money laundering
- Revision of the EXPERTsuisse statements on regulatory audits (Statement 70 “Regulatory audits”)
- Revision of minimum audit requirements
- Introduction of new suitability audit programmes for banks and collective capital investments
- Questions regarding auditor independence

¹¹ Press release of 30 November 2017, “FINMA revises its circular on auditing” www.finma.ch/en/news/2017/11/20171130-mm-pruefwesen/.

The international standard-setting bodies were less active during the reporting year compared to the period following the financial crisis. Nonetheless, they continue to play an important role in shaping the framework of Switzerland's financial centre. FINMA therefore maintained its presence in many of these bodies.

FINMA represents Switzerland's interests on a number of international committees in consultation with the State Secretariat for International Financial Matters (SIF). These include the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commissions (IOSCO) and some of the Financial Stability Board (FSB) groups. These bodies provide a valuable conduit for supervisory authorities to exchange experiences; they also serve to define minimum international standards for financial market regulation and supervision. These standards underpin international guidelines that do not distort competition and are implemented within the framework provided by current national legislation. FINMA advocates proportional solutions permitting implementation appropriate to the Swiss financial sector (proportionality principle).

Financial Stability Board

Switzerland's involvement in the Financial Stability Board (FSB) enables it to participate in structuring the G-20 reform agenda established in the wake of the financial crisis. FINMA works closely on FSB matters with the Swiss National Bank (SNB) and the State Secretariat for International Financial Matters (SIF). The SNB and SIF represent Switzerland in the FSB Plenary – the FSB's decision-making body – and in other working groups. In 2017, FINMA held the Chair in the Resolution Steering Group. FINMA also represents Switzerland in the Standing Committee on Supervisory and Regulatory Cooperation and other groups.

The main FSB tasks last year included the finalisation of detailed implementation recommendations regarding the international minimum requirements issued in 2016 for the total loss-absorbing capacity of global systemically important banks. Recommendations were also made regarding the planning of recovery and resolution measures for central counterparties.

The financial crisis showed how trading in over-the-counter (OTC) derivatives needs a greater central clearing function and greater emphasis has been placed on the stability of these financial market infrastructures as a result. The FSB also issued recommendations relating to the regulation and monitoring of investment funds to mitigate stability risks from shadow banking. The recommendations cover the areas of liquidity, the level of debt financing, operational risks and securities financing transactions. During the year under review, the FSB also initiated a programme to assess the effects of the G-20 reform agenda for the financial market sector following the financial crisis.

Basel Committee on Banking Supervision

FINMA and the Swiss National Bank (SNB) represent Switzerland on the Basel Committee on Banking Supervision (BCBS). The main issue in 2017 was the finalisation of the Basel III reform agenda, which was completed at the end of the year. One notable content of the reform was the revision of the rules governing differentiated risk-weighted capital requirements. The standard approaches for determining capital requirements for credit and operational risks were reviewed in this connection. Extensive amendments were also made to the model-based approach for securing credit risks, mainly in the form of stricter specifications for banks' internal model calculations. A 72.5% floor was set for calculating total risk-weighted assets when determining equity requirements for market or credit risks using internal models, i.e. the risk-weighted assets must be at least 72.5% of what they would have been using the standardised approach. Besides finalising the Basel III reform agenda, the committee also addressed cyber risks and FinTech, among other topics.

The country reviews on the progress made in implementing the Basel III minimum standards under the Regulatory Consistency Assessment Programme

(RCAP) also continued in 2017. As in the past, FINMA actively contributes to these issues and monitors, in terms of timing and content, the implementation of other international standards by other financial centres. A review of Swiss regulation governing implementation of the liquidity coverage ratio was concluded in October 2017 with a positive outcome.

International Association of Insurance Supervisors

FINMA represents Switzerland in the International Association of Insurance Supervisors (IAIS). It advocated the Swiss position at all levels of the IAIS in 2017, especially the principle-based supervisory approach. FINMA had to surrender its seat on the Executive Committee at the end of November 2017, in keeping with the rotation principle observed by the IAIS Western Europe region.

Revision of the core principles for effective insurance supervision and the development of the common framework (ComFrame) for the supervision of internationally active insurance groups, including a risk-based global insurance capital standard, were key topics in 2017.

Macroprudential focus was on determining global systemically important insurers (G-SIIs) and developing an activities-based approach as opposed to an entity-based approach to mitigating systemic risks. For the G-SII identification exercise, the unchanged entity-based assessment methodology was used. The FSB did not publish a new G-SII list in November 2017 and commissioned the IAIS to pursue an activities-based approach as a priority measure. FINMA welcomes the FSB's decision and will actively contribute to the methodical development of such an approach.

International Organization of Securities Commissions

FINMA continues to contribute to the work done by the International Organization of Securities Commissions (IOSCO) through participation in the organisation's Board and various committees. The implementation of the FSB recommendations disclosed in January 2017 on the regulation and monitoring of investment funds progressed further. Following a public hearing mid-2017, IOSCO published at the beginning of 2018 revised and supplemented recommendations on liquidity risk management of investment funds and an associated paper on good practices. IOSCO also published a FinTech report featuring an analysis of the opportunities and risks of the new technology for investors, regulators and markets, and details of various innovative business models. There were many other publications covering, for example, central counterparties, benchmarks, securitisations, protection of client assets, hedge funds and market misconduct.

Other key topics were cyber risks and initial coin offerings (ICOs) and the Board decided to create a Board Level Task Force on Cyber Resilience. As an initial step in 2018, the task force will conduct a gap analysis which will incorporate the ongoing work of other international committees.

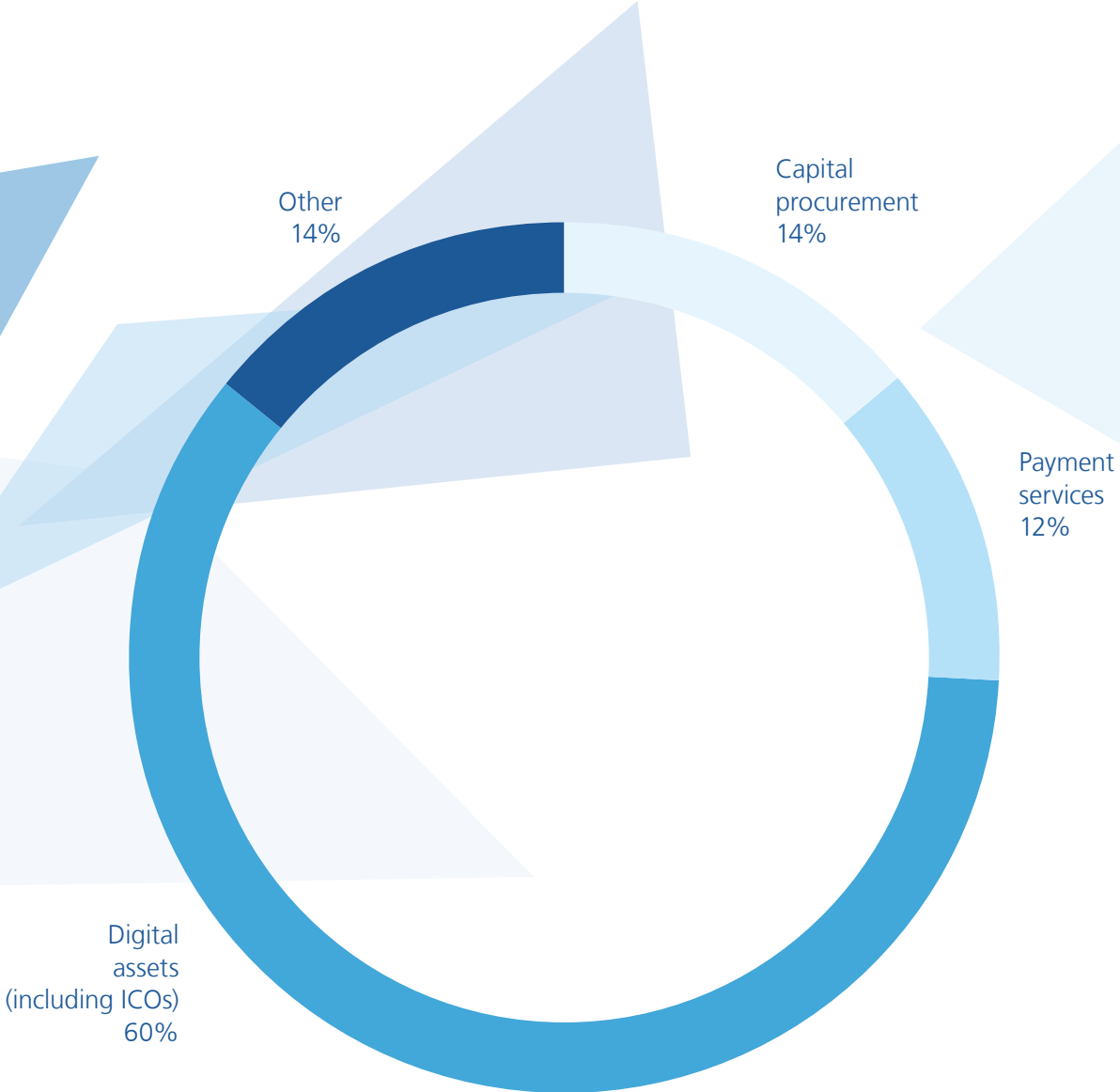
FINMA's international cooperation in figures

FINMA was represented in a total of 69 working groups of the four international standard-setting bodies in 2017.

Standard-setting bodies	Number of working groups
FSB	13
BCBS	26
IAIS	16
IOSCO	14
Total	69

The level of activity in the international committees has been consistently falling since 2015, following a spell of increased engagement in the wake of the financial crisis. FINMA regularly reviews the necessity and priorities of its engagement in international committees from the perspective of Switzerland's interests.

Most FinTech enquiries are about blockchain applications



453 FinTech enquiries

Main activities

- 30** Money laundering prevention: a strategic goal
- 34** Future orientation of auditing
- 36** Effective market supervision in the interests of all market participants
- 38** Financial technology and digitalisation



Interest in financial technology (FinTech) remains high. FINMA's FinTech Desk handled 453 enquiries last year, a notable increase from the 260 enquiries in 2016. Most queries in 2017 were about blockchain, cryptocurrencies, initial coin offerings (ICOs) – topics which are also central to FINMA's supervisory work. In 2017, FINMA closed down fake cryptocurrency providers and published FINMA Guidance 04/2017 outlining its position on ICOs. It also organised a blockchain roundtable discussion in which over 150 industry representatives participated.

Money laundering prevention: a strategic goal

FINMA has set itself the goal of achieving a sustained impact on institutions in their efforts to prevent money laundering. Its focus in 2017 was on institutions' reporting systems and their risk management.

Consistent compliance with measures designed to prevent criminal financial activity is strategically important to Switzerland's export-oriented and internationally networked financial centre. The reporting system prescribed in the Anti-Money Laundering Act (AMLA) is a significant measure in that regard. Once market participants involved in criminal activity realise that financial institutions are likely to report suspect funds to the Money Laundering Reporting Office Switzerland (MROS), they will be more reluctant to bring illicit funds into Switzerland; reporting suspect funds also helps the criminal authorities with their work. FINMA therefore stepped up its supervision and investigations of reporting under AMLA with 23 on-site supervisory reviews in 2017. It also filed criminal charges in seven instances based on contravention of the reporting obligation in Article 9 in conjunction with Article 37 AMLA. FINMA imposed its own enforcement measures in a number of cases.

FINMA encountered good and bad practices in the course of its supervisory and enforcement activity during the reporting year. Some of the more common situations are outlined below.

Examples of good reporting conduct

- ✓ After criminal proceedings are initiated against a client due to a serious offence, the financial intermediary conducts its own enquiry. It then submits a report as it cannot exclude the possibility that the assets in question are connected to the offence.
- ✓ A financial intermediary conducts an in-depth investigation of a client in response to media reports of a suspected criminal offence. The investigation includes checking information according to the know-your-customer (KYC) principle, examining the money flows and time sequences in detail and documenting the find-

ings. The financial intermediary concludes that the assets demonstrably are not linked with the matter reported in the press and are therefore not tainted. The analysis is documented.

- ✓ The financial intermediary has internal guidelines to regulate in which situations it would (as an exception) also inform FINMA of a reported matter in accordance with Article 34 AMLO-FINMA. These include the client's involvement in a major international money laundering scandal or a case that could develop into such a scandal due to, for example, the client being a politically exposed person (PEP) and having received funds of several million francs.

Examples of poor reporting conduct

- ✗ An international wealth management bank fails to regularly check its client base against a database maintained by an external compliance provider. It is unaware of new information coming to light about its client which otherwise should have led to the filing of a report.
- ✗ Unusual transactions are connected to a criminal offence committed abroad punishable by a custodial sentence of several years. The financial intermediary delays on reporting the issue. Instead it commissions a law firm to draw up a detailed legal opinion on the foreign criminal offence and its aptness of being a predicate money laundering offence (see Federal Administrative Court decision B-6815/2013 of 10 June 2014).
- ✗ The financial intermediary investigates money laundering suspicions arising from a dubious business relationship involving substantial assets and comes to the conclusion that there are no grounds for making a report. It does not document its investigations or the reasons why it did not exercise its right to report.

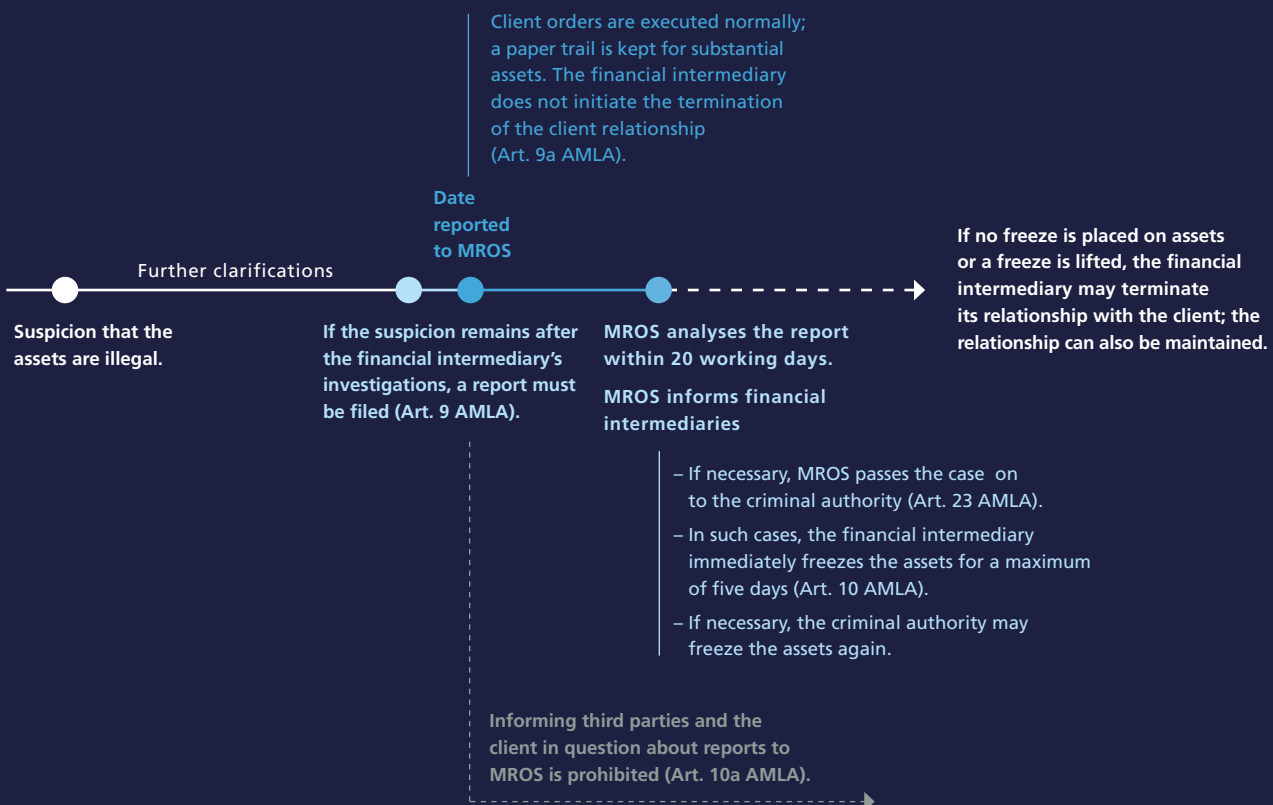
Case law and practice for reporting requirements

The Anti-Money Laundering Act (AMLA) specifies the procedures a financial intermediary should follow if it suspects assets might be illegal.

The provisions governing special duties of due diligence as outlined in Article 6 of AMLA require financial intermediaries to clarify the economic background and purpose of a transaction or business relationship if it appears unusual. The investigations carried out must be documented to enable third parties to reach a well-founded judgement on the transaction or business relationship and establish whether it complies with AMLA.

Reasonable suspicion exists when the results of these clarifications fail to refute the suspicion that the assets are linked with a crime. The financial intermediary must report such business relationships to MROS (duty to report under Article 9 AMLA; see decisions of the Swiss Federal Criminal Court SK.2017.54 of 19 December 2017 and SK.2014.14 of 18 March 2015, consid. 4.5.1.1). If it is unclear whether a report must be filed, the financial intermediary may still do so (reporting right in accordance with Article 305^{ter} para. 2 SCC).

Procedure for handling suspected illegal assets



- × A politically exposed person (PEP) deposits an eight-digit sum with an offshore domiciliary company as remuneration for “consulting services” in the commodities business. When making enquiries, the financial intermediary receives a written consulting contract that does not document the timeframe involved or the nature of the consulting services. It is not clear how the “consultant” is qualified to provide the alleged consulting services. The financial intermediary ends the client relationship without making any further investigations and without reporting it.

Connection to risk management

Shortcomings in the AMLA reporting system are not only a focal point at FINMA; the last country report by the Financial Action Task Force on Money Laundering (FATF) criticised Switzerland in that respect. Instead of resulting from public information such as articles appearing in the media, reporting should take place beforehand as a consequence of the financial intermediary’s transaction monitoring process. Regulatory auditors should also examine compliance with reporting requirements more thoroughly when suspect transactions are involved.¹² This is where the connection between risk management and financial intermediaries becomes apparent, since only if a financial intermediary uses carefully selected criteria to assess high-risk business relationships and transactions can it then identify legitimately suspicious activity and report it to MROS.

Supervisory experiences of high-risk business relationships

Financial intermediaries are required to establish criteria to identify high-risk business relationships as part of their anti-money laundering regulatory obligations. The FINMA Anti-Money Laundering Ordinance-(AMLO-FINMA) and its annex contain non-

exhaustive lists of potential risk criteria with reference to money laundering. The key criterion is that the risk factors selected by the financial intermediary are based on a detailed risk analysis of its client base.

FINMA observed the following activities when carrying out its supervisory role and evaluating the annual AMLA audits:

- ✓ The financial intermediary’s risk assessment incorporates risks specific to the service or product offered.
- ✓ The definition of high-risk countries in its guidelines extends to the place where the client generates its assets.
- ✓ When a financial intermediary selects a high-risk country as a target market, it employs staff with specific knowledge of that country.
- ✓ It also draws up a list of clients with whom it will not establish a business relationship.
- × The financial intermediary has great difficulty managing the large amount of high-risk business relationships (for example over 30% for wealth management banks) with current compliance resources.
- × The low proportion of high-risk business relationships (for example below 10% for wealth management banks) does not mean the bank has a low level of risk tolerance, rather that it is carrying out inadequate risk assessments.
- × Risk criteria do not exist for tax fraud as a predicate offence.
- × The financial intermediary’s guidelines do not define any high-risk professions or fields of business.

Supervisory experiences of high-risk transactions

In addition to business relationships, high-risk transactions must also be identified. Transaction monitoring, for example, must be able to identify trans-

¹² FATF country report on Switzerland of 7 December 2016, www.fatf-gafi.org/media/fatf/content/images/mer-switzerland-2016.pdf.

actions involving high-risk countries; it must also be able to spot deviations from normal activities, either involving the business relationship in question or similar relationships. Furthermore, it must take into account the financial intermediary's business activity. For example, a risk profile for transactions at a wealth management bank with an international clientele would focus on corruption risks, while a retail bank would concentrate more on risks from drug dealing.

In the past year, FINMA encountered numerous positive and negative examples of transaction monitoring:

- ✓ The financial intermediary's transaction monitoring is scenario-based (a combination of risk criteria) and the scenarios are structured according to the specific risks inherent in the business relationship.
- ✓ The risks posed by the business relationship and transactions are considered as being linked, e.g. a high-risk business relationship requires closer transaction monitoring. High-risk transactions also lead to a reassessment of the risk posed by the business relationship.
- ✓ Transaction monitoring combines static and dynamic criteria.
- ✓ International financial intermediaries update their internal sanction lists for terrorism financing and compare them against their client base at least once a week.
- ✗ A large sum of money is shifted back and forth between accounts of the same beneficial owner. Since the accounts belong to the same beneficial owner, the bank believes nothing suspicious is taking place and does not pursue the matter further.

Future orientation of auditing

Regulatory auditing is an important tool in ongoing supervision. The aim is to make auditing more efficient and effective in the future by improving the cost-benefit ratio.

One of FINMA's strategic goals is to keep the costs of supervision stable and achieve further efficiency gains. That includes improving the cost-benefit ratio of the regulatory audits performed by audit firms. Regulatory audits cost approximately CHF 116 million in 2016, only slightly lower than the direct costs for FINMA's entire supervisory function. FINMA sees potential for lowering costs without jeopardising the system's security. Cost reduction will be achieved through stronger risk orientation and steering of audit activities to enhance cost transparency.

Audit firms make an important contribution to supervising Switzerland's financial market through their work on behalf of FINMA. Supervised institutions will continue to select and commission the regulatory audit firm.

Auditing is regulated in Article 24 of the Financial Market Supervision Act (FINMASA) and is detailed further in the Financial Market Auditing Ordinance (FINMA-PV) and FINMA Circular 2013/3 "Auditing". The amended auditing procedure outlined in the revised Circular will come into effect in 2019. The changes mainly affect banks and securities dealers, institutions governed by the Collective Investment Schemes Act (CISA), and financial market infrastructures.

Basic audits: longer audit cycles

Basic audits conducted by audit firms cover individual audit areas and fields in predefined audit cycles. This standardised approach will be retained for supervised small and medium-sized companies. Cycles will be lengthened and basic audits will be more focused and cover smaller areas. For example, if a net risk is regarded as "medium", the corresponding audit area or field will only be audited every six years, as opposed to the current frequency of every three years. The thinning out process is risk-based,

i.e. cycles are lengthened for individual institutions in those areas where risks are not regarded as "very high". Lengthening of cycles is in line with current regulations for all other categories (low, medium, high).

Audits once every two to three years

Regulatory audits of supervised institutions have so far been conducted annually. This is a standard approach and is thus unaffected by the business model or risk situation of the supervised institution. FINMA is working on an evaluation process for exempting certain institutions from the annual regulatory audit. Under the new regime, there will only be audits of companies in Supervisory Categories 4 and 5 once every two or three years, provided they have been free of high risks and not exhibited major shortcomings. In effect, FINMA is reinforcing the way in which it applies the proportionality principle. Supervised institutions will benefit from the resulting synergies, as regulatory audits will be pooled and reporting will only take place every two or three years. However, where necessary banks can request an audit to be conducted in addition to the regulatory audits mandated by FINMA.

Greater support from internal audit

While an audit firm conducts the regulatory audit, internal audit also performs its own audit to ensure adequate corporate governance. Traditionally, the internal and external audits have been conducted independently of each other. FINMA plans to increase mutual cooperation allowing the external auditor to base its work more on the findings of the internal audit. This applies particularly to findings from the risk analysis, coordinating the audit strategy, and specific actions within the defined audit areas and fields. This will improve the alignment between the two audit processes and reduce duplication.

Simplified reporting

Annual reports submitted by audit firms include detailed descriptions of processes and control functions of individual audit areas and fields. FINMA now aims to shift the focus to irregularities and recommendations by changing its reporting requirements. Audit firms must also classify their findings based on clear criteria. This will allow FINMA to act in a targeted way, draw conclusions and, where necessary, define supervisory measures. The reporting will also contain other information relevant to FINMA's supervisory role.

Effects of changes to the audit process

These changes can reduce audit costs by an estimated 30% from their current level without compromising systemic security. Moreover, the lower audit frequency and the additional input when the audit strategy is defined enable a risk-based approach. This will allow FINMA to commit some of the cost savings to focused and in-depth investigations by third parties (mandataries) or allow it to conduct its own audits.

The new audit system will facilitate dialogue between the audit firm and FINMA, as well as between the audit firm and internal audit. The increased risk orientation of regulatory audits and improvement in the quality of interventions (by adapting them to the supervised institution's specific situation) will also contribute to increasing the efficiency of regulatory auditing.

Effective market supervision in the interests of all market participants

Market participants' trust in a properly functioning market pricing system is key to efficient capital allocation. Market abuse undermines trust in fair and transparent pricing and can lead to market failure.

In 2017, FINMA had considerable success combating cases of insider trading and market manipulation. It uncovered repeated instances of insider trading by at primary insider at several listed Swiss companies. FINMA also issued sanctions against three proprietary traders for conducting complex manipulation schemes in securities and derivatives. In both instances, FINMA initiated enforcement proceedings against the market participants at fault and disgorged the illegally generated profits amounting to several million francs. The disgorgement of unlawfully earned profits also aims to restore trust in a functional and efficient Swiss securities market. FINMA's supervisory and enforcement activity ensures a level playing field among investors and maintains trust in the functioning of the Swiss capital market.

How market supervision works

FINMA receives indications of possible market abuse from the trading surveillance units of stock exchanges, its own market monitoring and the ongoing monitoring of the institutions it supervises. In addition, it receives information from market participants and other domestic and foreign authorities. FINMA consistently follows up on any information received. Under its legal mandate and investigative scope, its main focus is on cases of suspected serious market abuse, where rapid information is provided to market participants. Investigating supervised institutions involved in market abuse is also a priority for FINMA. Once grounds for suspicion of market abuse are substantiated, FINMA coordinates further investigations with the trading surveillance units of the stock exchanges, the Office of the Attorney General and, if necessary, foreign financial market supervisory authorities.

Close coordination with the Office of the Attorney General

The trading surveillance units support FINMA in investigating possible cases of market manipulation at the relevant trading venue. Provided manipulation is linked to buying and selling securities for the account of the same client, it is a supervisory and criminal matter (price manipulation). In these instances, FINMA and the Office of the Attorney General work closely together. They also work together when false or misleading information is spread in an attempt to influence prices. Given that many factors in these cases are not relevant under criminal law (e.g. market manipulation through fictitious orders), FINMA itself has to conduct investigations and enforcement proceedings. However, FINMA does not have the same investigative powers as criminal authorities and, for example, may not conduct house searches. As a result, investigations into manipulation often prove complex and time-consuming.

Close coordination with the Office of the Attorney General occurs in suspected cases of insider trading, in which confidential and price-relevant information about securities transactions is being exploited. In each instance, the procedure adopted by FINMA depends on its investigatory powers. Where a FINMA-supervised institution is involved, it is possible to access the necessary information since the institution is obliged to provide information and cooperate under supervisory law to establish the facts. If, however, the investigation concerns persons or entities not supervised by FINMA, it usually does not have the necessary investigatory powers (as with market manipulation). At this point, the Office of the Attorney General conducts further investigations whenever possible and informs FINMA of its

findings (national cooperation), which then form the basis on which FINMA decides whether to launch enforcement proceedings.

Improved quality of information reported from 2018

The material scope of the reporting obligation for securities dealers will, as of 1 January 2018, be expanded to derivatives used as underlying assets for securities admitted at a Swiss trading venue. Additionally, it will also be extended to include the beneficial owner of a transaction. The nationality, date of birth and an internal ID number for the securities dealer will be used as a standard anonymous reference to identify the beneficial owner. As a result of this regulatory change, the trading surveillance units will be able to enhance the quality and specificity of their reports to FINMA. This could simplify the multidimensional pattern and event analyses, whereby insider networks and recurring suspect trading patterns featuring suspected insiders and manipulators can be identified more easily. It will also be easier to generate event-based analyses of the profits of the persons and companies under investigation. FINMA takes steps to receive additional reports from foreign financial market supervisory authorities of transactions in Swiss securities and derivatives made abroad. These additional data and possibilities for advanced analysis will facilitate and accelerate the detection of market abuse, which will subsequently promote trust in the proper functioning of the Swiss financial markets.

Blockchain was the dominant topic in 2017 and the subject of a FINMA roundtable discussion in May. Two events of regulatory significance were the introduction of a sandbox and the expost review of FINMA Circular 2016/7 “Video and online identification”. FINMA also concluded further cooperation agreements with foreign authorities.

Technology has opened up a whole new dimension for established financial services providers who want to increase cooperation with start-ups.

Main focus on blockchain

There was a marked increase in enquiries over the previous year (from 270 to over 453) to the FinTech Desk. Most of the questions were about blockchain, virtual currencies and, in particular, initial coin offerings (ICOs). Data management queries (outsourcing and operational risks) also rose due to issues relating to cloud computing, while enquiries about payment transaction services declined slightly.

FINMA roundtable discussion on blockchain

FINMA held a roundtable discussion on blockchain in May. Over 100 participants from the financial sector, technology industry and academia attended the event. The main area of discussion was virtual currencies. FINMA shared its initial experiences and exchanged opinions with the experts on upcoming blockchain developments. The dynamic market development in blockchain technology raises some fundamental questions going beyond financial market law and into civil and bankruptcy law.

Initial coin offerings

FINMA has noted major growth in initial coin offerings (ICOs) conducted or offered in Switzerland since mid-2017. ICOs are a digital form of public fundraising. FINMA acknowledges the innovative potential of blockchain technologies, but also points out its inherent risks, especially for investors. Some parts of the ICO procedure may already be covered by supervisory law depending on the structure. In Sep-

tember, FINMA published Guidance 04/2017 containing information for market participants about their potential statutory authorisation requirements. FINMA also initiated investigations of several ICOs to examine possible breaches of supervisory law. In specific instances, FINMA closed down providers of fake cryptocurrencies.

Introduction of the Swiss sandbox

The Federal Council implemented the new sandbox provisions on 1 August. These provisions are designed to facilitate the testing of innovative business models. Companies can now accept funds of up to CHF 1 million without having to hold a licence. They are, however, obliged to inform their clients that they are not under FINMA supervision and that there is no depositor protection for the deposited funds. FINMA has amended its Circular 2008/3 “Public deposits at non-banks” to reflect the new provisions. The changes came into force on 1 January 2018. As announced at the time of issuance, FINMA has also started to revise Circular 2016/7 “Video and online identification”.

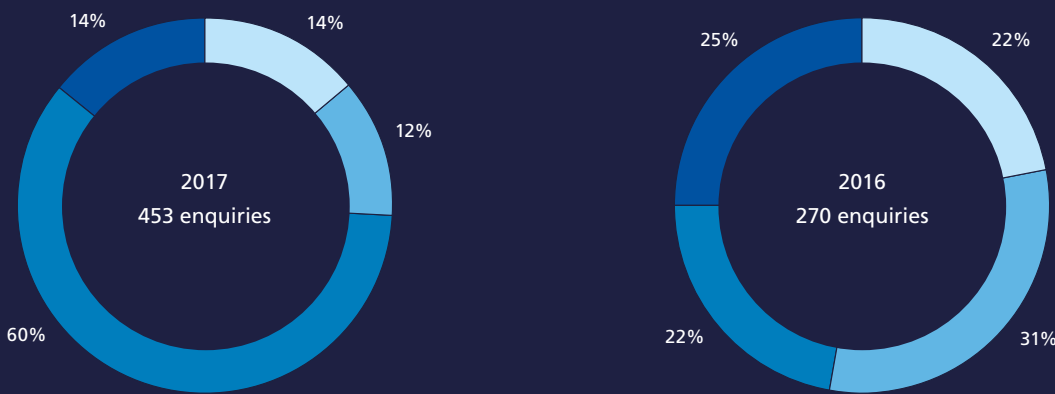
Internationally recognised partners

FINMA represents Swiss FinTech interests when interacting with its international partners. Its participation in international committees seeks to promote Swiss interests by achieving operating conditions favourable to innovative developments and appropriate protection for clients and systems. In addition, FINMA concluded FinTech cooperation agreements with Australia and Israel. These agreements will support Swiss FinTech companies in expanding into foreign markets.

FinTech enquiries handled by FINMA

Compared to 2016, most of the enquiries handled by the FinTech Desk in 2017 were about ICOs and cryptocurrencies. Especially in the second half of the year, there was a sharp increase in enquiries about raising capital via ICOs. On the other hand, the number of crowd-based financial models declined considerably compared to the previous year. As many business models are not restricted to a specific type of service, it is not always possible to allocate the enquiries FINMA receives to one of the four categories indicated below. This explains why the values have been rounded.

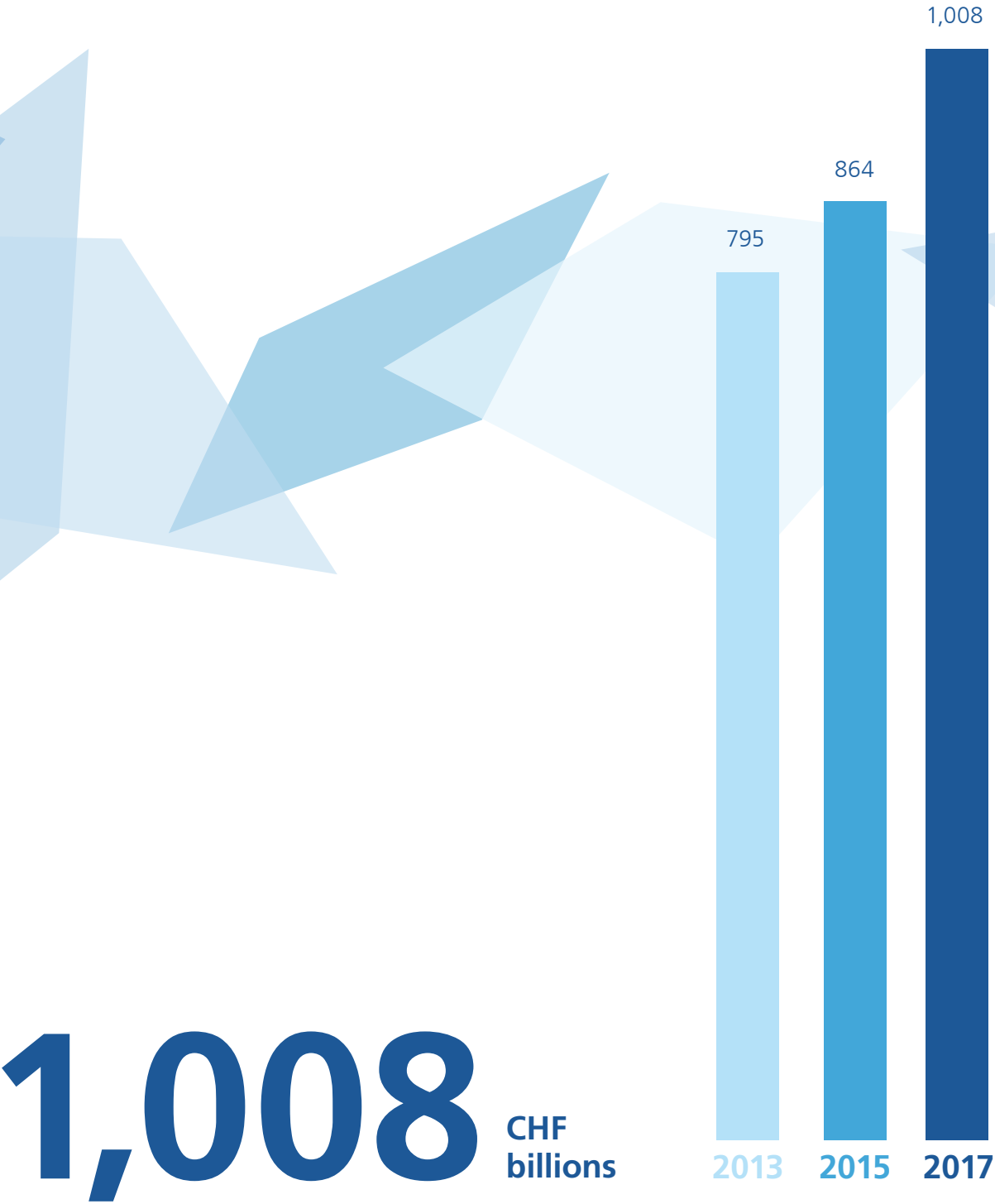
FinTech enquiries processed by FINMA



- **Capital procurement**
 - Crowd investing
 - Crowd donating
 - Crowd lending
 - Crowd supporting
- **Payment transactions**
 - Mobile payment
 - Digital invoicing
- **Digital assets**
 - Cryptocurrencies
 - Initial coin offerings (ICOs)
 - Smart contracts
 - Other blockchain applications

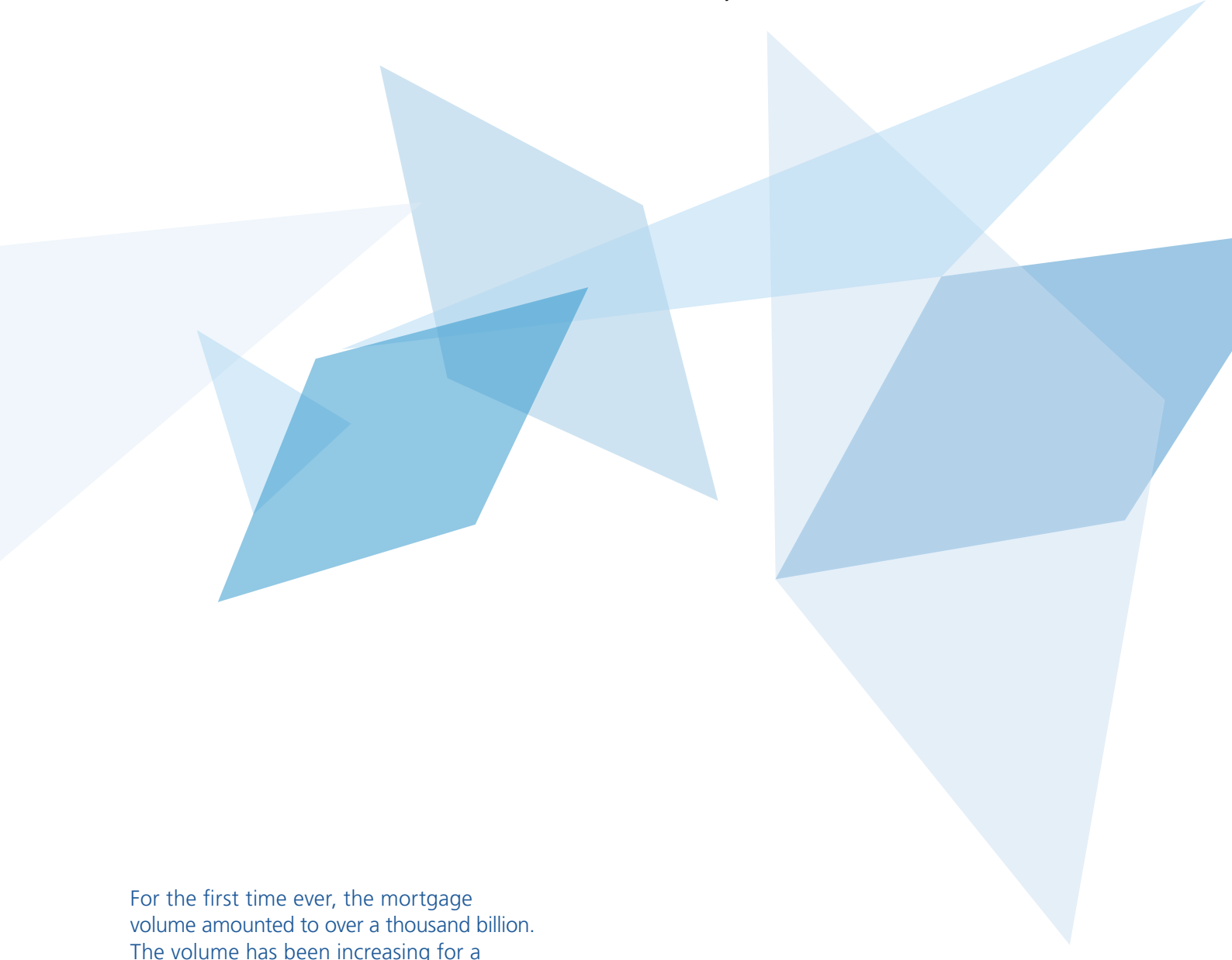
- **Enquiries about other topics:**
 - Banking technology/trading platforms**
 - New trading platforms
 - Banking software/digital solutions
 - Financial research
 - Asset management**
 - Robo-advisoring
 - Algorithm-based client trading
 - Data management**
 - Cloud computing
 - Big data

Mortgage volume in Switzerland exceeds the trillion mark



Supervision, enforcement, resolution and regulation

- 42 Banks and securities dealers
- 52 Insurance companies
- 64 Markets
- 74 Asset Management
- 84 Enforcement
- 92 Recovery and resolution



For the first time ever, the mortgage volume amounted to over a thousand billion. The volume has been increasing for a number of years, much more rapidly than the economic growth rate. Recently, however, prices in the investment property sector have gone up considerably.

Source: Swiss National Bank

Overview of banks and securities dealers

The low interest rate policy maintained by the leading central banks once again dominated the banking environment. FINMA is monitoring developments in the mortgage market closely. It is also focusing on non-economic risks, especially in the increasingly prevalent practice of outsourcing central services.

Banks' profitability under pressure

Historically low interest rates, the strong Swiss franc and persistently low investor transaction volumes are weighing on banks' profitability. Among wealth management banks in particular, the earnings situation remains tight and the cost-income ratio high, despite increasingly positive trends as the year went on. Although these banks are successfully accessing new sources of funds from clients, they are generating significantly less income than in the past. Switzerland's classic locational advantages – political and economic stability and legal certainty – no longer offer them a guarantee of profitable long-term growth. Wealth management banks are also particularly affected by the Swiss National Bank's (SNB) negative interest rates owing to their limited exemption thresholds. In 2017, provisions for fines to foreign authorities were significantly reduced, and progress was made in regularising foreign client deposits. Nevertheless, costs remain a problem. Banks focused on the domestic market continue to experience margin pressure in the interest business, which is central to their operations. While their results remain stable for now, they are often only able to achieve them by continually expanding their balance sheets or taking on greater risks without cutting costs. All Swiss banks will probably need to focus on optimising processes and restructuring their value chain in an effort to improve their cost situation.

Outsourcing and investments in new technologies

Persistent margin pressure and the associated measures to reduce costs are increasingly prompting banks to outsource business processes and IT services to external providers or internal service companies. Targets of outsourcing have included IT systems and core banking solutions, database operation and maintenance, and business processes related to payment services.¹³

This development is changing banks' risk profile and creating interfaces outside their infrastructure that require monitoring and protection. There are also risks associated with dependence on external providers, risk concentrations and outsourcing of critical data, all of which need to be assessed and monitored. Banks remain accountable to FINMA for their outsourced activities, just as if they carried them out themselves.

Pressure to cut costs is also driving investments in digitalising the banking business. Banks often see IT solutions as a way of increasing efficiency by, for example, automating business processes or generating economies of scale through cloud computing. This trend is likely to continue and fundamentally transform the banking business, for example through closer collaboration with FinTech firms or the use of virtual branches. Digitalisation is clearly opening up new areas of use for information and communication technologies. It is also changing the potential threats and vulnerabilities that financial institutions are exposed to, both of which need to be captured and assessed in the institutions' risk analysis. The risks associated with outsourcing, such as the danger of cyber attacks, are especially important.

Negative interest rates and interest rate risks

The negative interest rates introduced by the SNB at the start of 2015 are impacting income from interest operations by squeezing margins and contributions from maturity transformation and by driving up interest risk hedging costs. Institutions are adopting different strategies to prepare for future interest rate movements. FINMA has observed that banks are passing negative interest rates on to institutional and, to a lesser extent, commercial clients, though still mostly holding back where private clients are concerned. To compensate for the resulting negative margin pressure on the liability side, they continue to exploit their scope for raising fees and

¹³ See figure "At a glance: outsourced functions at banks and insurance companies in Switzerland", p. 50.

commissions. In a fiercely competitive environment, however, these options could ultimately disappear.

On the asset side, intense competition and slightly increased refinancing costs have reduced margins in the mortgage business. As higher-interest investments mature, the only option is to replace them with lower-interest alternatives. Although market rates rose somewhat in the multi-year segment, the relatively flat yield curve weighed on earnings from maturity transformation. To react more flexibly to interest rate changes, banks have slightly shortened the maturities of their assets and liabilities since negative interest rates were introduced.

The low interest rate policy has led to growth in the volume of sight deposits. FINMA has observed that over a multi-year period banks have actually increased rather than reduced the modelled holding period of deposits. While initially this seems unusual, it is a logical response, given the growing popularity of bank deposits among private clients in particular for reasons of liquidity and security. However, client behaviour may change sharply when the interest rate environment shifts.

Continuing low and negative interest rates are placing increased pressure on profitability, as are reduced exemption thresholds. To avoid a further squeeze on income from the interest business, banks may be tempted to take on extra risks that would materialise if interest rates were to rise rapidly. The issue of model risk¹⁴ therefore needs to be taken into account. Modelling of client behaviour, with regard to both deposits and loans, is a key factor in determining and managing interest rate risk. Such behavioural models may be exposed to increased model risk if interest rates rise sharply over a short time, as they are mostly based on the current (end-2017) protracted period of falling rates.

Imbalances in investment properties

Persistently low interest rates also mean that investors still face a dearth of supposedly low-risk return opportunities, and investing in real estate therefore remains attractive. Continuing growth in the prices of residential investment properties may lead to a pronounced imbalance, as rents fall and vacancy rates rise while prices go up. Construction activity remains brisk, leading to oversupply that cannot be absorbed in a situation of slightly falling net immigration. These developments are making residential investment properties – already a category with a high level of risk – even riskier for banks. Against this backdrop, it is very important for banks to monitor and actively manage their mortgage portfolios. Increasingly, private individuals are acquiring owner-occupied apartments as an investment and immediately letting them out. This heightens owners' risk as vacancy rates rise and – subject to the degree of borrowing – ultimately increases the default risk for lending banks. FINMA will continue to monitor developments in the mortgage market closely.

There is also an oversupply of office premises, and vacancy rates are high; however, rents have fallen, and prices are also expected to do so. Overall, there may be signs of rising demand for office space, as unemployment fell year on year in 2017 and the number of unfilled positions also increased.

Relaxing lending rules is dangerous

The mortgage market is of enormous size and importance to Switzerland. Its volume significantly exceeds the country's annual economic output. Strict lending standards are therefore vital. Growth at the expense of sustainable lending could jeopardise the stability of the banking system in the event of abrupt price corrections, as historical experience both in Switzerland and elsewhere has shown. FINMA is opposed to any relaxation of affordability standards.

¹⁴ Managing interest risks is often based on replication models, whereby asset and liability products with an indefinite interest rate period (new fixed interest rate period) are modelled according to the observed or expected performance in strata of fixed-interest tranches.

If banks systematically deviate from the Swiss Bankers Association (SBA) guidelines or employ less stringent affordability calculations for individual products or client groups that are not based on a sustainable imputed interest rate, they will no longer meet the strict prudential criteria of the Basel minimum standard. Such mortgages need to be underpinned by higher levels of equity.

Only one imputed interest rate may be set for each property category (for example as defined in the SBA guidelines), and this can be based on long-term averages. FINMA considers that frequent adjustments (quarterly, for example) to the imputed interest rate do not comply with the SBA guidelines. As the effective conversion rates applied by pension funds decline, lenders must also pay due attention to long-term affordability once the borrower retires. The systematic affordability calculation must in all cases be based on the borrower's actual debt and income situation at the start of the credit relationship.

Credit may be granted under an exception to policy (ETP) where there are good reasons for doing so, but such financing must be categorised, measured and reported in terms of affordability, loan-to-value ratio and amortisation. Monitoring ETP trends over time is a key task of the board of directors.

Key metrics for greater transparency

Banks and securities dealers must appropriately inform the public about their risks and their capital adequacy in particular. Since 2016, to improve transparency and comparability, FINMA has published a list of key regulatory metrics for banks and securities dealers in the "FINMA Public" section of its website. The metrics are based on publicly available information that authorised institutions are required to publish at least annually, within four months of the end of the financial year (normally by the end of April) under FINMA Circulars 2016/1 and 2008/22 "Disclosure – banks".

Reducing the administrative burden on small banks

One of the financial sector's strengths is its diversity. Small banks and microbanks should be given every chance to continue operating. FINMA is therefore committed to identifying unnecessary obstacles and costs for small banks and eliminating them where possible.

FINMA aims to further simplify the regulation and supervision of smaller banks. Although the principle of proportionality is already applied, FINMA is going a step further and considering the introduction of a simpler regulatory framework for small institutions that rigorously and consistently implements the principle of proportionality. Measures envisaged include dispensing completely with certain regulatory requirements provided an institution voluntarily exceeds a certain number of simplified key indicators. The goal is to tangibly reduce the administrative burden on small institutions without increasing risks for clients and financial stability.

Findings of the key indicator analysis

One routinely criticised issue is the workload involved in implementing and maintaining the system of regulatory indicators. Small institutions often lack the staff and financial resources to maintain the complex, expanded system of regulatory indicators

required under Basel III. In addition to the capital ratio, which has been in place for decades, Basel III introduced the leverage ratio (LR), short-term liquidity coverage ratio (LCR) and net stable funding ratio (NSFR). Small banks complain that they are required to administer a complex set of regulatory risk metrics alongside their own risk management based on internal procedures. FINMA is therefore discussing with those affected by the regulations whether calculating these figures can be simplified – or in some cases dispensed with altogether – for small banks.

An initial analysis has shown that certain regulatory structural ratios, such as the LR and NSFR, can be usefully derived from simple balance sheet figures. However, with regard to regulatory indicators more closely geared to risk such as the capital ratio, simpler alternatives cannot be implemented appropriately.

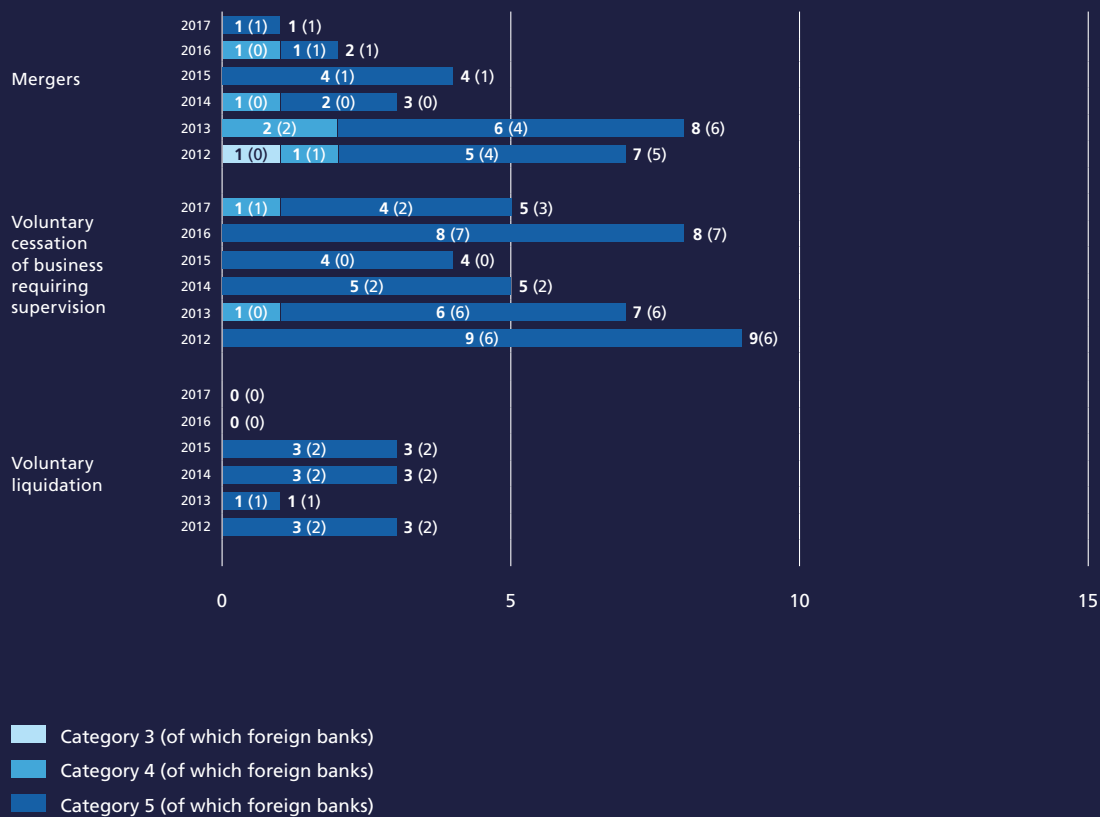
Next steps towards more proportionate regulation

These matters were discussed with representatives of the small banks at the Small Bank symposium on 2 October 2017. FINMA's efforts to reduce complexity and the workload for institutions in Categories 4 and 5 were well received. The expert panel on small banks which is now to be set up will continue this work. As regards regulatory indicators, the best approach appears to be a regime based on a simplified calculation of certain key indicators for all banks in Categories 4 and 5. If such banks meet conservative requirements, certain components can be omitted. Another issue requiring investigation is the relevance of regulatory indicators to banks' day-to-day risk management.

FINMA will conduct a limited pilot of the small banks regime at the start of 2018, involving institutions in Categories 4 and 5 that substantially exceed the existing leverage ratio requirements, among others.

Market exits: banks

Market exits since 2012



Market exits since 2012	2017	2016	2015	2014	2013	2012
Total (of which foreign banks)	6 (4)	12 (8)	11 (3)	12 (4)	16 (13)	20 (14)

Focal points of bank and securities dealer supervision in 2018

The Swiss banking industry's risk situation is multilayered. FINMA's response to these challenges involves focused monitoring, targeted stress tests and systematic on-site supervisory reviews. These activities will continue in 2018.

Systematic monitoring of interest rate risk

In 2018, FINMA will maintain its focused supervision of interest rate risk, with measures including continual monitoring of equity capital sensitivity to interest rate changes. Banks will also be instructed to expand their monitoring of interest rate risk by including stress scenarios based on rapid rises in interest rates. Targeted supervisory consultations with institutions that have attracted FINMA's attention, as well as a joint assessment of the risk situation, will help to either reduce the current risk profile or put in place increased capital requirements to hedge against risk.

Monitoring the mortgage market

In view of the growing risks in the Swiss real estate market, especially investment properties, FINMA is stepping up its supervision of domestically oriented banks, which are particularly exposed in this area. As in the past, FINMA will be conducting targeted on-site supervisory reviews, focusing particularly on the development of lending against investment properties. It will also be carrying out stress test analyses for selected banks to better assess their susceptibility and capacity to absorb increased losses from the mortgage business. For particularly exposed banks, FINMA will order measures to reduce risks or require an appropriate capital add-on to hedge heightened risk.

Money laundering prevention

Preventing money laundering will remain a key area of supervision in 2018. Targeted on-site supervisory reviews will audit Swiss institutions' consolidated supervision of their foreign-based subsidiaries and branches, centring on compliance with codes of conduct for dealing with money laundering risks within a group. In the past, entities based abroad have increasingly taken on higher risk clients and carried out inappropriate transactions. FINMA will be continuing the series of on-site supervisory reviews of money laundering reporting systems that were carried out in 2017.

IT security and outsourcing

With banks' earnings under further pressure, increasing efficiency and lowering costs are becoming ever more important. One way of achieving this is through outsourcing. FINMA expects outsourcing to be included in banks' compliance with the revised requirements for appropriate organisation that come into force on 1 April 2018, and will be carrying out on-site supervisory reviews of particularly exposed institutions to ensure that this is the case. Growing digitalisation of the value chain and increased outsourcing of business processes and IT services are raising the inherent cyber risk. FINMA will therefore be specifically investigating whether banks are tackling those risks in a systematic and holistic manner.

Changes in banking regulation

Several FINMA circulars were amended in the past year, in particular because of implementation of the international standards on banking regulation in law and a Federal Council ordinance.

FINMA circulars	Adjustments to circulars			Changes	In force from
	Type	Content/subject matter	Aim/reasons		
FINMA Circular 2018/3 "Outsourcing – banks and insurers"	Full revision	Relates to outsourcing solutions adopted by banks, securities dealers and insurers, which are subject to requirements for appropriate organisation and risk limitation.	Update of the 2002 circular to take account of the changed environment and dynamic market developments over recent years.	Area of application shared with insurers, strengthening of institutions' individual responsibility, clarification of the rules when outsourcing risk management and compliance, new regulations on the right to audit (when outsourcing abroad) and taking account of the group context.	1 April 2018
FINMA Circular 2015/2 "Liquidity risks – banks"	Partial revision	The partial revision in particular includes relaxations of the requirements for small banks and further clarifications in certain areas.	Necessitated by adjustments to the Liquidity Ordinance. Even more systematic application of the proportionality principle, also for data collection. Implementation of adjustments and clarifications arising from the RCAP (Regulatory Consistency Assessment Programme) or previously contained in FAQs.	Optional simplifications in the survey form, clarifications on the handling of framework credit agreements, facilities, Pillar 3a and vested benefits accounts, precious metals accounts, terminated deposits and the requirement on reporting in accordance with the settlement day or trading day principle.	1 Jan. 2018
FINMA Circular 2019/1 "Risk diversification – banks"	Full revision	Detailed regulations on the fully revised section of the risk diversification rules in the Federal Council's Capital Adequacy Ordinance.	Implementation of the Basel III rules on risk diversification.	Rules on identifying related counterparties and the application of risk minimisation techniques, measurement of certain items such as items in the trading book. Relaxations for small institutions.	1 Jan. 2019

Outlook

2017 saw the finalisation of the Basel III reform agenda. Its national implementation is under the leadership of the Federal Department of Finance. This will necessitate amendments to the Capital Adequacy Ordinance and subsequently to a number of FINMA circulars, especially as regards market and credit risks and operational risks.

At a glance: outsourced functions at banks and insurance companies

In the wake of globalisation, digitalisation, cost pressure and a growing division of labour, outsourcing has become increasingly important in recent years. The majority of banks and insurance companies in Switzerland have outsourced material functions. In a revised circular, FINMA prescribes a principle-based approach to handling risks in banks' and insurers' outsourced services.

Outsourcing is becoming increasingly important to the financial services sector. Handing central functions over to external providers allows processes to be streamlined, costs to be reduced and expertise to be accessed that is not available in-house. From a supervisory perspective, the requirements concerning appropriate organisation must be complied with and risks must be limited. In addition, the supervision of outsourced business areas must be guaranteed.

FINMA Circular 2018/3 "Outsourcing – banks and insurers"

FINMA has therefore completely revised its previous Circular 2008/7 "Outsourcing – banks". The new Circular 2018/3 "Outsourcing – banks and insurers" has also harmonised, where possible, the supervisory rules for banks and insurers. It contains the following key points:

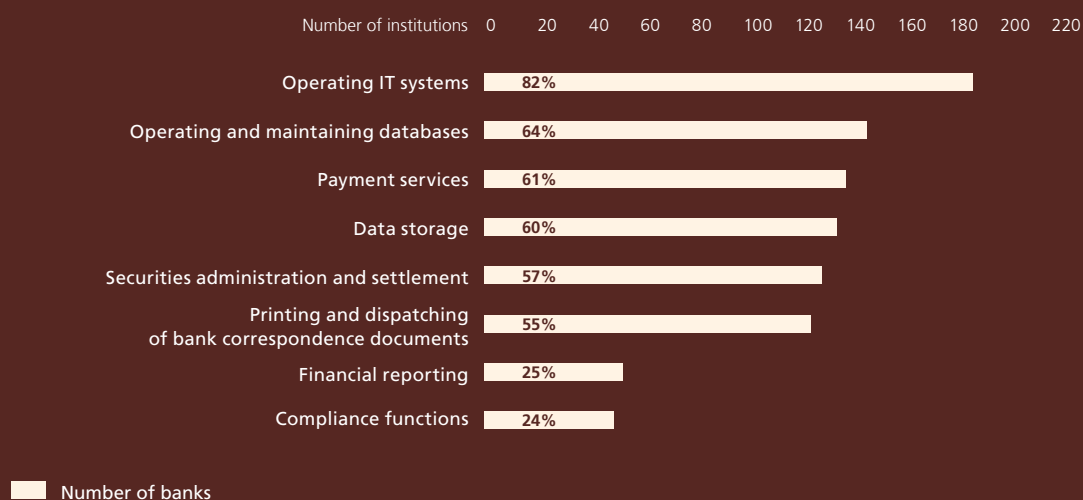
- The definition of materiality is governed by a principle-based approach, and emphasis on the institution's responsibility for self-assessment has been added.
- There are specific rules on the outsourcing of risk management and compliance.
- An inventory of material outsourced functions must be maintained.
- In internal outsourcing, the group and conglomerate context can be taken into account, as long as the risks typically associated with outsourcing do not exist, are not relevant or are otherwise regulated.
- Supervised institutions are responsible for ensuring that the legal authority for conducting audits is maintained when outsourcing is done abroad.

The Circular comes into force on 1 April 2018 and applies to new outsourcing agreements. Banks have five years to adapt outsourcing arrangements contained in existing agreements to meet the new regulations.

Outsourced functions of banks in Switzerland

The chart opposite shows an aggregated overview of the material functions of banks currently being outsourced. It indicates the areas affected (no distinction is made between outsourcing within the group/company and external outsourcing).

Outsourced functions at banks in Switzerland



A clear majority of banks in Switzerland (220) have outsourced material business areas. Most of those that have not are foreign-controlled banks in Categories 4 and 5.

The most frequently outsourced function is the operation of IT systems: 180 of the 220 banks (82%) have entrusted this to other providers, most of them external.

Often, outsourcing also covers the operation and maintenance of databases, payment services, data storage, securities administration and settlement, and the printing and mailing of bank documents. Around a quarter of banks have outsourced financial reporting – or material parts of it – and compliance functions.

Principle 9 in Appendix 3 of FINMA Circular 2008/21 “Operational risks – banks” contains implementing provisions on outsourcing services related to client identifying data (CID). These apply when outsourcing involves the external provider having access to mass CID. In total, 133 banks entrust tasks requiring authorisation for mass CID to external providers.

Insurers' solvency ratios were generally stable in 2017, with the industry continuing to be in good condition despite the prevailing low interest rates and the exceptional natural events that weighed heavily on reinsurers in the second half of the year.

In the supervision of the supplementary health insurance and occupational pensions sectors, one focus was on reviewing and approving tariffs. Non-life insurers continued to maintain a good level of profitability, as did reinsurers, although their claims burden increased considerably in the second half of the year due to exceptional natural events.

No significant regulations were enacted, apart from those laid out in Circular 2018/3 "Outsourcing – banks and insurers". The focus was largely on applying and implementing the FINMA circulars that were revised and streamlined in 2015 and 2016.

Review of supplementary health insurance tariffs

Policyholders are unaware of the tariff attributes that apply to age categories when they sign a supplementary health insurance contract, and are therefore unable to gauge the financial burden they will face from the insurance in the years ahead. Due to the system of health checks and age limits that apply on purchase of a contract, there is no functioning market from a policyholder's perspective as soon as they have reached a certain age or develop a health condition. Statutory regulations do not provide for the financial freedom of movement that would favour a switch to another insurer. As a result, changing the insurance provider is not an option for all policyholders. Moreover, most supplementary health insurers' products are designed to provide lifelong cover.¹⁵ Insurers must, therefore, refrain from effectively circumventing this part of the contract through unjustified tariff increases. This explains why the legislator has assigned FINMA the duty to review tariffs.

In 2017, health insurers requested approval of tariff changes (increases and decreases) for 160 products. In the case of 36 of these products, FINMA re-

quested changes to the originally submitted tariff. It also rejected product changes in 12 cases and ordered tariff decreases for 28 others. In summary, FINMA reviewed approximately a quarter of the supplementary health insurance products available as of 1 January 2018. FINMA intervened most frequently when it found inflation assumptions to be insufficiently plausible, profit margins impermissibly high, or ageing reserves inadequate.

The costs of hospitals and doctors are the key factors determining the premiums paid for supplementary hospitalisation insurance. FINMA found this sector to be partly lacking transparency and supplementary insurance benefits to be inadequately separated from those provided under the basic insurance. It therefore prompted health insurers to work with service providers in designing their contracts and charging statements so that supplementary health insurance includes only genuine incremental services that do not overlap with those covered by mandatory basic insurance. Companies operating in this sector must also ensure that the costs invoiced are reasonable for the additional services provided.

Fewer full-coverage insurance contracts in the occupational pensions sector and interest rate guarantees in individual insurance

In the occupational pensions sector, insurers must have the tariffs underlying their premiums approved. On-site supervisory reviews, however, have identified irregularities in how these tariffs were applied. For example, FINMA noticed that by using gross simplifications insurers effectively ignored basic statistical principles recognised in supervision. Increasingly, these findings have led FINMA to approve tariffs only for certain periods, thereby granting insurers the time they need to make the necessary adjustments. FINMA had already identified a reduction in

¹⁵ Health insurers waive their right of termination.

the supply of full-coverage¹⁶ insurance products in its transparency report on occupational pensions.

For the most part, only individual life insurance products with or without a reduced interest rate guarantee are currently being offered. Adjusting the respective supervisory rules therefore appears to be less urgent. Nevertheless, FINMA continues to work with the insurance industry to define a technical interest rate that would permit an interest rate guarantee. The supervisory framework should make it possible to offer such products also in the future.

Non-life insurers remain stable also in 2017

Despite market saturation and intense competition, Swiss non-life insurers generated consistently high profits in 2017, in part also thanks to better investment results. The domestic market continued to be profitable and once again recorded growth in premiums.

Non-life insurers are actively preparing for a digital future. While some insurers are launching their own projects to identify and meet their customers' expectations and requirements, others are looking to acquire companies that already have the knowledge and technologies they need. New lifestyles and technological changes call for new types of insurance solutions and new insurance products. Furthermore, protection against claims resulting from IT data loss is gaining in importance, as are insurance against cyber bullying and policies covering damage to property that customers take out when the property is purchased. At the end of 2017, FINMA had 97 non-life insurers under supervision.

Solid reinsurers in a continuing difficult environment globally

Two new reinsurance companies and one reinsurance captive company began operations in Switzerland on 1 January 2017. During the year, three merg-

ers of companies registered in Switzerland took place, one reinsurer was released from supervision and moved its headquarters abroad, while there was one newly licensed reinsurance captive company.

The market environment continued to be challenging and characterised by excess capacity. Natural catastrophes, such as tropical hurricanes, led to an above-average number of major losses in the second half of the year, concluding the period with below-average claims from major events that extend back to 2011. These events are most likely to affect the supply and demand of reinsurance policies, in particular for natural catastrophes.

International cooperation in group supervision supplementary to solo supervision

In 2017, six insurance groups were under FINMA's supervision: a national one, four international ones, and an international insurance conglomerate. The supervision of groups and conglomerates complements solo supervision. A central part of FINMA's group supervision involves working with foreign supervisory authorities responsible for the supervision of insurance entities abroad, primarily through supervisory colleges. In 2017, the supervisory colleges focused on joint risk assessments of groups. Besides holding semi-annual and annual meetings, FINMA exchanges information with other foreign supervisory authorities on an ongoing basis.

Implementation of the new FINMA Circular 2017/3 "SST" and preference for use of standard models over internal models

The new FINMA Circular 2017/3 "SST" came into force on 1 January 2017. It is based on the revised Insurance Supervision Ordinance (ISO) that came into force on 1 July 2015 and lays out the authorisation process and requirements for use of an internal SST model, among others.

¹⁶ Insurers guarantee retirement benefits at 100% and interest (statutory minimum interest rate) is paid on policyholders' OPA retirement assets annually irrespective of whether the insurers have earned returns on retirement assets they invested in the capital market. A shortfall is not possible.

In 2017, approximately 25 insurance companies submitted a proof of need. Insurers must explain why FINMA's standard model does not appropriately capture its risk situation. In many cases, however, such proof did not cover the entire SST model but only specific parts of it. FINMA recognised the requirement for an internal model, in particular with respect to modelling natural catastrophe risks.

Standard models for reinsurers and the occupational pensions business have been developed since 2016. The latter involved a partial revision of the model for insurance risks and a complete redesign of the market risk model that is to be used in all insurance sectors. FINMA adjusted the standard model for health insurers by taking their long-term insurance liabilities into account. As part of the documentation requirements for internal models for natural catastrophe risks, FINMA published a standard template that will enable an efficient review of these models.

During the reporting year, 60 of the 143 insurers subject to SST regulations reported SST ratios that are based on an internal model, and 83 companies, especially health insurers and almost all captives, used a standard model. With the further development of the standard models, FINMA expects the number of companies using an internal model to drop again by half by 2020. The internal models will therefore mostly cover natural catastrophe risks and, in the case of insurance groups or conglomerates, modelling of the group.

SST figures by insurance sector

Required target capital (TC) and risk-bearing capital (RBC) in all insurance sectors remained relatively stable in 2017 compared to the previous year. Because the market value margin (MVM) is now taken into account differently, the SST ratios increased by approximately 10% (or 20 percentage points) on average across the market. In previous years, the SST ratio was defined as the ratio of the risk-bearing capital to the target capital. Since the beginning of 2017, however, the SST ratio is calculated as the ratio of the risk-bearing capital less the expected value of the discounted MVM, divided by the one-year risk capital. See comparison of figures for SST 2016 using the new calculation approach in the table provided.

Initial Own Risk and Solvency Assessment for insurance companies

In line with FINMA Circular 2016/3 "Own Risk and Solvency Assessment (ORSA)", supervised insurance groups submitted their first ORSA report on 31 January 2016. Insurance companies in supervisory Categories 2 and 3 met this requirement for the first time on 31 January 2017. Companies in supervisory Categories 4 and 5 must conduct an ORSA and document the results internally. Among the central elements of the ORSA are the projections of the current year and at least two additional financial years. The insurance company presents its overall risk profile in an integrated manner and thereby covers all of its significant risks. Based on this, it evaluates its total capital requirements by considering all the perspectives that are relevant for the company. The

SST figures by insurance sector

Insurers	SST 2017 (after adjustments as per 1 January 2017)		SST 2016 (after adjustments as per 1 January 2016)	
	SST ratio	Under- funded	SST ratio	Under- funded
Life insurers	160%	1 (16)	158%	1 (17)
General health insurers	250%	0 (20)	263%	0 (22)
Non-life insurers	225%	0 (53)	203%	1 (54)
Reinsurers	223%	0 (30)	219%	0 (31)
Reinsurers and reinsurance captives	200%	3 (24)	204%	0 (20)
Total	202%	4 (143)	195%	2 (144)

Note: "Reinsurance captives" includes captives that use the relevant designated model. All others reinsurance captives are included in the category "Reinsurers".

The number before the brackets refers to the number of underfunded companies, while the number in brackets refers to the total number of companies. Example: "1 (16)" means that 1 of 16 companies is underfunded.

report explains the activities that are covered with the ORSA and lays out the measures that have been implemented or planned in order to mitigate risk.

When selecting perspectives for capital requirements, some companies focused exclusively on the

SST. It is essential for insurers to include all the relevant metrics that are used in the corporate management process. In future, the ORSA will be integrated even more closely into companies' processes and will develop into an important planning and risk management instrument. Insurers benefit from the added

No new regulation – implementation of the revised FINMA circulars

No new regulations were issued during the reporting year apart from FINMA Circular 2018/3 “Outsourcing – banks and insurers”. In addition to implementing FINMA Circular 2017/3 “SST”, the focus was on implementing the Own Risk and Solvency Assessment (ORSA) for insurance companies, as well as on public disclosure and corporate governance. To enable insurance companies to introduce the updated and adjusted provisions, some of the new circulars provide for transitional periods, not all of which have expired.

FINMA circular with running transition periods

FINMA Circular 2017/2 “Corporate Governance – insurers” contains interim provisions on the minimum number of directors (margin no. 17), the independence requirements for a director (margin nos. 18–23) and the audit and risk committee (margin nos. 25–27). It must be implemented at the latest by 31 December 2019. FINMA may approve exceptions when warranted.

FINMA Circular 2017/3 “SST” provides for an interim transition period until 1 January 2020 for implementing the assumptions regarding valuation at the end of the one-year period from the reference date (margin nos. 35–43) in the approved SST models.

value the ORSA provides, especially because it offers integrated perspectives on the various metrics. The continuous further development of the instrument will establish best practice for the various elements of the ORSA over the next few years. FINMA will monitor this development by remaining in constant dialogue with the companies involved.

Initial report on the financial situation relating to public disclosure

All insurance companies submitted a report on their financial situation for the first time on 30 June 2017. The report also includes market-consistent figures and information on SST solvency, in addition to financial reporting information. FINMA Circular 2016/2 "Disclosure – insurers" sets out the structure and content of the report.

FINMA evaluated the reports on the financial situation in 2016 in terms of their completeness and reporting structure in accordance with Circular 2016/2, and it gave detailed feedback to all insurers which will have to be taken into account in the financial year 2017.

FINMA has decided against publishing the reports on the financial situation for the financial year 2016. For the financial year 2017, the reports on the financial situation must be published at the latest by 30 April 2018 and submitted to FINMA immediately thereafter.

Implementation of the updated corporate governance circular

FINMA monitors implementation of its updated Circular 2017/2 "Corporate governance – insurers" continuously as part of its regular supervisory processes. For example, the governance assessment¹⁷ provides information on the situation at the companies. Corporate governance practices are regularly the subject of FINMA's on-site supervisory reviews. In 2017, FINMA paid particular attention to the requirements on the compliance function, the new independence regime for directors and the establishment and composition of the executive committees.

¹⁷ Governance assessment is an instrument which allows FINMA to systematically assess corporate governance practices at insurers based on the periodic collection of information.

FINMA supervises an insurance company throughout its entire life cycle – from commencement of activities until release from supervision on having fully met its contractual obligations.

FINMA supervises a company's operations from the time of its licensing and taking up operations until its release from supervision. In critical cases, FINMA takes measures to protect policyholders against insolvency risks of insurance companies and abusive practices. Such measures can go as far as revoking licences to do business.

FINMA continuously monitors the ordinary business activities and solvency of insurance companies. The following section explains the instruments used for ongoing supervision.

**Regular information flow:
supervisory reporting**

The supervisory process is primarily based on figures and reports that insurance companies and groups submit, mostly annually. Supervisory reporting includes the annual report and the supervisory report, both as at 31 December. It also includes SST reporting, liquidity reporting and a self-assessment of various aspects relating to corporate governance. Insurance groups and companies with larger total assets and high risk potential (companies in Categories 2 and 3) must additionally provide a self-assessment of their risk situation and capital requirements (see ORSA, p. 54). These reports are supplemented by the respective audit firm's documents, which include a risk analysis, a report on the regulatory audit, and audit documentation on key topics.

**Changes at an insurance company:
ad hoc notifications**

Ad hoc notifications can supplement these regular and fixed reports and are triggered by changes at an insurance company. For example, a change in the composition of the board of directors or executive board must be reported and approved in accordance with the supervisory rules that apply to the insurance

company's business plan as approved under supervisory law. Furthermore, specific transactions, such as material changes in shareholdings, mergers, demergers and transfers of insurance portfolios are subject to reporting and/or approval. Finally, incidents outside the insurance company are also subject to reporting requirements if they have a material influence on the company.

**Ongoing information processing
and supervisory rating**

FINMA continuously analyses the annual supervisory reports, the ad hoc information it receives and other circumstances. It also examines matters on site at the insurer's premises. The information compiled in this way and its evaluation result in what is referred to as the supervisory rating per company. FINMA uses the overall assessment result to define further supervisory activities. These can range from follow-up documentation of individual points to intensified supervision or enforcement procedures.

**Topic-specific analyses using the example
of life insurance**

Life insurers offering occupational pension products in Switzerland must meet special supervisory requirements, such as holding specific tied assets which secure the entitlements of their policyholders. The market value of tied assets held by all life insurers in the occupational pensions sector is currently around CHF 200 billion. Special legal provisions require insurers to maintain a high degree of transparency vis-à-vis their policyholders and to specify how profits are to be allocated between policyholders and the life insurer. The "operating statement of occupational pensions" serves as the means of ensuring that this is the case. FINMA examines this operating statement based on a specially designed audit programme and publishes a transparency report with detailed

information on all life insurers operating in this sector. It also examines the tariffs and general insurance conditions that apply in the occupational pensions sector before the insurers are permitted to use them. The tariffs should neither jeopardise the insurance company's solvency nor be abusive. A special challenge in the occupational pensions sector is the fact that certain parameters, such as the mandatory conversion rate, are prescribed by regulation.

Tariff approval in supplementary health insurance

Health insurers must provide FINMA with tariff information and the general insurance conditions before they can introduce an insurance product in the market supplementing social health insurance. FINMA approves products that neither harm the company's solvency nor contain any abusive elements. In particular, an abusive practice can involve insurance companies earning excessively high profits from certain products in the long term or when tariffs are set resulting in unequal treatment that is not justifiable. FINMA also monitors whether insurance companies correctly grant statutory transfer rights in cases involving closed insurance portfolios. Policyholders with products no longer sold in the market must be able to switch to other insurance solutions that continue to attract new customers and therefore have a better mix of risks. This also has a favourable effect for the policyholder with respect to premiums.

Supervisory dialogues

Depending on the size, complexity and dynamics of an insurance company, FINMA sets a reasonable schedule for discussing current matters with it. Such an exchange takes place at various hierarchical levels, sometimes in the presence of FINMA's CEO. For some years now, regular dialogues have been

taking place with the boards of directors of large and medium-sized companies.

Solo and group supervision

The supervision of individual insurance entities is complemented by the supervision of insurance groups and conglomerates. Many topics are relevant for solo and group supervision. The key focus of group supervision is to analyse and assess the risks assumed by major insurance groups, which are mostly active internationally. FINMA uses a consolidated overall perspective in its supervision of such groups. In addition, it analyses their group internal transactions and structures. In group supervision, regulation frequently only requires compliance with pure reporting obligations; for insurance companies, it often lays down an approval obligation.

Supervision in the international context

Most of the insurance groups and conglomerates that FINMA supervises have an international focus. In its role as group-wide supervisor, FINMA cooperates and coordinates with the supervisory authorities of foreign subsidiaries and branches in so-called supervisory colleges. FINMA enters into coordination agreements that formalise such cooperation. Between 5 and 25 foreign supervisory authorities are members of the supervisory colleges, depending on the size of the insurance group.

Annual insurance supervision cycle

Insurers must submit their annual supervisory reporting on 30 April every year while reinsurers must submit their reports on 30 June. In the months that follow, FINMA examines these documents and concludes its reviews by providing feedback to the companies at the end of October. If necessary, FINMA also defines generally by the end of October the model to be used for the Swiss Solvency Test (SST) in the following year. It is usually impossible to predict the insurers' ad hoc notifications, which create a varying additional workload to review.



Focal points of insurance supervision in 2018

In 2018, insurance supervision will continue to place strong emphasis on corporate governance, the low interest rate environment and SST standard models. Insurance supervision will become more risk-based and reflect more the need to protect specific customer groups whilst further developing the system landscape.

Supervisory activities must continue to focus on corporate governance and, in particular, the legal and de facto integrity of insurance companies, whereby robust and stress-resilient structures are a priority. The supervisory authority will also continue paying close attention to the impacts of the low interest rate environment. Ensuring that life insurers are maintaining adequate levels of reserves will remain at the centre of these activities. The work with industry partners in developing new standard models for the SST is also scheduled for completion in 2018 and includes performing shadow calculations and conducting field tests. In 2018, all insurance companies will also publish their financial reports for the first time, including their solvency ratios.

Supervision with stronger emphasis on being risk-based with a focus on client protection

Under FINMA's strategy, the supervisory activities should be risk-based whilst reflecting the need to protect specific customer groups. On-site supervisory reviews with an emphasis on identified risks will continue to play an important role. To make this supervisory instrument as effective as possible, FINMA's activities must ensure that all information on the condition of the insurance companies is analysed systematically. The additional resources used for on-site supervisory reviews will be provided by efficiency gains in other areas.

More efficient exchanges between FINMA and supervised institutions

FINMA's strategic goals call for greater efficiency in its supervisory activities. A digital platform is designed to cover all workflows – from data collection and validation to the approval process – simply and efficiently without any media disruptions. This applies to data collection, notification and reporting. The new platform will replace the current FIRST (FINMA Insurance Reporting and Supervisory Tool) mechanism.

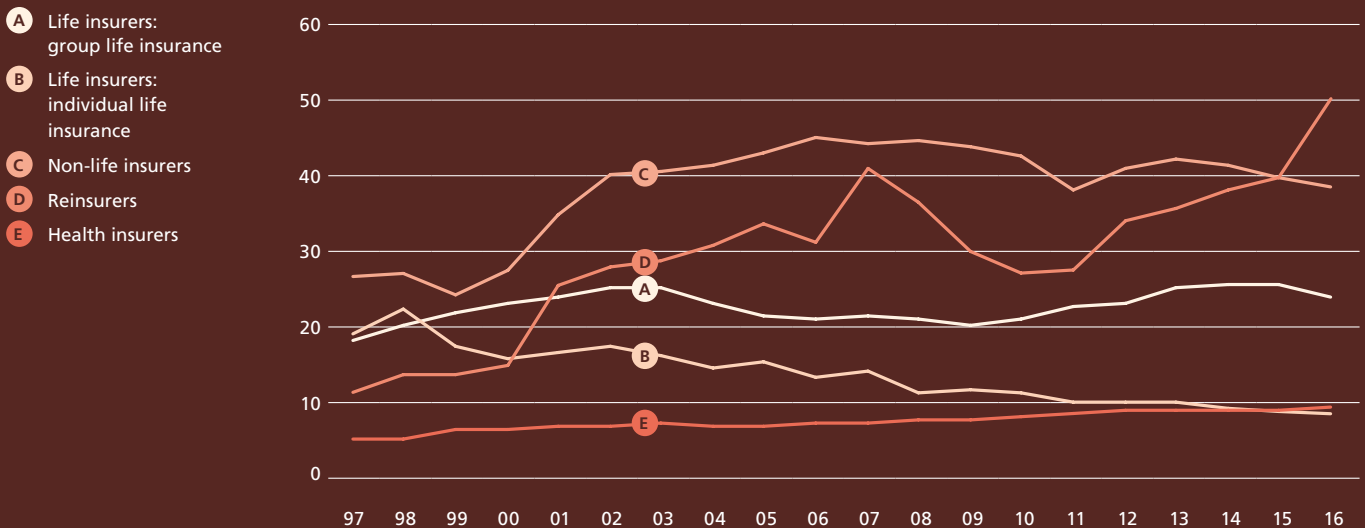
At a glance: long-term trends at insurance companies

Despite market concentration, competition between Swiss companies has been intense over the past 20 years. This is evident from the significant shifts among the market leaders. Return on equity was high across all sectors, with a range of trends developing in several branches in recent years.

Gross booked premiums

Development of gross booked premiums, broken down by sector; life insurers (individual life business, group life business), non-life insurers, reinsurers (excluding reinsurance captives), health insurers (including health insurance companies offering supplementary cover)

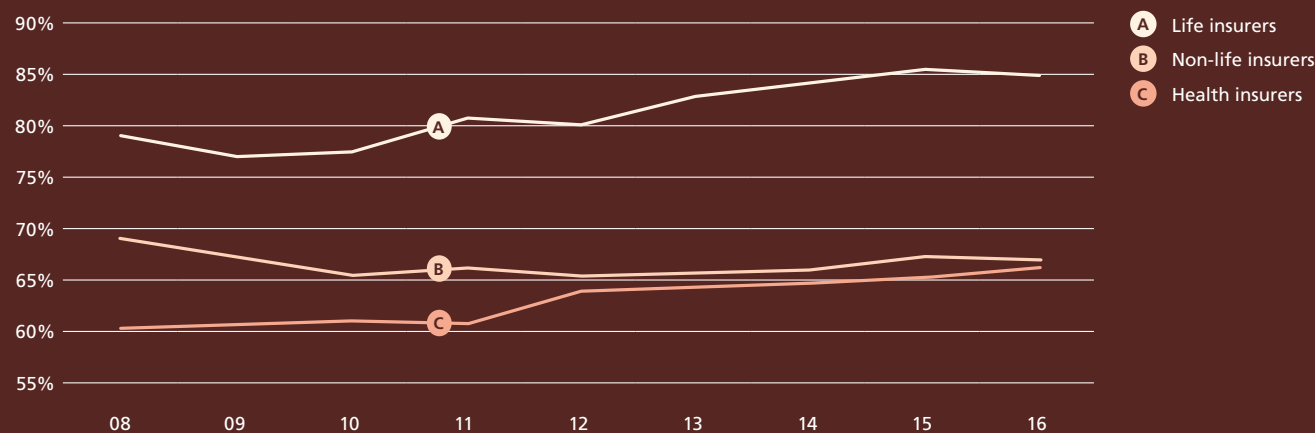
in CHF billions



Premium volumes have risen in all sectors over the last two decades, except in the individual life sector, where a downward trend emerged relatively early in parallel to the number of providers. After a peak in 1998, with premiums of over CHF 22 billion, premium volume fell by more than 60% to less than CHF 9 billion. The volume of the group life business in the autumn of 2016 was again lower than in 2003. Gross premiums written by Swiss reinsurers approximately quintupled, while the number of reinsurers doubled, which can be seen as proof of the competitiveness of Switzerland as a financial centre. At the same time, gross premium growth was inconsistent. The first peak in 2007 was followed by a significant decline, which can be explained primarily by the crisis at a large Swiss reinsurer. This chart is of limited value in explaining the trend in non-life insurance, because the total volume of the market is strongly influenced by a provider writing a significant amount of its premiums abroad. Health insurance shows relatively steady growth over the entire period, which can largely be explained by rising healthcare costs.

Combined market share of the five largest insurers by sector

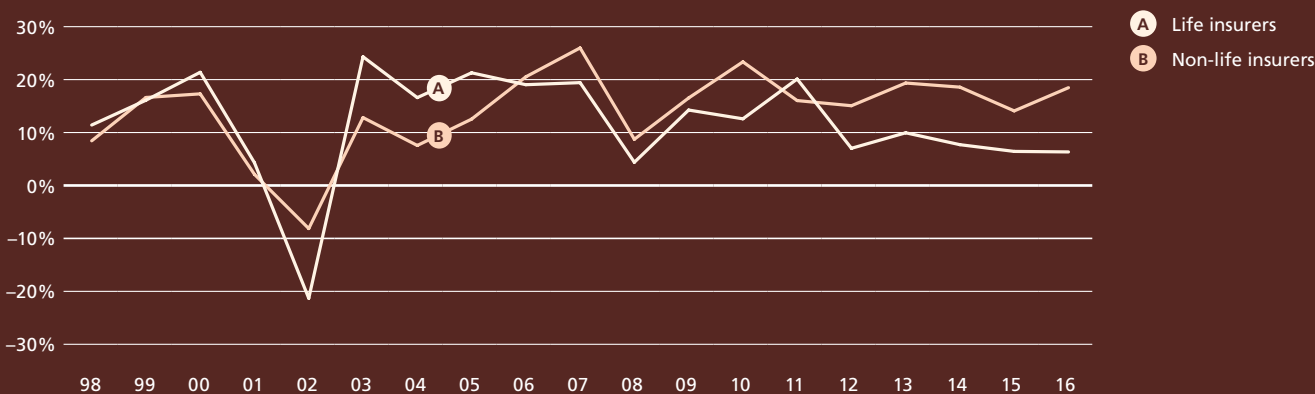
Trend in the combined market share of the five largest insurance companies in the direct Swiss business, by sector; life insurers, non-life insurers, health insurers



A look at the market shares of the five largest providers since 2008 shows a continued high concentration of health and life insurance, while the non-life sector tends to remain unchanged. Market share among the various providers has shifted noticeably, with leading providers losing market presence.

Return on equity

Trend in the average return on equity (worldwide); life insurers, non-life insurers (excluding supplementary health insurers)



Over the past 20 years, the number of life insurers fell from 32 to below 20, while the number of non-life insurers (including supplementary health insurers) rose from 105 to around 120. These diverging trends can be explained by the declining attractiveness of the occupational pensions sector, the persistently low interest rate environment and the return on equity. Although some reservations apply, the return on equity, as shown here on a statutory basis over the longer term, serves as a good indicator. It also indicates that the non-life and life insurance sectors have been developing more or less in parallel for a long time, with the crisis of 2002 having had a clear impact on both. The average statutory return on equity during this period was approximately 13%. This parallel development lasted until 2010, followed by a change whereby the return on equity of non-life insurance rose to around 20% while that of life insurance fell to well below 10%. Although the low interest rate environment seems to be making the business model of life insurers less attractive, it is having little impact on the returns of non-life insurers.

FINMA's market supervisory activities in 2017 focused on follow-up measures to the Financial Action Task Force country review, further developing risk-based supervisory approaches for self-regulatory organisations and sanctions and reporting systems at SROs. Client segmentation in the investment business was also examined jointly with other FINMA supervisory divisions.

FINMA's supervisory remit extends to financial market infrastructures (FMIs), directly supervised financial intermediaries (DSFIs) in the parabanking sector and self-regulatory organisations (SROs) established under the Anti-Money Laundering Act (AMLA). FINMA has set up central centres of competence for combating money laundering, observing rules of conduct vis-à-vis investment clients (suitability), derivatives trading and trading facilities, rating agencies, auditing and financial accounting. These centres of competence coordinate supervision across the different supervisory areas.

Follow-up measures to the FATF country review

The Financial Action Task Force (FATF) conducted its fourth country review of Switzerland from 2015 to 2016. It examines a country's anti-money laundering and counter-terrorist financing system, with a particular focus on financial market regulation. As a result of shortcomings identified during the review, Switzerland is now in the enhanced follow-up process, in spite of achieving a good overall result. On 28 June 2017, the Federal Council communicated guidelines for the follow-up work to the FATF country evaluation and instructed the Federal Department of Finance (FDF) to prepare a consultation draft. The Federal Council also highlighted the importance of amending the FINMA Anti-Money Laundering Ordinance (AMLO-FINMA), the Agreement on the Swiss Banks' Code of Conduct with regard to the Exercise of Due Diligence (CDB) and the regulation of self-regulatory organisations.¹⁸ As part of this package of measures, FINMA discussed possible implementation approaches with representatives of the financial centre and held a public consultation on the partial revision of AMLO-FINMA in September and October 2017. AMLO-FINMA is due to be finalised in summer 2018, coming into force in 2020, although materi-

al decisions pertaining to the verification of the beneficial owner and periodic updating of client information will have to be regulated at statutory level in accordance with the outcome of the consultation.

The country report also recommends the implementation of measures for improving the effectiveness of supervision by FINMA and SROs with respect to combating money laundering. FINMA responded by increasing its supervision of AMLA reporting systems. It is also working towards aligning the SROs' approaches to supervision. Switzerland must report annually to the FATF as part of the enhanced follow-up. Switzerland's follow-up work is coordinated by the State Secretariat for International Financial Matters (SIF).

Supervision of the parabanking sector in 2017

FINMA refined and updated its approach to the supervision of directly subordinated financial intermediaries and self-regulatory organisations during the year under review. In doing so, FINMA based its actions on its own findings and the recommendations of the FATF country report. The amendments are compatible with the national risk analysis of the interdepartmental coordinating group on combating money laundering and the financing of terrorism (CGMT). FINMA also further developed the risk-based approaches of SROs with the aim of harmonising risk-adequate supervision in the parabanking sector. The conclusions of the FATF country review prompted FINMA to focus on sanctioning and reporting systems during its on-site supervisory reviews of SROs in 2017.

Findings from suitability supervision

The suitability supervision function defines annual focus areas, which are included in all on-site supervisory reviews to allow subject-specific benchmarking of the implementation of regulatory requirements at supervised institutions. In 2017, FINMA focused on client segmentation in investment busi-

¹⁸ Federal Council press release of 28 June 2017, www.admin.ch/gov/de/start/dokumentation/medienmitteilungen/bundesrat.msg-id-67338.html.

ness by service (asset management, investment advice, execution only) and the associated rules of conduct. The distinction between services provided by the financial intermediary to the client in investment business is currently governed by general risk management requirements, statutory due diligence obligations (especially SESTA), recognised self-regulation and case law, among other factors.

Supervision in this field shows that some banks already practise consistent client segmentation by service provided, while others have yet to fully differentiate between investment advice and execution-only clients. This means that some clients are classified as execution-only, although most of them are occasionally or even regularly advised by the bank. The distinction is difficult, not least because advisory services are often delivered without a written contract. However, an investment advisory contract can result, even without express declaration, from advice being provided; if this is not recognised, it can lead to latent legal risks. That is why financial services providers must be extremely vigilant when defining their suitability processes and evaluating which rules of conduct apply to which clients.

FINMA focused more closely on the sometimes striking differences between financial institutions in terms of the quality and extent of their suitability processes. Those institutions with an international orientation and which are primarily involved in asset management have often already implemented extensive processes, partially due to meeting more stringent international standards. FINMA sees room for improvement at the level of regional banks, which have traditionally centred their operations on credit provision. Many of these institutions have sought to diversify their earnings sources and counter the effects of low interest rates by expanding their investment business. This requires them to introduce and imple-

ment the requisite processes to ensure adherence to the relevant rules of conduct.

Value adjustments for default risks in banking

The provisions governing the forming of value adjustments for default risks have remained practically unchanged since 1994. They prescribe a two-part procedure consisting of value adjustments for impaired loans and latent default risks. Both types of value adjustment are based on an incurred loss approach, i.e. they are only formed in response to a loss event. The overall value adjustment level, as measured by credit volume in the banking sector, was extremely low at the end of 2017.

International practice has taken on a new direction. The formation of value adjustments is no longer to be delayed until a corresponding loss event occurs. The new approach is more forward-looking and relies on more comprehensive information. The method for forming value adjustments has therefore been fundamentally changed in the International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (US GAAP). The new standards prescribe the expected loss approach for the formation of value adjustments.

In light of international developments, FINMA believes that the existing provisions governing the formation of value adjustments for default risks should be amended. Current standards are rather generic and it is presumed that their backward-looking approach could be a contributory factor to the presently very low value adjustment level. FINMA deems it important to adopt a risk-based approach to the formation of value adjustments for default risks. A detailed analysis of the current situation is being conducted and FINMA expects to provide further information in 2018 as to what measures it will follow.

Application of ratings to determine tied assets

FINMA-supervised institutions have hitherto been able to use ratings provided by fedafin AG of Swiss public law entities for supervisory purposes. FINMA has now expanded its recognition of the rating agency with effect from the start of October 2017, enabling insurance companies to use fedafin ratings of state-affiliated and commercial companies in Switzerland to determine tied assets. In doing so, FINMA is responding to market demand to allow a larger number of rating agencies to be sourced. Moreover, other rating agencies are undergoing a mutual recognition process. FINMA has stipulated that insurers may use banking ratings as an information source for their own credit ratings with regard to tied assets. However, a supplementary assessment must be carried out.

Implementation of the Financial Market Infrastructure Act

Further progress was made in implementing the Financial Market Infrastructure Act. Established financial market infrastructures were reauthorised and new infrastructures were approved. New risk mitigation and reporting requirements were stipulated for the derivatives market.

New supervised institutions under the FMIA

Further progress was made in implementing the FMIA, which came into force on 1 January 2016. The following applicants were reauthorised: the central securities depository SIX SIS Ltd, the central counterparty SIX x-clear Ltd, the stock exchanges SIX Swiss Exchange Ltd and BX Swiss Ltd and the multilateral trading facility SIX Corporate Bonds Ltd. The following new financial market infrastructures also received authorisation: SIX Repo Ltd, to operate a multilateral trading facility, and SIX Trade Repository Ltd, to operate a Swiss trade repository. FINMA approved in parallel the revised regulations submitted by the stock exchanges and multilateral trading facilities for the fulfilment of their obligations (deferred until 1 January 2018) under the FMIA. These regulations pertain to pre-trade and post-trade transparency; ensuring orderly trading; algorithmic and high-frequency trading; and recording and reporting requirements for participants. FINMA also recognised a foreign trade repository and two more foreign central counterparties.

Risk mitigation obligations and margin requirements for OTC derivatives

A number of derivatives-trading requirements came into force during the reporting year. The first risk mitigation obligations for over-the-counter (OTC) derivatives trading came into force on 1 January 2017. These requirements cover timely confirmation of trades concluded, portfolio reconciliation, dispute resolution, portfolio compression and valuation. The introduction of margin requirements for non-centrally cleared derivatives (OTC derivatives) began in early 2017 to align with EU regulation. The collateral obligations for derivatives concluded between two counterparties in the highest category (derivatives portfolio of at least CHF 3 trillion) came into force on 4 February 2017. As a second step, OTC derivatives had to be collateralised by initial margins if

they were concluded by a Category 2 counterparty after 1 September 2017 (derivatives portfolio of at least CHF 2.25 trillion). At the same time, the obligation to pay variation margins also came into effect for all counterparties. Mandatory payment of initial margins by all counterparties will be expanded incrementally every 1 September until 2020. There is now also a three-year transition period for options on equities and similar products (Art. 131 para. 5^{bis} FMIO).

The Federal Council amended the requirements for bilateral collateralisation of non-centrally cleared OTC derivatives (Arts. 100–106 FMIO) on 1 August 2017. The new requirements contain a number of provisions which will help alleviate the misgivings about Swiss market participants being at a competitive disadvantage in global derivatives trading, especially as regards EU counterparties. The amendments are therefore based primarily on the corresponding EU regulation, which came into force at the beginning of 2017. The principle-based regulatory approach will be maintained and the amended regulations will conform to international standards.

Inception of derivatives-reporting requirement

The derivatives-reporting requirement under the FMIA is part of the G-20 regulatory requirements for the derivatives market. The reporting requirement is designed to enhance transparency on derivatives markets and financial system stability. It applies to all derivatives transactions executed by all financial and non-financial counterparties. Reports must be submitted to derivatives trade repositories.

FINMA approved and recognised the trade repositories SIX Trade Repository Ltd, Zurich, and Regis-TR S.A., Luxembourg, respectively on 1 April 2017. Swiss market participants may therefore meet their derivatives-reporting requirements under Swiss law

via one of those entities. The reporting requirement entered into force for the first group (significant financial market participants and central counterparties) on 1 October 2017. It extends to small financial counterparties as of 1 January 2018. FINMA has extended the transition provision from 1 April 2018 to 1 January 2019 to allow sufficient preparation time for small non-financial counterparties not supervised by FINMA, making it possible for them to complete the technical implementation of their reporting requirements for derivatives transactions to a trade repository.¹⁹

The derivative-reporting requirement is not synonymous with the duty to report securities transactions. The latter predates the FMIA and aims primarily to ensure market integrity and transparency. The FMIA stipulates that approved trading participants must report all concluded securities transactions approved for trading at that venue in the interests of transparency and integrity of the securities markets. Reportable transactions must be traceable by the venue's trading supervisory body in the course of its monitoring operations so as to enable the reporting of any suspected illegal activity to FINMA. The reporting requirement was extended to derivatives transactions based on securities approved for trading at the trading venue with effect from 1 January 2018. In future, the report must contain details of the beneficial owner.

Introduction of clearing requirement for derivatives

The clearing requirement for derivatives via central counterparties (CCPs) has already been implemented in several jurisdictions. The clearing requirement became applicable in Switzerland once FINMA recognised the first foreign CCPs offering derivative-clearing services. The legislator has instructed FINMA to define the derivatives categories covered by the clearing requirement. A proposal for specifications in FMIO-FINMA was submitted for a hearing at the end of 2017. The introduction of the obligation to trade specific derivatives via recognised trading venues or organised trading facilities will be executed next as a second step.

The clearing requirement applies to financial counterparties (FC) and non-financial counterparties (NFC) based in Switzerland which exceed a given trading volume of open OTC derivatives. Furthermore, it extends to cross-border trade with foreign trading partners for both financial and non-financial counterparties.

Both types of counterparty can meet the requirement via CCPs acting as the contracting party between the buyer and seller of a derivative. The CCP thus guarantees fulfilment of the obligations entered into by buyer and seller. This mitigates counterparty default risk and contributes to financial market sta-

¹⁹ FINMA Guidance 5/2017 of 18 October 2017, www.finma.ch/en/news/2017/10/20171018-mm-aufsichtsmitteilung-05-2017/.

bility. Should there be too few recognised CCPs to meet the clearing requirement for a derivatives category, the OTC derivatives can be cleared via certain non-recognised foreign CCPs for a limited duration.

Derivatives trading in Switzerland predominantly takes place across borders, mainly with EU market participants. Swiss regulation is therefore primarily oriented towards EU law, specifically the European Market Infrastructure Regulation (EMIR) and its associated implementation provisions. FINMA follows the same approach when defining compulsory clearing categories for OTC derivatives and for granting supervisory equivalence to foreign legal systems with reference to derivatives regulation.

Development of audit programmes for derivatives trading

FINMA has started developing audit programmes to monitor compliance with derivatives-trading obligations, providing instructions on how to conduct in-depth audits of the obligations stipulated in the FMIA. FINMA is cooperating with relevant industry associations and audit firms for this project, especially the EXPERTsuisse expert panels. (EXPERTsuisse is the Swiss Expert Association for Audit, Tax and Fiduciary.)

Focal points of market supervision in 2018

As regards trading venues, in 2017 FINMA clarified the necessary measures to implement the requirements for stock exchange operations effective from 2018. These measures cover greater pre-trading transparency and the identifiability of participants' algorithmic trading activities. The volume of data available to the trading surveillance units will increase markedly through the new reporting requirements.

Trading surveillance units

Cooperation between trading surveillance units is being further encouraged. FINMA will monitor the use of the data exchanged to strengthen the supervision of market abuse. Circular 2018/1 "Organised trading facilities", which came into effect on 1 January 2017, also specifies the duties of operators of organised trading facilities (OTFs), which are normally banks or securities dealers. The initial audits in this area will focus on the operators' compliance with the new organisational requirements.

Financial groups with financial market infrastructures

Article 15 of the FMIA forms the basis for the consolidated supervision of financial groups which include financial market infrastructures (FMIs). The corresponding banking regulations for financial groups apply by analogy. FINMA assesses other risks besides those specific to FMIs and considers requirements for an appropriately consolidated documentation and covering of these risks on a group-wide basis.

IT security and outsourcing

FMIs outsource many activities to third parties, especially parts of IT services. The evaluation of these outsourcing solutions is a central part of FINMA's supervisory remit. At the international level various organisations, such as the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO), have given high priority to evaluating and increasing IT security. FINMA accordingly monitors cyber security very closely.

Recovery planning for financial market infrastructures

Following the coming into effect of the FMIA and the associated change in the status of certain FMIs (central counterparty/central securities depository; previously regulated as banks), FINMA has taken over full authority and responsibility for the recovery and resolution planning of those FMIs from the Swiss National Bank. FINMA will therefore assess the existing recovery plans, which were based on the National Bank Ordinance and evaluated by the Swiss National Bank (SNB), with the relevant institutions and redefine them if necessary. Work on restructuring planning is also under way with due regard of the framework defined by the FSB during the reporting year.

Implementation of harmonised supervisory approaches for self-regulatory organisations

Parabanking supervision will focus on auditing the material implementation of harmonised supervisory approaches for self-regulatory organisations (SROs). FINMA will continue to closely monitor SROs with many members from high-risk sectors. Moreover, FINMA will follow up the measures on sanctions and reporting derived from the on-site supervisory reviews with a view to harmonising how they are implemented by the SROs. Another supervisory priority is ensuring SROs comply with rules governing independence.

Changes in market regulation

In the area of financial market infrastructures, reporting requirements were further refined, as were requirements for recording transactions and maintaining documentation. In addition, Circular 2018/1 “Organised trading facilities” specifies the relevant supervisory practice for the first time.

FINMA circulars	Regulatory projects			Changes	In force from
	Type	Content/subject matter	Aim/reasons		
Circular 2018/2 “Duty to report securities transactions”	Total revision	Specification and explanation of the reporting requirement as per Article 39 FMIA, Article 37 FMIO, Article 15 SESTA, Article 31 SESTO and Articles 2–5 FMIO-FINMA.	Amendment to comply with new legal regime and specification of new statutory regulations.	Replaces Circular 2008/11 “Duty to report securities transactions”.	1 Jan. 2018
Circular 2008/4 “Securities journal”	Partial revision	The obligation to record transactions and maintain a journal were refined as per Article 1 FMIO-FINMA on the basis of Article 15 para. 1 SESTA, Article 38 FMIA, Article 30 SESTO and Article 36 FMIO.	Changes to the Circular mainly result from the revised reporting requirements.	The provision on the revised reporting requirement was implemented in addition to editing changes.	1 Jan. 2018
Circular 2018/1 “Organised trading facilities”	New circular	The Circular clarifies the term “organised trading facility” (OTF) as per Article 42 FMIA. It defines the duties of an OTF operator as per Articles 43–46 FMIA and Articles 38–43 FMIO and gives shape to the supervisory practice for OTFs, which are regulated by law for the first time.	Specification of the statutory provision on regulated non-independent trading facilities.	–	1 Jan. 2018

Outlook

FINMA continues to implement statutory requirements for market participants in derivatives trading. It has also started the regulatory process to introduce a clearing requirement for specific derivatives categories. The decision to enact mandatory at-venue trading for these derivatives will be made in 2018, taking account of the corresponding steps in the EU.

As regards money laundering prevention, the FINMA Anti-Money Laundering Ordinance (AMLO-FINMA) and Circular 2016/7 “Video and online identification” will be revised in 2018. Revision of the Ordinance is part of the Federal Council’s package to address the shortcomings identified in the FATF country review and the new version should enter into force in 2020. Revision of the Circular is based on experience gained and technological developments.

At a glance: client segmentation in investment business

The new Financial Services Act (FinSA) will come into effect in summer 2019 at the earliest. It regulates the conditions for providing financial services, in which client segmentation plays a key role.

In future, client segmentation will take place according to degree of professionalism, i.e. private, professional and institutional clients. Each client segment will have its own rules of conduct. To deliver legal certainty in dealing with investors, financial services providers must distinguish clearly between their asset management, investment advice (portfolio vs. transaction-based) and execution-only services.

Current case law already demands segmentation along those lines to differentiate between rules of conduct. FinSA offers clients a range of possibilities to opt in or out of investor protection through a written declaration depending on the segment. High-net-worth individuals will now have the option of declaring that they wish to be treated as if they were professional clients (opting out). Professional clients can also say that they wish to be managed as private clients and institutional clients can request to be treated as professional clients (opting in).*

The chart and the explanations on FinSA are based on the current status of the parliamentary debates on the draft law.



* Definitive wording in the law has still to be confirmed.

Client segmentation and conduct rules under FinSA

	Financial service				
	Asset management The financial services provider is charged by the client with managing their assets independently and according to the agreed investment strategy for which the former is paid a fee. Investment decisions are made by the financial services provider.	Portfolio-based investment advisory services End-to-end investment advisory services which assess the client's entire portfolio. Investment decisions are made by the client.	Transaction-based investment advisory services Advisory services for individual transactions without regard to the client's entire portfolio. Investment decisions are made by the client.	Execution only Transactions are only executed. There is no advisory service for clients; recommendations are not made (actively nor reactively).	
Private clients	Suitability check Knowledge and experience: Is the investor well informed about the products? Do they understand the risks involved? → risk awareness Financial circumstances: Can the investor bear the financial risk of the investment strategy? → risk capability Investment objectives: What are the investor's investment objectives? How much risk do they want to assume? Does the investment strategy suit the investor's investment goals? → risk appetite		Adequacy check Knowledge and experience: Is the investor well-informed about the products? Do they understand the risks involved? → risk awareness		No suitability or adequacy checks required
Professional clients	Limited suitability check** Investment objective: What are the investor's investment objectives? How much risk do they want to assume? Does the investment product match the investor's investment objectives? → risk appetite		No suitability or adequacy checks required		No suitability or adequacy checks required
Institutional clients	No suitability or adequacy checks required		No suitability or adequacy checks required		No suitability or adequacy checks required

** Suitability check required only in connection with investment objectives.

Overview of asset management

Last year, digitalisation was the driver behind developments in the asset management industry. FINMA's supervisory activities focused on securities lending.

2017 saw a continuation of previous trends in the industry. The low, and in some instances, negative interest rate environment persisted, putting pressure on the asset management industry's cost bases and potential to earn returns. Lower margins fuelled a movement towards the increased outsourcing of tasks to non-supervised institutions and the wider use of digital technology. Liquidity risk management was the key theme at the international level.

Outsourcing to non-supervised entities

In terms of licensing, FINMA again noted a rising tendency amongst supervised institutions to outsource duties to third parties. This also concerned certain functions in fund administration, where this is permissible under the provisions of the Collective Investment Schemes Act (CISA). The reason for this outsourcing, in some cases to non-supervised entities, was efficiency and cost-cutting, in addition to the increasing focus on core expertise. Despite this trend, it is FINMA's aim to ensure that supervised institutions still perform core functions such as investment valuation and that they have a solid control framework in place to carefully select, instruct and monitor mandataries.

Increased use of digital technology by the industry

Digitalisation is becoming ever more prevalent in the financial services industry. While it gives rise to new opportunities for the supervised area of the asset management industry, it also presents new types of challenge.

For example, two new electronic publication platforms for investment fund prices and mandatory publications of investment funds were recognised in 2017. In its recognition procedure, FINMA's verifications focused on whether owners fulfilled technological prerequisites, whether suitable business continuity management (BCM) and a business resumption plan (BRP) had been implemented, and whether managers had the requisite technical expertise and demonstrated proper business conduct. Additionally, investors must have free, non-discriminatory access to the data, and the platforms must be operated independently of any licence holders.

New communication channels with FINMA

Following the successful introduction of the delivery platform, which enables supervised institutions and

audit firms to submit documents electronically to FINMA, the supervisory authority laid the groundwork in September 2017 for sending documents over legally compliant and secure channels.

Documents sent using the dispatching platform carry the official qualified electronic signature (QES). Following consent from recipients, FINMA can send a large proportion of previously mailed rulings and correspondence electronically. FINMA last year sent out its first electronic rulings in the fund segment. In summer 2017, FINMA's dispatching platform came fully into operation. By the end of 2017, approximately one fifth of its rulings had been dispatched electronically.

First asset management symposium

FINMA held its first-ever asset management symposium on 4 October 2017 to strengthen face-to-face dialogue with supervised institutions. Themes discussed at the event – attended by fund management companies and asset managers of collective investment schemes – were the international standing of Switzerland's asset management industry and the opportunities and challenges raised by digitalisation.

Prevalence and structuring of performance fees among Swiss registered funds

In-depth investigations conducted by FINMA discovered that the levying of performance fees was not common practice among Swiss-registered funds. At a few institutions, however, FINMA ordered remedial measures to ensure compliance with the applicable standards. Considering the importance of transparency, FINMA is assessing various potential measures for making fee schedules clearer for investors.

Structuring and execution of securities lending by Swiss registered funds

A market review showed that a full one fifth of Swiss registered funds were active in securities lending. FINMA saw no evidence of breaches of applicable regulations in the context of specific investigations or on-site supervisory reviews. Regulatory requirements – many of which were adapted in the wake of the financial crisis – were implemented satisfactorily, ensuring the proper structuring and execution of securities lending transactions.

Leverage ratios of real estate funds

With the amendment of the Collective Investment Schemes Ordinance (CISO) in 2013, the maximum average leverage ratio permitted for real estate funds was reduced from 50% of market value to 33.3%. Licence holders having to reduce their indebtedness were granted a grace period expiring on 28 February 2018.

As this expiry date approached, FINMA periodically checked the leverage ratios of real estate funds. As at 30 September 2017, the average leverage of real estate funds relative to market value was approximately 20%. Around one quarter of the real estate funds exhibited leverage ratios over 30%. FINMA will continue to analyse developments and, where required, take appropriate remedial measures.

International activities in liquidity riskmanagement

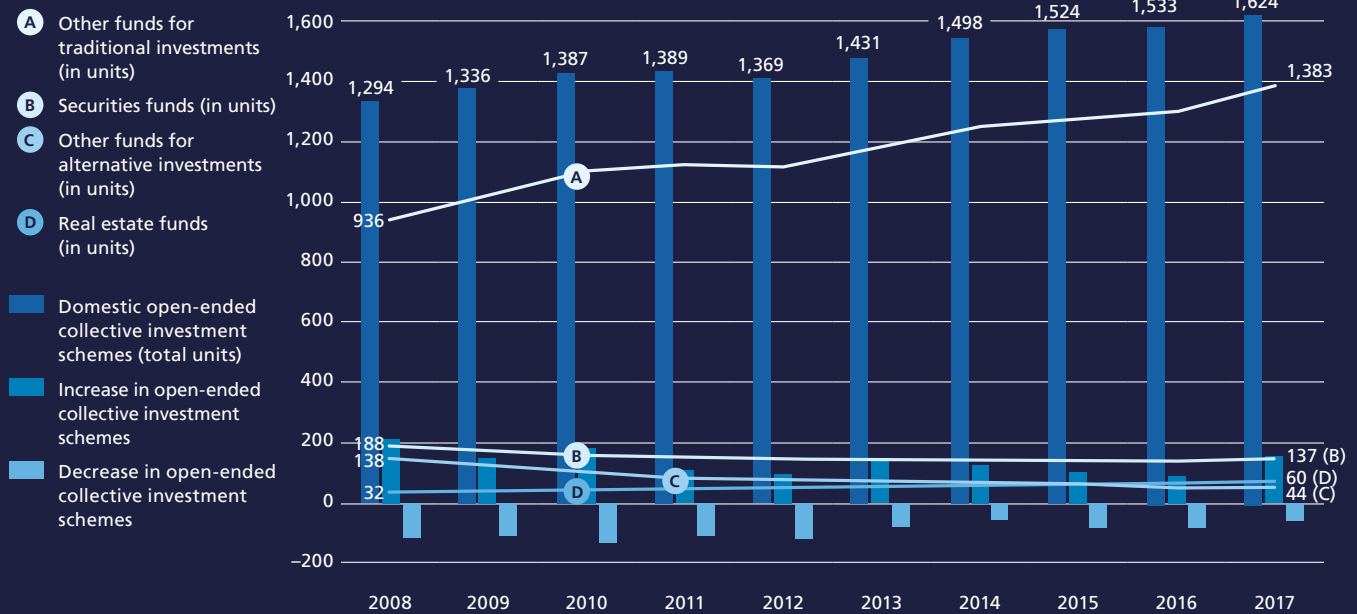
As in preceding years, FINMA actively engaged with the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO) in 2017 regarding liquidity risk management

of collective investment schemes. In January 2017, the FSB published 14 final policy recommendations to address structural vulnerabilities within asset management activities. From the FSB's standpoint, the greatest hazard is liquidity mismatch between the investments made by funds and the terms and conditions governing redemptions. IOSCO has been commissioned to take the FSB's high-level recommendations forward. Additionally, IOSCO is revising its report on the liquidity risk management of collective investment schemes (CIS), dating from 2013, into which it is incorporating two new recommendations on contingency planning. FINMA will analyse the requirement for further action arising from the above-mentioned report and, if necessary, design appropriate measures.

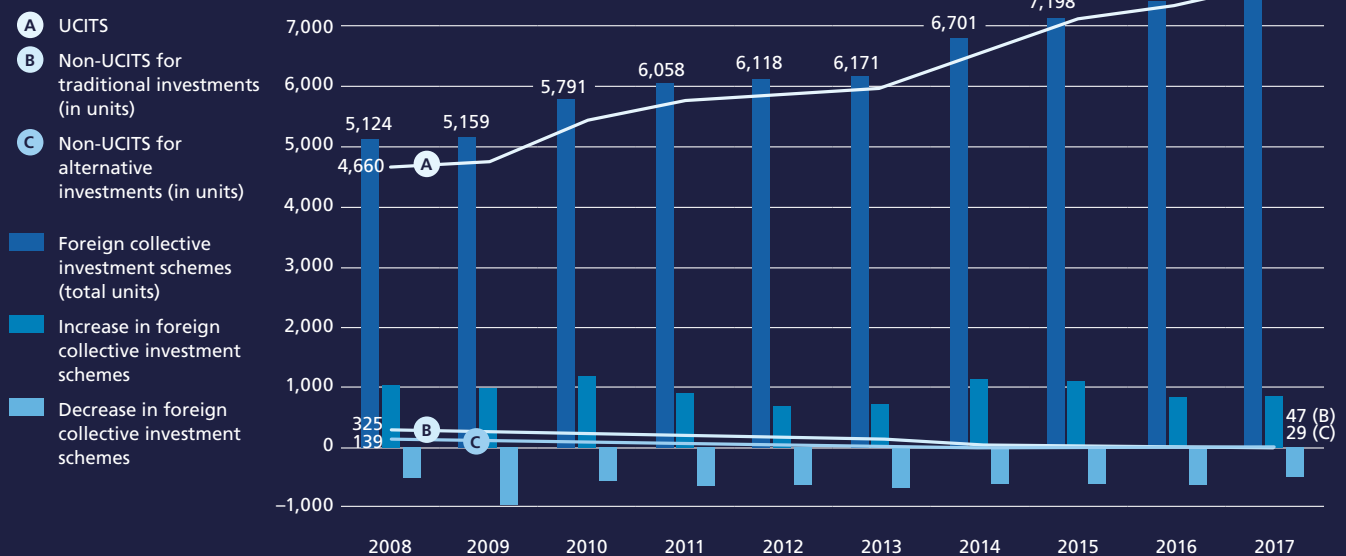
Product trends

The number of newly approved Swiss collective investment schemes rose sharply in 2017 after several years during which this metric decreased.

Growth in the number of domestic open-ended collective investment schemes between 2008 and 2017 by fund type



Growth in the number of foreign collective investment schemes between 2008 and 2017



Market conditions and digital developments influenced the nature of fund approval applications. Last year, FINMA was able for the first time to approve funds registered in Hong Kong for distribution in Switzerland.

As in the past, fund providers were eager to find new opportunities for offering positive returns to investors. As a result, FINMA noted high demand in the collective investment schemes (CIS) industry for innovative solutions. Additionally in 2017, FINMA was able to approve funds registered in Hong Kong for distribution in Switzerland, for the first time.

Focus on risks arising from innovative solutions and target-group suitability

FINMA handled various approval applications for private-loan funds, i.e. funds which originate loans, either consumer credit or corporate loans for SMEs. When a fund is established that either originates loans itself or invests in loans, FINMA's verifications focus on the scope for valuation of the investments and liquidity risk management, in other words, the ability of funds to honour redemptions in stress situations. Additionally, fund management companies must have the requisite in-house expertise to assess debtor creditworthiness, without reference to external ratings.

In 2017, FINMA approved a fund primarily investing in mortgage loans issued by an originating bank to its business clients. Investments in mortgages for retail clients are not included in the fund. The investments are selected by an independent asset manager, who picks mortgages that correspond to the fund's profile. The bank is the mortgage servicer, collecting the relevant payments and transferring them to the fund. Investors are primarily occupational pension funds. In particular, the approval process examined asset valuations, fund liquidity in various stress scenarios and whether all parties involved have adequate organisational structures. As a precaution against conflicts of interest, attention was also paid to monitoring mechanisms between originator, servicer, fund management company, custodian and asset manager.

In addition, FINMA approved the private placement of mortgage-backed securities as a funding source for a real estate fund. The fund management company issues these securities – secured against mortgage notes from fund assets – on behalf of and for the account of a real estate fund. A bank is appointed to underwrite the issue and sell the mortgage-backed securities on to third-party investors. As the escrow agent, it also retains the mortgage notes as collateral for investors. If the issuance of mortgage-backed securities is an administrative operation for managing the real estate fund's assets, it is considered a permitted activity of the fund management company. Moreover, this is a permitted option for borrowing up to the maximum encumbrance on all the real property.

By law, closely related persons may neither acquire nor transfer property or infrastructure assets to or from limited partnerships for collective investment schemes. FINMA has determined that this prohibition is limited to projects within the meaning of Article 121 para. 1 let. a of the Collective Investment Schemes Ordinance (CISO). In contrast, risk capital investments are not covered by this prohibition. What is decisive at all times is the substance of the investment, not how it is officially designated: investments in companies or special purpose vehicles whose value is substantially determined by one or more projects under the definition of Article 121 para. 1 let. a CISO constitute project financing, not risk capital.

Interest in cryptocurrencies for investment purposes

Cryptocurrencies, such as bitcoins, and the underlying blockchain technology also demanded much of FINMA's attention in the asset management segment last year. Providers were keen to expand their investor bases, as a result of which FINMA received a number of queries about new cryptocurrency-based funds.

Regulatory focus with regard to these funds centred on cryptocurrency valuations, custody arrangements and how these duties are organised. From a product standpoint, attention is paid to whether cryptocurrencies can be permitted as investments and whether the rules governing risk spreading and liquidity have been appropriately defined.

First Hong Kong funds approved for distribution in Switzerland

In December 2016, FINMA and the Securities and Futures Commission of Hong Kong (SFC) signed a Memorandum of Understanding (MoU) to foster closer cooperation and pave the way for reciprocal market access for investment fund providers. As a consequence, FINMA was able to approve in summer 2017 the first Hong Kong-registered fund for distribution to retail investors in Switzerland. These funds are deemed equivalent to Swiss securities funds and they invest primarily in Asia-Pacific equities and bonds. Investment decisions are made by the Hong Kong-registered management company.

New opportunities in single-investor funds

One of the advantages that single-investor funds have over direct investment is that investors are dispensed from paying stamp duty on securities transactions. Another is that changes in portfolio positions can be implemented quickly and cost-effectively. Additionally, these funds are covered by enhanced product governance, since the fund management company's responsibility constitutes an additional layer of control. Demand for single-investor funds remained strong in 2017. Previously, only social insurance funds, occupational pension plans and life insurers were exempted from stamp duty when setting up a single-investor fund. However, the Federal Tax Administration (FTA) published a circular in 2017 stating that domestic single-investor funds formed by FINMA-supervised non-life

insurers now also qualify as exempt investments under the Stamp Duties Act as laid down in the Collective Investment Schemes Act. By virtue of this recognition by the FTA, FINMA was able to approve the first single-investor funds formed by non-life insurers. The number of such applications for FINMA approval is expected to rise in the future.

Mandating a legal entity as valuation expert of a real estate fund

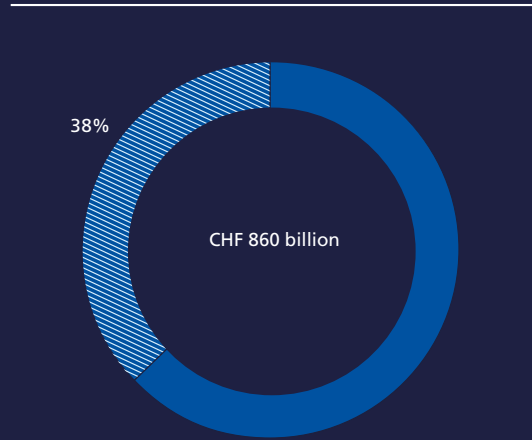
Fund management companies or SICAVs of real estate funds are legally obliged to appoint a valuation expert to estimate the market value of properties included in the real estate fund. FINMA approves assignments granted to valuation experts by fund management companies or SICAVs. However, it neither licenses nor supervises these experts. Until now, only individuals were mandated as valuation experts of Swiss real estate funds.

In 2017, FINMA could approve for the first time a legal entity as valuation expert. To meet the qualifications and independence requirements, the legal entity must have at least two qualified employees to manage the relevant mandate. Moreover, fund management companies or SICAVs must confirm to FINMA that the legal entity has adequate personnel and is appropriately organised. It must also have its own professional liability insurance, and monitor and ensure that the mandated legal entity permanently complies with the prerequisites for the approval of an assignment.

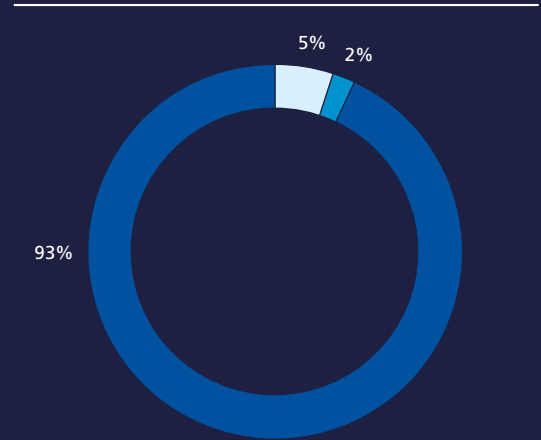
Single-investor funds in proportion to the Swiss investment fund market

Relative to the entire industry, single-investor funds are an important part of the market and account for 38% of assets under management. Investors are primarily occupational pension funds with professional treasury operations.

Number of single-investor funds in the Swiss fund market

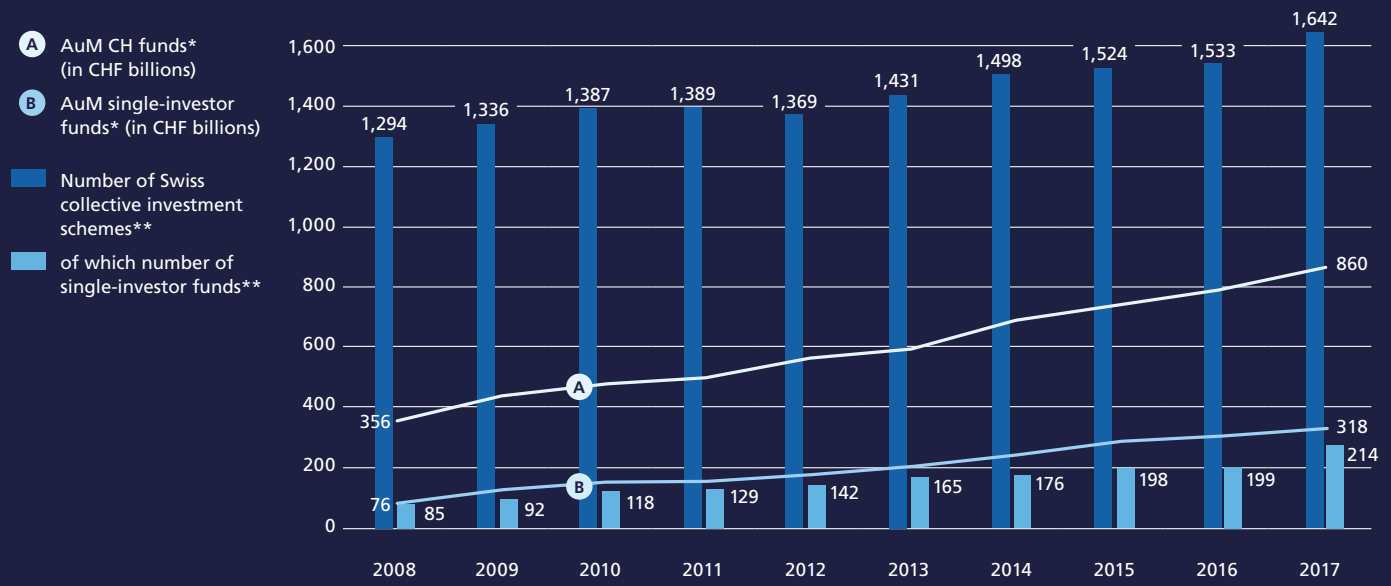


Investor groups of single-investor funds



- Net fund assets of Swiss collective investment schemes
- of which net fund assets (NFA) of Swiss single-investor funds
- Life insurers
- Non-life insurers
- Occupational pension funds with professional treasury operations

Trends in single-investor funds



* As of 30 September 2017.
** As of 31 December 2017.

Focal points of asset management supervision in 2018

An increased number of deep dives are planned in 2018 in addition to on-site supervisory reviews. Supervision of business conduct remains a key part of these on-site checks. FINMA is also focusing on expanding the use of data-driven supervisory techniques and the auditing of products' liquidity risks. It is also making exact preparations for processing innovative business models and products in the future.

Supervisory reviews and deep dives

On-site checking was enhanced in 2017 with the introduction of deep dives as a new instrument of supervision. Unlike supervisory reviews, deep dives are shorter in duration and focus on a particular area. Within the scope of risk-based supervision, an increased number of deep dives are planned in 2018.

Supervision of business conduct

Conduct supervision will be enhanced further. The focal point regarding suitability concerns whether funds are appropriate for clients and risk profiles, both of which are foundational for determining investment strategies. Market conduct rules focus on the appropriateness of risk analysis and the monitoring of staff transactions. In anti-money laundering, client risk classifications will be scrutinised.

Additionally, findings by audit firms on these areas – in relation to the first-time application of newly implemented minimum audit requirements – will be analysed and evaluated. Moreover, an increased number of on-site inspections are planned in connection with these topics.

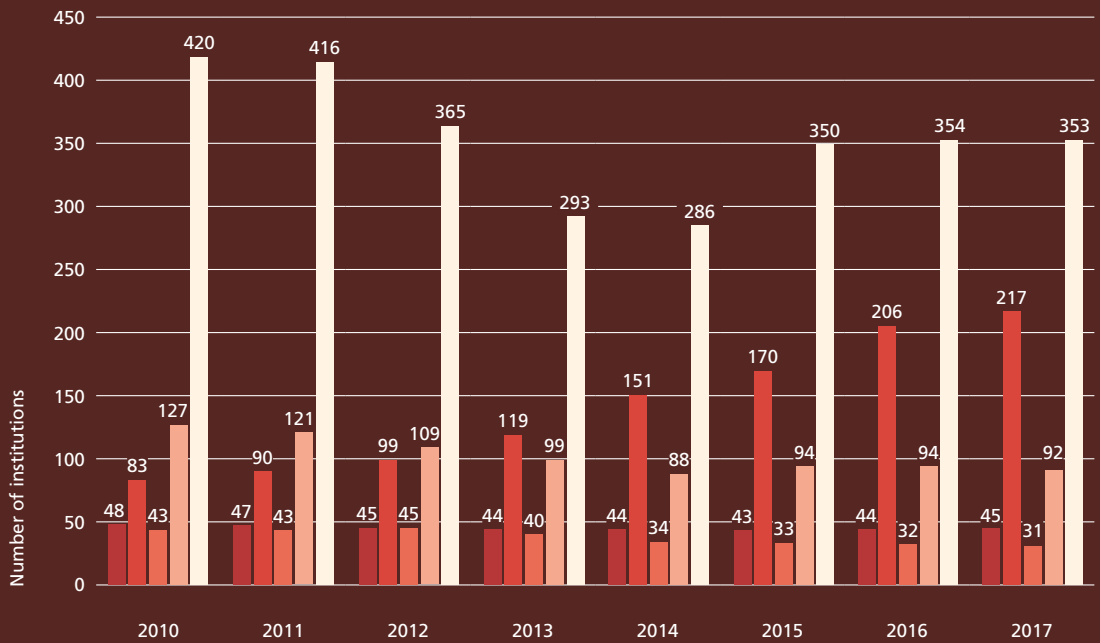
Innovative business models and products

Digitalisation and the scarcity of investment opportunities are two factors prompting market participants to submit various preliminary enquiries or applications for innovative business models and products, either for a statement of opinion or approval/authorisation – for instance to approve or authorise a fund investing in virtual currencies as an asset class. These developments are giving rise to fresh challenges for all parties involved. In 2018, FINMA will continue the dialogue with industry players to clarify upcoming fundamental issues.

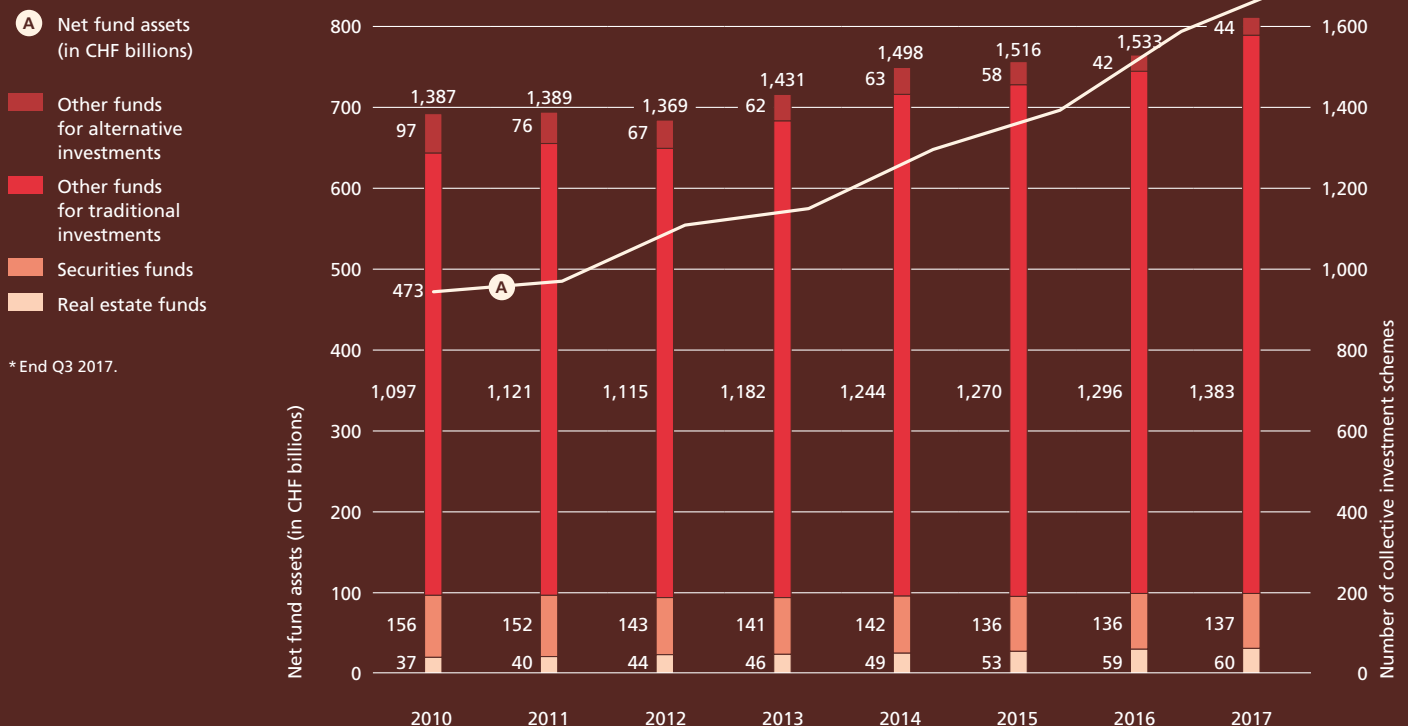
At a glance: the Swiss fund market

Assets managed by Swiss collective investment schemes set a new record high in 2017. The asset management industry is mostly based in and around Zurich, Basel and Geneva.

Number and growth of institutions based in Switzerland under CISA



Number of open-ended Swiss collective investment schemes and assets under management



Breakdown of CIS and assets under management by region

The Swiss asset management industry (CIS asset managers and fund management companies) is clustered around Lake Geneva and Zurich. These two areas also employ the most staff in the industry by a wide margin. In contrast, the Zurich and Basel regions have the highest totals of assets under administration (excluding assets under advisory). The Lake Geneva region ranks third on this metric.

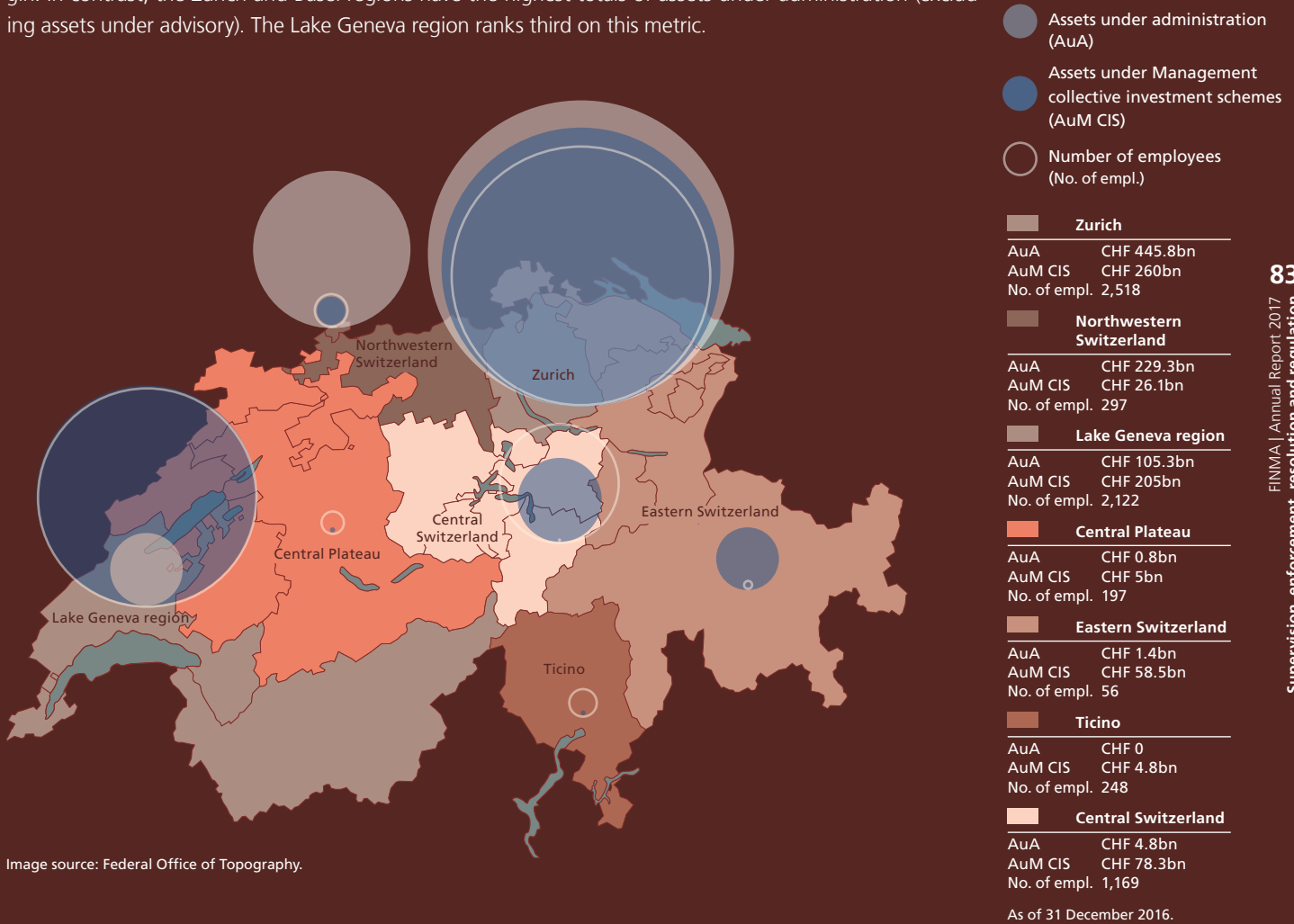
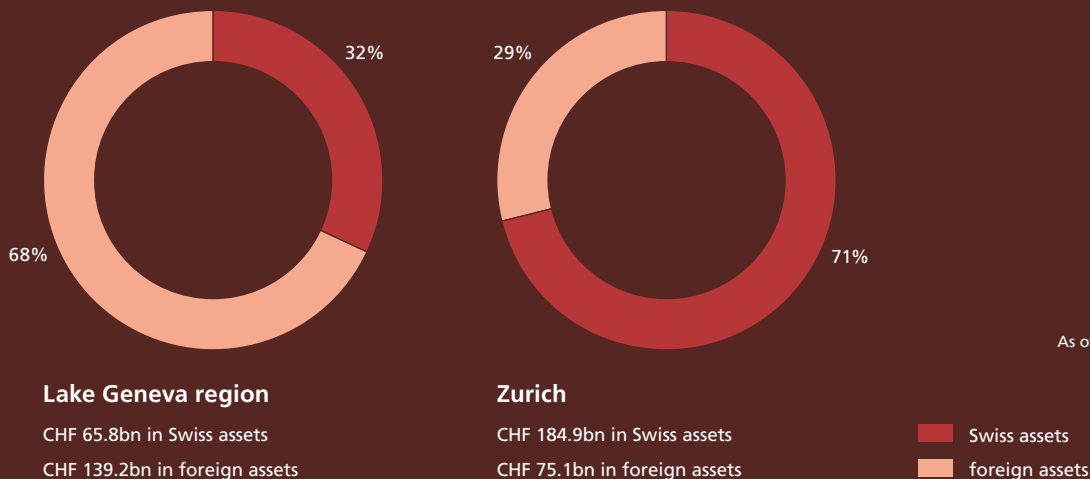


Image source: Federal Office of Topography.

Origin of managed assets

Geneva and Zurich – Switzerland’s two main financial centres – account for a large part of collective investment scheme management (excluding assets under advisory). The Lake Geneva region manages more foreign than Swiss assets whereas, in the Zurich region, the opposite applies.



Lake Geneva region

CHF 65.8bn in Swiss assets
CHF 139.2bn in foreign assets

Zurich

CHF 184.9bn in Swiss assets
CHF 75.1bn in foreign assets

Swiss assets
foreign assets

In 2017, FINMA conducted numerous investigations and proceedings against companies and individuals, many of which were complex and international in scope.

FINMA applies enforcement as a visible means of acting against breaches of supervisory law and to restore compliance with the law. Enforcement proceedings may be conducted against licence holders and their employees, unauthorised financial services providers and participants in the Swiss securities market. The Enforcement division also covers any matters governed by takeover and disclosure law, and the provision of administrative and/or legal assistance to foreign supervisory authorities and domestic criminal authorities. Financial market insolvency proceedings handled by FINMA have been managed by the newly formed Recovery and Resolution division since August 2016.

Since 2015, FINMA has published a separate annual report on its enforcement activities during the previous year. It contains anonymised case summaries and the annual statistics of FINMA's enforcement investigations and proceedings.

Business conduct of licence holders – focus on due diligence obligations

Compliance by licence holders with their due diligence obligations under the Anti-Money Laundering Act (AMLA) was again a focus area in 2017, within the scope of both preliminary investigations and enforcement proceedings. With regard to the global corruption and money laundering scandals from previous years (Malaysian sovereign wealth fund 1MDB, FIFA, Petrobas), FINMA has opened enforcement proceedings against 13 institutions since 2016, 8 of which have since been concluded. As part of its investigations into these scandals, FINMA has also opened proceedings against seven employees allegedly responsible for breaching regulations.

In conducting its preliminary investigations, FINMA focuses in particular on adherence to the AMLA reporting requirements in addition to verifying com-

pliance with general AMLA due diligence obligations.²⁰ Here FINMA determined that incidents were often only reported to the Money Laundering Reporting Office Switzerland (MROS) with reluctance and after considerable delay: in certain instances, it was not until cases received widespread media coverage or specific official queries were received that the business relationships in question were reviewed and reported to MROS. Where cases were not reported, some institutions also failed to clearly and adequately document the reasons for not reporting them, despite being obliged to do so.²¹ Accordingly, breaches of reporting requirements were a key factor in numerous enforcement proceedings. Based on its legal obligations, FINMA also brought charges before the FDF in cases where it determined reporting requirements had been breached.²²

Economic approach for companies engaged in unauthorised activities

In 2017, FINMA consistently focused its investigations of unauthorised activities on companies and individuals engaged in activities governed by financial market laws without the relevant authorisation. Investigations focused on possible breaches of the Banking Act, i.e. accepting deposits from the general public without authorisation to do so. One point of note was that investors were increasingly being offered complex and creative financial products. By specifically drafting their contracts and putting in place multi-layered corporate structures, providers were attempting to legally structure financial market activities requiring authorisation in such a way that they did not appear to require such authorisation.

When considering these business models, FINMA's standard practice involves adopting an economic approach for the overall situation. The key factor here is the intended purpose of the contract, rather than the formal legal structure. If, for example, this overall assessment determines that the company's purpose

²⁰ Article 9 AMLA.

²¹ Article 7 AMLA in conjunction with Article 31 para. 2 AMLO-FINMA.

²² Article 38 FINMASA.

Key enforcement indicators

is to accept deposits or issue securities, FINMA reclassifies it and deems the business models it has scrutinised to require authorisation. The aim is to avoid the circumvention of supervisory provisions which protect investors and creditors by using legal constructs under civil law. The same also applies with regard to collaboration between related legal entities. If FINMA determines that various individuals and/or legal entities are working together, whether through sharing human resources, organisational structures and/or financing, it classifies them as a group.

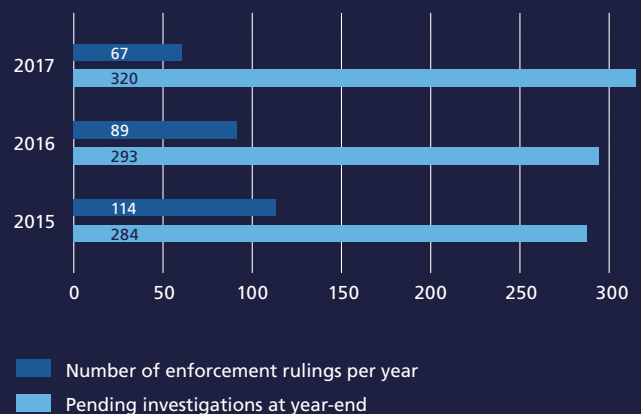
The Federal Supreme Court has upheld FINMA's practice, under which structures that are not economically reasonable are investigated to determine whether their purpose is inconsistent with the objectives of the relevant laws. If the structures have been misused, the supervisory assessment does not take into account the selected legal structure, but instead bases its assumptions on the legal structure that would have been appropriate to achieve the economic purpose (manipulation of facts).²³ However, two recent rulings issued by the Federal Administrative Court have shown the limits of an economic assessment.²⁴

In terms of unauthorised financial market participants, there is an overall trend towards such evasive constructions. FINMA is taking decisive action against these individuals and companies. Within the scope of the enforcement proceedings conducted to restore compliance with the law, FINMA regularly orders the liquidation of legal entities used for unauthorised activities.

New exemption clauses in Banking Ordinance

Another factor of interest in investigating unauthorised activity was the revision of the Banking Ordinance (BO), which entered into force on 1 August 2017, carried out within the scope of the Federal Council's FinTech regulations. Under this revision, FinTech com-

Investigations and enforcement rulings



²³ Federal Supreme Court rulings 2C_352/2016 of 9 December 2016 consid. 3.2 and 2C_1055/2015 of 2 October 2015 consid. 2.2.

²⁴ Federal Administrative Court rulings B-4354/2016 of 30 November 2017 consid. 5 and B-4772/2017 of 19 December 2017 consid. 5.

panies and other firms providing services outside the typical banking business²⁵ are regulated according to their risk potential and barriers to market entry are lowered for these companies. The partial revision of the Banking Ordinance essentially contains two innovations for market participants:

- The creation of an innovative space for operating on a commercial basis (a “sandbox”)²⁶: public deposits up to CHF 1 million may now be accepted without a licence, even if this results in deposits being accepted on an ongoing basis from more than 20 depositors or public recommendations being issued to accept deposits from the public. However, public deposits may not be invested and bear interest. Depositors must be informed in advance that the sandbox is not subject to FINMA supervision and that the deposits are not covered by the deposit protection scheme. Deposits may be invested and interest-bearing if they are intended to fund a commercial or an industrial main activity. One particular aim of the sandbox is to allow companies to test new business models without requiring a banking licence. In implementing the sandbox, the Federal Council is also aiming to create a new source of financing for SMEs, which allows for interest to be paid on deposited funds provided they relate to a commercial or an industrial main activity and are used exclusively to finance this activity.
- Extension of the time frame for settlement accounts (settlement account exemption)²⁷: In line with FINMA’s standard practice, under the settlement account exemption it was only permitted to accept deposits from third parties in their own settlement accounts and conduct client transactions for a period of 7 days. The Federal Council has now decided to set the maximum period for which deposits may be used to conduct client transactions at 60 days.

Crowd funding platforms are among the parties likely to benefit from this extended time frame. FINMA believes it is reasonable to regulate (FinTech) companies in line with their risk profile. As such, it welcomes the partial revision of the Banking Ordinance. The practical relevance of the revised Ordinance provisions remains to be seen. In carrying out its investigations into unauthorised activities, FINMA will verify whether and to what extent these provisions are illegally or inappropriately applied. The amendments to the Banking Ordinance also entailed amendments to FINMA Circular 2008/3 “Public deposits at non-banks”, as the Circular already referred to commercialism²⁸ and the settlement account exemption²⁹ prior to the entry into force of the new provisions.

International administrative assistance

Following the comprehensive changes brought about by the revision of the administrative assistance provisions which entered into force the year before, in 2017 FINMA specifically applied the new rules with regard to international administrative assistance and developed a standard practice.

The Circular 2017/6 “Direct transmission” entered into force on 1 January 2017. This sets out the criteria under which licence holders can directly transmit information to foreign authorities and entities. During the year, it became clear that the Circular was successful in answering most of the questions that arose in practice. The Circular creates a stable framework that facilitates the exchange of information with foreign authorities and entities, while reducing the previous legal uncertainty for licence holders. It was possible to allay any concerns that by reserving administrative assistance channels, FINMA would make it more difficult to transmit information than was the case before the Circular entered into force. FINMA has made and will continue to make restrict-

²⁵ Typically a bank accepts short-term deposits (deposits business) and lends some or all of this money as long-term loans (lending business). The liquidity and interest rate risks resulting from this maturity transformation are reduced by means of regulatory requirements (banking licence). Many FinTech or other companies do not have this risk profile as they only engage in the deposits business. It therefore appears disproportionate to require these companies to fully comply with the high requirements set out in banking legislation in order for them to provide such services.

²⁶ Article 6 para. 2–4 BO.

²⁷ Article 5 para. 3 let. c BO.

²⁸ Article 6 BO.

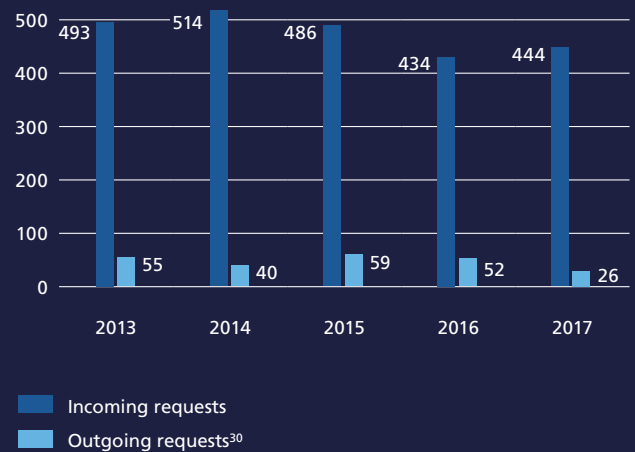
²⁹ Article 5 para. 3 let. c BO.

International administrative assistance

ive use of its ability to refer foreign supervisory authorities to the administrative assistance channel. Only in a few cases where there was a strong supervisory interest has FINMA prohibited direct transmission by the supervised institution. Despite the growing amount of requests for information from abroad, the number of reports to be sent to FINMA before a transmission, which is only necessary for very important reports, was kept to a minimum.

The number of on-site supervisory reviews undertaken by foreign financial market supervisory authorities at Swiss licence holders was again comparatively high in 2017. Numerous licence holders and foreign supervisory authorities who were applying the expanded options in Article 43 FINMASA for the first time had to familiarise themselves with the adjusted rules. In order to assist these parties in familiarising themselves with the review process, FINMA published guidelines on its website in March.

Requests for administrative assistance per year



³⁰ The statistics include only outgoing FINMA requests linked with its own enforcement proceedings.

FINMA conducts investigations into ICOs

In its press release and guidance issued on 29 September 2017, FINMA announced that it would be conducting enforcement investigations into so-called initial coin offerings (ICOs) or token-generating events after it identified a sharp increase in the number of ICOs carried out in Switzerland within a short period of time. FINMA determined that this digital form of initial public offering could result in a breach of financial market licencing requirements. FINMA ascertained that given the close resemblance, in some respects, between ICOs and conventional financial market transactions, it was likely that these were in breach of provisions on combating money laundering and terrorist financing, banking law provisions, provisions on securities trading and provisions set out in collective investment scheme legislation. FINMA warned investors against fraudulent ICO activities as well as the high price volatility of coins and tokens acquired as part of an ICO. It also issued a warning about the considerable uncertainty remaining as to how projects will be financed and implemented in the future.

FINMA amends Ordinance on Data Processing

In performing its duties, FINMA collects data to monitor proper business conduct requirements (conduct data collection). The aim is to ensure that only persons who comply with the proper business conduct requirements assume board and executive management positions. This should prevent persons who have breached those requirements from taking up an executive post at a future employer.

FINMA's data collection is governed by the FINMA Ordinance on Data Processing (SR 956.124), which was revised on 15 September 2017. The amended ordinance implements a ruling (BGE 143 I 253) made by the Federal Supreme Court (FSC) on 22 March 2017. This ruling confirmed that FINMA may maintain a database and defined which data categories it may include. The existing database entries were reviewed and adjusted in accordance with the court ruling and the entry into force of the revised ordinance.

Enforcement statistics

As in previous years, FINMA concluded many investigations and proceedings involving both authorised and unauthorised activities. There was also a high number of requests for international administrative assistance. The number of appeals remains high.

Overview of key enforcement figures³¹

	Outstanding on 1 January 2017	Proceedings initiated	Proceedings concluded	Outstanding on 31 December 2017
Investigations	295	599	574	320
– licence holders	66	106	123	49
– unauthorised activities	115	337	295	157
– inadmissible market conduct	98	95	110	83
– disclosure	16	61	46	31
Enforcement proceedings	47	34	38	43
– licence holders	18	11	9	20
– proceedings against individuals	20	11	17	14
– unauthorised activities	9	12	12	9
International administrative assistance	142	470	486	126
– incoming requests (submitted to FINMA)	129	444	457	116
– outgoing requests (made by FINMA to foreign authorities)	13	26	29	10
Appeal proceedings	55	47	41	61
– Federal Administrative Court (FAC)	54	35	36	53
– Federal Supreme Court (FSC)	1	12	5	8

³¹ Continuous updating of the database may result in some minor discrepancies between the statistics for 2017 and those published in last year's report.

At a glance: enforcement measures

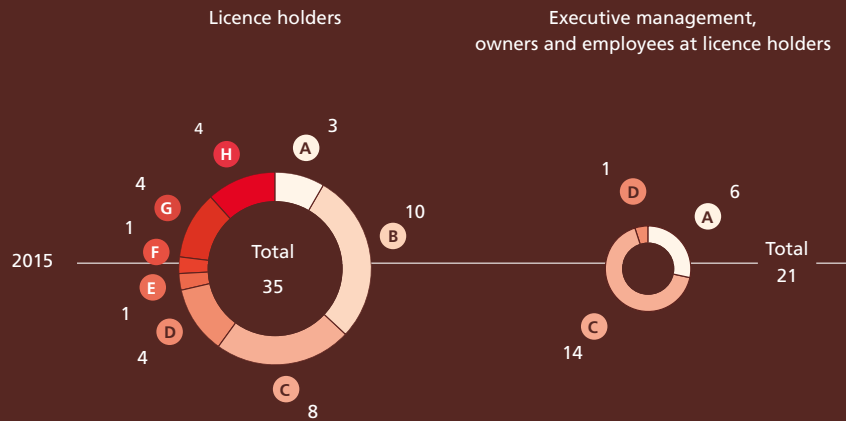
The Financial Market Supervision Act has granted FINMA greater enforcement powers than its predecessor authorities. The charts below show how FINMA uses these powers.

Type and number of measures: licence holders

Licence holders (I)

Measures against licence holders

- A** Appointment of investigating agents (II)
- B** Declaratory rulings/reprimands
- C** Special conditions and restrictions (III)
- D** Implementation overseen by third parties (IV)
- E** Suspension and removal of top management officials (V)
- F** Disgorgement of profits
- G** Licence withdrawals
- H** Liquidation/bankruptcy proceedings
- I** Ruling publications



Measures against executive management, owners and employees

- A** Declaratory rulings/reprimands
- B** Suspension and removal (VI)
- C** Industry and activity bans (VII)
- D** Disgorgement of profits

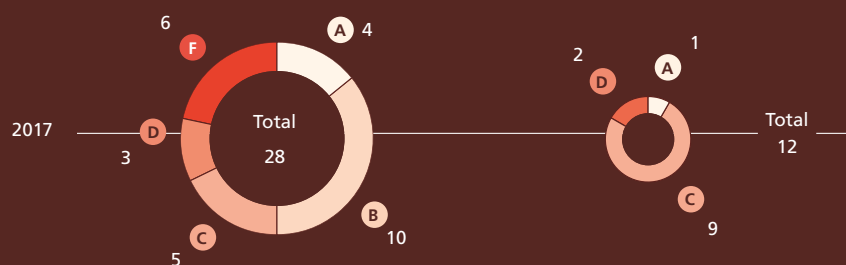
Unauthorised activities

Measures against companies

- A** Appointment of investigating agents (II)
- B** Declaration of unauthorised activities
- C** Liquidation
- D** Bankruptcy proceedings (VIII)

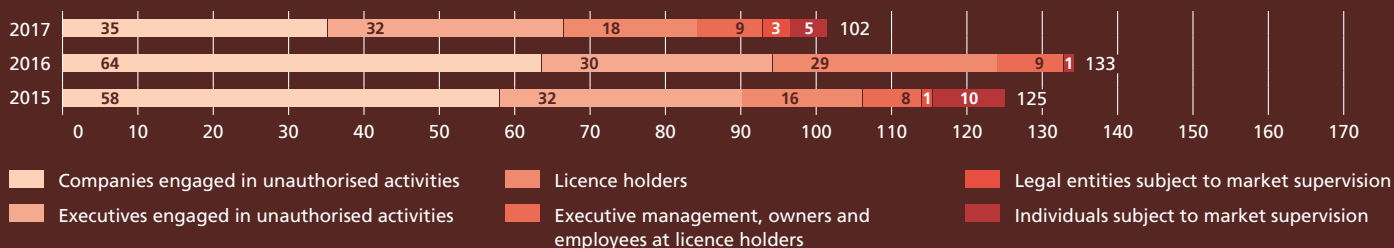
Measures against individuals

- A** Declaration of involvement in unauthorised activities
- B** Cease-and-desist orders
- C** Ruling publications (IX)

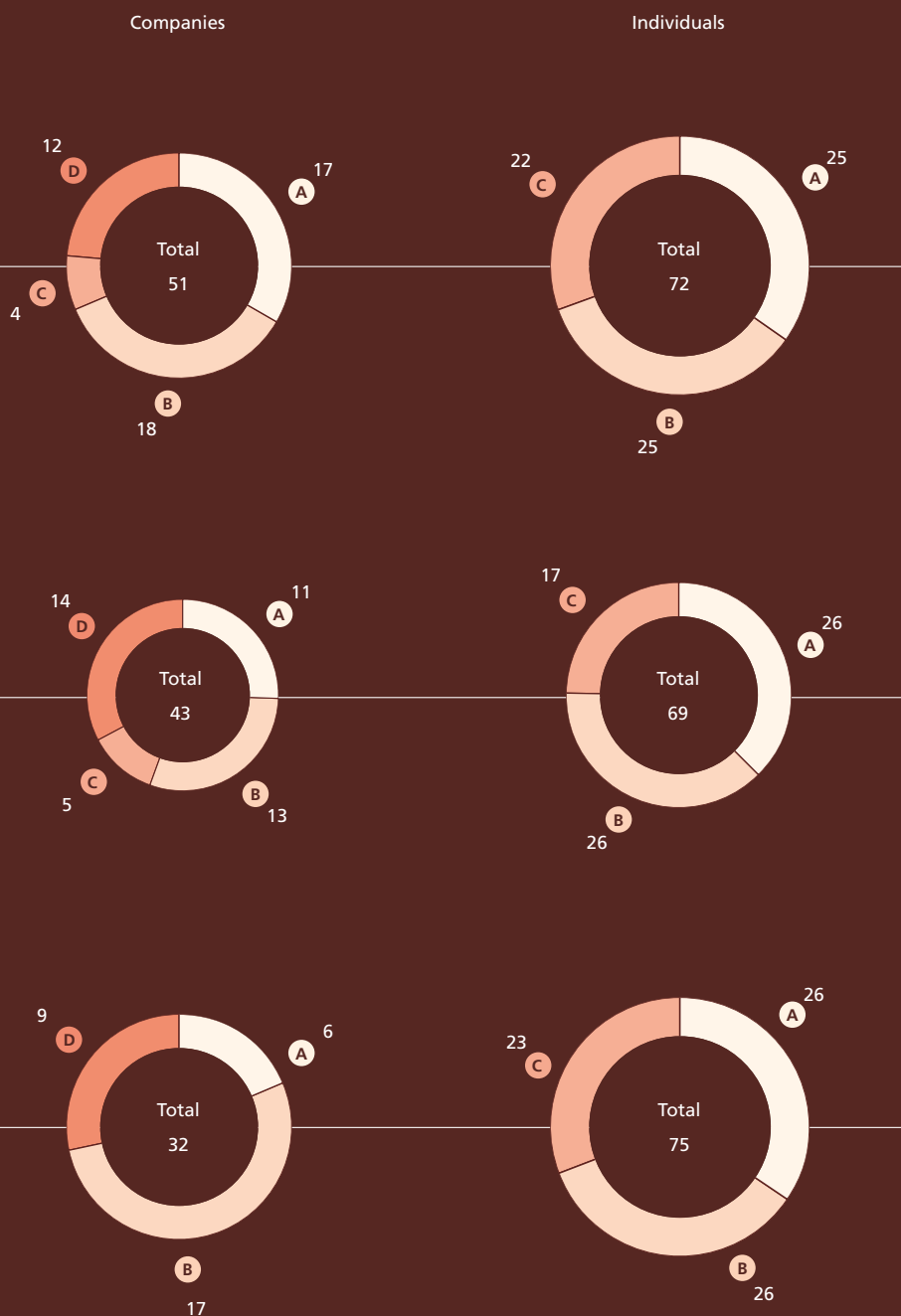


Number of addressees of enforcement rulings by sector and parties affected

FINMA issues enforcement rulings against authorised and unauthorised companies and individuals that are subject to financial market supervision. This chart shows the category and number of addressees of enforcement rulings (excluding international cooperation) between 2015 and 2017.



Type and number of measures: unauthorised activities



Method of counting

The diagrams show the number of parties affected (and not the number of rulings). Where a number of different measures were imposed on an individual/entity at the same time (e.g. an organisational measure to restore compliance with the law under Art. 31 FINMASA and an order to disgorge profits), these have been counted separately. However, when a number of similar measures were imposed on an individual/entity (e.g. a number of measures to restore compliance with the law), these have been counted only once.

Individual categories

- I Incl. measures in market supervision
- II Precautionary measures ordered during the investigation
- III Rulings based on Art. 31 FINMASA
- IV In a final ruling on adopting controls to implement special conditions
- V Number of licence holders affected
- VI Number of licence managers
- VII Under Art. 33 FINMASA and Art. 35a SESTA
- VIII Bankruptcy proceedings initiated following a liquidation ordered by FINMA were not counted in this chart.
- IX Mainly cease-and-desist orders

FINMA's recently created Recovery and Resolution division is a centre of competence for crisis restructuring, emergency and resolution planning, and execution of restructuring and insolvency proceedings.

The Recovery and Resolution division is responsible for supporting and drawing up bank-specific recovery, emergency and resolution plans for systemically important licence holders. In this context, it critically examines, among others, the recovery and emergency plans as preventively drafted by the systemically important banks. Furthermore, it preventively develops resolution plans for those banks, thus creating a framework for orderly national and international insolvency proceedings. FINMA has a range of restructuring measures at its disposal for use in acute crises, up to and including imposing protective measures as a precaution.

Another focus is intervention when financial institutions are facing a crisis. This includes developing intervention concepts and managing and monitoring complex proceedings relating to the reorganisation or restructuring of these companies.

The division's tasks also include initiating and conducting liquidation and bankruptcy proceedings against companies supervised by FINMA. These may be either companies that hold the necessary licence for their activities or, in line with current practice, unauthorised institutions, i.e. those without a licence therefore have to be liquidated. The total number of liquidation and bankruptcy proceedings fell by 10% between the end of 2016 and 31 December 2017. A clear majority of these relate to unauthorised supervised institutions in the banking segment. FINMA is making increased use of external liquidators and bankruptcy administrators to conduct the actual proceedings, while focusing its own efforts on their coordination and supervision. The Recovery and Resolution division also conducts proceedings to recognise foreign bankruptcy decrees. In 2017, three proceedings were initiated and one was concluded.

International cooperation in recovery and resolution

Switzerland's two large banks have strong international ties, necessitating well-established cooperation with foreign supervisory authorities. FINMA organises three meetings a year, convening colleges and workshops to exchange information with the home foreign supervisory authorities and thus facilitate cross-border restructuring in a crisis. As home regulator, FINMA is responsible for organising and deciding on the content of the meetings.

Since 2010, the Financial Stability Board (FSB) has been conducting peer reviews in which member states assess each other's implementation of agreed standards. FINMA acted as auditor in a peer review for the first time in 2017, assessing Singapore and its legal framework for macroprudential instruments and resolution. The review will conclude with a report, which will be adopted and published by the FSB Plenary in the first quarter of 2018.

Significant insolvencies

Banque privée Espírito Santo in Liquidation

A number of key stages in the proceedings were successfully completed in 2017. The schedule of claims was published in April, providing a ruling on registered bankruptcy claims amounting to some CHF 2.7 billion. Once final and binding, it allowed the claims of first- and second-class creditors – including former employees of the bank – to be settled in full in September 2017. The creditors' committee set up by FINMA met regularly during the year and was actively involved in fundamental decisions regarding the proceedings. On the basis of work carried out by the bankruptcy liquidator, the decision was taken to initiate liability proceedings against the bank's former governing bodies and to contest various transactions carried out prior to the bankruptcy. A number of proceedings are already pending.

Hottinger & Cie AG in Liquidation

The process of paying out privileged deposits and handing over custody assets to clients was largely concluded by the end of 2016. In parallel with ongoing realisation of the available assets, further key steps in the proceedings were completed in 2017: the schedule of claims, listing over 1,500 creditors and registered claims amounting to more than CHF 353 million, was published in March. To involve creditors in the process of resolving complex claims, FINMA permitted the bankruptcy liquidators to hold creditors' meetings. As a result, in May 2017, a decision by the creditors was adopted by written resolution. Once the vast majority of the schedule had acquired binding force, payment of a first instalment to creditors began in August 2017. The claims of first- and second-class creditors were settled in full; those in the third class received an initial reimbursement of 30% of their claims.

Lehman Brothers Finance AG in Liquidation et al.

Following the global collapse of Lehman Brothers, a ruling by the then Swiss Federal Banking Commission in 2008 ordered the commencement of bankruptcy proceedings against Lehman Brothers Finance AG. Some 300 claims amounting to more than CHF 70 billion were registered. By the end of 2017, 12 of the 14 objections to the schedule of claims published in 2013 had been completed. Two cases are still pending before the courts. By October 2017, instalment payments totalling 61.8% had been made to creditors from the assets realised to date. The bankruptcy proceedings concerning Lehman Brothers International (Europe), London, Zurich Branch, in Liquidation, and the ancillary bankruptcy proceedings concerning Lehman Brothers International (Europe), London, in Liquidation, were fully concluded in 2017. The latter released a significant surplus of tens of millions of Swiss francs, which can be distributed among the creditors in the liquidation proceedings.

In addition to pooling specialist skills in the area of recovery and resolution, a key theme for the division in 2017 was resolution planning for banks.

The creation of a separate Recovery and Resolution division has efficiently pooled FINMA's expertise in this area, and this organisational enhancement has already had a tangible impact, both internally and externally.

Efficient handling of liquidation and insolvency proceedings

FINMA has made greater use of external liquidators and bankruptcy administrators in liquidation and insolvency proceedings. This has raised the completion rate for proceedings, and enabled limited human resources to be deployed efficiently in coordinating and overseeing the conduct of proceedings. It also allows for continual exchange with external specialists and uniform procedural practice.

Major progress in resolution planning for the large banks

In 2017, the two large banks made substantial progress with their global resolution plans towards implementing the legal requirements.

Based on the resolution plans drawn up by the banks, FINMA is developing an operable resolution strategy and a FINMA resolution plan. The two large banks further expanded their loss-absorbing capacity in the year under review, and are well on the way to implementing the revised 2016 "too big to fail" requirements (TBTF 2) for gone concern capital.³² They have also further enhanced operational independence within their respective groups by progressively outsourcing their critical intra-group services to legally independent service companies. Furthermore, the detailed process to operationally execute a bail-in³³ under Swiss law was defined. Since 1 January 2017, the legal framework has been in place for the Swiss legal entities of the large banks to directly issue capital instruments for resolution purposes. This gives FINMA the authority to order a bail-in in a crisis.

Emergency planning for systemically important banks

Switzerland's five systemically important banks (Credit Suisse, PostFinance, Raiffeisen, UBS and Zürcher Kantonalbank) are obliged to demonstrate in their emergency planning that the continuity of systemically important functions³⁴ can be maintained without interruption even if the bank faces the threat of insolvency. None of the five currently has an approved emergency plan. When reviewing the plans submitted, FINMA concluded that they needed to be updated to include evidence (as required by law) that systemically important functions can continue uninterrupted. As regards the two large banks, the strong operational interdependencies and financial ties between their Swiss subsidiaries and other group companies make implementing emergency plans a challenge. With regard to the domestically focused systemically important banks, the main hindrances involve the lack of gone concern capital needed to implement the resolution strategy set out in the emergency plan. The systemically important banks still have much work to do to comply with the deadlines set by the legislator for ensuring that emergency plans can be implemented.

³² Gone concern capital means capital globally active systemically important banks must hold should they be unable to continue their business activities; it serves to guarantee resolution or an orderly restructuring of the institution while maintaining continuity of systemically important functions.

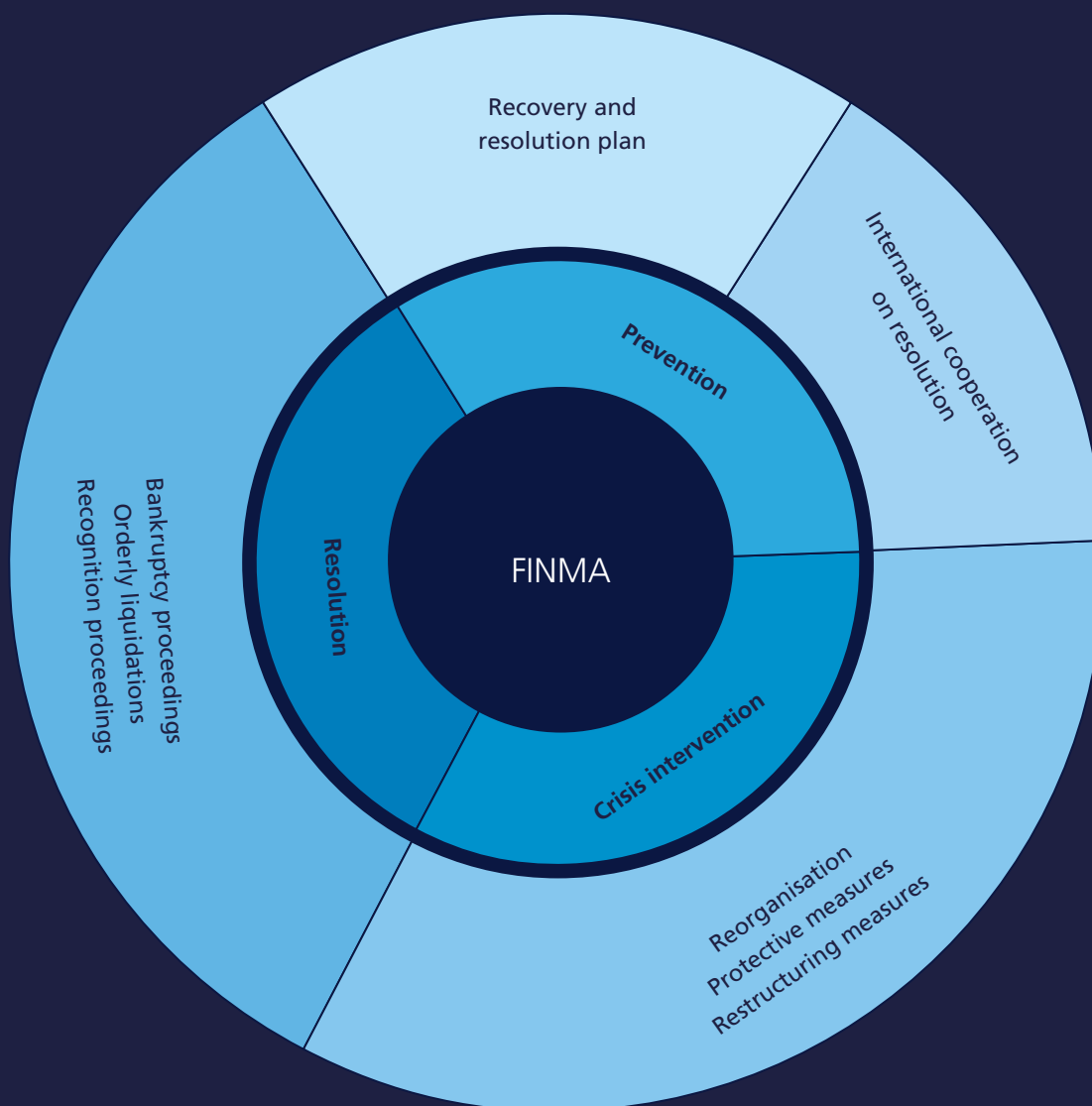
³³ A bail-in is a measure taken to restructure a financial institution in distress. It empowers FINMA to write off claims from unsecured creditors of an institution in default and to convert the claims into equity capital.

³⁴ Functions are deemed systemically important if they are essential to the Swiss economy and cannot be substituted in the short-term, for instance the domestic deposits and loans business and payment transactions.

Recovery and resolution: responsibilities

FINMA's recovery and resolution activities cover the entire crisis cycle, from prevention and intervention in an acute crisis situation to resolution in cases where no recovery is possible.

Responsibilities in a crisis and restructuring cycle



Focal points of recovery and resolution supervision in 2018

Operationalising the resolution strategy for large banks and ensuring all the systemically important banks make progress in their emergency planning will be a key topic for FINMA.

Bail-in approach at group level

Work is progressing to ensure FINMA's preferred approach – a bail-in at group level – can be implemented swiftly (bail-in at holding company level as single point of entry while retaining business operations at subordinate banks level). Requirements for the reporting and valuation process in a crisis are being defined, and a strategy to ensure access to key financial market infrastructures is being drawn up and implemented. The operational processes for measures required in recovery and resolution are also being refined. Especially critical interfaces between the parties involved in proceedings are being worked on to ensure that proceedings can be conducted smoothly when required.

Funding in resolution

One key element in the successful restructuring of a large bank via a bail-in is the availability of sufficient liquidity during preparations for and in the phase immediately after conversion (writing off creditors' claims and conversion into equity capital), to ensure that systemically important functions can be maintained without interruption until the necessary market confidence has been fully restored. Taking account of international standards, FINMA, working closely with the Swiss National Bank (SNB), will continue assessing the two large banks' liquidity requirements in possible crisis scenarios and comparing them with the currently available liquidity reserves.

Implementation of internal loss-absorbing capacity

In July 2017, the Financial Stability Board (FSB) published its Guiding Principles on the Internal Total Loss-Absorbing Capacity of G-SIBs (Internal TLAC). These are designed to ensure that material subgroups of G-SIBs have sufficient loss-absorbing capital for recapitalisation in a crisis, thus preventing foreign regulators from adopting unilateral measures that would be at odds with a sustainable, group-wide resolution strategy. At the international level, FINMA will work with the established crisis management colleges to implement these recommendations. The FSB principles are to be implemented by 1 January 2019.

Support with emergency planning

FINMA provides close support to the five systemically important banks in formulating functional emergency plans, which they are required to submit to FINMA annually. In its assessment of these plans, FINMA highlights areas in which the banks need to do more to demonstrate that systemically important functions can be maintained without interruption.

Changes in regulation affecting recovery and resolution

In 2017, the FINMA Banking Insolvency Ordinance was partially revised to restrict contract termination rights. In addition to implementing the FSB recommendations on the internal TLAC for global systemically important banks, the main regulatory project of 2018 will be the revision of the banking insolvency law.

FINMA ordinance	Regulatory project			Changes	In force from
	Type	Content/subject matter	Aims/reasons		
FINMA Banking Insolvency Ordinance	Partial revision	Stay regulations: specifying which contracts are subject to an amendment requirement to ensure recognition of stays on early termination rights ordered by FINMA (Art. 12 para. 2bis BO, Art. 30a BA)	Creating legal certainty for those affected/alignment with international practice	Limiting the amendment requirement to the contracts customary for financial market transactions; defining implementation periods	1 April 2017

Outlook

As part of a revision of the banking insolvency law, topics that are currently governed at ordinance level (BIO-FINMA) are to be incorporated into federal law (BA). The main aims are to provide greater legal certainty when implementing restructuring measures and regulate for the first time certain issues that may arise during a restructuring. Specifically, these relate to the handling of potential compensation claims from creditors whose claims have been converted into equity or reduced as part of the bail-in, and the question of when creditors have become shareholders of the institution concerned because their claims have been converted into equity acquire voting rights and other rights of co-determination. The FDF is expected to schedule the consultation on these changes for the second half of 2018.

Recovery and resolution statistics

FINMA completed a number of liquidations and bankruptcies relating to unauthorised activities in 2017. Meanwhile, work continues on several complex bankruptcy proceedings in the authorised segment.

Case numbers

	Outstanding on 1 January 2017	Proceedings initiated	Proceedings concluded	Outstanding on 31 December 2017
Liquidations				
Licence holders	3	0	0	3
Unauthorised activities	32	0	4	28
Bankruptcies				
Licence holders	12	1	1	12
Unauthorised activities	88	11	11	88
Recognition process				
Licence holders	16	3	1	18
Unauthorised activities	1	0	0	1
Total proceedings	152	15	17	150

Breakdown of proceedings outstanding as of 31 December 2017 by supervisory area

	Bankruptcies	Liquidations	Recognitions	Total
Banks/securities dealers	92	26	18	136
Insurance companies	2	0	0	2
CISA collective investment schemes	5	3	1	9
Directly subordinated financial intermediaries (DSFIs)	1	2	0	3
Total proceedings	100	31	19	150

Age of outstanding proceedings as of 31 December 2017 in months (median)

	Licence holders	Unauthorised activities
Liquidations	28	50.5
Bankruptcies	71.5	44
Recognition proceedings	40	40

Breakdown of outstanding proceedings as of 31 December 2017 (internal and external)

	Internal proceedings	External proceedings
Liquidations	2	29
Bankruptcies	23	77
Recognition proceedings	18	1

At a glance: insolvency activities of Recovery and Resolution in 2017

Insolvency activities include processing bankruptcies and liquidation proceedings and recognising foreign bankruptcy decrees.

Regional breakdown of bankruptcies and liquidations

More than half of the currently outstanding bankruptcy and liquidation proceedings relate to companies based in the cantons of Zurich, Zug, Ticino and Geneva.

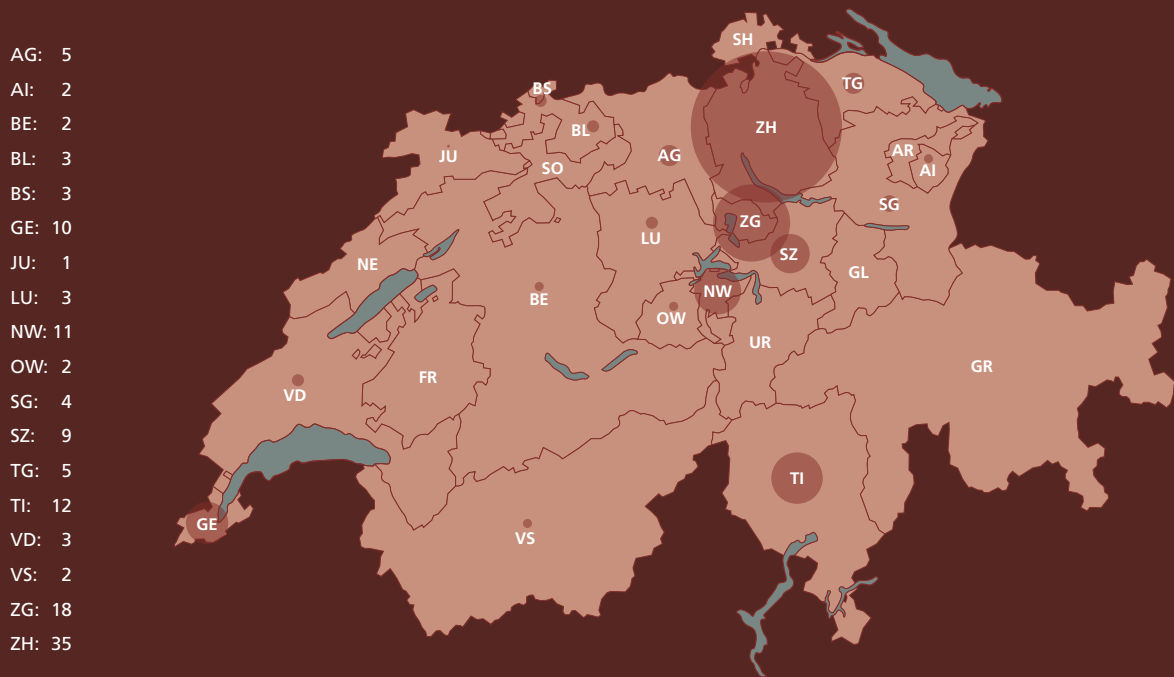
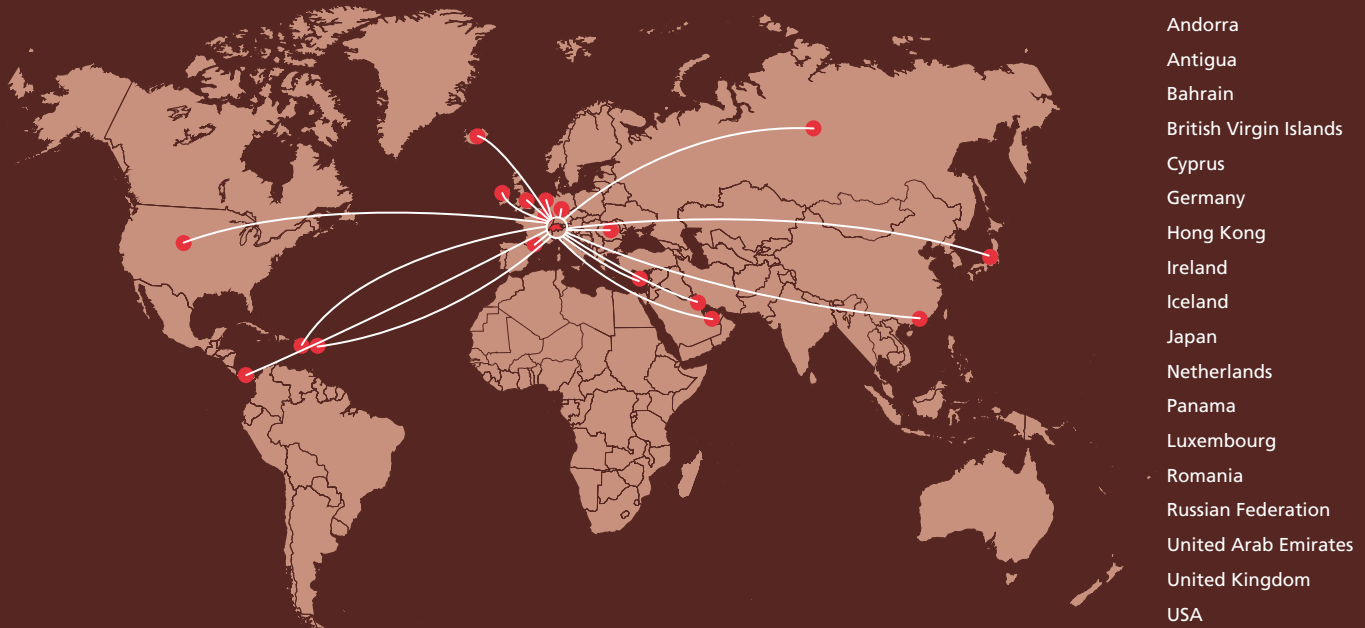


Image source: Federal Office of Topography.

International breakdown of recognition proceedings handled

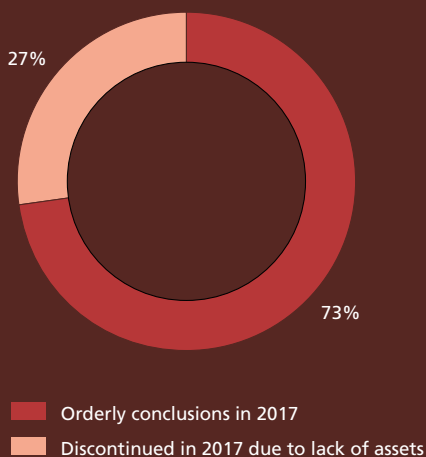
Around half of the proceedings to recognise foreign bankruptcy decrees relate to other countries in Europe, but they also include the Middle East, Asia, the US, the Russian Federation and Central America.



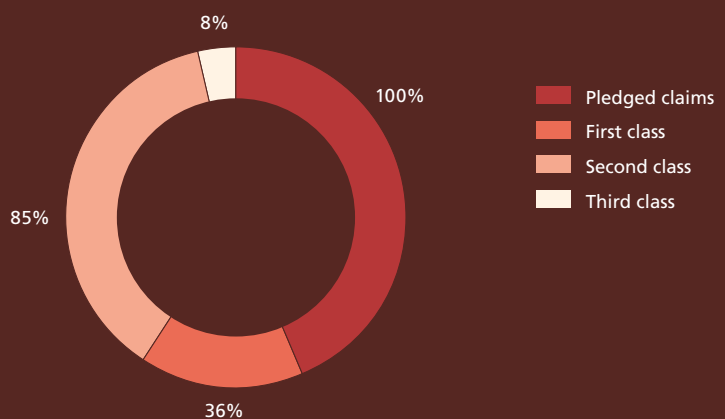
Results of bankruptcy proceedings

Around a quarter of bankruptcy proceedings were discontinued owing to lack of assets, while three quarters were completed with the insolvent company's remaining assets being distributed to creditors. In the proceedings concluded in 2017, creditors with pledged claims received full settlement, as these take precedence. The claims of subordinate creditors, however, were only partially satisfied.

Settlement of proceedings



Distribution of bankruptcy dividends to the various creditor groups



FINMA personnel
survey shows
positive results

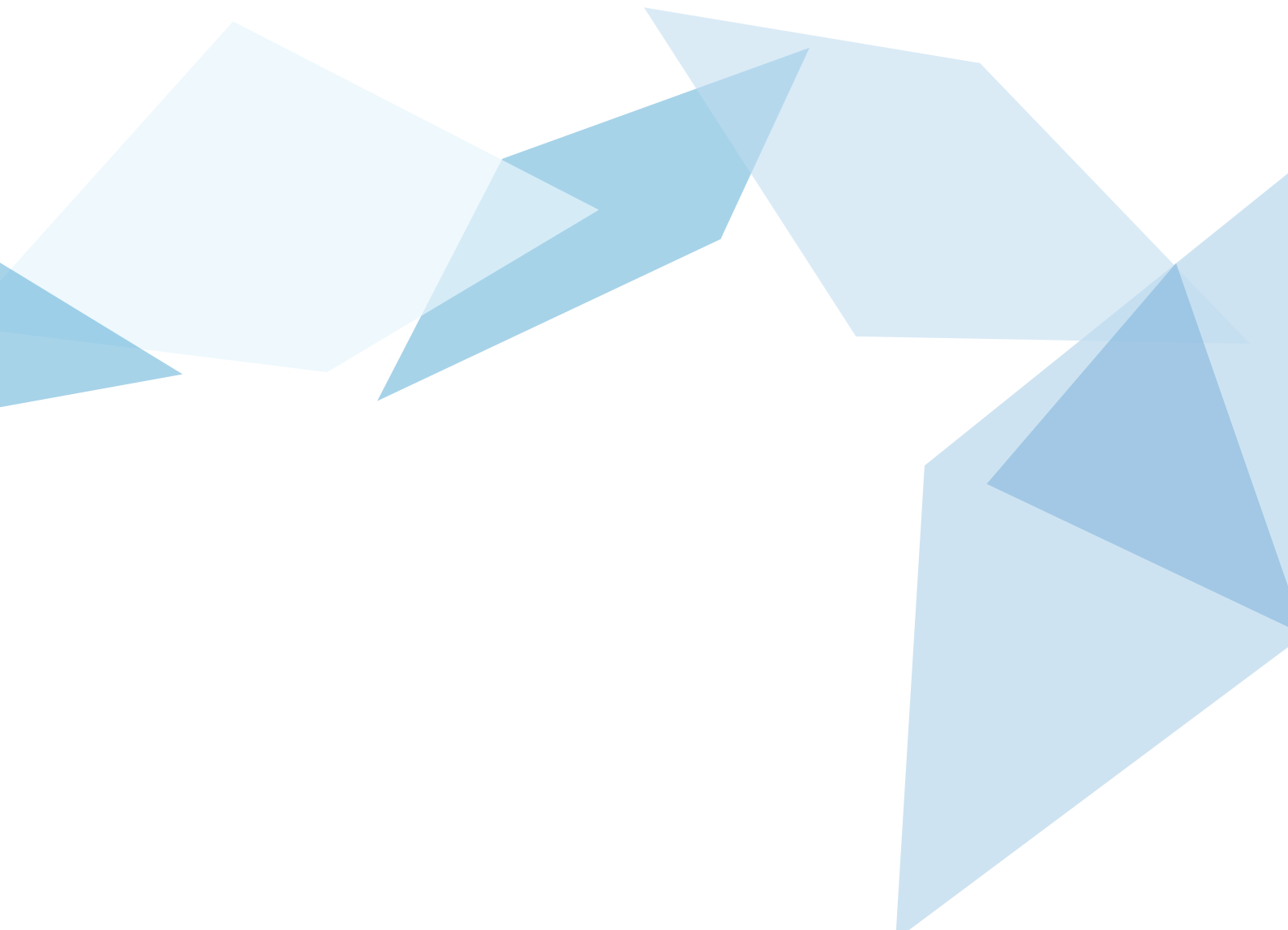


Organisation and staff

104 Board of Directors and Executive Board

108 Staff

111 Operations



As in 2015, FINMA conducted a comprehensive personnel survey last year. The responses to the questions, together with the high response rate, indicated a high level of job satisfaction and close identification with FINMA's work.

Board of Directors and Executive Board

FINMA is a public law institution in its own right.
It is governed by a Board of Directors and an Executive Board.

The Board of Directors

The Board of Directors is FINMA's strategic management body. It directs, supervises and controls FINMA's executive management. It decides on matters of substantial importance, issues ordinances and circulars, and is responsible for FINMA's budget. The Board of Directors acts as a collective body. Its decisions are taken by a majority of the votes of the members present.

Members of the Board of Directors (31 December 2017)

Dr Thomas Bauer	Chair
Philippe Egger	Vice-Chair
Prof. Marlene Amstad	Member
Bernard Keller	Member
Prof. Yvan Lengwiler	Member
Günter Pleines	Member
Dr Renate Schwob	Member
Franz Wipfli	Member

After serving for a period of four years, Bruno Frick resigned from FINMA's Board of Directors at the end of August 2017 to concentrate on his career as a lawyer and notary. Following his departure, FINMA's Board of Directors now has eight Board members. This meets the statutory requirement, which specifies a minimum of seven and a maximum of nine Board members.

Committees of the Board of Directors

The Board of Directors has three committees, formed from among its members: the Audit and Risk Committee, the Appointments Committee, and the Takeover and State Liability Committee. The Takeover and State Liability Committee is the complaints body with

which appeals against rulings by the Swiss Takeover Board may be lodged. It also rules on claims seeking to establish state liability under the Government Liability Act. The other two committees act in an advisory capacity by submitting proposals to the Board of Directors. Each committee has a chairperson who liaises with the Board of Directors and the Executive Board. In addition to its standing committees, the Board of Directors may form ad hoc committees to prepare business, or authorise individual members to undertake extraordinary tasks.

In 2015, the Board of Directors decided to create a Regulation Committee to assist the Board of Directors with the complex regulation process. Following an analysis which showed that anticipated efficiency gains had not been realised, the Board of Directors dissolved the Regulation Committee in January 2017. The Board as a whole has always retained its decision-making powers when it comes to regulatory issues.

On 7 December 2017, the Board of Directors decided on a further change with regard to its committees. Specifically it decided to transfer the power to rule on claims of state liability to the existing Takeover Committee. The reorganisation was linked to an objection made by the Federal Administrative Court in November 2017 which claimed that FINMA's Enforcement Committee ruled on enforcement and state liability matters. Consequently, FINMA's Board of Directors took measures to ensure that claims of state liability will now be handled by a Board committee whose members have no involvement in enforcement proceedings.



Dr Thomas Bauer



Philippe Egger



Prof. Marlene Amstad



Bernard Keller



Prof. Yvan Lengwiler



Günter Pleines



Dr Renate Schwob



Franz Wipfli

Board of Directors
(31 December 2017)

The fact that FINMA must decide about its own state liability in first instance is laid down in law (Liability Act). This is also the case with other public authorities whose organisational structure is similar. The

Federal Administrative Court's requirements have been taken into account to the extent possible by separating enforcement issues from claims of state liability.

The standing committees of the Board of Directors and their members (31 December 2017)

	Audit and Risk Committee	Appointments Committee	Takeover and State Liability Committee
Dr Thomas Bauer		Chair	
Philippe Egger	X		
Prof. Marlene Amstad			X
Bernard Keller	X		
Prof. Yvan Lengwiler		X	X
Günter Pleines		X	
Dr Renate Schwob			Chair
Franz Wipfli	Chair		

The Executive Board

The Executive Board is FINMA's operational management body. It is charged with supervising banks, insurance companies, exchanges, securities dealers and other financial intermediaries in line with statutory regulations and the strategy FINMA follows. It prepares the necessary files and materials on matters dealt with by the Board of Directors and is responsible for implementing the resolutions of the Board of Directors and its committees.

Members of the Executive Board (31 December 2017)

Mark Branson	CEO
Dr Peter Giger	Deputy CEO and Head of Insurance division
Léonard Bôle	Head of Markets division
Patric Eymann	Head of Enforcement division
Alexandra Karg	Head of Operations division
Dr Michael Loretan	Head of Asset Management division
Rupert Schaefer	Head of Strategic Services division
Michael Schoch	Head of Banks division
Dr David Wyss	Head of Recovery and Resolution division



Mark Branson



Dr Peter Giger



Léonard Bôle



Patric Eymann



Alexandra Karg



Dr Michael Loretan



Rupert Schaefer



Michael Schoch



Dr David Wyss

Executive Board
(31 December 2017)

Enforcement Committee

The Enforcement Committee (ENA) is a standing committee of the Executive Board responsible for making decisions on enforcement. It issues enforcement rulings and decides whether to initiate and/or discontinue proceedings, particularly against supervised institutions and individuals. Where matters of substantial importance are involved, these decisions are reserved for the Board of Directors.

Permanent members of the Enforcement Committee (31 December 2017)

Mark Branson Chair
Rupert Schaefer
Patric Eymann

Division heads handling a particular case also join the Enforcement Committee as voting members on a case-by-case basis.

FINMA is committed to a sustainable personnel policy with a focus on efficiency and transparency over the long term. Regular staff surveys and the opportunities they provide to identify improvements are a key aspect of personnel management at FINMA.

FINMA conducts a full survey of its workforce every two years. 92% of FINMA staff took part in the last survey. The detailed responses from these surveys give FINMA a basis for in-depth quantitative analysis. The many supplementary comments from employees also deliver a comprehensive and conclusive overview.

Results of the survey

FINMA employees generally show high levels of job satisfaction and largely identify with their employer. The scores for these assessment categories have risen since the last survey in 2015. The following topics in particular show a marked improvement over the results from the last survey: "Working together", "Workload", "Attractiveness as an employer" and "Understanding of/identification with FINMA's objectives".

However, there were also some critical responses identifying areas in which improvements can be made. These include appreciation of linguistic diversity, integration of employees at FINMA's Zurich offices, coordination of internal training and development, transparency as regards career prospects, and the stability of IT systems. The responses to the survey were analysed in workshops at all levels in each division, and work has already begun on implementing the relevant improvements.

Work-life balance

In December 2016, FINMA decided to implement a number of enhancements to its personnel policy and conditions of employment based on the results of a benchmark report on work-life balance. These measures were implemented in the first half of 2017 and included:

- adjusting FINMA's personnel regulations to include additional part-time positions;
- additional elements of working time autonomy in the form of an annual holiday purchase scheme and the right to unpaid leave after five years of service;
- creation of an independent point of contact for privacy rights and initial counselling for individuals facing difficult life situations;
- extension of paid paternity leave to ten working days;
- enhancement of parental leave and a general entitlement to an unpaid extension;
- facilitated re-entry through a temporary workload reduction to 40% for female employees during the first 12 months after childbirth;
- changes to the regulations for carers, which now also explicitly cover the provision of emergency care to elderly family members.

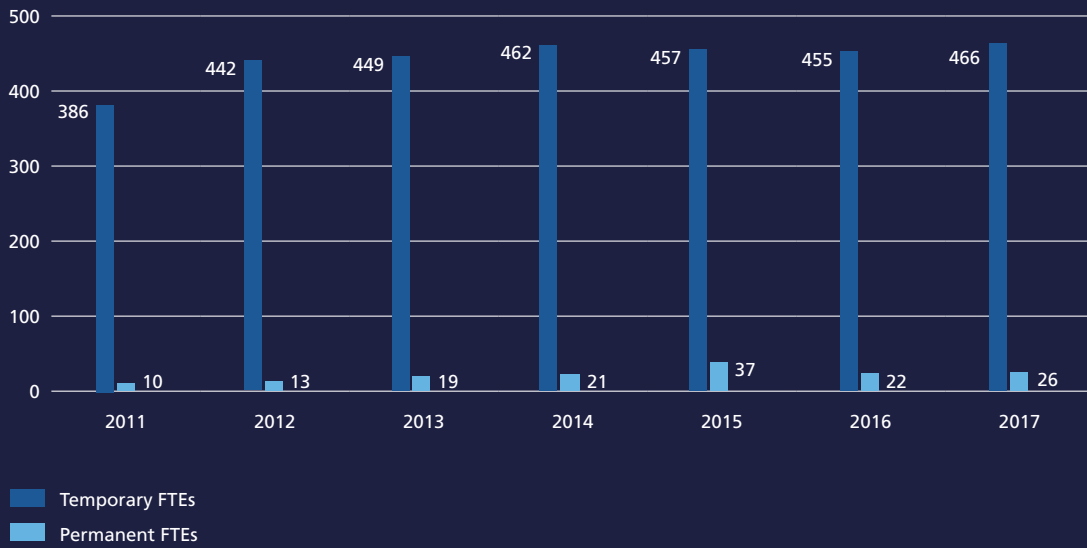
Given that FINMA employees already enjoy part-time working models, an equal opportunity salary model and substantial flexibility as regards working hours and work locations, the new measures further enhance FINMA's position as a modern and attractive employer.

Promotion of young talent

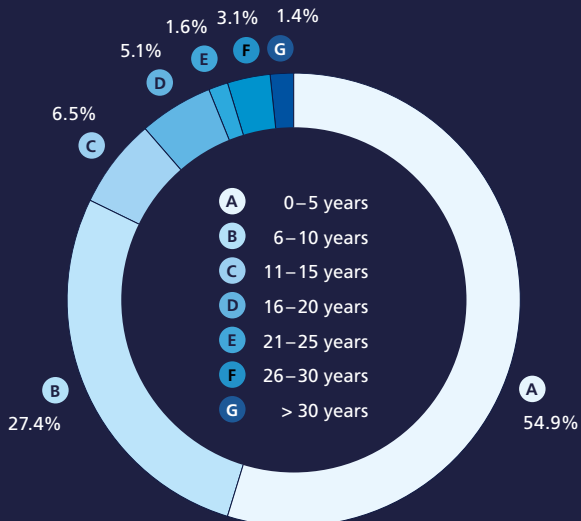
FINMA has expanded its Legal and Compliance Officer programme for junior lawyers which was created in 2011. The aim of the programme is to train participants to become networked finance generalists with broad expertise in financial market law. There are now five places for the three-year trainee programme. Deployment opportunities in the Enforcement and Banks divisions have now been added to those already available in the Markets and Asset Management divisions.

Key personnel indicators at FINMA

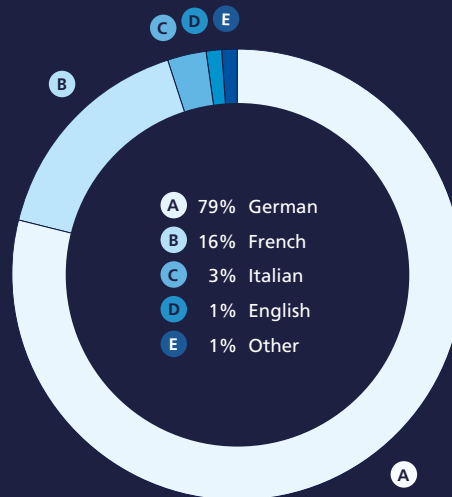
Average full-time equivalents (FTEs)



Years of service



Breakdown by language



The newly created FINMA apprenticeship position in basic commercial training (profile M) was filled by an apprentice in the summer of 2017. It is planned to recruit an additional trainee annually for each of the three apprenticeship years.

FINMA's commitment to staff development and the promotion of young talent is paying off. In the year under review, 10 of 24 management positions, including those held by specialists, were filled internally, resulting in an internal recruitment ratio of 42%.

Equal pay audit

In 2016, independent experts from the Swiss Association for Quality and Management Systems (SQS) awarded FINMA's remuneration system the "Good Practice in Fair Compensation" certificate, confirming that FINMA has a fair and balanced remuneration system. The maintenance audit took place in the autumn of 2017. The wage differential between men and women as measured by Logib, the Swiss government's pay equality tool, is 3.1% (2016: 2.6%).

Key personnel indicators

In 2017, the maximum headcount approved by the Board of Directors for permanent employment was 481 full-time equivalent positions, of which an average of 466 were filled (2016: 455). In 2017, FINMA had an average of 534 employees (2016: 513) across 492 full-time equivalent positions (2016: 494) in permanent and temporary employment. Some 32% of employees worked part-time (2016: 28%). The headcount approved by the Board of Directors for 2018 is unchanged.

The average age of employees in 2017 was 42 (2016: 41). Approximately 66% (2016: 71%) of staff were aged between 30 and 49. 24% (2016: 22%) of employees were aged 50 and over, while around 10% (2016: 9%) were young talents. Senior management positions were held by 284 employees (2016: 261) or 52% (2016: 50%). This category at FINMA includes all line management and specialist functions in Salary Bands 1 to 3. 94 employees (2016: 86), or around 33% (2016: also 33%), had a line management function, with women making up around 24% of line managers (2016: 20%). In 2017, women accounted for 40% of the total workforce (2016: 39%). At the end of 2017, the number of non-Swiss nationals working for FINMA was 81 (2016: 72).

At the end of December 2017, staff turnover (excluding retirement) was 5%, a significant decrease on the previous year (2016: 11%). This can be explained by the high level of job satisfaction and identification with FINMA as also shown in the 2017 personnel survey. Of FINMA's overall workforce, some 18% have worked for FINMA or one of its predecessor organisations for more than ten years.

Operations

The introduction of an exchange platform which allows external users to share documents digitally was a key milestone in FINMA's postal services. Supervised institutions now can send confidential documents to FINMA in digital form.

The launch of a new portal to exchange documents digitally saw the implementation of the first leg of the Extranet project. After a one-off registration process, external users can share confidential documents digitally with FINMA.

Extranet project – a platform for communicating with external partners

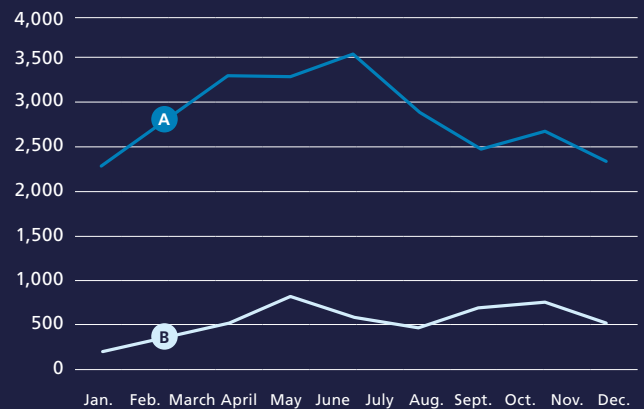
The Extranet project represents a milestone in the digitalisation of FINMA's operations. Following a one-off registration process, external users can log in to the new portal to access functions and applications and share digital documents with FINMA via a secure channel. Three such channels – the delivery platform, the distribution platform and the collaboration platform – have already been launched and other modules will follow.

The delivery platform allows supervised institutions to submit documents to FINMA electronically. Through this unidirectional channel, institutions can send legally compliant submissions with a qualified certificate and electronic signature to FINMA. For its part, FINMA can use the recently launched distribution platform to send electronically signed documents to supervised institutions. Both processes make it possible to share legally compliant documents without media disruption while reducing transmission delays and making a positive contribution to the environment.

Physical and electronic mail in 2017

In the first few months, the number of documents received electronically via the delivery platform was between 500 and 1,000 per month, while the amount of physical mail received started to decline in late spring. By the end of the year, more and more documents were submitted to FINMA electronically.

Physical mail processed between January 2017 and December 2017



- A Total physical mail received
- B Total documents received electronically

FINMA takes
increased action
against individuals

76

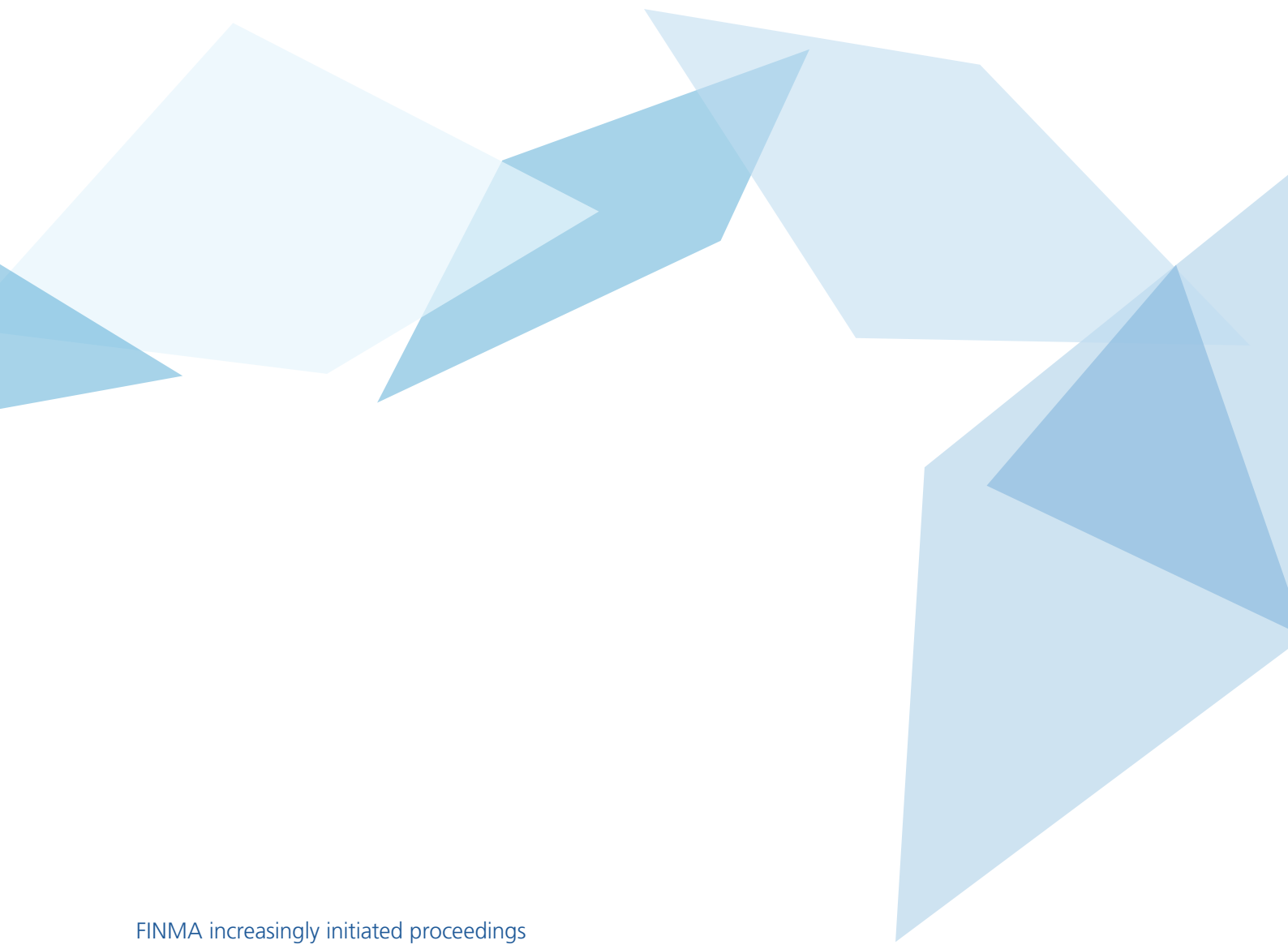
rulings against
legal entities

53

rulings against
individuals

Appendix

- 114** Supervisory categories
- 116** Statistics
- 120** Agreements signed by FINMA
with other supervisory authorities
- 122** Abbreviations



FINMA increasingly initiated proceedings against individuals who are directly responsible for serious breaches of regulatory provisions. The aim here is to exert a more preventive effect by holding those responsible to account.

Supervisory categories

FINMA-supervised institutions are assigned to one of six categories depending on their potential risk impact on creditors, investors, policyholders and the Swiss financial centre as a whole. FINMA also gives each institution a rating which reflects its assessment of the institution's current status.

Based on category and rating criteria, the supervisory approaches adopted by FINMA for each institution is determined by the intensity of supervision, the supervisory tools used and the interaction be-

tween the use of audit firms and FINMA's direct supervision. These measures enable FINMA to apply risk-based supervisory approaches and to monitor institutions with a high risk exposure more intensely.

Supervisory categories – banks³⁵

Banks are categorised in line with the rules set out in FINMA Circular 2011/2.³⁶

Category	Criteria (in CHF billions)	Number of institutions		
		2017	2016	
1	Total assets	≥ 250	2	2
	Assets under management	≥ 1,000		
	Privileged deposits	≥ 30		
	Capital requirements	≥ 20		
2	Total assets	≥ 100	3	3
	Assets under management	≥ 500		
	Privileged deposits	≥ 20		
	Capital requirements	≥ 2		
3	Total assets	≥ 15	24	29
	Assets under management	≥ 20		
	Privileged deposits	≥ 0.5		
	Capital requirements	≥ 0.25		
4	Total assets	≥ 1	57	63
	Assets under management	≥ 2		
	Privileged deposits	≥ 0.1		
	Capital requirements	≥ 0.05		
5	Total assets	< 1	199	202
	Assets under management	< 2		
	Privileged deposits	< 0.1		
	Capital requirements	< 0.05		

³⁵ Market participants not subject to prudential supervision are in Category 6.

³⁶ Circular 2011/2 "Capital buffer and capital planning – banks", (www.finma.ch/en/~media/finma/dokumente/dokumenten-center/myfinma/rundschreiben/finma-rs-2011-02.pdf?la=en).

Supervisory categories – insurance companies³⁷

Category	Criteria	Number of institutions	
		2017	2016
1	–	–	–
2	Total assets > CHF 50bn or complexity	5	5
3	Total assets > CHF 1bn or complexity	38	37
4	Total assets > CHF 0.1bn or complexity	56	60
5	Total assets < CHF 0.1bn or complexity	105	105

Supervisory categories – asset management

Category	Criteria	Number of institutions	
		2017	2016
1	–	–	–
2	–	–	–
3	–	–	–
4	Assets under management ³⁸ ≥ CHF 30bn	14	11
5	Assets under management ³⁸ < CHF 30bn	398	394

Supervisory categories – markets

Qualitative criteria	Trading venues	Central counterparties	Central securities depositories
Relevance for issuers, investors and pricing	X		
Relevance for trading venues, settlement and custody		X	
Relevance for trading venues and clearing participants			X
Risk of market manipulation and insider trading	X		
Complexity (ancillary services, technology)	X	X	
Complexity (products cleared, technology)			X
International network	X	X	X

Financial market infrastructures (FMIs) are categorised according to quantitative and qualitative criteria based on FMI type.

Currently, two financial market infrastructures are assigned to Category 1, three to Category 2 and two to Category 4. The categorisation of two newly licensed financial market infrastructures is still under review.

Directly supervised financial intermediaries (DSFIs) are assigned to Category 6 and are not subject to prudential supervision.

³⁷ Market participants not subject to prudential supervision are in Category 6.

³⁸ The assets under management are the total net fund assets of all managed or administered funds and all individual portfolio management assets.

Supervised financial market participants³⁹

(31 December 2017)

Supervised banks

	2017	2016
Banks, of which	272	282
– under foreign control	86	91
– branches of foreign banks	29	29
– exiting the market	16	16
Raiffeisen banks	261	271
Representative offices of foreign banks	53	56

Supervised securities dealers

	2017	2016
Securities dealers, of which	48	52
– under foreign control	12	14
– branches of foreign securities dealers	11	11
– exiting the market	6	6
Representative offices of foreign securities dealers	41	40
Recognised foreign remote participants	137	126

Supervised financial market infrastructures

	2017	2016
Swiss stock exchanges/domestic trading venues ⁴⁰	3	3
Domestic institutions similar to stock exchanges/trading venues ⁴⁰	0	3
Domestic multilateral trading facilities	2	0
Recognised foreign stock exchanges/trading venues ⁴⁰	61	55
Recognised foreign central counterparties	4	1
Domestic central securities depositories	1	0
Domestic trade repositories	1	0
Recognised foreign trade repositories	1	0

Supervised collective investment schemes

	2017	2016
Swiss collective investment schemes		
Total Swiss collective investment schemes, of which	1,642	1,551
– domestic open-ended collective investment schemes (Art. 8 CISA)		
– contractual investment funds and SICAVs	1,624	1,533
– of which intended for qualified investors only	698	645
– closed-ended Swiss collective investment schemes (Art. 9 CISA)		
– limited partnerships for collective investment schemes and SICAFs	18	18
Foreign collective investment schemes		
Total foreign collective investment schemes, of which	7,761	7,401
– EU compatible (UCITS)	7,685	7,314
– non-EU compatible (non-UCITS ⁴¹)	76	87

³⁹ “Supervised” does not necessarily mean that an institution is subject to prudential supervision.

⁴⁰ Authorisation category names changed when FMI entered into force on 1 January 2016. As the transition periods only

expired at the end of 2016, the old and new terms are used here for the 2016 figures.

⁴¹ Non-UCITS schemes are collective investment schemes not subject to the EU UCITS Directive.

Supervised fund management companies, asset managers, custodian banks, representatives and distributors under CIS

	2017	2016
Fund management companies	45	44
Asset managers	217	206
Representatives of foreign collective investment schemes	92	94
Distributors under CISA	353	354
Custodian banks	31	32

Supervised insurers and general health insurers

	2017	2016
Life insurers, of which	19	19
– insurers domiciled in Switzerland	16	16
– branches of foreign insurers	3	3
Non-life insurers, of which	118	120
– insurers domiciled in Switzerland (incl. 19 supplementary health insurers [2016: 21])	73	74
– branches of foreign insurers (incl. 2 supplementary health insurers [2016: 2])	45	46
Total reinsurers	55	55
– reinsurers	28	30
– reinsurance captives	27	25
General health insurers offering supplementary health insurance	12	13
Total supervised insurers and health insurers	204	207
Insurance groups (groups and conglomerates)	6	6

Supervised financial intermediaries

	2017	2016
Total supervised self-regulatory organisations	12	12
Total directly supervised financial intermediaries	163	199
Total group companies subject to FINMA money laundering supervision	134	136
Total registered insurance brokers	15,997	15,611

Recognised credit rating agencies

	2017	2016
Total recognised credit rating agencies	5	5

Authorisations issued (1 January to 31 December 2017)

Banks

	2017	2016
Bank licences (Art. 3 BA)	1	2
Branches (Art. 4 FBO-FINMA)	3	3
Representative offices (Art. 14 FBO-FINMA)	2	1
Additional licences (Art. 3 ^{ter} BA)	3	7
Released from supervision	6	8

Securities dealers

	2017	2016
Securities dealers' licences (Art. 10 SESTA)	2	1
Branches (Art. 41 SESTO)	2	0
Representative offices (Art. 49 SESTO)	1	4
Additional licences (Art. 10 para. 6 SESTA and Art. 56 para. 3 SESTO)	1	0
Released from supervision	4	4
Recognition of foreign stock exchange participants/participants	10	6

Financial market infrastructures

	2017 ⁴²	2016
Authorisation of domestic trading venues	2	0
Authorisation of domestic multilateral trading facilities	2	0
Recognition of foreign stock exchanges/trading venues	42	3
Recognition of foreign central counterparties	3	1
Authorisation of domestic central depositories	1	0
Authorisation of domestic trade repositories	1	0
Authorisation of foreign trade repositories	1	0

Collective investment schemes

	2017	2016
Swiss collective investment schemes	166	90
Foreign collective investment schemes	873	829

Fund management companies, asset managers, custodian banks, representatives and distributors under CISA

	2017	2016
Fund management companies	1	2
Asset managers	24	33
Representatives of foreign collective investment schemes	6	2
Distributors under CISA	27	42
Custodian banks	1	1

⁴² Re-authorisations under FMIA are included.

Insurers and general health insurers

	2017	2016
Life insurers, of which	0	0
– insurers domiciled in Switzerland	0	0
– branches of foreign insurers	0	0
Non-life insurers, of which	2	2
– insurers domiciled in Switzerland	1	1
– branches of foreign insurers	1	1
Reinsurers	2	0
Reinsurance captives	2	1
General health insurers offering supplementary health insurance	0	0
Total	6	3
Insurance groups (groups and conglomerates)	0	0

Financial intermediaries

	2017	2016
Directly supervised financial intermediaries	2	9
Money laundering supervision under FINMA group supervision	6	9
Registered insurance brokers	897	988

Credit rating agencies

	2017	2016
Recognised credit rating agencies	0	0

Enforcement: key figures

	2017	2016
Enforcement rulings	67	89
Appeals filed against enforcement rulings	35	41
Appeals settled	38	33
Charges filed with criminal authorities	135	167

Other rulings issued by the Enforcement Committee

	2017	2016
ENA rulings (e.g. data protection law, concession law, accountability, recusals)	4	3

Agreements signed by FINMA with other supervisory authorities

FINMA cooperates internationally with numerous other authorities. In 2017, it signed a number of agreements to strengthen this cooperation.

International agreements are non-binding administrative conventions relating to supervisory cooperation. The term “memorandum of understanding” (MoU) is widely used for such agreements, as are the terms “cooperation agreement” (COAG) and “coordination arrangement”. In these agreements, the participating supervisory authorities agree to cooperate within the scope of their national law and define the relevant arrangements. International agreements cannot be used by FINMA, the foreign partner authorities and/or third parties to establish any rights or obligations.

Supervisory cooperation agreements on FinTech

In 2017, FINMA concluded two cooperation agreements to promote supervisory cooperation relating to FinTech, one with the Australian Securities and Investments Commission (ASIC) and the other with the Israeli supervisory authority Capital Markets Insurance and Savings Authority (CMISA) and the Israel Securities Authority (ISA). These agreements enable FinTech companies from both countries to expand their business in the other country’s market and accelerate authorisation requirements and procedures, shortening the time before they commence operations. The agreements also provide a basis for exchanging FinTech-specific information.

In 2017, FINMA concluded the following agreements:

Country	Supervisory authority	Type	Area of application
Australia	Australian Securities and Investments Commission (ASIC)	bilateral/general	Promoting supervisory cooperation in the area of FinTech
Bermuda	Bermuda Monetary Authority (home authority), college members (host authorities)	multilateral/ institution-specific	Cooperation on supervision of the Catalina Group
European Union	European Securities and Markets Authority (ESMA)	bilateral/general	Cooperation agreement on trade repositories
Israel	Capital Markets Insurance and Savings Authority (CMISA) and Israel Securities Authority (ISA)	bilateral/general	Promoting supervisory cooperation in the area of FinTech
The Netherlands	De Nederlandsche Bank NV (home authority), college members (host authorities)	multilateral/ institution-specific	Cooperation agreement on crisis management of EuroCCP Group
Switzerland	FINMA (home authority), college members (host authorities)	multilateral/ institution-specific	Cooperation agreement on crisis management of Credit Suisse Group
Switzerland	FINMA (home authority), college members (host authorities)	multilateral/ institution-specific	Cooperation agreement on crisis management of UBS Group
United Kingdom	Bank of England (home authority), college members (host authorities)	multilateral/ institution-specific	Cooperation agreement on crisis management of LCH Group

Abbreviations

AEOI Automatic exchange of information	FAC Federal Administrative Court
AMLA Swiss Federal Act of 10 October 1997 on Combating Money Laundering and Terrorist Financing in the Financial Sector (Anti-Money Laundering Act; SR 955.0)	FAOA Swiss Federal Audit Oversight Authority
AMLO-FINMA Ordinance of 3 June 2015 of the Swiss Financial Market Supervisory Authority on Combating Money Laundering and Terrorist Financing (Anti-Money Laundering Ordinance; SR 961.011.0)	FATF Financial Action Task Force on Money Laundering
ASIC Australian Securities and Investment Commission	FBO-FINMA Ordinance of 21 October 1996 of the Swiss Financial Market Supervisory Authority on Foreign Banks in Switzerland (FINMA Foreign Banks Ordinance; SR 952.111)
AuM Assets under Management	FC Financial counterparties
BA Swiss Federal Act of 8 November 1934 on Banks and Savings Banks (1 January 2016) (Banking Act; SR 952.0)	FDF Federal Department of Finance
BCBS Basel Committee on Banking Supervision	FIFA Fédération internationale de football association
BCM Business Continuity Management (to maintain the continuity of business processes in a crisis situation)	FinIA Financial Institutions Act (draft law)
BIO-FINMA FINMA Banking Insolvency Ordinance of 30 August 2012 on the Insolvency of Banks and Securities Dealers; SR 952.05)	FINMA Swiss Financial Market Supervisory Authority
BO Swiss Federal Ordinance of 8 November 1934 on Banks and Savings Banks (Banking Ordinance; SR 952.02)	FINMA-PV Financial Market Auditing Ordinance of 5 November 2014 (SR 956.161)
BRP Business resumption plan	FINMASA Swiss Federal Act of 22 June 2007 on the Swiss Financial Market Supervisory Authority (1 January 2016) (Financial Market Supervision Act; SR 956.1)
CC-CS Control Committee of the Council of States	FinSA Financial Services Act (draft law)
CCP Central counterparty	FinTech Financial technology
CDB Swiss Banks' Code of Conduct with regard to the Exercise of Due Diligence	FIRST FINMA Insurance Reporting and Supervisory Tool
CGMT Coordinating group on combating money laundering and the financing of terrorism	FMI Financial market infrastructure
CHF Swiss franc	FMIA Swiss Federal Act of 19 June 2015 on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading (Financial Market Infrastructure Act; SR 958.1)
CID Client identifying data	FMIO Swiss Federal Ordinance of 25 November 2015 on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading (Financial Market Infrastructure Ordinance; SR 958.11)
CIS Collective investment scheme	FMIO-FINMA FINMA Ordinance of 3 December 2015 on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading (Financial Market Infrastructure Ordinance; SR 958.111)
CISA Swiss Federal Act of 23 June 2006 on Collective Investment Schemes (1 January 2016) (Collective Investment Schemes Act; SR 951.31)	FSB Financial Stability Board
CISO Swiss Federal Ordinance of 22 November 2006 on Collective Investment Schemes (Collective Investment Schemes Ordinance; SR 951.311)	FSC Federal Supreme Court
CMISA Capital Markets Insurance and Savings Authority (Israel)	FTA Federal Tax Administration
COAG Cooperation agreement	G-20 Group of the 20 leading industrialised and developing economies
ComFrame Common Framework	GHOS Group of Central Bank Governors and Heads of Supervision
CRO Chief Risk Officer	G-SIB Global systemically important bank
DSFI Directly subordinated financial intermediary	G-SII Global systemically important insurer
EMIR European Market Infrastructure Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories	IAIS International Association of Insurance Supervisors
ENA FINMA Enforcement Committee	ICO Initial coin offering or token-generating event
ESMA European Securities and Markets Authority	ICS International Capital Standard
ETP Exceptions to policy (loans granted outside internal banking regulations)	IFRS International Financial Reporting Standards
EU European Union	IOSCO International Organization of Securities Commissions
	ISA Israel Securities Authority
	ISO Swiss Federal Ordinance of 9 November 2005 on the Supervision of Private Insurance Companies (Insurance Supervision Ordinance; SR 961.011)
	KYC Know your customer

LCR Liquidity coverage ratio

LLP Last liquid point

Logib Federal government's equal pay instrument

LR Leverage ratio

LT Low trigger

MELANI Reporting and Analysis Centre for Information Assurance

MoU Memorandum of Understanding

MROS Money Laundering Reporting Office Switzerland

MVM Market value margin

NFA Net fund assets

NFC Non-financial counterparty

NSFR Net stable funding ratio

ORSA Own Risk and Solvency Assessment

OTC Over the counter

OTF Organised trading facilities

PEP Politically exposed person

QeS Qualified electronic signature

RBC Risk-bearing capital

RCAP Regulatory Consistency Assessment Programme

RWA Risk-weighted assets

SBA Swiss Bankers Association

SESTA Swiss Federal Act of 24 March 1995 on Stock Exchanges and Securities Trading (Stock Exchange Act; SR 954.1)

SESTO Swiss Federal Ordinance of 2 December 1996 on Stock Exchanges and Securities Trading (Stock Exchange Ordinance; SR 954.11)

SFAMA Swiss Funds & Asset Management Association

SFC Securities and Futures Commission (Hong Kong)

SIA Swiss Insurance Association

SICAF Investment company with fixed capital

SICAV Investment company with variable capital

SIF Swiss State Secretariat for International Financial Matters

SIX SIS Securities Services client AG

SNB Swiss National Bank

SQS Swiss Association for Quality and Management Systems

SR Classified compilation of federal law

SRO Self-regulatory organisation

SST Swiss Solvency Test

Suva Swiss Accident Insurance

TBTF Too big to fail

TC Target capital

TLAC Total loss-absorbing capacity

TOB Swiss Takeover Board

UCITS Undertakings for Collective Investment in Transferable Securities

UFR Ultimate forward rate

US GAAP United States Generally Accepted Accounting Principles

Organisation chart

(31 December 2017)

- Divisions
- Sections and groups reporting directly to the division heads
- Internal Audit
- * Member of the Executive Board.



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FINMA's core values

Independent decision-making

FINMA is functionally, institutionally and financially independent. It fulfils an important supervisory role in the public's interest, serving and protecting different groups of stakeholders equitably. In line with its remit, FINMA preserves its autonomy, making independent and proportionate decisions.

Consistent supervision

FINMA is charged with protecting creditors, investors and policyholders and is responsible for ensuring the proper functioning of Switzerland's financial markets. Among its key tasks are licensing, monitoring, enforcement and regulation. FINMA adopts a risk-based approach to supervision that ensures continuity and predictability, fostering dialogue with supervised institutions, authorities, professional associations and other key institutions in and outside Switzerland.

Responsible staff

FINMA's staff combine experience with responsibility, integrity and the ability to deliver results. Working professionally and independently, its staff show a high degree of flexibility and can handle challenging situations. They keep abreast of new developments and respond with concrete measures that are timely and appropriate.

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