



SWITZERLAND

May 2014

REPORT ON OBSERVANCE OF STANDARDS AND CODES ON THE FOLLOWING TOPICS: BANKING SUPERVISION, INSURANCE SUPERVISION, AND SECURITIES REGULATION

This Report on Observance of Standards and Codes on Switzerland was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in April 2014.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: <http://www.imf.org>
Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.



SWITZERLAND

FINANCIAL SYSTEM STABILITY ASSESSMENT

April 2014

REPORTS ON OBSERVANCE OF STANDARDS AND CODES

Prepared By
**Monetary and Capital
Markets Department**

These reports are background documents to the Financial System Stability Assessment report, and were prepared in the context of the work of the Financial Sector Assessment Program (FSAP) mission that visited Switzerland during the periods September 11–24 and December 4–16, 2013.¹ The findings were discussed with the authorities on March 20–24, 2014.

¹ Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>.

CONTENTS

GLOSSARY	3
BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION	5
A. Introduction	5
B. Information and Methodology Used for Assessment	5
C. Overview of the institutional Setting and Market Structure	7
D. Preconditions for Effective Banking Supervision	8
E. Main Findings	11
F. Recommended Actions	22
G. Authorities' Response to the Assessment	24
IAIS CORE PRINCIPLES FOR EFFECTIVE INSURANCE SUPERVISION	25
A. Introduction	25
B. Methodology Used for Assessment	25
C. Main Findings	25
D. Recommended Actions	39
E. Authorities' Responses to the Assessment	42
IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION	43
A. Summary	43
B. Introduction	45
C. Information and Methodology used for Assessment	45
D. Institutional and Market Structure—Overview	46
E. Preconditions for Effective Securities Regulation	50
F. Main Findings	51
G. Recommended Action Plan and Authorities' Response	62
H. Authorities Response to the Assessment	64
TABLES	
1. Summary Compliance with the Basel Core Principles—ROSC	19
2. Recommended Action Plan to Improve Compliance with the Basel Core Principles	22
3. Summary Compliance with the IAIS Core Principles—ROSC	29
4. Recommendations to Improve Observance of the ICPs	39
5. Key SSX Market Information	48
6. Market Shares of Bank and Non-Bank Securities Dealers	49
7. Assets under Management in Swiss Collective Investment Schemes	50
8. Summary Implementation of the IOSCO Principles—Detailed	54
9. Recommended Action Plan to Improve Implementation of the IOSCO	62

Glossary

AC	Additional Criteria
ALM	Asset Liability Management
AML	Anti-Money Laundering
AMLA	Federal Act on Combating Money Laundering and Terrorist Financing in the Financial Sector (Anti-Money Laundering Act)
AOA	Federal Act on the Licensing and Oversight of Auditors (Auditor Oversight Act)
APLIEM	Anti-persistent low interest rate environment measures
AUM	Assets Under Management
BA	Federal Act on Banks and Savings Banks (Banking Act)
BCBS	Basel Committee on Banking Supervision
BCP	Basle Core Principles
BOD	Board of Directors
CAO	Capital Adequacy Ordinance
CartA	Federal Act on Cartels and other Restraints of Competition (Cartel Act)
CCP	Central Counterparty
CEO	Chief Executive Officer
CHF	Swiss Franc
CIS	Collective Investment Scheme
CISA	Federal Act on Collective Investment Schemes (Collective Investment Schemes Act)
CO	Code of Obligations
COCO	Convertible capital
CRA	Credit Rating Agency
CRO	Chief Risk Officer
EBK	Swiss Federal Banking Commission (predecessor institution of FINMA)
EC	Essential Criteria
ETF	Exchange Traded Fund
Eurex Clearing	Eurex Clearing AG
Eurex Zurich	Eurex Zurich Ltd
FAOA	Federal Audit Oversight Authority
FDF	Federal Department of Finance
FFSA	Federal Financial Services Act
FINMA	The Swiss Financial Market Supervisory Authority
FINMASA	Federal Act on the Swiss Financial Market Supervisory Authority (Financial Market Supervision Act)
FISA	Federal Act on Intermediated Securities (Federal Intermediated Securities Act)
FMI	Financial Market Infrastructure
FSB	Financial Stability Board
GAAP	Generally Accepted Accounting Principles
G-SIB	Global Systemically Important Bank

SWITZERLAND

G-SIFI	Global Systemically Important Financial Institution
IAS	International Association of Insurance Supervisors
IFRS	International Financial Reporting Standards
LCR	Liquidity Coverage Ratio
MerA	Federal Act on Merger, Demerger, Transformation and Transfer of Assets (Merger Act)
MMOU	Multilateral Memorandum of Understanding
MOU	Memorandum of Understanding
NAV	Net Asset Value
OTC	Over-the-counter
SAS	Swiss Auditing Standards
SBA	Swiss Bankers Association
SER	SIX Exchange Regulation
SFAC	Swiss Federal Administrative Court
SFAMA	Swiss Funds and Asset Management Association
SIF	State Secretariat for International Financial Matters
SIX Structured Products Exchange	SIX Structured Products Exchange Ltd
SNB	Swiss National Bank
SSX	SIX Swiss Exchange
TOB	Takeover Board

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

A. Introduction

1. This assessment of the current state of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) in Switzerland has been completed as a part of a Financial Sector Assessment Program (FSAP) update undertaken by the International Monetary Fund (IMF) during 2013.² It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework, which have been addressed in the broader FSAP exercise.

B. Information and Methodology Used for Assessment

2. An assessment of the effectiveness of banking supervision requires a review of the legal framework, and detailed examination of the policies and practices of the institution(s) responsible for banking regulation and supervision. In line with the BCP methodology, the assessment focused on banking supervision and regulation in Switzerland and did not cover the specificities of regulation and supervision of other financial intermediaries, which are covered by other assessments conducted in this FSAP.

3. The Swiss authorities agreed to be assessed according to the Revised Core Principles Methodology issued by the BCBS (Basel Committee of Banking Supervision) in September 2012. This assessment was thus performed according to a significantly revised content and methodology as compared with the previous BCP assessment carried out in 2002 which was conducted under the first BCP methodology.³ It is important to note that this assessment cannot and should not be compared to the previous undertaking, as the revised BCP have a heightened focus on risk management and its practice by supervised institutions and its assessment by the supervisory authority, raising the bar to measure the effectiveness of a supervisory framework (see box for more information on the Revised BCP).

4. The Swiss authorities also chose to be assessed and rated against the Essential and Additional Criteria. In order to assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle. The essential criteria (EC) were usually the only elements on which to gauge full compliance with a CP. The additional criteria (AC) are recommended best practices against which the Swiss authorities have agreed to be assessed and rated. The assessment of compliance with each principle is made on a qualitative basis. A four-part

² The assessment team was comprised of Nick Le Pan and Mamoru Yanase.

³ A factual update of BCP assessment was conducted in 2007 although with a limited coverage.

grading system is used: compliant; largely compliant; materially noncompliant; and noncompliant. This is explained below in the detailed assessment section. The assessment of compliance with each CP is made on a qualitative basis to allow a judgment on whether the criteria are fulfilled in practice. Effective application of relevant laws and regulations is essential to provide indication that the criteria are met.

5. The assessors reviewed the framework of laws, rules, and other materials provided and held extensive meetings with officials of the Swiss Financial Market Supervisory Authority (FINMA), and additional meetings with auditing firms, and banking sector participants. The authorities provided a self-assessment of the CPs, as well as responses to additional questionnaires, and provided access to supervisory documents and files, staff and systems.

6. The assessors appreciated the cooperation received from the authorities. The team extends its thanks to staff of the authorities who provided cooperation, including provision of documentation and access, at a time when staff was burdened by many initiatives related to global regulatory changes and changes in Swiss supervisory processes.

7. The standards were evaluated in the context of the Swiss financial system's structure and complexity. The CPs must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, according to the methodology, a proportionate approach is adopted, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the CPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. The assessment considers the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

8. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. Reaching conclusions required judgments by the assessment team. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Swiss authorities with an internationally consistent measure of the quality of its banking supervision in relation to the BCPs, which are internationally acknowledged as minimum standards.

9. To determine the observation of each principle, the assessment has made use of five categories: compliant; largely compliant, materially noncompliant, noncompliant, and non-applicable. An assessment of "compliant" is given when all EC and ACs are met without any significant deficiencies, including instances where the principle has been achieved by other means. A "largely compliant" assessment is given when there are only minor shortcomings, which do not raise serious concerns about the authority's ability to achieve the objective of the principle and there is clear intent to achieve full compliance with the principle within a prescribed period of time (for instance, the regulatory framework is agreed but has not yet been fully implemented). A principle is considered to be "materially noncompliant" in case of severe shortcomings, despite the existence of

formal rules and procedures and there is evidence that supervision has clearly not been effective, the practical implementation is weak or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. A principle is assessed "noncompliant" if it is not substantially implemented, several ECs are not complied with, or supervision is manifestly ineffective. Finally, a category of "non-applicable" is reserved for those cases that the criteria would not relate to the country's circumstances.

C. Overview of the institutional Setting and Market Structure

10. Switzerland has a diversified financial sector that is systemically important to the global markets. It comprises a few significant global players in banking and insurance, two dozen cantonal banks, regional financial institutions, private banks, foreign banks, internationally oriented insurance companies, and many pension funds. It has one of the largest banking sectors globally in terms of assets to GDP. The two large banks rank among the world's top ten banks and are designated as Global Systemically Important Banks (G-SIBs). Switzerland is a global leader in private wealth management with a market share of more than a quarter in global cross-border private banking. The Swiss financial system contributes about 10 percent to Swiss GDP and employs over 5 percent of the labor force.

11. The banking industry is highly concentrated, but also it has a large number of medium and small banks. The banking sector has approximately 70 percent of the total financial sector assets with CHF 2.7 trillion, or over 450 percent of the country's GDP. The banking sector consists of 297 banks (end-2012), although the two large banks account for about one-half of the Swiss banking system's global assets and are important intermediaries in global financial markets. They are classified as Category 1 banks by the authorities in terms of size and complexity. The two largest are universal banks in their home Swiss market but focus more selectively abroad, where they are global players in asset and wealth management and in certain investment and corporate banking businesses. They are systemically important domestically as well with a share of over 30 percent in local markets. Major Swiss banks have been leaders globally in the extent of their restructuring and exiting of certain business in response to changed profitability dynamics and enhanced capital and liquidity requirements.

12. Other banks are much smaller, although some of them are relatively large compared to the size of economy and are systemically important domestically or regionally within the country. There are some relatively large banks serving more domestic or European markets on the asset side but many also gathering funds internationally into their asset or wealth management arms. Three Category 2 banks average CHF150B of assets and the 27 Category 3 banks have average assets of some CHF20B. There are 24 cantonal banks included in from Categories 2 to 4, which are historically established by cantonal laws and play an important role in each region, with a share of around 15 percent of the total banking assets. They tend to be classic retail banks with deposit gathering and lending to individuals and enterprises, together with wealth management. There are also a number of small regional banks focusing on traditional retail, mostly mortgage finance, within specific geographical regions. Foreign banks and private banks are heavily involved in cross-border

and wealth management activities. Potential risks to smaller banks tend to be in credit risk and interest rate risk in the banking book. Wealth management functions are more exposed to operational and reputational risk. The 250 smallest and least complex banks as classified by FINMA have median assets of CHF250m.

13. FINMA, an independent public law institution, is a unified supervisor which regulates and supervises banks. It was created in 2008 by unifying the Federal Banking Commission (EBK), which was in charge of supervision and regulation of the banking sector, the Federal Office of Private Insurance, the insurance regulator and supervisor, and the Anti-Money Laundering Control Authority, to improve the financial sector supervision and the supervisor's international role. It started its operation from the beginning of 2009, but it had been long planned as the original bill was drafted in 2006 and the law was approved in 2007. In addition to regulation and supervision of banks and insurance firms, FINMA also regulates capital markets and their intermediaries. In terms of banking regulation, laws and ordinances are submitted by the Federal Department of Finance (FDF) and enacted by the Federal Parliament and Federal Council, respectively. The Swiss National Bank (SNB) has responsibility over the stability of financial system and is in charge of monetary policy operations. It also is responsible for the supply of liquidity and acts as a lender of last resort.

D. Preconditions for Effective Banking Supervision

14. Switzerland has a competitive economy with prudent public finances and one of the highest GDP per capita globally. Sound and sustainable fiscal policies are anchored in a debt brake rule contained in the federal constitution and in constitutions governing 25 of 26 cantonal governments. SNB conducts the country's monetary policy as an independent central bank. It is obliged by the Federal Constitution and its statute to act in accordance with the interests of the country as a whole. It has to ensure price stability, while taking due account of economic developments. Within this framework, the National Bank Act also confers on the SNB the mandate of contributing to the stability of the financial system

15. The macroeconomic situation in Switzerland has been stable but facing difficulties in the past few years:

- *GDP growth in Switzerland has decelerated and inflation remains negative.* Driven by lower net exports, growth slowed in 2012 to only 1 percent and is expected to reach around 1¼ percent in 2013, and to regain momentum only gradually. Core and headline consumer price inflation are negative as the pass-through from the past exchange rate appreciation continues to run its course, while expectations are anchored in positive territory. Unemployment is low, and immigration is fueling labor force growth.
- *The exchange rate floor was introduced by SNB and it has helped safeguard macroeconomic stability.* The floor was introduced in September 2011 as a measure to contain the effects of "safe haven" flows into Swiss assets. These inflows resumed in mid-2012, prompting further heavy intervention and an expansion of the balance sheet of the SNB, but pressures on the Swiss franc have waned since late 2012. Following the introduction of the floor, the real exchange rate

has depreciated. While there have been difficulties in some segments, Swiss exports have performed well in recent years. The current account surplus remains sizable, reflecting favorable net interest income.

- *The fiscal position is strong.* Discretionary fiscal policy is limited by the structurally balanced budget rule (“debt brake”) at the federal level and other fiscal rules at the cantonal level. With conservative budget planning and execution, the federal government has consistently outperformed the fiscal rule. The debt-to-GDP ratio is expected to fall further to about 45 percent of GDP in 2016, although there are spending pressures over the medium term and long-term challenges from population aging.
- *Developments in real estate and mortgage lending are important macroprudential concerns.* With interest rates at historically low levels, mortgage lending has accelerated, bringing mortgage debt to about 140 percent of GDP. In parallel, housing prices have been rising, particularly in certain segments of the market. The authorities have taken measures to address these risks as described below.

16. In terms of financial sector policies, Switzerland’s approach has been to be an early adopter of the new Basel capital and liquidity measures and to tailor them with additional add-ons for certain banks for systemic reasons. Higher minimum capital ratios apply to the two G-SIFIs and to a lesser degree also to other banks except the smallest ones. Stability in the financial sector has been significantly strengthened by the ‘too big to fail’ (TBTF) legislative revision for the regulation of systemically important banks. The revision was approved by Parliament on September 30, 2011 and put into force by the Federal Council on March 1, 2012. The corresponding amendments to the Capital Adequacy Ordinance (CAO) and the Banking Ordinance (BO) were passed by the Federal Council, approved by Parliament and entered into force on January 1, 2013.

17. The Federal Council decided on February 13, 2013 to activate the countercyclical capital buffer, targeted at mortgage loans financing residential property in Switzerland. This was on the recommendation of the SNB. Currently, banks have to hold an additional 1 percent of their risk-weighted assets in the mortgage sector as a consequence of imbalances in the real estate sector built up during the last couple of years. FINMA has also introduced measures to raise risk weights for mortgage lending and new requirements for mortgage financing through Swiss Bankers Association, including a minimum down payment and minimum repayment requirements

18. The role of SNB relates to macro-prudential supervision. The SNB is responsible for the designation of the systemically important banks according to Art. 8 of the Swiss Banking Act, and to apply for the activation of the countercyclical capital buffer with the Swiss Federal Council. Between FINMA and the SNB a Memorandum of Understanding (MOU) is in place. It provides for regular meetings at head of organization level and ongoing exchange of views in the areas of (i) assessment of the soundness of systemically important banks and/or the banking system; (ii) regulations that have a major impact on the soundness of banks, including liquidity, capital adequacy and risk distribution provisions, where they are of relevance for financial stability; (iii) contingency planning and crisis management.

19. Switzerland has a consensus-driven culture with strong support for principles-based, proportional regulation and supervision, once adopted. Rating agencies have described the domestic credit culture as conservative. The system of business laws is well developed, as is the practice of professions important to banking such as accountancy and auditing, the legal profession, and banking and risk management. However, given the size and reach of domestic banks, FINMA (and its predecessor) concluded that there were not sufficient high quality resources available in Switzerland to effectively conduct bank supervision using own resources only. That led to the development of the supervision model of having the outside auditors of banks, and their global network, conduct regulatory audits on behalf of FINMA (as an 'extended arm'), but paid for by the banks.

20. All stock corporations and other commercial entities in Switzerland must prepare financial statements including a balance sheet, an income statement and notes. The financial statements of stock corporations are subject to an annual audit. Publicly traded companies, banks, other financial institutions, mutual funds and pension funds are subject to additional reporting requirements. Auditors of public companies are subject to regulation and inspection by an independent authority.

21. FINMA is the supervisory authority and also the insolvency and resolution authority for banks and securities dealers in Switzerland. It is also responsible for intensified supervision of banks in a recovery status. At the point of non-viability, FINMA is responsible for establishing intervention measures, and the resolution or the liquidation of the bank. Systemically important banks, as required by FINMA, need to establish recovery plans which are subject to FINMA's approval. In addition, FINMA defines institution-specific resolution plans. FINMA is responsible for the international coordination and cooperation process regarding the global resolution strategy for both Swiss G-SIBs.

22. In 2011, FDF, SNB and FINMA signed a tripartite memorandum of understanding on crisis management. The MOU governs exchange of information on financial stability and financial market regulation issues, as well as collaboration in the event of a crisis. In accordance with the MOU, strategic coordination of the crisis management organization and of any intervention is performed by a Steering Committee (SC), comprising the head of the Federal Department of Finance (FDF), the Chairman of the Governing Board of the SNB and the Chairman of FINMA. Meetings of the SC shall be held whenever necessary. FINMA leads international crisis management colleges for the two major Swiss banks, especially with participation of the United States and the United Kingdom.

23. Regarding recovery and resolution, the coming into force of the new Banking Insolvency Ordinance (BIO) established by FINMA was an important step for Switzerland. This Ordinance sets out the process to be followed so that not only shareholders but also bondholders contribute towards restructuring. As part of its restructuring plan, FINMA can order a compulsory conversion of bonds or a waiver of claims (bail-in): it ensures that banks can still continue to operate and safeguard financial stability. In the case of systemically important large banks, additional capital measures have been taken in the form of convertible capital (CoCos). This involves a two-stage

approach which, as a first step, converts CoCos into equity capital. If this measure to sustainably stabilize the bank proves insufficient, the next step is resolution at the highest group level by means of a bail-in. This procedure triggers FINMA's resolution strategy in cooperation with its key host regulators.

24. In 2008 the limit on depositor protection was increased from CHF 30,000 to CHF 100,000, and extended to employee pension accounts. In addition, the upper limit for overall secured assets was increased from CHF 4 billion to CHF 6 billion. In September 2011, the temporary provisions were made permanent in the revised Banking Act. The Depositor Protection scheme is set up as an ex-post financed association with which all banks in Switzerland must be affiliated. In the event of a bank going bankrupt, all members transfer to this scheme the amounts required of up to a total amount of CHF 6 billion within five days. To guarantee this, banks are required to deposit 125 percent of the guaranteed amounts in Switzerland.

E. Main Findings

25. Switzerland has recently made major enhancements in the practice of banking supervision and now has a high level of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs). Not all the results of improvement to date are embedded in the system or yet observable. The Swiss banking system is very large relative to the size of the economy, conducts significant transactions with non-residents, and contains two G-SIFIs with large international operations and a number of banks that are systemically important in domestic terms. The sector faces a number of challenges to parts of its business model as expectations related to transparency and tax authorities increase. Major Swiss banks are also adjusting to the new international prudential standards. More recently, several material issues have arisen in domestic or cross-border markets that have indicated weaknesses in controls or practices that are being dealt with by banks and the authorities. Given the nature of the Swiss banking system and its importance to the country and globally, it is essential that the supervisory system meet the highest standards for effectiveness. To reach that goal, Swiss authorities need to go farther along the path they have already started and aim for a higher level of intensive supervision.

26. Significant portions of guidance and legislation related to qualitative risk management and control standards are not as detailed or comprehensive as in many other major countries and need to be updated and selectively strengthened. Supervisory risk assessments and guidance to auditors, as the extended supervisory arm of FINMA, need to be further materially improved, beyond what is now envisioned. Additional skilled resources within FINMA are necessary to meet these goals and to conduct more on-site supervisory work. The assessors saw many examples of high quality initiatives and practices in FINMA. The model of using auditors is understandable given the structure of the Swiss banking system to multiply FINMA expertise and take advantage of auditor's global networks, but needs to be handled carefully. Switzerland has one of the most principles based approaches to rules and guidance among major countries. It remains considerably focused on capital and liquidity metrics, and less focused than necessary on qualitative elements of risk management and robustness of internal controls. The

recommendations in this report would add to the effectiveness of supervision, would increase FINMA's ability to assess the quality and completeness of information coming from auditors, and would put more incentive on auditors to perform in a better and more consistent manner. FSAP assessments focus solely on whether the core principles are met in practice, and take no position to endorse or otherwise a country's basic supervisory approach.

Responsibilities, objectives and powers (CP1)

27. The responsibilities and objectives of FINMA that emphasize protecting creditors, investors and insured persons, as well as ensuring proper functioning of the financial market, should be clearly stated in legislation as pre-eminent. The objectives currently indicate that it is through this approach that the competitiveness of the Swiss financial sector is to be achieved. Such a formulation risks misinterpretation as to what FINMA's objectives are. Currently, there are moves in the federal parliament to elevate promoting competitiveness of the financial sector as a separate objective with equal status to FINMA's existing prudential and market mandate. Changes of this nature would risk confusing the purpose of banking regulation and supervision and would not be consistent with the BCP.

28. There is a legal framework in place that is highly principles-based. As noted in several CPs, additional qualitative rules, guidance or supervisory methodology should be put in place in selected areas to meet the BCP. While FINMA uses its general authority to make up for deficiencies, experience elsewhere shows this may not be sufficient in times of stress. Without more detailed guidance, the criteria for regulatory auditors' assessment is not sufficiently clear. That reduces the effectiveness of the regulatory audit and reduces FINMA's ability to judge what the regulatory audit is really accomplishing. FINMA has recently updated several regulations and guidance. Nevertheless, there are other areas where regulations (ordinances) and FINMA guidance either need to be enhanced with respect to qualitative standards, or where FINMA rules need to make explicit reference to international principles as the standards that they expect banks to meet and regulatory auditors to assess against. FINMA is rightly sensitive that guidance appropriate for international banks should not apply to smaller banks. There are ways to deal with this proportionality challenge while still enhancing clarity of supervisory expectations.

Independence, accountability, resourcing and legal protection for supervisors (CP2)

29. FINMA has limited on-site and off-site supervisory resources that have been increased in recent years, but are now subject to a self-imposed headcount cap, which should be relaxed. Resources of FINMA are too little to supervise and regulate the entire banking system in a way that meets the core principles, including sufficient in-depth on-site work, and oversight of supervisory work done by external auditors particularly for medium and small banks. This is contributing to shortcomings in supervision and regulation, and weak practical implementation in certain areas, as described in various CPs. FINMA's adherence to a head-count freeze, that it has decided upon, needs to be relaxed to achieve compliance.

30. FINMA has well established operational independence, which is enshrined in legislation. Accountability arrangements are to the Federal Council through the federal Minister of Finance. FINMA is governed by an executive reporting to a board which plays more of an oversight role, though it has authority for FINMA guidance in circulars, and general authority to involve itself in any individual supervisory decision. The recently published rules addressed a problem that Board members were not precluded from also having certain positions in the financial sector. More clearly delineating and limiting the FINMA Board's ability to be involved in individual decisions could enhance sound governance and ability to attract Board members. Current moves in Parliament require the Federal Council to transfer FINMA's power to set general Pillar 2 capital buffers to the Council. These changes should either not be proceeded with, or the legislation should indicate that the Council's Pillar 2 power will be exercised only on the formal advice of FINMA.

Cooperation and collaboration (CP3)

31. There is a well-developed framework for cooperation on prudential matters between FINMA, the Swiss National Bank (SNB), and the Federal Department of Finance, and between FINMA and other prudential supervisors internationally that are important to FINMA. This consists of MOUs domestically and combinations of MOUs and other arrangements internationally. These are important to FINMA's effectiveness given the significant international structure of a number of major banks. Assessors reviewed evidence of these arrangements working effectively in practice during the course of the mission

Permissible activities, licensing, transfers of ownership, major acquisitions (CPs 4–7)

32. FINMA has a well-developed system of ensuring that permissible activities, as required by law, are only conducted by authorized banks, and the licensing process is actively used to provide notification of, and control the extent of, bank's activities. FINMA takes action to shut down unlicensed banking activities, or those holding themselves out to be licensed who are not, including on the internet. Banks are required during licensing to have their internal corporate documents specify their high-level organization structure, and the business lines and geographies they intend to pursue. Changes in these require FINMA notification and approval, which triggers an assessment by FINMA of the bank's ability to conduct the new business, or in a new country, with appropriate risk management and controls.

33. For transfers of ownership, FINMA has a well-developed regime that is based on notification and approval requirements well before changes in control. FINMA reviews are extensive including fit and proper requirements, beneficial ownership, business plans, and related matters. FINMA has a well-developed ability to assess the capability of foreign supervisors' regimes and exercises due care in approving foreign acquisitions. But the scope of what entities are included in the definition of those able to significantly influence a bank's activities, and who therefore have to be approved as owners, is less clear than desirable.

Supervisory approach, supervisory tools, supervisory reporting, corrective and remedial powers (CPs 8–11)

34. Switzerland has a unique supervisory process involving a mix of FINMA resources and extensive resources of audit firms doing regulatory audits on FINMA's behalf. FINMA has materially enhanced supervisory processes and practice in the past three years to address identified deficiencies and the new intensity expected post the financial crisis. This welcome development is necessary and beneficial. The new process requires audit firms to be more forward looking and effective in their work, adds capability for FINMA to do more supervisory work itself, and enhances FINMA interventions. Assessors saw evidence of how that process is working in practice.

35. However, that process only started to be implemented recently, certain of the impacts were not able yet to be observed by assessors, and the quality and depth of that process and the oversight and direction of auditors work by FINMA need to be further enhanced to meet international standards. In particular, risk assessments that drive the supervisory process should be made more consistently forward looking, more granular and thus more useful for the larger and mid-size banks, and more consistent across audit firms. Revisions to risk analysis methodology to improve granularity are planned. 'Deep dive' onsite work by FINMA should be increased in frequency and depth, selectively assessing the quality of various risk management governance and internal control systems on a proactive rather than reactive basis. That would complement FINMA's excellent work on quantitative capital and liquidity-related matters for larger banks. This will require materially more resources at FINMA. This will also require more ability for FINMA off-site staff to direct, monitor and compare during the supervisory cycle the audit work being done on their behalf. FINMA will also need more resources to participate periodically in the regulatory work of audit firms for major banks, especially in assessments in international locations, to assure themselves of its quality. This includes selective participation in 'deep dive' work done by the firms for FINMA. They should also participate more frequently in foreign supervisory reviews of the major Swiss banks. FINMA itself should conduct more theme reviews in areas where it, rather than regulatory auditors, is best placed to do so, because of expertise or because it "sees" the whole sector.

36. FINMA makes extensive use of its general corrective and remedial powers to achieve prudential results. FINMA has especially used Pillar 2 add-ons as a supervisory tool. Experience with FINMA supervisory requirements and recommendations, is that they are treated very seriously by licensed banks. FINMA has experience in closing smaller institutions, and has progressed in recovery and resolution planning for its two largest banks. For enforcement of prudential matters for banks, the fact that FINMA does not have power to fine institutions is not a serious problem. If having that power meant that standards of proof in enforcement matters were raised, that could reduce the effectiveness of the current system.

Consolidated supervision and home-host relations (CP12–CP13)

37. FINMA consolidated supervision is of high quality, but the legal framework should be enhanced to support such supervision. The legal framework does not apply all powers available at the level of the bank to the holding company in banking or conglomerate groups. FINMA is,

however, able to achieve its goals indirectly in those cases. Experience in other jurisdictions suggests that, in extremis, the power to act at the level of the individual institution may not be enough to achieve group-wide results. As a preventative measure, the law should be strengthened to allow interim and permanent enforcement decrees to be applied at the holding company level.

38. FINMA has a well-established and effective network of home-host relations for prudential matters.

This is based on a network of MOUs and other bilateral relations. Communication and coordination with the U.K. and U.S. is particularly close, given the operations of the major Swiss banks in those jurisdictions. Work in crisis management colleges on recovery and resolution plans is proceeding. The BCP assessment did not consider the state of international information sharing or cooperation on conduct of business or enforcement matters, which are outside the BCP methodology.

Board of directors (CP14)

39. FINMA practice in the governance area is evolving as is the case with other supervisors and assessment of governance effectiveness should be improved.

Interaction with boards of major institutions is extensive. However, the level of banking and risk expertise in boards of a range of mid-size institutions appears to be less than desirable, as does the prevalence of separate risk committees. Guidance is incomplete, but could easily be updated to add more specificity and reference international standards. FINMA plans to revise relevant circulars in 2014. There is room to formalize and enhance practice of assessing boards by FINMA and/or by external auditors.

Risk management (CP15)

40. FINMA generally has high expectations of banks' risk management. However the comprehensiveness of qualitative guidance in certain areas should be improved and updated or explicit reference should be made to Basel texts. Guidance to banks and/or auditors should be put in place re enterprise-wide risk measurement and risk management.

This would enhance institutions' understanding of FINMA expectations, and would also enhance the extent to which regulatory audits are appropriately addressing the right things. More domestic systemically-important mid-size banks should elevate the position of CRO to be a full executive board member, and more mid-size domestically systemic banks should be required to have a separate board risk committee and interact more regularly with the risk function. FINMA should review thematically risk appetite frameworks and capital planning and related stress testing across mid-size banks, building on the general approach to mortgage stress testing they have recently done.

Capital adequacy (CP16)

41. Switzerland has a robust capital adequacy framework fitting with its strategy to be an early adopter of new Basle rules without exceptions, and to provide significantly higher requirements on too big to fail banks.

New requirements based on Basel III rules have become effective in 2013, and are assessed as consistent with the Basel rules by BCBS. The old standardized approach for domestic banks will be phased out in a few years. Substantially higher capital

requirements are imposed on the largest banks including core capital and bail-in instruments. Lesser levels of Pillar 2 add-ons are also required of the other banks except the smallest ones. Such a framework ensures that Swiss banks will continue to have very high capital adequacy ratios. The number of banks using advanced approaches is limited, but FINMA has a robust framework to assess and validate models and methods used by banks for these approaches. The recent Parliamentary initiative to bring FINMA's power to require Pillar 2 add-ons to a group of banks to the Federal Council and to potentially set the maximum amount to be charged would be counterproductive for the safety of the banking system.

Credit risk and problem assets (CP 17–CP18)

42. FINMA qualitative rules and guidance re credit risk management and provisioning are not fully comprehensive or as detailed as in many jurisdictions. However, the supervisory and auditing process fills gaps, is comprehensive and allows FINMA to understand the quality of credit risk management and satisfy itself as to the adequacy of provisions. Some improvements to guidance and instructions to regulatory auditors could be made to ensure that their work is focusing consistently on credit risk management across the full range of banks and audit firms involved in regulatory audits. No issues were identified with respect to provisioning policies or approach.

Concentration risk and large exposures (CP19)

43. Rules, guidance and/or instructions to regulatory auditors need to be expanded to ensure that relevant concentrations are picked up appropriately in banks' risk management processes and are supervised correctly by statutory auditors on FINMAs behalf. Assessments of other forms of concentration risk should be conducted by FINMA under an enhanced stress testing program. Requirements for statutory auditors to express an opinion of concentration risk have only recently been clearly articulated. Assessment of concentrations beyond single name credit concentrations, such as concentrations resulting from possible system-wide stress events, or concentrations of funding, are better addressed by FINMA rather than by external auditors, given the skills and system-wide view needed for such assessments. That should occur through active use of stress and scenario testing and should be built on the efforts made by FINMA to date. Major banks appear to run relatively sophisticated approaches, but beyond single-name exposure verification, they have not been assessed comprehensively by the supervisory process.

Transactions with related parties (CP20)

44. The definition of what constitutes a related party, and the requirements for dealings with related parties to be at market terms and conditions, and for board oversight, need to be updated. Major problems in this regard have not been identified, but the current rules and guidance have a potential to miss transactions that should be caught, thus unnecessarily undermining the reputation of the system. Reporting of related party transactions to the supervisor should also be brought in line with international standards. The updated framework, possibly in a circular, should explicitly cover a full range of transactions, and stipulate requirements for policies

and processes for managing the related risk. Guidance should be clearer that these are expected to be at market terms and conditions, and provide reporting requirements on aggregated related party exposures to the supervisor.

Country and transfer risk, market risk and interest rate risk in the banking book (CP21–23)

45. Assessors reviewed rules and guidance applying to country and transfer risk, market risk and interest rate risk and believe that it sufficiently meets Core Principle requirements.

Discussions with major banks indicated, as expected, generally sophisticated approaches to these risks. Country risk and market risk is generally much less for mid-size and smaller banks. Even mid-size and smaller banks, for which interest rate risk can often be a major issue to be managed, showed a degree of awareness and ability to manage the risk that is necessary. Supervisory practice should be enhanced, including FINMA thematic reviews on these risks (for relevant mid-size and smaller banks), but that is part of the more general issue raised in other CPs.

Liquidity risk (CP24)

46. FINMA has enhanced liquidity quantitative information gathering (LCR reporting from mid-2013) and has updated liquidity risk guidance in progress that reflects international standards and enhances qualitative guidance for all banks.

This circular will be in place at the beginning of 2014. However, application of its elements to smaller banks could be broadened, such as the requirement for diversification of funding structure. Quantitative requirements for large banks are of high quality but those for other banks are outdated. The authorities' current plan to implement LCR according to the agreed international schedule will provide a substantial improvement.

47. Looking forward, it is essential for FINMA to have close dialogue with mid-size and smaller banks as well as regulatory auditors to set expectations for implementation and supervisory assessment of liquidity risk.

FINMA needs to monitor to minimize the risk that the proportionality argument is used by these banks to apply qualitative liquidity requirements in an insufficient manner. FINMA should conduct a thematic review of the new circular after a few years and revise it, and supervisory instructions to auditors, to reflect lessons learned.

Operational risk (CP25)

48. The current regulatory framework on operational risk has limited application of basic qualitative requirements, and lacks requirements on operational risk regarding information systems. FINMA's supervisory rating system should explicitly incorporate operational risk to aid in this risk getting more strategic focus.

Operational risk may be the primary risk for banks specializing in asset or wealth management, and is increasing in relative importance at the largest banks. Changing the rating system would have the benefit of giving operational risk more priority overall in the FINMA supervisory approach, which is appropriate given the strategic orientation of Swiss banks. There is also absence of clear expectations of reporting of operational risk related

incidents to the supervisor, with the exception of the two large banks. Given the importance of operational risk in the country, it is also important for FINMA to assess common risk factors in the operational risk area in a proactive manner. Based on the assessment, FINMA should conduct thematic supervisory reviews by itself from time to time. This will require additional resources.

Internal controls and audit, financial reporting and external audit, disclosure and transparency (CP26–CP28)

49. FINMA has a well-developed focus on internal controls and audit, which is understandable and necessary given its supervisory approach. Regulatory auditors are in a good position to judge the effectiveness of internal audit. FINMA also focuses on this directly, and through regulatory audit, and intensity has increased recently. Recent highly-publicized breakdowns related to compliance at a number of banks have, in some cases, been related to fraudulent behavior which supervision cannot fully prevent, but ex-post FINMA reviews have found that significant control weakness at banks contributed to the matters not being detected sooner. The supervisory approach as regards qualitative risk management and controls needs to be ramped up proactively to reduce the risk of serious breakdowns. This is part of a more general issue of supervisory approach that is assessed under CP8/9.

50. Use of Swiss GAAP is prevalent (outside the largest banks), but Swiss GAAP is similar or more conservative generally than IFRS. Disclosure obligations of Swiss GAAP are generally less than for IFRS. However in the banking sector additional Pillar 3 disclosure requirements are applied. The recent regulatory capital review found Switzerland complying with Pillar 3 disclosure requirements of the Basel capital rules.

Abuse of Financial Services (CP29)

51. The Swiss regulatory framework regarding abuse of financial services is well developed and the banks' compliance against it is rigorously checked through significant work done by external auditors and FINMA. Laws and regulations provide comprehensive and very detailed requirements to prevent abuse of financial services, in particular in regards to AML/CFT issues. Not only banks' adherence to these requirements is subject to annual regulatory audits by external auditors, which in turn reviewed by FINMA, but also the supervisor itself has carried out on-site reviews on the issue from time to time.

Table 1. Switzerland: Summary Compliance with the Basel Core Principles—ROSC	
Core Principle	Comments
1. Responsibilities, objectives and powers	Initiatives to give competitiveness more weight in FINMA's objectives are being pursued in parliament. The current inclusion of competitiveness as flowing from FINMA achieving its main objectives can be confusing to some observers. FINMA's framework of rules and guidance is highly principles based and less comprehensive and detailed than in many other jurisdictions, especially with respect to qualitative risk and control requirements.
2. Independence, accountability, resourcing and legal protection for supervisors	Resources of FINMA are too little to supervise and regulate the entire banking system in a way that meets the core principles, including sufficient in-depth on-site work and oversight of supervisory work done by external auditors. This is contributing to shortcomings in supervision and timely regulation, and weak practical implementation in certain areas, as described in various CPs. FINMA's adherence to a head-count freeze, that it has decided upon, needs to be relaxed to achieve compliance. While the new rule precludes FINMA Board members from having certain positions in the financial sector, the board's ability to decide to be involved in any supervisory issue would still affect sound governance and ability to attract Board members. There are parliamentary efforts well advanced to restrict FINMA's Pillar 2 power.
3. Cooperation and collaboration	There are appropriate frameworks domestically and internationally for prudential matters, and they appear to work effectively. The BCP assessment does not cover communication and collaboration on market conduct or enforcement issues.
4. Permissible activities	FINMA has a well-developed system of ensuring that permissible activities, as required by law, are only conducted by authorized banks.
5. Licensing criteria	The licensing process is actively used to provide notification of, and control the extent of, bank's activities.
6. Transfer of significant ownership	The definition of who holds a qualified participation and therefore needs approval lacks clarity, which could damage the effectiveness of current system that relies on banks reporting and assessments by external auditors.
7. Major acquisitions	Banks are required during licensing to have their internal corporate documents specify their organization structure and the business lines and geographies they intend to pursue. Changes in these through major acquisitions require FINMA notification and approval.

8. Supervisory approach	Major improvements in the supervisory approach have only recently been implemented and results are not fully evident. Risk assessments (that have been implemented) made by auditors and approved by FINMA that drive the supervisory process are not as comprehensive, granular and forward looking as they need to be.
9. Supervisory techniques and tools	The use of regulatory auditors as an extension of FINMA supervision gives an annual broad view of the banks and major enhancements in the approach are underway. But control and direction of the regulatory auditors' work to ensure consistency and quality need material improvement, and the amount of proactive, in-depth on-site work and cross-system theme reviews is not sufficient, without material increase in FINMA resources and on-site work.
10. Supervisory reporting	While the use of different accounting standards reduces the potential comparability of supervisory reporting, the similarities in accounting in practice are not serious.
11. Corrective and sanctioning powers of supervisors	FINMA uses its existing powers extensively. For prudential issues having the authority to impose monetary penalties is not necessary.
12. Consolidated supervision	FINMA supervision is of high quality. Certain powers do not apply to holding companies in financial groups, but FINMA uses other powers aggressively to compensate. Risk assessment of non-financial affiliates could be enhanced
13. Home-host relationships	FINMA has a well-established and effective network of home-host relations for prudential matters, which is based on a network of MOUs and other bilateral relations.
14. Corporate governance	FINMA practice is evolving to more formally assess governance effectiveness. Guidance does not fully cover such matters as required risk and banking skill sets on boards, and requirements for risk appetite frameworks. For mid-size banks that can be domestically systemic the lack of separate risk committees in a number of cases, and management structures, may mean that risk management and CROs do not have enough stature. The requirement for independent directors only applies to one third of the board.
15. Risk management process	Comprehensiveness of risk management guidance in several areas is below standards. Development of risk appetite frameworks at mid-size banks requires improvement as does data aggregation capability at major banks. FINMA's review of banks relating capital to risk could be enhanced.

16. Capital adequacy	Switzerland has a robust capital adequacy framework fitting with its strategy to be an early adopter of new Basle rules without exceptions, and to provide significantly higher requirements on too big to fail banks.
17. Credit risk	While credit risk management guidance is not as comprehensive or detailed as in many other jurisdictions, the supervisory and auditing process fills gaps.
18. Problem assets, provisions, and reserves	The definitions of impaired and non-performing loans are aligned with IAS39-definitions. No issues were identified with respect to provisioning policies or approach.
19. Concentration risk and large exposure limits	Rules/guidance/supervisory instructions to auditors need to be expanded. FINMA and regulatory auditors have not conducted thematic reviews of other than single name credit concentrations.
20. Transactions with related parties	The definition of what is a related party and the definition of required terms for related party transactions have gaps and/or are unclear.
21. Country and transfer risks	Rules and guidance applying to country and transfer risk are consistent with the requirements. Banks' compliance with these rules and regulations are primarily assessed by external auditors.
22. Market risk	Regulation provides comprehensive requirements on banks' trading book activities, which are primarily assessed by external auditors.
23. Interest rate risk in the banking book	Regulation sets out comprehensive and detailed requirements regarding interest rate risk in the banking book.
24. Liquidity risk	FINMA updated guidance to reflect international standards will not be in place until 2014. Quantitative requirements for mid-size and smaller banks are outdated.
25. Operational risk	The current qualitative requirements have some basic gaps and do not apply to many banks. FINMA's supervisory rating system does not explicitly incorporate operational risk despite that being a major and increasing risk for many banks and for the system. FINMA's capability to do thematic reviews, oversee auditors work, or update guidance is limited because of specialist resource constraints.
26. Internal control and audit	FINMA has put pressure on regulatory auditors to enhance their effectiveness and to be more forward looking in all of their assessments, including of control systems.
27. Financial reporting and external audit	While Swiss GAAP is used by many mid-size and smaller banks, it is generally more conservative than IFRS, though it does permit macro hedging.

28. Disclosure and transparency	While Swiss accounting standards provide for less disclosure generally than does IFRS, the recent BCBS Basel III review found that Pillar 3 disclosures were compliant.
29. Abuse of financial services	The Swiss regulatory framework regarding abuse of financial services is well developed and the banks' compliance against it is rigorously checked through significant work done by external auditors and FINMA.

F. Recommended Actions

Table 2: Switzerland: Recommended Actions to improve Compliance with the Basel Core Principles

Reference Principle	Recommended Action
CP1-Responsibilities, objectives and powers	Do not elevate competitiveness objective in FINMA mandate. Instead consider removing competitiveness reference.
CP2- Independence, accountability, resourcing	Increase FINMA resources, especially for on-site inspection and risk expertise. Clarify and limit the cases in which the Board can become involved in supervisory decisions and improve conflict code. Do not remove or limit FINMA Pillar 2 powers, or explicitly provide in legislation that any Federal Council decisions re Pillar 2 is to be on the formal recommendation of FINMA.
CP6-Transfers of Significant ownership	Broaden and clarify definition of qualified participation subject to the rules.
CP8-Supervisory approach	Improve methodology for regulatory risk assessment and enhance FINMA oversight of the process. Improvements include updating of Circular 08/24 re qualitative risk management and governance standards and related auditor instructions, providing more guidance for rating criteria, ensuring inherent risk assessments reflect actual business risk, requiring more granularity in risk assessments for larger institutions, enhancing methodology to emphasize forward-looking elements such as explicit consideration of whether risks are increasing decreasing or stable, and instituting more cross-institution analysis by FINMA staff of the risk assessments and what they imply for supervisory effort and focus.
CP9-Supervisory techniques	Enhance guidance for regulatory auditors' on-site work and oversight by FINMA to improve consistency and quality. Proactively add more in-depth supervisory review by auditors and by FINMA. Increase FINMA participation in foreign supervisor reviews conducted by auditors or by other supervisors.

CP12- Consolidated supervision	Extend FINMA authority to issue enforcement decrees to apply to holding companies in conglomerate or consolidated groups.
CP14-Corporate governance	Enhance guidance re skill sets on boards. Use supervisory process proactively to have more separate risk committees at major mid-size banks and to ensure consistently that CRO role has adequate stature. Consider gradual increase in requirements for more independent board members.
CP15- Risk management	Consider high level guidance re enterprise-wide risk management expectations. Continue to push for improvement in risk appetite frameworks at mid-size banks, by further specifying FINMA expectations or referring to international guidance, and conduct thematic review by FINMA. Aggressively push for improvements in data aggregation capability at major banks. Have FINMA conduct more regular thematic reviews of banks capabilities to relate capital to risk.
CP19-Concentration risk	Expand rule, guidance or instructions to auditors on assessing risk concentrations. FINMA should conduct thematic reviews of concentration risk other than single name credit exposures.
CP20-Transactions with related parties	Update definition of related parties' transactions to cover all transactions. Make clear that transactions with related parties must be at market terms and conditions.
CP23- Interest rate risk in the banking book	FINMA should update and extend its thematic reviews in this area to more banks, including small and medium-sized ones.
CP24-Liquidity risk	Proceed with plans to update qualitative guidance and quantitative metrics. Plan a cross-system review of implementation within two years of implementation.
CP25-Operational risk	Proceed with plan to update qualitative requirements. Enhance FINMA specialist resources to permit enhanced supervision, thematic reviews, and enhanced oversight of auditors work. Give operational risk relatively more focus in supervisory methodology and practice including by making it an explicit part of the supervisory rating system.
CP 27-Financial reporting and external audit	FINMA should satisfy itself that differences in Swiss GAAP and IFRS do not interact with emerging regulatory standards to provide unintended benefits to banks.

G. Authorities' Response to the Assessment

52. The Swiss authorities would like to thank the IMF for its “detailed assessment of observance” relating to the “Basel Core Principles (BCP) for Effective Banking Supervision” as part of its comprehensive Financial Stability Assessment Program on Switzerland. Discussions about Switzerland’s compliance with the BCPs were always constructive.

53. Overall, the Swiss authorities welcome the positive assessment of compliance with the BCPs, which acknowledges the strong efforts of Swiss authorities in recent years to enhance the effectiveness of banking supervision. In this context it is worth highlighting again that Switzerland has been ahead of most countries in implementing enhanced regulation, as recently evidenced by the Regulatory Consistency Assessment Program of the Basel Committee on Banking Supervision. In order to continue on this path, effective rule making remains an essential prerequisite. That is why the Swiss authorities welcome the observation on BCP2 that FINMA’s power to set general Pillar 2 capital buffers should not be removed.

54. From a Swiss perspective some clarifications are required concerning the assessment results and recommendations provided by the IMF. The first important issue relates to observations on BCP2, where the IMF concludes that “resources of FINMA are too little to supervise and regulate the entire banking system in a way that meets the core principles”, which is “contributing to shortcomings in supervision and regulation, and weak practical implementation in certain areas”. It is important to highlight that with its current level of resources FINMA feels well equipped to effectively supervise the Swiss banking system, a belief borne out by its recent track record in prevention, correction and, where necessary, enforcement. In addition, the Swiss authorities believe that the comment “FINMA’s adherence to a head-count freeze, that it has decided upon, needs to be relaxed to achieve compliance” does not reflect the preparedness to act where needed. FINMA clearly has the budgetary independence required for additional resources to be added to the supervisory functions if deemed necessary.

55. A similar comment is made by the IMF on BCP9 relating to FINMA’s supervisory techniques and tools, stating that FINMA’s resources and the auditors’ methodology do not result in adequate in-depth supervisory reviews on a proactive basis. FINMA disagrees with this assessment, given its track record in prevention and the view that the currently applied risk-based approach to performing supervisory reviews, with experienced and skilled people has been successful. Concerning the auditors’ methodology FINMA only recently introduced amended guidance on risk analysis for auditors where it is too early to judge its effectiveness.

56. The IMF has provided the Swiss authorities with recommendations of which many are already in the process of being implemented. Others will be additionally considered of which the following are worth mentioning. As part of an already planned policy review FINMA will assess whether and where amendments are required to better reflect qualitative risk management and governance standards as well as expectations regarding skill sets on boards and enterprise-wide risk management. To maintain and further improve the effectiveness and efficiency of FINMA’s supervisory and regulatory processes the adequacy of FINMA’s resources will periodically be

reassessed and, if deemed necessary, corresponding measures to reallocate or adjust resources will be taken.

IAIS CORE PRINCIPLES FOR EFFECTIVE INSURANCE SUPERVISION

A. Introduction

57. This report is a detailed assessment of Switzerland's compliance with the Insurance Core Principles (ICPs) of the International Association of Insurance Supervisors (IAIS), as adopted in October 2011 and revised in October 2012. The review was carried out as part of the 2013 Financial Sector Assessment Program (FSAP) assessment of Switzerland, and was based on the regulatory framework in place, the supervisory practices employed, and other conditions as they existed in September 2013. The assessment was carried out by Dr. Rodolfo Wehrhahn, Technical Assistance Advisor in the Financial Supervision and Regulation Division, a part of the Monetary and Capital Markets Department, IMF and Ms. Mimi Ho, Consultant.

B. Methodology Used for Assessment

58. Supervision of the private insurance industry in Switzerland is the responsibility of the Swiss Financial Market Supervisory Authority (FINMA). FINMA is the supervisory authority of the insurance sector that includes insurers, reinsurers, intermediaries as well as entities and organizations which, in any form, perform functions partly included in the operational cycle of insurance or reinsurance undertakings.

59. The assessment is based solely on the laws, regulations and other supervisory requirements and practices that are in place at the time of the assessment in September 2013. Ongoing regulatory initiatives are noted by way of additional comments. The assessors had access to a complete self-assessment on the ICPs and responses to a detailed questionnaire FINMA provided prior to the commencement of the exercise. Anonymized examples of actual supervisory practices and assessments provided by the authorities enhanced the robustness of the assessment. Technical discussions with and briefings by officials from FINMA also enriched this report, as did discussions with industry participants.

60. The assessment has been informed by discussions with regulators and market participants. The assessors met with staff from FINMA, insurers, industry associations, professional bodies and audit firms. The assessors are grateful for the full cooperation extended by all.

C. Main Findings

61. The insurance industry in Switzerland is well developed having among the highest insurance penetration and expenditure per capita in the world. Insurance penetration is the fourth highest in the world with 14.1 gross premium as percentage of GDP, well above the EU average penetration of 7.8 percent. Expenditure per capita on insurance leads worldwide with over

CHF 10 thousand. Total premium in 2012 amounted to CHF 83 billion, of which 40 percent corresponds to life insurance, and 30 percent each to non-life and to comprehensive health insurance. Total assets of the sector are CHF 460 billion or around 15 percent of the financial sector assets, of which two thirds correspond to life insurance. Over half of the investments on own account are in fixed income instruments, 17 percent in real estate and mortgages, and only 2 percent in equities.

62. The sector is dominated by a few players writing significant international business. The life sector is dominated by two players, responsible for 54 percent of the business and the top ten life insurers account for 97 percent of the market. The non-life sector is also concentrated but less than the life sector; here the top ten insurers account for 65 percent of the business. Without taking Swiss Re and Zurich Insurance Group into account, the Swiss insurance groups write on average around 35 percent of the premium outside Switzerland and over 45 percent of their assets are related to foreign business. For Swiss Re and Zurich Insurance Group the domestic premium is only 1.7 percent and 9.8 percent, respectively, of their total premium income.

63. The industry has weathered the 2008 crisis well; however the current low interest rate environment is affecting the sector. The negative impact on the share prices of Swiss insurers during the crisis has basically been reversed. However, the ensuing challenging economic environment is adversely affecting the industry, which has not been growing, except for the mandatory occupation pension business, which grew 6 percent in 2011. Low interest yields have reduced the government-mandated guarantees that insurers are required to offer, making their products less attractive, and has probably created negative spreads in a few portfolios. Measures being introduced include the reduction in 2012 of the statutorily guaranteed return for the occupational pensions to 1.5 percent.

64. The lack of availability of Swiss government bonds to match long term liabilities of life insurers and pension funds could be a source of vulnerability. The long term nature of the liabilities of life insurers and pension funds could in principle be matched by investment in Swiss government securities. However, the CHF one trillion of assets managed by life insurers and pension funds is disproportionate to the CHF 80 billion outstanding bonds by the federal government. Before taking diversification benefits into account, the cost of capital under the Swiss Solvency Test (SST) to hold equity investments can require high returns; thus leaving real estate as the main domestic alternative for investments; this in turn runs the risk of contributing to the creation of a real estate bubble, and possibly raise liquidity issues.

65. Significant regulatory reforms and increased supervision since 2003 have updated Switzerland's regulatory and supervisory regime for the insurance industry to levels consistent with international best practices. The Financial Market Supervisory Authority Act of June 22, 2007 (FINMASA), together with two related Ordinances, serves as an umbrella law for sector-specific laws governing financial market regulation and supervision and also establishes the integrated financial services supervisor FINMA. The new insurance law effective on January 2006 and the introduction of the SST have reoriented the regulatory focus towards a risk based supervision supported by a strong risk sensitive solvency regime.

66. The Swiss authorities succeeded in passing and implementing a state-of-the-art solvency regime. This Swiss solvency test should serve to properly assess the risks run by the insurers; however, its risk sensitive provisions showing at an early stage the negative effects of the low interest rate environment on the solvency ratio has led the authorities to introduce temporary measures to offset the stress to the sector, partly to avoid that Swiss companies become disadvantaged vis-à-vis those from areas without an advanced regime. The temporary measures have been taken with care and maintaining as much transparency as possible; however the measures have implicitly reduced policyholders' protection and it is recommended to remove them as scheduled in 2016.

67. Supervision focuses on ensuring sufficiency of liquid assets to meet policy liabilities. There are statutory accounting methods to determine technical provisions and value of assets on a prudent basis for "tied asset" purposes. Insurers (excluding reinsurers) are required to earmark and ring-fence assets designated as tied assets subject to a liquidity test to back the technical provisions plus a risk margin. Policyholders have priority claims over the tied assets. In addition, robust solvency requirements ensure there is sufficient capital to safeguard the insurers' financial soundness under adverse conditions. The triple focus on the adequacy of technical provisions, liquidity and safety of tied assets, and the adequacy of capital forms the basis of FINMA's supervision.

68. FINMA supervision is particularly strong in quantitative analysis and group supervision, while risk management, internal control and governance requirements are relatively new. FINMA has highly qualified staff. A large group of actuaries and mathematicians support the offsite reviews, internal model approval and other SST quantitative work. All but two domestic insurance groups have active colleges in place that engage in group wide supervision. The granular and aggregated approaches towards solvency of a group are also commendable. Qualitative assessment of insurers' operating environment is newer. The Swiss Qualitative Assessment (SQA) was first carried out in 2008, covering all insurers. The second SQA was carried out in 2012 and was risk-prioritized to cover groups and insurers in the high-risk categories. For SQA various means are used to gather information and carry out the analyses, including a questionnaire answered separately by key functions of the insurer, followed up with onsite visits to discuss findings and set out remedial steps if needed.

69. Increasing the intensity of onsite supervision will complement FINMA's strong supervisory framework. Increasing the intensity of onsite supervision will complement FINMA's strong supervisory framework. In addition to onsite inspections, FINMA uses a variety of other ways to gather information and make assessments. As a result, FINMA's onsite inspections tend to be focused in scope and, compared to some jurisdictions, less frequent. The main purpose of a FINMA inspection is either to verify a specific concern identified during offsite analysis, to gain understanding of an observed emerging trend, or determine if the insurer has a weakness or is not complying in a specific area. There is a danger that FINMA may not be able to identify weaknesses in the insurer's operation without direct observation and verification through onsite inspections. FINMA should therefore increase the frequency and scope of inspections. More in-depth onsite

inspections will enhance FINMA's understanding of insurers' operations and facilitate more accurate risk ratings. FINMA is encouraged to maintain its direct supervision of insurers, limiting the use of external auditors to checking compliance with clearly defined guidelines that require minimal or no supervisory judgment.

70. The position of Switzerland as global insurance center and a reinsurance hub sets additional demands on the regulatory framework.

- In 2012 FINMA started a review of the possibility of expanding public disclosure requirements, taking into account international standards and practices. It is recommended that FINMA completes its review and Swiss authorities institute the necessary regulatory changes to be more in line with international standards.
- While laws clearly stipulate the intention to protect policyholders and entrust FINMA to intervene on behalf of the policyholders and their beneficiaries, FINMA has yet to articulate specific rules on business conduct. Supervision of tied agents is indirectly through insurers. Supervision of brokers is minimal. There are no on-going reporting requirements for intermediaries. It is recommended that Swiss authorities press on with the legislative effort to improve policyholder protection and enhances brokers' supervision.
- The requirements on the investments of reinsurers need to be strengthening. Notwithstanding the specific characteristics of the reinsurance business, the lack of the requirement to have tied assets backing up reinsurance liabilities could weaken the asset quality of reinsurers as well as the ability of FINMA to liquidate them. Ultimately this could impact on policyholder's protection given that cedents can use reinsurance recoverable as part of their tied assets. FINMA's legal reach to the assets in case of liquidation is particularly relevant in its role as home supervisor given the ability of reinsurers to operate in foreign jurisdictions without local capital requirements.
- All reinsurers established in Switzerland are supervised by FINMA, although branches of companies headquartered outside Switzerland and conducting only reinsurance business are exempted from supervision. The scope of relevant Swiss law on this point (ISA Art. 2 (2)) is transparent and known in the marketplace in addition, FINMA is in close contact with their home supervisors where needed. However, given the relevance of reinsurance for the stability of the insurers abroad, it may be helpful for FINMA to more actively communicate its approach in regard of the supervision of branches of foreign reinsurers. A more prudent approach would be for FINMA to bring such reinsurance activity into its supervisory ambit.

Table 3. Switzerland: Summary Compliance with the IAIS Core Principles—ROSC

Insurance Core Principle	Overall Comments
1. Objectives, Powers and Responsibilities of the Supervisor	<p>FINMASA designates FINMA as the consolidated financial market supervisor, with clearly defined objectives, responsibilities and powers. Article 7 of FINMASA requires FINAMA to take into account, among other things, cost of compliance and impact on market competitiveness in carrying out its supervisory activities. FINMA staff has consistent understanding that their primary responsibility is to protect consumers with secondary responsibility to ensure the proper functioning of financial markets as provided under Article 5 of the FINMASA. The issuance of the Guideline on Financial Market Regulation, and the articulation of its supervisory strategy and priority in its annual reports are good measures in clarifying FINMA’s supervisory approach.</p> <p>There is a recent Parliamentary initiative to make market competitiveness of equal importance to consumer protection. If the initiative is successful, there could be potential tension between prudential objectives and market competitiveness.</p>
2. Supervisor	<p>FINMA is operationally independent, but the Federal Council is the authority on certain policy matters such as definition of insurance, classes of insurance, risk management, professional qualification for insurance practitioners, and disclosure of information to customers by intermediaries.</p> <p>FINMA is accountable to the Parliament, by presenting its annual report to the Parliamentary Control Committees every year, addressing supervisory outcomes, issues and concerns. There are legal provisions in place to safeguard confidential information and protect FINMA personnel from civil and criminal liabilities when carrying out their duties in good faith. The internal audit function has been revised a year ago, a comprehensive framework has been since developed and several internal processes have been audited.</p>
3. Information Exchange and Confidentiality Requirements	<p>The statutory regulations enable FINMA to engage in comprehensive exchange of information for the purposes of administrative assistance, better supervision and international cooperation with due regard to safeguarding confidentiality. Strict laws in Switzerland protect information received from other supervisors.</p> <p>FINMA has appropriate resources and procedures to be able to provide effective and timely assistance to foreign counterparts.</p>
4. Licensing	<p>Every insurer or reinsurer operating in Switzerland must be licensed by FINMA with the exception of (a) branches of foreign insurers conducting only reinsurance business, and (b) entities providing compulsory insurance under federal or cantonal laws. While it is not uncommon to exclude public entities providing mandatory coverage from supervision, FINMA</p>

	<p>should engage dialogues with cantonal supervisors to encourage the adoption of similarly prudential standards as for private insurers.</p> <p>FINMA does not have data on the volume of business conducted by unlicensed foreign reinsurers operating in Switzerland. However, it is widely acknowledged that one of such reinsurers has substantial business operation out of Switzerland.</p> <p>While the internal auditor and the actuary are explicitly mentioned in FINMA’s regulations, “control functions” are not defined in Swiss laws or supervisory procedures. (See ICP 5 for more discussion.)</p>
5. Suitability of Persons	<p>Suitability assessment is generally conducted for members of the board and senior management only, since “control functions” are not specified. Consequently, suitability of heads of risk management, compliance, internal audit and actuarial functions are not assessed unless they are members of the management board.</p> <p>The procedures to ensure continued suitability of key persons subsequent to initial licensing or new appointments of key persons can be improved. FINMA relies on Article 29 of FINMASA, which requires insurers to inform FINMA of any matters that may be of material significance for FINMA’s supervision of the insurer, for continued suitability. In the absence of guidance, however, the industry may not have consistent understanding that Article 29 reporting obligations include changes in circumstances materially adversely affecting the suitability of persons in key positions.</p>
6. Changes in Control and Portfolio Transfers	<p>The ISA sets ownership and control thresholds, both above and below which notification to FINMA is required. FINMA may impose conditions or disallow the acquisition/disposition. In essence, the notification is a de facto approval requirement.</p> <p>Moreover, notification/approval is required of any person who may exert “significant influence” on the business activities of the insurer, regardless of his level of ownership of the insurer.</p>
7. Corporate Governance	<p>The CG framework consists of requirements in corporate law, insurance ordinance and FINMA circulars, as well as voluntary code of best practice for listed companies. FINMA monitors compliance and assesses quality of CG as part of its qualitative supervision.</p>
8. Risk Management and Internal Controls	<p>ISA articulates the principle that insurers should have effective risk management and internal control systems. Circular 2008/32 provides details on the necessary elements of such systems. However, there is no requirement that there should be dedicated risk management and compliance functions. FINMA is currently assessing the need to provide additional clarity and specificity relating to RM and ICS.</p>
9. Supervisory Review and Reporting	<p>FINMA’s risk-based approach includes offsite analysis of financial information and SST reports, and onsite verification of issues identified</p>

	<p>through offsite review or observed trends in the market. FINMA leverages on external auditors to verify areas where there are clear regulatory requirements such as tied assets and technical provisions. FINMA also relies on external auditors to audit insurers in the low risk categories. FINMA is particularly strong in quantitative analysis. It has a number of actuaries and mathematicians on staff to conduct in-depth analysis of solvency and internal models.</p> <p>Onsite inspections typically focus on one area (such as derivative instruments, data security, adherence to business plan, reserving interest rate, and outsourcing) and are of short durations. With the limited scope and duration of inspections, it is difficult for FINMA to gain a comprehensive view on the effective implementation of insurers' own policies and procedures and compliance with regulatory requirements. Onsite inspection may provide information that can supplement the analysis from offsite monitoring and provide the opportunity to verify information FINMA has received. Onsite inspection may also help detect problems that may not be apparent through offsite reviews. Important objectives in conducting an onsite inspection include verifying the implementation of the insurer's risk management processes and compliance with relevant insurance laws and regulations. This will help FINMA in identifying the strengths and weaknesses in the insurer's policies and procedures.</p> <p>FINMA's risk-based approach is to devote its resources to those with high market impact. While the failure of a smaller insurer may not have market-wide impact, it will affect policyholders.</p>
10. Preventive and Corrective Measures	<p>FINMA, working with the criminal prosecutors, is empowered to take action against a person/entity who conducts insurance activities without the necessary license. FINMA's supervisory framework supports early intervention to minimize losses to policyholders. FINMA has adequate power to initiate timely and proportionate preventive and corrective measures where insurers do not adequately address supervisory concerns</p>
11. Enforcement	<p>Legislations have given FINMA a wide enforcement power, except the power to impose monetary fines. There is an Enforcement Committee that meets weekly to ensure consistent and fair application of enforcement actions.</p> <p>By law, FINMA is obliged to report all criminal offences under the insurance laws to FDF for consideration for criminal proceedings. FINMA does not track the outcome of reported criminal breaches. In practice, FINMA relies on its supervisory power to restore compliance with the law; it rarely takes enforcement action.</p>
12. Winding-up and Exit from the Market	<p>There are extensive provisions in the legislation for FINMA to manage an insurer's exit from the market in an orderly manner. These also provide for policyholders to rank second only to liquidator. The tied assets regime</p>

	<p>is a robust tool in ensuring policyholder protection.</p>
<p>13. Reinsurance and Other Forms of Risk Transfer</p>	<p>The supervision of reinsurers is in general in line with the supervision of direct insurers, while considering the specific business models of reinsurers. From the perspective of ceded reinsurance of primary insurers, it is to be noted that Switzerland retains tied assets requirements. These include limited allowances and require the monitoring of reinsurance recoverables.</p> <p>While from the perspective of ceded reinsurance of reinsurers there are no tied assets requirements, there are general investment principles and specific limits of asset categories which apply. These help protect against the weakening of the asset quality of reinsurers.</p> <p>It is recognized that FINMA has already begun dialogs with the largest groups on recovery and resolutions plans and is using its active involvement at the level of IAIS and FSB in these areas to identify best practices in these areas.</p> <p>All reinsurers established in Switzerland are supervised by FINMA, although branches of companies headquartered outside Switzerland and conducting only reinsurance business are exempted from supervision. The scope of relevant Swiss law on this point (ISA Art. 2 (2)) is transparent and known in the marketplace; in addition, FINMA is in close contact with their home supervisors where needed. However, given the relevance of reinsurance for the stability of the insurers abroad, it may be helpful for FINMA to more actively communicate its approach in regard of the supervision of branches of foreign reinsurers. A more conservative approach would be to include the supervision of that reinsurance activity. Concentration of reinsurance in a given reinsurer is supervised during the SST for the insurers. In addition, where reinsurance recoverables are recognized in tied-assets, insurers are required to report major reinsurer counterparties individually by their share and with information on their country and rating. Reinsurers for their part have to report their top 20 single retrocessionaires besides the respective lines of business, geographic area and lines of business of ceded reinsurance.</p> <p>FINMA can monitor reinsurance concentrations, including any major exposure to a single reinsurer, and identify any inappropriate practices or trends. Where this is the case FINMA requires the matter to be addressed.</p> <p>Regulation requires insurers to analyze the effects of reinsurance on the balance sheet of insurers.</p> <p>With respect to risk transfer, it is the responsibility of the appointed actuary to ensure correct risk-transfer treatment, which is part of the business plan. In the case of major Swiss insurers which are part of a listed company, their reporting uses U.S. GAAP or IFRS. These companies are</p>

	<p>thus required to apply certain risk-transfer tests. These are applied also in statutory accounting, provided it does not result in any conflict with the statutory accounting rules. However risk transfer definitions vary in accounting systems. Under one system uncertainty in the time of payment would be sufficient to have risk transfer in place. In another accounting system, in addition underwriting risk would also need to be transferred in a contract for it to qualify as a reinsurance contract. U.S.-GAAP and IFRS differ on this perspective for instance.</p> <p>FINMA supervises at time of licensing that reinsurance contracts are in place and that new contracts and major changes to contracts are reported. These are subject to FINMA's ongoing supervision. In addition, FINMA has the right to review any contract at any time, not only when there are changes. With most reinsurers involved in traditional reinsurance business, the contractual relationships tend to be long-term where FINMA is well acquainted with the material arrangements.</p>
14. Valuation	<p>Regulation concerning market-consistent valuation in the SST is independent of international accounting standards.</p> <p>FINMA sets the valuation requirements for assets and liabilities to be applied for solvency purposes. Under the Swiss Solvency Test (SST) positions are valued on a market consistent basis. The insurers own credit risk cannot be taken into account in the valuation of its liabilities and to provide a full economic picture, the SST includes positions which would be off-balance in accounting standards. The use of models for the valuation of liabilities is subject to strict requirements to warrant the economic valuation.</p> <p>Most assets are valued at market and the concept of the discounted best estimate and the market value margin (MVM) applies with regard to liabilities and technical provisions.</p> <p>For discounting liabilities, risk-free yield curves have to be used and FINMA makes counterparty risk-free yield curves available in the most commonly used currencies (CHF, EUR, USD, GBP, JPY) as per 1 January and 1 July of every year. Where other risk-free yield curves are required, the insurer is responsible for calculating them.</p> <p>Some elements distorting the full economic valuation of assets and liabilities are however present in the regulation:</p> <ul style="list-style-type: none"> • FINMA allows for new business stemming from Swiss group life cash flows beyond the contractual obligation, but considers the impact of new business in capital requirements. • The valuation of the statutory technical reserves for the purpose of the tied assets coverage requirement (but not for the SST) is currently

	<p>done using the interest rates produced by the investment portfolios under stress and subject to prudential assumptions of individual companies as the discount rates that are in the order of 4 to 2.5 percent. Given that the tied assets regime is the main protection for policyholders in absence of a guarantee scheme, a conservative approach is recommend defining a forward looking maximum discount interest rate for the valuation of liabilities.</p> <p>As a result of the low interest rate environment affecting the insurance sector FINMA has introduced temporary measures that reduce the solvency requirements for insurers, while these measures have been introduced in line with the ICP requirements and with sufficient safeguards, to maintain the level of protection for policyholder as intended by the SST framework, the temporary measures should be seen as temporary and reverted as planned.</p>
<p>15. Investment</p>	<p>The investment activities of insurers are regulated in a manner to properly address the risks faced by insurers.</p> <p>Swiss domiciled (re)insurance companies must submit their investment guidelines for approval. The assessment is also based on the prudent investor rule and considers common practice of modern portfolio management.</p> <p>Specially designated assets are required for backing up the insurance liabilities. These tied assets are subject to limits and rules to provide security, liquidity, diversification and legal access in case of bankruptcy. More complex types of assets are subject to stricter limits, including prohibitions, detailed reporting and full understanding of their inherent risks.</p> <p>Asset-Liability mismatching as well as permissible concentration risk are penalized through capital surcharges. Use of derivatives is restricted for hedging purposes and portfolio optimization; further all positions need to be fully covered.</p>
<p>16. Enterprise Risk Management for Solvency Purposes</p>	<p>FINMA has established well documented, detailed, comprehensive and forward looking requirements for enterprise risk management for the supervised entities that address all relevant and material risks that could affect their solvency. These requirements are part of the insurance law and are further defined through circulars and supervisory practice and FINMA monitors their implementation by insurers and insurance groups.</p> <p>While ORSA is not a formal separate requirement, through the annual risk, capital planning, liquidity and the SST, insurers are required to consider current and emerging risks that could affect the ability to meet the SST and the models and scenarios used to determine solvency have to include those risks. In addition, qualitative scenarios are used for better</p>

	<p>understanding and planning future capital needs.</p> <p>The SQA complement the SST on checking the quality of the risk management systems of the entities.</p> <p>In addition to management and the risk office, also the responsible actuary plays an important role in the documentation process. The responsible actuary report presents the current status as well as possible developments from an actuarial perspective, in particular actuarial developments which may endanger the financial condition of the company. But this report is only available to the supervisory authority on request. FINMA is recommended to require the responsible actuarial report on a regular basis.</p>
17. Capital Adequacy	<p>The solvency regime set up by FINMA is risk sensitive, comprehensive having due regard of all risks insurers at the solo and group level are taking and provides appropriate degrees for supervisory intervention.</p> <p>The use and approval of models is well controlled and sophisticated.</p> <p>The capital requirements are transparent, objective and in line with the level of risk run by the institution. The permissible capital resources allow for the absorbance of unforeseen losses, under both, going and gone concern, with the exception when the APLIEMs are used. There, the additional capital resource created by the difference in the discounted liabilities does not have the required loss absorbance property, but is treated as a temporary measure.</p> <p>The SST does not quantify operational risk and only certain aspects of this risk are directly covered.</p>
18. Intermediaries	<p>Supervision of insurance intermediaries is through the mandatory registration of independent intermediaries and voluntary registration of non-independent intermediaries. Through FDF, FINMA takes action against unregistered intermediaries when it becomes aware of their illegal activities.</p> <p>Since registration by non-independent intermediaries is voluntary (this includes brokers who are deemed not-independent based on the source of income test), the register is only a partial roster of intermediaries practising in Switzerland. However, FINMA observes that increasingly insurers require their tied agents to be registered, and that insurers are reluctant to deal with brokers who are not registered.</p> <p>Registration requirements include professional competence and personal attributes. FINMA relies mainly on registrants' notification to ensure</p>

	<p>continuing accuracy of information kept in the register. There are no on-going reporting requirements for intermediaries. Supervision of tied agents is indirectly through insurers. Supervision of brokers is minimal.</p>
19. Conduct of Business	<p>Swiss laws clearly stipulate the intention to protect policyholders and entrust FINMA to intervene on behalf of the policyholders and their beneficiaries. Life insurers have ongoing duties to disclose certain information to policyholders, including investment performance and surrender values. However, other than as indicated, FINMA has yet to articulate additional specific rules on business conduct. Without additional explicit rules, it is difficult to have consistent implementation of the expectation of treating customer fairly. Recognizing the shortcomings, FINMA has taken steps to introduce the FFSA to address the following key areas:</p> <ul style="list-style-type: none"> • documentation of products characteristics; • selling practice: implement “Know Your Customer”, review of appropriateness and suitability of products, documentation and accountability, disclosure of third-party remuneration; • training of intermediaries who provide advice to ensure they are proficient of knowledge on an continuing basis; and • reversing the burden of proof in cases of mis-selling.
20. Public Disclosure	<p>The information published by the insurers and by FINMA does not provide sufficient details on the insurers:</p> <ul style="list-style-type: none"> • policies and processes for managing capital; • investment objectives, processes and sensitivity to market variables; • technical provisions by appropriate segment, the rationale for the choice of discount rates, and description of the method used to determine technical provisions; • information on ERM and ALM; • financial performance: earnings analysis, claims statistics including claims development, pricing adequacy, information on returns on investment assets and components of such returns; • nature of risk, reinsurance and other risk transfer arrangement, risk concentration; and • nature of its business, key products, the external environment in which it operates, and its business objectives and the strategies in place to achieve them. <p>It is noted that FINMA has started a review of the possibility of expanding public disclosure requirements in 2012, taking into account international standards and practices.</p>
21. Countering Fraud in	<p>There is an established legal framework enabling criminal authorities to</p>

Insurance	investigate and apply sanctions in cases of insurance frauds. Fraud prevention is included in FINMA's on-going supervisory process, and the SQA. The recent SQA II has made a number of insightful observations relating to insurers' fraud (both external and internal) prevention controls. There are no explicit anti-fraud requirements. While FINMA includes fraud prevention in its on-going review of an insurer's risk management and compliance procedures, the source of information on insurer's fraud prevention practice appears to be limited to the ad hoc survey and SQA II. The survey is ad hoc and on a sampling basis. SQA is done pursuant to a time cycle and covers groups and the insurers in the highest risk categories. To ensure a consistent standard of fraud prevention in the insurance industry, FINMA should issue anti-fraud guidance to insurers and intermediaries, clearly stating FINMA's expectation with respect to anti-fraud policy, procedures and controls in place to deter, detect, prevent, report and remedy frauds. FINMA should include insurers' anti-fraud procedures in its offsite review and require insurers to report fraud cases to FINMA as part of FINMA's assessment of the effectiveness of insurer's anti-fraud procedures.
22. Anti-Money Laundering and Combating the Financing of Terrorism	<p>FINMA is the designated competent authority for AML matters relating to financial institutions. MROS is the financial intelligence unit responsible for receiving and analysing suspicious transaction reports. There is a mechanism in place for FINMA to cooperate, coordinate and exchange information with MRO and other relevant law enforcement agencies.</p> <p>FINMA delegates the AML/CFT supervisory responsibility to recognized SRO. AML/CFT rules issued by SROs with approval from FINMA are binding on members. FINMA assesses the effectiveness of SROs on an annual basis</p>
23. Group-wide Supervision	FINMA has a clear and transparent approach to identifying entities subject to its group-wide supervision. The scope of the group covers all entities, whether regulated or not, within the group. FINMA's group supervision is complementary to solo supervision, based on coordinated cooperation with solo supervisors and the involvement of specialist functions (such as SST, SQA).
24. Macroprudential Surveillance and Insurance Supervision	FINMA has established periodic monitoring and analysis of market and financial developments and other environmental factors that may impact insurers and insurance markets. Information capture in the Risikobarometer process is used to assessing the possible impact of the identified risks and to implement measures effective in improving the resilience of the financial sector. The impact analysis is shared with FINMA's executive board and is an internal document. Also the recently developed tools, the Business Indicators Cockpit and a Group Indicators Cockpit allow monitoring market trends and identifying potential risk and

	<p>adverse market developments. The Group Indicators Cockpit is analyzed on a semi-annual basis. Reports are used in the preparation of risk rating decisions of insurers, as well as an early warning tool.</p> <p>The historical financial market stress scenarios required under SST are used to assess resilience of the sector to financial crisis; however there are no clear requirements to consider feedback loops and spillover effects.</p> <p>The D-SII designation process in Switzerland has excluded insurers. However FINMA's highest risk rated insurers are subject to intense supervision.</p> <p>Notwithstanding the absence of a Swiss insurer in the FSB G-SIIs list, the strong participation of FINMA at the FSC IAIS committee continues and, in preparation of a possible G-SII designation of an Swiss insurer or reinsurer, FINMA has implemented a FINMA Insurance Bankruptcy Ordinance (IBO) and is further drafting regulation to comply with the FSB recommendations applicable to G-SIIs.</p> <p>The existing of current tools used by FINMA to identify systemic risk, including shocks, interconnectedness and feedback effects; need to be developed and implemented into a comprehensive surveillance framework that ultimately will reduce the likelihood of systemic risk and mitigate spillover effects within the financial system and into the real economy.</p>
<p>25. Supervisory Cooperation and Coordination</p>	<p>FINMA has the authority to enter information and coordination agreements with foreign authorities responsible for financial market supervision. FINMA is signatory to various MOUs that allow for smooth information sharing and coordination in supervisory matters.</p> <p>FINMA has a vast experience in organizing and effectively running colleges. It has created colleges for the relevant Swiss insurance groups and it also participates in several international colleges that are relevant for the Swiss policyholders as the host supervisor.</p> <p>Notwithstanding being the home supervisor it takes the pragmatic approach in the determination of the group supervisor to be the national authority where the decision management of the group is located.</p>
<p>26. Cross-border Cooperation and Coordination on Crisis Management</p>	<p>For colleges lead by FINMA emergency plans compliant with the standards of this principle have been developed. The emergency plans are regularly tested and improved.</p> <p>Using as a guidance the recovery and resolution plans developed for banks, FINMA has requested and discussed resolution plans for the three largest insurers groups. These plans have already produced concrete actions of the groups toward improving the speed of reaction to serious emergency situations that included dialogue with foreign supervisors applicable during such situations.</p>

D. Recommended Actions

Insurance Core Principle	Recommendations
2. Supervisor	<p>It is recommended that FINMA should have the delegated authority over matters of operational relevance such as definition of insurance, classes of insurance, risk management, professional qualification for insurance practitioners, and disclosure of information to customers by intermediaries.</p> <p>While FINMA continues to integrate the supervision process in among the different financial sectors, the effective use of FINMA staff in insurance supervision should be maintained and the use of external auditors limited to checking compliance with clearly defined guidelines that require minimal or no supervisory judgment.</p>
4. Licensing	<p>It is recommended that FINMA should require branches to be incorporated in Switzerland and to be subject to FINMA supervision when their size reaches a pre-determined level.</p>
5. Suitability of Persons	<p>FINMA should provide greater clarity as to its requirements with regard to the continuing suitability of key persons in control functions.</p> <p>The control functions should be defined to ensure consistency across companies.</p>
7. Corporate Governance	<p>It is recommended that Circular 2008/32 be amended to indicate explicitly that the BOD has the oversight responsibility over risk management and internal controls for the avoidance of doubt.</p> <p>It is also recommended that Circular 2008/32 be amended to include the requirement for insurers to disclose their CG practices on a par with CCG (the voluntary code for listed companies).</p>
8. Risk Management and Internal Controls	<p>It is recommended that FINMA requires explicitly the establishment of risk management and compliance functions in companies while recognizing exceptions based on the size, nature and complexity of the operations.</p>
9. Supervisory Review and Reporting	<p>It is recommended that FINMA increase the intensity of onsite supervision to strengthen the qualitative aspect of its supervision by raising the frequency and scope of onsite inspection. This will require that FINMA increase its resources, in terms of number of staff and their level of experience.</p> <p>FINMA may wish to consider measures to strengthen the key account manager approach, to preserve institutional knowledge and to inject fresh perspectives from time to time; for example, a periodic rotation of the key account manager and limiting the role of the division chief to quality control and assurance of the integrity of the process.</p>
11. Enforcement	<p>For offences that are administrative in nature, such as the infringements listed under Article 86 of the ISA, FINMA should be given the power to impose administrative fines. It is recommended that Article 86 of ISA be amended to de-</p>

	<p>criminalize the offences and delegate the responsibility of imposing administrative fines to FINMA.</p>
13. Reinsurance and Other Forms of Risk Transfer	<p>Consideration should be given to strengthening further FINMA’s access to reinsurers’ assets in case of liquidation.</p> <p>To enhance the transparency of reinsurance treaties, FINMA may consider introducing a mandatory treaty clause stating the completeness of the reinsurance treaty.</p> <p>FINMA should consider issuing specific rules on risk transfer to bring additional certainty as to what constitutes a valid reinsurance transaction.</p> <p>FINMA should consider additional steps to increase insurers’ retention of adequate documents on the agreed terms and conditions of reinsurance contracts and have them formalized over a reasonable period of time.</p> <p>For systemic risk monitoring purposes, FINMA is recommended to further monitor concentration by type of reinsurer, including rating and geographic origin; and also monitor exposure to single reinsurer on critical single large risks.</p>
14. Valuation	<p>Given that the tied assets regime is the main protection for policyholders in absence of a guarantee scheme, consideration for introducing a conservative approach defining a forward looking maximum discount interest rate for the mathematical reserves is recommended.</p> <p>To maintain the level of protection for policyholder as intended by the SST framework, it is recommended to remove the temporary measures as planned in 2016.</p> <p>FINMA should consider regular updates of the cost of capital rate of currently 6 percent</p>
16. Enterprise Risk Management for Solvency Purposes	<p>FINMA is recommended to require the responsible actuarial report on a regular basis.</p>
17. Capital Adequacy	<p>FINMA is recommended to promote the use of the standard model for life insurers and use it to enhance its scrutiny as an additional checking tool of the internal models.</p> <p>FINMA is advised to consider incorporating the quantification of operational risk into the SST.</p> <p>The provision of a standard model or the approval of internal models by the supervisor each carries with it a certain degree of risk to the supervisor. With regard to internal models’ considerations should be given to reemphasizing further to insurers that the board of directors bears responsibility for the</p>

	<p>approval of the internal model, even if subsequently it is to FINMA's objection rights. FINMA should maintain the strong level of supervisory checks on the internal model.</p> <p>Concerning the model approval process, further development of the insurance risk sensitivity methodology is encouraged when assessing internal models using portfolio replication methods and onsite verification of the appropriateness of the stochastic scenarios used in internal models is recommended.</p>
18. Intermediaries	<p>It is recommended that FINMA consider the following:</p> <ul style="list-style-type: none"> • Require registration of all intermediaries, to eliminate the current gap in the register. For tied agents, make the insurers responsible for ensuring the data is kept up to date. • Broaden the on-going supervision of brokers to include offsite review (financial statements and auditor's opinion where applicable, ownership structure), and onsite inspection (corporate governance and internal controls, basis of placing business, complaint handling). • Strengthen indirect supervision of agents by including in the on-going supervisory review of insurers how they control the behavior of their agents and the disciplinary action against errant agents. • Require independent intermediaries to put in place safeguards in handling client monies, and assess these safeguards during onsite inspections. • Require disclosure of intermediaries' financial interest in the transaction where a potential conflict exists. • Apply appropriate CG standard to legal entity intermediaries.
19. Conduct of Business	<p>It is recommended that FINMA press on with the legislative effort to improve policyholder protection, particularly fair treatment of customers, after sales disclosure, avoidance of conflict of interest by intermediaries, and timely payment of claims. In addition, it is recommended that FINMA issue rules on business conduct.</p>
20. Public Disclosure	<p>It is recommended that FINMA completes its review and institute the necessary regulatory changes to be more in line with international standards.</p>
21. Countering Fraud in Insurance	<p>To ensure a consistent standard of fraud prevention in the insurance industry, FINMA should issue anti-fraud guidance to insurers and intermediaries, clearly stating FINMA's expectation with respect to anti-fraud policy, procedures and controls in place to deter, detect, prevent, report and remedy frauds.</p> <p>FINMA should include insurers' anti-fraud procedures in its offsite review and require insurers to report fraud cases to FINMA as part of FINMA's assessment of the effectiveness of insurer's anti-fraud procedures.</p> <p>It is recommended that FINMA consider the risk of fraud by intermediary in relation to misrepresentation of insurance cover to a customer in its current</p>

	review of policyholder protection. (See ICP 19).
24. Macroprudential Surveillance and Insurance Supervision	For the historical financial market stress scenarios FINMA should introduce feedback loops and spillover effects. The tools currently used by FINMA to identify systemic risk need to be developed and implemented into a comprehensive surveillance framework that ultimately will reduce the likelihood of systemic risk and mitigate spillover effects within the financial system and into the real economy.
25. Supervisory Cooperation and Coordination	To enhance the information exchange, FINMA is recommended to develop for their colleges a secure information exchange platform.
26. Cross-border Cooperation and Coordination on Crisis Management	FINMA is recommended to enter agreements with the relevant foreign supervisors on each party's obligations in the situations that would require resolution of the supervised entity. To enhance the resolution of complex groups, FINMA is recommended to acquire the power to act as the liquidator also of non regulated entities belonging to the insurance group.

E. Authorities' Responses to the Assessment

71. The Swiss authorities would like to thank the IMF for the thorough and professional assessment of Switzerland's observance of the Insurance Core Principles of the International Association of Insurance Supervisors.

72. We are very pleased that the assessment recognizes the considerable work and progress Switzerland has made in these areas. While we appreciate the recognition on the regulatory side, we believe our efforts have been as strong on the supervisory side.

73. We were also pleased to see that in the most critical areas the assessment shows Switzerland in observance, and that our practices in the solvency area are recognized as market leading.

74. We acknowledge there are areas requiring further improvement. In some of these areas we had already begun actions prior to the assessment. In others we will be working on action plans as part of our commitment to continuous improvement. The IMF observations will be very useful in this regard.

75. In earlier exchanges with the IMF we shared observations on where we believe the assessment did not take sufficiently into account how Switzerland meets the spirit and substance of certain aspects of the ICP. Here we would like to summarize only two points.

Licensing

76. We strongly believe Switzerland meets the necessary threshold of observance of ICP 4 as a whole but also in respect of each of its components. Thus our review of our practices against each of the standards under ICP 4 shows consistency therewith. As we demonstrated, we have a clear and thorough licensing process, which has been improved further recently, including with the introduction of an approvals committee. We also interact with other supervisors where needed during the licensing review process to ensure all relevant considerations are taken into account. We do not deem the observations of the IMF—including regarding the current exemption for branches of foreign reinsurers which is already taken into account under ICP 13 — as sufficient for lowering our rating from “Observed” to “Largely Observed”.

Reinsurance

77. Switzerland effectively regulates and supervises reinsurers in a manner that we believe is consistent with the requirements of ICP 13. In earlier exchanges with the IMF, we indicated how we believe we meet ICP 13, including in respect of matters involving 1) treaties and documentation, 2) risk transfer, and 3) monitoring and acting on inappropriate risk concentrations. The fact that we currently do not supervise branches of foreign insurers is transparent in our law and supervision, though we will be considering ways to make this even better known publicly. Further, as already communicated, we will be considering changes to our regulation to cover branches of foreign insurers.

78. The Swiss authorities have already launched a process to systematically evaluate all IMF recommendations in order to assess in detail how, within which timeframe and to what extent the recommendations can be considered for implementation.

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

A. Summary

79. Switzerland has made progress in addressing the recommendations from the IOSCO assessment of the 2001-02 Financial Sector Assessment Program (FSAP). Major achievements include the establishment of the Federal Audit Oversight Authority (FAOA) to supervise and enforce compliance with audit quality and independence requirements. The Collective Investment Schemes Act (CISA) has also been recently revised, and provides a strengthened framework for regulating and supervising the offering and management of collective investment schemes (CIS). The discussions about the regulation and supervision of independent asset managers are gaining momentum, and the intention is to subject offers of unlisted securities and of some other currently unregulated products to regulation under the upcoming Federal Financial Services Act (FFSA). At the same time, Switzerland is preparing to introduce a new legislative framework for operators of financial market

infrastructures and exchanges, also for the purpose of complying with the G-20 over-the-counter (OTC) derivatives commitments.

80. In supervision, the Swiss Financial Market Supervisory Authority (FINMA) has further developed the risk-based supervisory system that it uses to determine the supervisory approach for each supervised entity. The approach is determined by the entity's potential systemic impact, and its firm level risk. Less systemic and/or less risky entities are subject to less intrusive supervision. In those cases, the supervision continues to largely rely on annual audits conducted by regulatory auditors. FINMA is in the process of gradually increasing the intensity of its own direct supervision for the more systemic and riskier entities. For the entities covered by the scope of the IOSCO assessment, the approaches taken across various FINMA Divisions differ to some extent. For example, all non-bank securities dealers are subject to relatively limited supervision, whereas some other entities solely active in securities markets (such as fund management companies and CIS asset managers) are expected to become subject to more intrusive supervision. In relation to securities markets, FINMA's own supervisory reviews are still largely to be introduced, with the exception of some thematic reviews conducted on banks' securities activities such as investment banking and wealth management.

81. FINMA's enforcement powers have recently been enhanced through the introduction of specific prohibitions on insider trading and market manipulation in the Federal Act on Stock Exchanges and Securities Trading (Stock Exchange Act, SESTA). This enables FINMA to complement the enforcement of the more narrowly defined criminal market abuse provisions with the use of its administrative enforcement powers. Establishing cooperation with the Office of the Attorney General of Switzerland (Attorney General's Office), to which the criminal enforcement powers were transferred from the cantonal prosecution authorities, has progressed well. Cooperation with the Legal Services of the Federal Department of Finance (FDF) in other areas of criminal enforcement is more established following the signing of a Memorandum of Understanding (MOU) in 2011. Nevertheless, the question remains as to whether the Swiss administrative and criminal authorities as a whole have an appropriate range of sufficiently dissuasive sanctions at their disposal. For example, FINMA can address market abuse by unsupervised entities only through the issuance and possible publication of decrees, and orders for the disgorgement of profits. Therefore, the authorities need to further explore the possibility of introducing an administrative fining power. If such power is not achievable, the authorities should consider whether the current criminal enforcement powers are a sufficient deterrent.

82. The Swiss authorities will face a significant challenge in coping with the upcoming securities regulatory overhaul. The planned framework will impact on practically all the areas of FINMA, as it is likely to require the assumption of new tasks in relation to the regulation and supervision of the issuance of unlisted securities, financial market infrastructures, independent asset managers, and conduct of business of banks and securities dealers. New regulatory challenges will also emerge from the international regulatory agenda, including on shadow banking. Given the pace and scope of change, the authorities need to assess the impact of all these changes on the resources and organization of FINMA in anticipation of the legislative process. This will also provide

an opportunity to consider on how best to strengthen conduct of business supervision more generally.

B. Introduction

83. An assessment of the level of implementation of the IOSCO Objectives and Principles of Securities Regulation (IOSCO Principles) was conducted in Switzerland from September 11 to October 1, 2013. The assessment was made as part of the IMF FSAP by Eija Holttinen, Monetary and Capital Markets Department, IMF. The previous IOSCO assessment of Switzerland was conducted in 2001-02 before the first IOSCO Assessment Methodology had been developed. Comparisons with the prior assessment are discouraged since the process has since been refined to promote consistency and has become progressively more rigorous.

C. Information and Methodology used for Assessment

84. The assessment was made on the basis of the IOSCO Principles approved in 2010 and the Assessment Methodology adopted in 2011. As has been the standard practice, Principle 38 was not assessed due to the existence of separate standards for securities settlement systems and central counterparties.

85. The IOSCO Assessment Methodology requires that assessors not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice. The ongoing global financial crisis has reinforced the need for assessors to make a judgment about supervisory and other operational practices and to determine whether they are sufficiently effective. Among other things, such a judgment involves a review of the inspection programs for different types of supervised entities, the cycle, scope and quality of inspections, as well as how the relevant authorities follow up on findings, including by using enforcement actions.

86. The assessment was based on several sources. These comprise (i) a self-assessment and additional written responses prepared by the authorities; (ii) reviews of the relevant legislation and regulations; (iii) meetings with the management and staff of FINMA, the State Secretariat for International Financial Matters (SIF), the FDF, the Attorney General's Office, and the FAOA; and (iv) meetings with self-regulatory organizations and market participants, including the SIX Exchange Regulation (SER), SIX Swiss Exchange Ltd (SSX), Swiss Bankers Association (SBA), Swiss Funds and Asset Management Association (SFAMA), banks, securities dealers, fund management companies, asset managers, issuers, audit firms, and retail investor representatives.

87. The assessor wants to thank the Swiss authorities and market participants for their cooperation and willingness to share information. The views of authorities and market participants on the current status and the best way forward for the regulation and supervision of the Swiss securities markets provided an essential input to the conclusions of the mission. In the organizational side, particular thanks go to Mr. Lukas Wyss from FINMA, who coordinated the arrangements for the assessment mission with patience, efficiency and good humor.

D. Institutional and Market Structure—Overview

Regulatory Structure

88. FINMA is the supervisory authority responsible for the authorization and prudential and conduct of business supervision of almost all entities covered by the IOSCO assessment.

The exception is audit firms, which fall under the remit of the FAOA. FINMA is also the administrative enforcement authority and, where necessary, conducts restructuring and bankruptcy proceedings. FINMA is organized into six Divisions: Banks, Insurance, Markets, Enforcement, Strategic Services, and Operations.

89. Listing of securities and setting and monitoring compliance with the related disclosure requirements is undertaken by SER, which is the self-regulatory unit of the SIX Group (see Section B).

SER and the Swiss based subsidiary of Eurex Group Ltd (Eurex Zurich Ltd) also have other statutory self-regulatory functions, in particular in the area of market surveillance. The Swiss Takeover Board (TOB) has been established to ensure compliance with the rules applicable to public takeover bids, while FINMA maintains a role as the appeal body for the TOB's decisions.

90. FINMA was established on January 1, 2009 through the merger of the Swiss Federal Banking Commission, the Federal Office of Private Insurance and the Anti-Money Laundering Control Authority.

FINMA's objectives, tasks and responsibilities are set out in the Federal Act on the Swiss Financial Market Supervisory Authority (FINMASA). The other main Acts covering the scope of the IOSCO assessment are the Federal Act on Stock Exchanges and Securities Trading (Stock Exchange Act, SESTA), the Federal Act on Collective Investment Schemes (Collective Investment Schemes Act, CISA), the Federal Act on Banks and Savings Banks (Banking Act, BA), the Federal Act on the Licensing and Oversight of Auditors (Auditor Oversight Act, AOA), and the Swiss Code of Obligations (CO).

91. The Federal Acts are complemented with related Federal Ordinances issued by the Swiss Federal Council that clarify or supplement the legislative provisions included in the Federal Acts.

The relevant authorities, such as FINMA and the FAOA, may also issue their own Ordinances, if so provided in the relevant Act. Ordinances have a binding effect on the relevant market participants. FINMA and the FAOA may also issue Circulars regarding the application of financial market legislation (cf. Art. 7 FINMASA). Although the Circulars are not binding, FINMA may base the orders it issues in individual cases on the policies expressed in its Circulars. Regulatory expectations are also set in standards issued by industry associations that FINMA has endorsed as a minimum standard – for example, for securities dealers and management of collective investment schemes, FINMA has recognized numerous standards issued by the SBA and SFAMA.⁴

⁴ These are referred to as self-regulation in Switzerland, but the associations are not self-regulatory organizations in the meaning of Principle 9 of IOSCO Principles, because they conduct only regulatory, but not supervisory and enforcement tasks.

92. FINMA cooperates with the FDF, the Swiss National Bank (SNB), the Attorney General's Office and the FAOA to coordinate the activities with shared responsibilities. MOUs have been signed between the authorities to formalize cooperation in relation to financial stability and crisis management (FINMA, the SNB, and the FDF), enforcement (FINMA and the FDF Legal Services), and the planned transfer of FINMA responsibilities for the oversight of regulatory auditors to the FAOA. FINMA is signatory to the IOSCO Multilateral Memorandum of Understanding (MMOU), and has several bilateral MOUs with foreign authorities.

Market Structure

Exchanges

93. There are two main securities exchanges in Switzerland: the SSX and SIX Structured Products Exchange Ltd (SIX Structured Products Exchange) that are both part of the SIX Group.⁵ SSX is the primary exchange in Switzerland, offering listing and trading in various financial instruments, including equities, bonds, and exchange traded funds (ETFs). Equity securities can be listed on four market segments (Standards): Main Standard, Standard for Investment Companies, Standard for Real Estate Companies, and Domestic Standard. SIX Structured Products Exchange is specialized in listing and trading structured products. Since the end of June 2013, SIX Structured Products Exchange is fully owned by the SIX Group after its joint venture shareholding by the SIX Group and Deutsche Börse was terminated. The holding company of the group, SIX Group Ltd, is owned by approximately 150 banks that are also the main users of the group's services. The SIX Group also provides central counterparty (CCP) clearing services through SIX x-clear Ltd and operates SIX SIS Ltd., a central securities depository (CSD). It is also possible to clear SSX trades in LCH.Clearnet Limited in the United Kingdom. The Eurex Group has a derivatives exchange subsidiary in Switzerland, Eurex Zurich Limited (Eurex Zurich). The clearing of trades made on Eurex Zurich takes place in Eurex Clearing AG (Eurex Clearing) in Germany. Finally, BX Berne eXchange has a limited authorization to conduct "stock exchange-like business"⁶ and primarily serves small and medium sized companies, and is a secondary listing location for some SSX listed companies.

94. Key market information on the most important products traded on the SSX is provided in the following table:

⁵ Until December 31, 2013, the name of SIX Structured Products Exchange Ltd was Scoach Switzerland Ltd. This exchange is referred to with the new name throughout this report.

⁶ Entities authorized for stock exchange-like business conduct more limited activities than fully fledged exchanges, and are in practice not subject to as stringent regulatory requirements.

Table 5. Switzerland: Key SSX Market Information

	12/2008	12/2009	12/2010	12/2011	12/2012
Shares					
Number of listed shares	338	326	308	291	283
Market capitalization (billion CHF)	864	1,041	1,098	975	1,086
Market capitalization (billion USD)	809	1,006	1,175	1,039	1,187
Market capitalization as % of GDP	152.2%	187.8%	191.3%	166.1%	183.2%
New listings	8	7	5	3	4
Annual turnover (billion USD)	1,425	773	883	824	595
Average daily trading volume (number of shares)	118,348,241	82,941,238	71,650,076	74,110,597	63,545,263
Average daily turnover (million USD)	5,676	3,079	3,477	3,245	2,382
Number of trading participants	115	119	117	127	115
Bonds					
Number of listed bonds	1,416	1,429	1,495	1,565	1,624
New listings	368	370	396	402	362
Annual turnover (billion USD)	43	46	47	47	43
Average daily turnover (million USD)	171	182	186	183	172
ETFs					
Number of listed ETFs	150	269	497	645	749
Number of new listings	27	126	295	152	117
Annual turnover (billion USD)	29	35	53	84	58
Average daily turnover (million USD)	114	141	208	330	230

Source: SSX

95. Eurex Zurich and SIX Structured Products Exchange also conduct significant trading activities, while BX Berne eXchange is much smaller. Eurex Zurich had listed 1,945 derivatives at the end of 2012, and traded a total of 249 million contracts the same year, with an average daily trading volume of 980,436 contracts. At the end of the year, it had 96 trading participants. At the end of 2012, SIX Structured Products Exchange had 32,496 tradable instruments and 119 trading participants, and its yearly trading turnover was approximately USD 34 billion. At the end of 2012, BX Berne eXchange listed 38 shares, and had 10 trading participants. Its total trading turnover in 2012 was USD 54 million.

Securities dealers

96. Provision of securities dealing services is dominated by banks in Switzerland. The total market share of the two largest banks (UBS AG and Credit Suisse AG) is more than 40 percent. They are also significant providers of discretionary asset management services, although reliable statistics on the total value of assets under management (AUM) in Switzerland are not available, because authorization is not required when only asset management services are provided. The following table provides additional information on the division of the market share between banks/securities dealers and non-bank securities dealers.

	Supervised entities		AUM		Value of securities turnover	
	Number	Market share	Billion USD	Market share	Million USD	Market share
Non-bank securities dealers	58	15.9%	8	0.2%	58	6.9%
Banks/securities dealers	306	84.1%	3,585	99.8%	787	93.1%
Total	364	100.0%	3,593	100.0%	845	100.0%

Source: FINMA

CIS

97. The fund management industry is also significant in Switzerland, and in addition to Swiss funds, a large number of foreign CIS are distributed in Switzerland. At the end 2012, there were 46 fund management companies and 98 CIS asset managers authorized in Switzerland.⁷ They managed a total of 1,421 funds, out of which 754 were retail funds and 667 were funds for qualified investors. At the same time, the number of the representatives of foreign CIS⁸ was 111, and

⁷ There were also 8 open-ended investment companies (SICAVs) and 33 subfunds of open-ended investment companies.

⁸ See Principle 24 for the tasks of a representative.

a total of 5,899 foreign funds had been approved for distribution in Switzerland.⁹ The development of the AUM of the Swiss CIS in the past three years is presented in the following table.

	2010 (Billion USD)			2011 (Billion USD)			2012 (Billion USD)		
	Retail funds	Qualified investor funds	Total	Retail funds	Qualified investor funds	Total	Retail funds	Qualified investor funds	Total
Securities funds (open)	52	0	52	49	0	49	51	0	51
Real estate funds (open)	22	6	28	23	7	30	26	8	34
Other funds for alternative investments (open)	4	1	5	3	2	5	2	2	5
Other funds for traditional investments (open)	108	313	422	108	332	440	119	402	521
Limited partnership for CIS ¹⁰	0	2	2	0	4	4	0	6	6
Total	186	323	509	183	345	528	199	418	616

Source: FINMA

E. Preconditions for Effective Securities Regulation

98. The CO includes the relevant provisions on company formation, duties of directors and officers, and shareholder rights. At a high level, it also regulates the public offers of securities that are not intended to be listed on a stock exchange. SESTA and related ordinances include requirements on takeover bids, while other change of control transactions are regulated in the Federal Act on Merger, Demerger, Transformation and Transfer of Assets (Merger Act, MerA). Listing and related disclosure requirements are not subject to any statutory provisions, but are dealt with through the requirements set by the stock exchanges. Significant shareholders of listed companies are subject to a legal, criminally enforceable duty to disclose any transactions leading to material

⁹ A significant number of these foreign funds are managed by Swiss fund management companies and asset managers, but the funds themselves are registered in a foreign jurisdiction, in the majority of cases either in Luxembourg or Ireland.

¹⁰ These are typically private equity funds.

changes in their shareholdings. The transfer of rights attaching to securities is covered in the Federal Act on Intermediated Securities (Federal Intermediated Securities Act, FISA.)

99. The Federal Act on Unfair Competition and the Federal Act on Cartels and other Restraints of Competition (Cartel Act, CartA) prohibit anti-competitive practices, unfair barriers to entry and abuse of a market dominant position. Courts provide the main channel for dispute resolution in Switzerland; the Swiss Federal Constitution guarantees legal equality and requires every person to be treated in good faith and in a non-arbitrary manner by state authorities. The Swiss Civil Procedure Code includes provisions on arbitration.

F. Main Findings

100. Principles for the Regulator. FINMA's regulatory and supervisory responsibilities and objectives are clearly set out in FINMASA. FINMA has a broad range of powers to meet its responsibilities, although its administrative enforcement powers do not include the ability to impose pecuniary fines. FINMA is operationally independent in its day-to-day activities, and subject to appropriate accountability mechanisms. Certain deficiencies in its governance arrangements may have been perceived to undermine its independence, but the FDF and FINMA have recently taken some measures to address those deficiencies. FINMA is self-funded through fees and charges from the industry, but some Divisions are thinly resourced and some are subject to high staff turnover. Appropriate governance and procedural arrangements, consultation practices and staff conduct requirements are in place. Internal processes for monitoring systemic risk are being improved, whereas the process to review the regulatory perimeter relies heavily on following developments in other jurisdictions. Supervised entities are subject to requirements to avoid, manage or disclose conflicts of interest.

101. Principles for self-regulation. Exchanges, as the only SROs in Switzerland, are subject to authorization and a requirement to submit their rules to FINMA for approval. Supervision by FINMA currently relies on meetings, reviews of reports and regulatory audits by audit firms.

102. Principles for enforcement. FINMA has sufficient inspection and investigation powers vis-à-vis supervised entities and other persons, but has outsourced the exercise of these powers to a significant extent to audit firms and investigating agents. Its requirements on the planning of and reporting on audit firms' regulatory audits are in the process of being enhanced. FINMA's own supervisory reviews are very limited. FINMA is active in investigating suspected market abuse and other misconduct, and has imposed a number of administrative sanctions in the past. However, it does not have the power to impose pecuniary administrative fines. For criminal offenses, the responsibilities are divided between the Legal Services of the FDF and the Attorney General's Office. Disciplining issuers is the sole responsibility of the stock exchanges' self-regulatory arms.

103. Principles for cooperation. Subject to FINMA's compliance with additional conditions, IOSCO approved FINMA as a full signatory to the IOSCO MMOU in 2010. FINMA has sufficient powers to share information with other domestic and foreign authorities. FINMA has provided assistance to numerous requests for information from foreign authorities under the MMOU. Foreign

requests for client information may lead to an obligation to notify the client who can then lodge a court appeal against FINMA's decision. The requirement to preserve client confidentiality consumes FINMA time and resources.

104. Principles for issuers. The full disclosure requirements apply only to issuers of listed securities, and the relevant requirements are developed through stock exchange self-regulation and monitored and enforced for compliance by the exchanges. The basic rights of shareholders are addressed in the regulatory framework. In principle, the obligation to make a public tender offer applies above the threshold of 33 1/3 percent of voting rights, unless the company has opted out from the requirement or applies a higher threshold. Acquisitions of large shareholdings in listed companies are required to be disclosed, and non-compliance is subject to criminal enforcement under SESTA. However, compliance with the directors' and senior managers' obligations to report their equity transactions is based only on self-regulation, and can be enforced by SER only vis-à-vis the listed company. Issuers of listed securities can choose between several accounting standards depending on the security issued and the market segment where it is listed. Certain issuers can use Swiss accounting standards, whose establishment is not subject to cooperation with or oversight by public authorities.

105. Principles for auditors, credit rating agencies, and other information service providers. The FAOA is responsible for the oversight of all audit firms carrying out statutory audits of public companies. It performs regular reviews at audit firms, and can stipulate remedial measures in case of non-compliance. Sufficient requirements on auditor independence are in place, but there is no requirement for a public company to have an Audit Committee to oversee the process of selecting and appointing external auditors. Public disclosure of the premature resignation of an auditor is required only on an annual basis. Auditing standards to be used depend on the accounting standards applied. In addition, the Swiss Auditing Standards (SAS), which are aligned with the international ones, always apply. Certain supervised entities are required to use credit ratings for specific regulatory purposes, which require the credit rating agency (CRA) to be recognized by FINMA, subject to compliance with the IOSCO Code of Conduct Fundamentals for CRAs. However, CRAs are not supervised on an ongoing basis. Supervised entities employing sell-side analysts are subject to the SBA self-regulatory requirements on financial research recognized by FINMA as a minimum standard.

106. Principles for collective investment schemes. All types of CIS and all entities involved in administering them, managing or safekeeping their assets, or distributing their units or shares are subject to authorization on the basis of comprehensive legal and regulatory requirements. FINMA is in the process of enhancing its supervisory approach in this area to complement the regulatory audits. Relevant fund documentation is subject to preapproval by FINMA. The fund management company and custodian have to be separate entities, but can be related parties. Some safeguards to avoid conflicts of interest are in place, but compliance with the relevant requirements is not sufficiently reviewed. The content of the initial and periodic disclosure requirements is stipulated in the legal framework. There are detailed requirements on the valuation of CIS assets, subscription

and redemption of CIS units/securities, and circumstances when redemptions can be suspended. The standard regulatory and supervisory framework for CIS applies also to hedge funds.

107. Principles for market intermediaries. There are comprehensive criteria for authorization of market intermediaries, with the exception of independent asset managers that are not subject to any regulatory requirements in Switzerland. Securities dealers are subject to initial and ongoing capital requirements, including on a consolidated basis. The organizational requirements for securities dealers build on those applied to banks. Regulation of conflicts of interest and conduct of business largely relies on the SBA standards recognized by FINMA as minimum standards. There are appropriate segregation requirements for clients' securities, whereas those applicable to clients' funds are less clear (see Principle 32). Securities dealers and banks' securities activities are subject to relatively limited supervision. FINMA's early warning mechanisms to identify a failing bank or securities dealer focus on the more systemic entities. FINMA does not have a specific plan to deal with a failure, but its powers are set out in legislation and have been used on several occasions. There is a deposit protection scheme in Switzerland, but no equivalent schemes protecting clients' securities from the failure of a securities dealer.

108. Principles for secondary markets. Exchanges and exchange-like institutions are required to be authorized. Certain gaps in the legal requirements for exchanges are due to be filled in the upcoming Financial Market Infrastructure Act. The exchanges have the front line responsibility for market surveillance. FINMA is in the process of introducing a new supervisory approach for exchanges intended to enhance its supervision from the current relatively limited level. Sufficient pre- and post-trade transparency requirements apply to trading on the SSX. The recently revised regulatory framework prohibits market abuse through both administrative and criminal provisions. The exchanges' market surveillance units, FINMA and the Attorney General's Office cooperate to investigate and address market abuse under the new framework. There are shortcomings in the cooperation arrangements to monitor open positions and deal with market disruptions, and regulatory and reporting requirements on short selling are limited.

Table 8. Switzerland: Summary Implementation of the IOSCO Principles—Detailed Assessments	
Principle	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	FINMA's regulatory and supervisory responsibilities and objectives are set out in FINMASA, with the protection of creditors, investors and insurers and the proper functioning of the financial markets set as FINMA's primary objectives. There is a pending parliamentary initiative to include the promotion of the reputation and competitiveness of the Swiss financial centre as an equal objective with the current ones. Use of self-regulation is recognized in FINMASA, and continues to play an important role in Switzerland. Subject to stipulated criteria, FINMA can provide exemptions under some financial market acts for transactions and/or market participants. The exemptions granted are not published individually or in summary format. There are inconsistencies in the regulatory treatment of certain economically equivalent products (see Principle 16), and the rules of conduct would also benefit from greater harmonization. Swiss authorities have well functioning cooperation arrangements in place.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	FINMA is operationally independent in its day-to-day activities, and subject to appropriate accountability mechanisms vis-à-vis the Federal Council and Parliament. FINMA is funded through fees and charges from supervised entities, and its budget is approved by its Board of Directors. The possibility that members of the FINMA Board of Directors could maintain a Board level position at a supervised entity, even though this was subject to pre-vetting by the Federal Council and strict recusal requirements, was unhelpful from a governance perspective. The conditions for FINMA Board membership were revised in early December 2013, which will prevent such dual roles in future nominations. The current supervised entity board membership by one FINMA Board member will be phased out by the end of 2015. FINMASA does not specify the circumstances enabling the removal of the members of FINMA Board of Directors and Chief Executive Officer (CEO); however, in practice there have been no attempts to remove a FINMA Board member or CEO. FINMA and its staff are subject to adequate legal protection in the discharge of their duties. The administrative procedures that FINMA has to apply provide sufficient procedural protections to persons impacted by FINMA's decisions.
Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	Overall, FINMA has sufficient powers and authority to meet its responsibilities. However, insufficient resources in some functions appear to limit its ability to be a proactive supervisor. This applies in particular to the Banks Division (see Principle 31). The resource needs are also impacted by the very high staff turnover in some Divisions having responsibility for the areas covered by the IOSCO Principles. FINMA has a set of governance rules and policies, and has focused on documenting its supervisory practices in detailed

	instructions for staff (see Principles 12, 24, 31 and 34). Swiss authorities are engaged in investor education only to a very limited extent.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	FINMA has a legal obligation to provide for a transparent regulatory process, consult those affected, and take into account the costs. FINMA uses various ways to solicit views from the public and supervised entities, depending on the nature and urgency of the regulatory project. As a matter of practice, it publishes the comments it receives and its feedback on them. Industry associations do not consult the public on their standards and guidelines, even though they would be recognized as a minimum standard. Publication of FINMA's individual decisions is possible subject to strict legal provisions, and FINMA uses this power cautiously (see also Principle 11).
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	FINMA staff and management are subject to a Code of Conduct and restrictions on holding and trading securities of supervised entities. The Code of Conduct is enforced, and compliance with the holding and trading restrictions has been subject to a review by an independent party. Strict confidentiality and official secrecy provisions apply to FINMA staff and management.
Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	The most important tool that FINMA uses to guide discussion on how to monitor, mitigate and manage systemic risk is its quarterly internal Risk Barometer. It addresses systemic risks possibly arising from the securities markets only to a limited extent, but provides a good basis to develop such analysis further.
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	There are significant gaps in the Swiss regulatory framework compared to the requirements of the IOSCO Principles. In addition to having made a conscious regulatory choice of not policing the perimeter in certain areas, FINMA and the other Swiss authorities appear to lack a holistic, independent process for reviewing the regulatory perimeter. Instead the emphasis is on following regulatory developments in other jurisdictions.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	Supervised entities are subject to requirements to avoid, manage or disclose conflicts of interest. Compliance with those requirements is subject to regulatory audits, and non-compliance can be enforced by FINMA. Potential misalignment of incentives by issuers is not addressed beyond general civil law requirements.
Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	At the moment the exchanges are the only SROs (as defined in Principle 9) in Switzerland. As exchanges, they are subject to authorization, and need to submit their rules to FINMA for approval. The legal requirements for the exchanges' self-regulatory functions are relatively high level and at times subject to interpretation. The self-regulatory functions are subject to regulatory audits, and there is regular engagement with FINMA in terms of meetings and periodic reporting. However, FINMA has not conducted any supervisory reviews on the exchanges' SRO functions.
Principle 10. The Regulator should have	FINMA has the power to inspect and investigate supervised

<p>comprehensive inspection, investigation and surveillance powers.</p>	<p>entities and obtain books and records from them. Sufficient record-keeping requirements on orders, transactions and client identity ensure the usefulness of the data requested. Inspections and investigations can be outsourced to audit firms and investigating agents. Responsibility for conducting real-time market surveillance has been specifically allocated to the exchanges in SESTA. The legislation would not however prevent FINMA from complementing its current ex post analysis with its own real-time market surveillance, if needed.</p>
<p>Principle 11. The Regulator should have comprehensive enforcement powers.</p>	<p>FINMA has administrative enforcement powers vis-à-vis supervised entities and those that conduct securities activities without appropriate authorization. Its investigative and enforcement powers were enhanced in May 2013 by introducing explicit insider trading and market manipulation prohibitions in SESTA. In parallel, FINMA’s administrative sanctioning powers to issue and publish a declaratory ruling and require disgorgement of profits were extended to cover breaches of those provisions as well as the failure to comply with the requirement to disclose major shareholdings. FINMA does not have the power to impose pecuniary administrative fines, and it does not normally publish its sanctioning decisions. For criminal violations, the investigative, prosecutorial and judgment power lies with either the Legal Services of the FDF or the Attorney General’s Office, depending on the nature of the suspected criminal offense. FINMA can share information with them, and good cooperation has been established in practice. Because issuer disclosure requirements are set through self-regulation, disciplinary powers rest solely with the exchanges and neither FINMA nor the criminal authorities can enforce non-compliance.</p>
<p>Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.</p>	<p>FINMA’s use of its inspection power is largely outsourced to regulatory auditors who conduct an annual basic audit in each supervised entity, and additional audits at FINMA’s request. On the basis of the recently revised approach on planning of and reporting on audits, FINMA aims at increasing its interaction with auditors and thereby also the usefulness of regulatory audits. FINMA’s own supervisory reviews are very limited, and focus on the large banks active in securities markets. FINMA is active in investigating suspected market abuse and other misconduct, and has imposed a number of administrative sanctions in the past. Firms are required to have compliance systems in place to prevent securities law violations.</p>
<p>Principle 13. The Regulator should have authority to share both public and nonpublic information with domestic and foreign counterparts.</p>	<p>FINMA can share information with other domestic authorities without the need for external approval, subject to compliance with certain conditions on the use of information. In case of a request for information from a foreign authority, FINMA may have to inform the client of the request and issue a formal decree that the client can appeal to the Swiss Federal Administrative Court (SFAC). When approving Switzerland as a full signatory to the MMOU, IOSCO concluded that this procedure complies with the MMOU as long as the</p>

	information to be disclosed is limited to the minimum facts to support the lawful basis of the request. So far FINMA has been able to comply with this requirement.
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.	FINMA is signatory to the IOSCO MMOU and has concluded four domestic MOUs. It also has several bilateral MOUs with foreign supervisory authorities. Within the constraints of its need to comply with the requirements of the Swiss law on provision of client information, FINMA has responded to a significant number of information requests.
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	FINMA has provided assistance to numerous requests for information from foreign authorities, and is required to assist them in getting access to information during cross-border on-site inspections, to ensure compliance with the Swiss client confidentiality rules. The requirement to protect client information consumes FINMA time and resources, and thereby has an impact on the ability of FINMA to process the requests in the most effective and timely manner possible. The possibility for companies limited by shares to use bearer shares may prevent access to information on their beneficial owners.
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	The full disclosure requirements apply only to issuers of listed securities; issuers of publicly offered securities and structured products are subject only to the requirement to prepare a prospectus compliant with the CO or the self-regulatory framework, respectively. Such prospectuses are not reviewed by any public authority or SRO. No data are available to assess the practical significance of these gaps. The obligation to publish semiannual reports applies only to issuers of equity securities, and the deadlines for publishing periodic reports are long compared to the practice in many other jurisdictions. SER reviews listing prospectuses and monitors compliance with periodic and ad hoc disclosure requirements.
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	The basic rights of shareholders are addressed in the regulatory framework. Acquisitions of large shareholdings in listed companies are required to be disclosed. The obligation to make a public tender offer applies to those that acquire at least 33 1/3 percent of the voting rights of a listed company, unless the company has opted out of compulsory takeover bids or raised the threshold in its articles of association. The offer prospectus is subject to examination by the TOB. Under SER rules, directors and senior managers have to report their transactions in the issuer's equity securities. However, SER can enforce compliance with this obligation only vis-à-vis listed companies. Disclosure requirements and the obligation to make a public tender offer do not apply to unlisted companies.
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	Issuers of listed securities can choose between several accounting standards depending on whether they issue equity or debt securities and on which SSX Standard their equity securities are listed. In addition to the International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (GAAP), use of Swiss GAAP FER is possible for the issuers of equity securities listed on the SSX

	<p>Domestic and Real Estate Company Standards and for all issuers of debt securities. Foreign issuers can also use other accounting standards, subject to the approval of the SER Regulatory Board. Even though the Swiss GAAP FER are not used internationally, audit firms and issuers generally consider their use to be appropriately circumscribed. Swiss GAAP FER are established by an independent foundation that is not subject to cooperation with or oversight by public authorities. SER monitors and enforces compliance with the accounting standards by issuers of listed securities. The audit requirement does not apply to issuers of unlisted equity securities, which is part of the regulatory gap identified under Principle 16.</p>
<p>Principle 19. Auditors should be subject to adequate levels of oversight.</p>	<p>The FAOA is responsible for the oversight of all audit firms carrying out statutory audits of public companies. It has sufficient powers and funding, and has established processes for performing regular firm and file reviews at audit firms to monitor compliance with the quality control and independence requirements. It can stipulate remedial measures in case of non-compliance, and has concluded several enforcement proceedings since its establishment.</p>
<p>Principle 20. Auditors should be independent of the issuing entity that they audit.</p>	<p>The regulatory framework includes sufficient requirements on auditor independence, including monitoring by the FAOA that the provision of non-audit services does not undermine auditor independence. Rotation requirements for auditors are in place. There is however no requirement for a public company to have an Audit Committee or equivalent body to oversee the process of the selection and appointment of external auditors. Public disclosure of the premature resignation of an auditor is required to be made only on an annual basis.</p>
<p>Principle 21. Audit standards should be of a high and internationally acceptable quality.</p>	<p>Depending on the accounting standard chosen, audit firms must comply with the related auditing standards the use of which has been recognized by the FAOA. In addition, the SAS apply, since they include some Swiss specific additions. The revised SAS are aligned with the revised International Standards on Auditing (ISA), and have to be used for the audit of financial statements ending on or after December 15, 2013.</p>
<p>Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.</p>	<p>For specific regulatory purposes, certain supervised entities are required to use credit ratings issued by domestic or foreign CRAs recognized by FINMA. Recognized domestic and foreign CRAs have to comply with the requirements included in a FINMA Circular that are largely aligned with the IOSCO Code of Conduct Fundamentals for CRAs. Non-compliance can lead to the revocation of their recognition, in which case their ratings cannot be used for regulatory purposes. However, FINMA does not supervise the one domestic CRA on an ongoing basis due to its limited activities. Supervision of recognized foreign CRAs relies on their respective competent authorities.</p>
<p>Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the</p>	<p>Supervised entities employing sell-side analysts are subject to the SBA directives on financial research recognized by FINMA as a minimum standard. They address the need to avoid, manage or disclose conflicts of interest and to establish</p>

<p>degree to which the regulatory system relies on them.</p>	<p>appropriate arrangements to monitor compliance. FINMA does not have any specific processes in place to consider whether other providers of analytical or evaluative services would warrant regulation (see also Principle 7).</p>
<p>Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.</p>	<p>All types of CIS and all entities involved in administering CIS, managing or safekeeping their assets, or distributing their units or shares are subject to authorization on the basis of comprehensive legal and regulatory requirements. Relevant conflict of interest and organizational requirements apply, and delegation is subject to detailed requirements tailored to the type of activity delegated. Record-keeping requirements are not sufficiently explicit. FINMA is in the process of enhancing its supervisory approach, building on its general approach to categorizing and rating supervised entities. FINMA has not conducted any own supervisory reviews, but plans to start them in 2014. Regulatory audit reports on CIS and their managers are already required to provide a more comprehensive view on compliance with securities regulatory requirements than those on some other entities covered by the IOSCO Principles.</p>
<p>Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p>	<p>CIS can be offered in various legal forms in Switzerland, but in practice most of them are still contractual funds. The relevant fund documentation is subject to preapproval by FINMA, enabling it to ensure that the legal form and structure requirements are complied with. The fund management company and custodian have to be separate entities, but can be related parties. Certain safeguards aiming at avoiding conflicts of interest are in place, and the regulatory auditors review compliance with these requirements, but only every 3-5 years. FINMA itself has not conducted any supervisory reviews focusing on (related party) custody.</p>
<p>Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.</p>	<p>The content of the prospectus to be provided to potential investors is stipulated in detail in the legal framework. FINMA approves the fund contract that includes the key information relating to each fund. The fund contract has to include information on the investment policy of the fund and the calculation of its net asset value (NAV). There are no specific legislative or regulatory deadlines for approving the fund contract, but FINMA applies internal deadlines and publishes information on the actual length of the approval periods. Despite this, market participants had concerns about the length of the approval periods. For certain funds, a simplified prospectus or a Key Investor Information Document (KIID) has to be provided in addition to the prospectus. The initial disclosure documents have to be kept up-to-date, and periodic reporting requirements to investors apply.</p>
<p>Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.</p>	<p>There are detailed requirements on the valuation of CIS assets, subscription and redemption of CIS units/securities, and circumstances when redemptions can be suspended. The valuation of CIS assets is verified by both the custodian and the audit firm. Treatment of pricing errors is covered in SFAMA guidelines in a sufficient manner, although the thresholds for qualifying pricing errors as significant are</p>

	relatively high.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	The standard regulatory framework for CIS applies also to hedge funds (referred to as "other funds for alternative investments") and their management companies, asset managers, custodians and distributors. FINMA also applies the standard CIS reporting requirements to them, and can obtain additional information when needed. The supervisory approach is subject to the same shortcomings as for other funds, and has been taken into account in the rating of Principle 24.
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	The Swiss regulatory framework does not currently require independent asset managers that deal in the name and for the account of the client to be authorized, nor does it subject them to any other regulatory requirements. Provision of services on a cross-border basis to Swiss clients is not subject to authorization or notification to the Swiss authorities. Otherwise there are comprehensive criteria for authorization as a securities dealer, and FINMA can prevent entry at the authorization stage or take appropriate measures later as needed. Information on authorized securities dealers is available on FINMA's website.
Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	Initial capital requirements for banks and securities dealers are differentiated. On an ongoing basis, securities dealers are subject to the same risk-based capital requirements as banks, and an additional requirement to have own funds amounting to at least one quarter of their annual costs. Reporting takes place quarterly, but securities dealers and banks must maintain sufficient capital adequacy on an ongoing basis. Risks from outside the supervised entity are addressed through consolidated supervision.
Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.	The organizational requirements (internal control, risk management, and compliance) applicable to securities dealers build on those applied to banks. Conflicts of interest are regulated both through FINMA Circulars and SBA standards. Business conduct is addressed in a more limited extent, but SBA standards recognized by FINMA as minimum standards would enable supervision by FINMA and regulatory auditors. The planned new FFSA is due to address these regulatory gaps. There are appropriate segregation requirements for clients' securities, whereas those applicable to clients' funds are less clear (see Principle 32). Record-keeping requirements are based solely on the Anti-Money Laundering Act (AMLA). In practice, the non-bank securities dealers and most banks/securities dealers active in securities markets (e.g., as discretionary portfolio managers) are subject to more limited supervision, in particular in relation to their conduct of business, than the other supervised entities covered by the IOSCO Principles. The new regulatory audit framework is expected to lead to more informative audit reports that should assist FINMA in identifying risks in supervised entities, including the smaller ones.
Principle 32. There should be a procedure for dealing with the failure of a market intermediary in	FINMA uses various mechanisms that are expected to give it an early warning of a potential default by a securities dealer or

<p>order to minimize damage and loss to investors and to contain systemic risk.</p>	<p>a bank. These mechanisms focus on assessing risks of the more systemic entities. FINMA does not have a specific plan to deal with a failure, but its powers applicable to both banks and securities dealers are clearly set out in the Banking Act (BA) and FINMA has used them on several occasions. Segregation requirements for clients' securities comply with Principle 32, but the regulatory framework does not clearly require securities dealers to segregate clients' funds. Since securities dealers can hold clients' funds deposited for investment purposes, they have to be members of the deposit protection scheme that however covers only up to CHF 100,000 per client. In case segregation requirements are not complied with, there is no investor compensation scheme protecting clients' securities from the failure of a securities dealer.</p>
<p>Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.</p>	<p>Exchanges and exchange-like institutions are required to be authorized. The authorization criteria are relatively high level, and in practice FINMA tailors the requirements to each individual case. There are some OTC trading platforms in Switzerland for trading unlisted shares, but according to FINMA they are not multilateral and trade very low volumes. As a result, they do not fall under the SESTA authorization requirement. Certain gaps in the legal requirements for exchanges are due to be filled in the upcoming Financial Market Infrastructure Act. FINMA approves the exchanges' listing and trading rules, and is therefore able to ensure the appropriateness of the admission criteria for products and participants.</p>
<p>Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.</p>	<p>The exchanges have the front line responsibility for market surveillance, and the SIX Group exchanges' participants are also subject to audits commissioned by SER. FINMA itself does not conduct real-time market surveillance, but investigates improper market conduct on the basis of referrals from the market surveillance units of the exchanges and its own analytical work. FINMA is in the process of introducing a new supervisory approach for exchanges (and operators of financial market infrastructures, FMIs) that is intended to enhance its supervision from the current relatively limited level. In addition to relying on the work of audit firms as well as meetings and other informal contacts with the exchanges, the new approach is expected to lead to FINMA supervisory reviews of at least the most systemically important exchanges/FMI operators.</p>
<p>Principle 35. Regulation should promote transparency of trading.</p>	<p>SESTA includes a high level requirement for exchanges to organize their markets so as to achieve transparency. This is complemented by the rules and practical arrangements of the exchanges. The trading system of the SSX provides sufficient levels of pre- and post-trade transparency of on-exchange trades. The SSX operates a block trading service, but the low volumes in that service do not raise concerns about the volume of dark trading.</p>
<p>Principle 36. Regulation should be designed to detect and deter manipulation and other unfair</p>	<p>The recently revised regulatory framework prohibits market abuse through both administrative and criminal provisions,</p>

trading practices.	with the latter having a more limited scope of application. The potential for market abuse is monitored by the market surveillance units of the exchanges that refer relevant suspicious activity to FINMA. FINMA in turn cooperates with the Attorney General’s Office to determine the best approach to address each case. Since the legislative change came into force only recently, it is premature to draw conclusions on the effectiveness of the new arrangements in terms of results from the investigations and sanctions given. The prior arrangements had led to limited results, which may be attributed to limited powers of both FINMA and the criminal authorities.
Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	Monitoring of open positions on secondary markets is primarily undertaken by the CCPs, although FINMA and the BNP also require certain large exposure reporting and have the general power to take action in various situations. Limited arrangements exist domestically and on a cross-border basis to share information on large exposures in secondary markets. MOUs enable consultation between Swiss and foreign authorities in case of market disruptions, but do not contain sufficient crisis management arrangements. Implementation of segregation and portability requirements by SIX x-clear is planned to be effected by mid-2014. The regulatory and reporting requirements on short selling are limited; assessing the significance of the gaps would benefit from data on settlement fails.

G. Recommended Action Plan and Authorities’ Response

<p align="center">Table 9. Switzerland: Recommended Action Plan to Improve Implementation of the IOSCO Principles</p>	
<p align="center">Principle</p>	<p align="center">Recommended Action</p>
Principle 1	<ol style="list-style-type: none"> 1. The FDF should ensure that the proposal for the FFSA will include sufficiently harmonized regulatory requirements for economically equivalent products (see also Principle 16). 2. FINMA should consider publishing information on its exemptive decisions, e.g. in summary format.
Principle 2	<ol style="list-style-type: none"> 1. The FDF and/or FINMA should include more specific criteria in FINMASA and/or FINMA Organizational Rules on the removal of the members of FINMA’s Board of Directors and CEO.
Principle 3	<ol style="list-style-type: none"> 1. FINMA should ensure that its supervisory resources in all divisions are sufficient to cover the securities activities under their responsibility. 2. FINMA should carefully consider the costs and benefits of the current high staff turnover in some divisions and take any appropriate measures. 3. Swiss authorities should consider enhancing investor education.
Principle 4	<ol style="list-style-type: none"> 1. FINMA should engage with the industry associations to assess the feasibility of conducting public consultations on their standards, in particular in the area of investor protection.
Principle 6	<ol style="list-style-type: none"> 1. FINMA should further develop its Risk Barometer by adding focus on the systemic risks potentially arising from securities markets.
Principles 7 and 23	<ol style="list-style-type: none"> 1. The authorities should develop more robust arrangements to conduct comprehensive analyses of potential risks emerging through unregulated products and entities and to take necessary measures, where appropriate.

Principle 8	1. The authorities should introduce appropriate ways to analyze and, if needed, address the potential misaligned incentives of issuers.
Principles 9, 33 and 34	1. FINMA should ensure that both the exchanges' business activities and their SRO activities are subject to robust supervision, including directly through FINMA supervisory reviews. 2. The FDF should ensure that the upcoming proposal for the Financial Market Infrastructure Act enhances and clarifies the requirements for exchanges' (and other potential trading platforms') self-regulatory responsibilities as well as FINMA's powers in the area of exchange and SRO supervision.
Principle 10	1. Taking into account the possible structural changes in the market (e.g., the volume of SSX/Eurex Zurich cross-market trading, potential establishment of competing trading platforms), FINMA should consider whether, when and how to increase its own market surveillance capacity.
Principle 11	1. The authorities should consider the need for and the legal possibility for introducing administrative fining powers, or alternative ways to ensure a more effective and dissuasive sanctioning regime, including reconsidering the sufficiency of the criminal sanctions for insider trading and price manipulation. 2. The authorities should consider whether relying solely on the exchanges' disciplinary powers provides a sufficient deterrent for issuer non-compliance. 3. FINMA should consider the benefits of adopting a more strategic approach to deciding on the publication of its sanctioning decisions, taking into account the legal limitations.
Principles 12, 24, 31 and 34	1. FINMA should further develop its supervisory approach, and ensure that it covers all supervised entities with similar risk characteristics in a sufficiently harmonized manner across the various Divisions.
Principles 13 and 15	1. The authorities should pursue the abolition of the strict client confidentiality requirements and the requirement to inform the client of foreign authorities' requests for information.
Principles 16 and 18	1. The FDF should ensure that the future FFSA will include disclosure requirements applicable to issuers of all publicly offered securities and structured products comparable to those applicable to issuers of other economically equivalent, regulated products. Annual accounts of all issuers of publicly offered securities should be subject to an audit requirement. 2. FINMA and SER should strengthen the periodic disclosure requirements applicable to issuers listed on the SSX and SIX Structured Products Exchange, in particular by requiring the publication of semi-annual financial statements by all issuers. They are also encouraged to consider whether the current deadlines for the publication of annual and semiannual reports are appropriately benchmarked.
Principle 17	1. The authorities should consider strengthening the regulatory requirements for the disclosure of the transactions of listed companies' directors and senior managers to make the requirements directly enforceable vis-à-vis the persons in question. Such requirements should be extended to all issuers that have made a public offer, independent of whether their securities are listed or not.
Principle 18	1. The authorities should consider whether the establishment of Swiss GAAP FER should be subject to cooperation with or oversight by the public sector.
Principle 20	1. The authorities should ensure that listed companies in practice comply with sufficient corporate governance requirements, in particular in relation to the need to establish an independent audit committee or equivalent body. 2. The authorities should introduce a requirement for the prompt disclosure of information on the resignation, removal and replacement of an external auditor.
Principle 22	1. The authorities should consider whether the current model where the domestic CRA is not subject to FINMA ongoing supervision is sufficient going forward.
Principles 24 and 31	1. The authorities should introduce more explicit and comprehensive record-keeping requirements in CISA and SESTA.
Principle 25	1. The authorities should apply further safeguards for related party custody, such as requiring specific, additional regulatory audits and allowing no overlap in directors of related companies.

Principle 26	1. The FDF should consider the costs and benefits of introducing a formal, sufficiently long deadline for the FINMA approval process of fund contracts, with appropriate safeguards enabling FINMA to effectively reject non-compliant proposals.
Principle 27	1. FINMA and SFAMA should consider whether the thresholds for significant pricing errors are too high compared to other jurisdictions.
Principle 29	1. The FDF should ensure that the proposal for the FFSA will introduce a robust regulatory and supervisory regime for independent asset managers that comply with IOSCO Principles 29-32. 2. The authorities should consider whether cross-border provision of securities dealing services to Swiss clients is sufficiently regulated and in particular whether there are sufficient tools to intervene in case of unauthorized service providers.
Principle 31	1. The FDF should ensure that the upcoming FFSA will address the regulatory gaps identified in Principle 31.
Principles 31 and 32	1. The FDF should introduce appropriate legal requirements for the segregation of clients' funds by securities dealers that apply on an ongoing basis and in bankruptcy. 2. The Swiss authorities should consider introducing an investor compensation scheme or equivalent regime to protect clients' securities in case of non-compliance with the segregation requirements.
Principle 37	1. The Swiss authorities should assess whether the current arrangements sufficiently cover exchange of information on trading exposures of common market participants and cooperation in crisis situations. 2. The Swiss authorities should ensure that they have access to sufficient data to assess the impact of short selling as a basis for deciding on any regulatory measures.

H. Authorities Response to the Assessment

109. The Swiss authorities wish to express their appreciation to the IMF assessment team for the dedication, time and resources committed to this assessment and for the constructive exchange of views for which the assessment has provided the opportunity.

110. We broadly agree with the findings of the report. Regarding certain deficiencies in the area of conduct regulation and supervision (principles 1, 12, 16, 18, 29, 31) as well as in the area of financial market infrastructure regulation (principles 9, 33, 34, 37) we would like to highlight – as is also stated in the report – that there are ongoing legislative projects that were initiated prior to the FSAP review which aim at reshaping the regulatory architecture to be in line with international principles in these areas

111. On some points the Swiss authorities do not share the views expressed in the report and think that these aspects warrant further clarification to reflect the Swiss situation appropriately:

112. Regarding the independence of FINMA (principle 2) the report acknowledges the measures recently taken by the Federal Council to reinforce the Board's independence.

However, the report unjustifiably criticizes that the conditions for removal of FINMA BoD members are not sufficiently specific. We would like to point out that the recently published (and priorly already existing) requirements for FINMA BoD members are not just applicable for the appointment but also for the duration of the exercise of the function. The legal clause for removal of BoD members (FINMA Art. 9) refers to these specified conditions for the exercise of the BoD function. In our view this implies that the conditions for the removal of BoD members are sufficiently specified

as well. And therefore, given the recent governance changes, we are of the strong opinion that the principle 2 should be rated as “implemented.”

113. Regarding the level of FINMA’s engagement with banks and securities dealers of lower supervisory categories (principles 12 and 31) we would like to point out that this current allocation of FINMA resources is justified by the prudential risks associated with the respective entities. The current allocation of supervisory resources is based on FINMA’s prudentially focused, risk based supervisory approach, in accordance with the regulatory focus of the Swiss legislator. However, the ongoing legislative project for the Federal Financial Services Act will put more emphasis on conduct supervision.

114. Regarding the supervision of credit rating agencies (principle 22) the report does, in our view, not adequately reflect the fact that, with one exception, all credit rating agencies that provide ratings used for regulatory purposes are subject to supervision in their home jurisdiction. The IOSCO methodology explicitly provides for the option for “ongoing supervision [...] not necessarily by the regulator in whose jurisdiction the ratings are used.” Regarding the one domestic CRA it is important to note that the regulatory use of these ratings is very limited in scope, such that the lack of an ongoing supervision by FINMA poses no material risk to investors.

115. Regarding the existing safeguards for related party custody (principle 25), in Switzerland, fund management companies and custodian banks can be related parties. There do exist safeguards and independence requirements between both entities. In this sense, there can be no overlap between the two entities on an operational level including the executive committee. Also, it is not possible to have people responsible for the custodian bank activities within the Board of Directors of the Fund Management Company. Regulatory audits are already in place as to the independence between those two entities. Furthermore, these independence requirements are verified with every approval and authorization within FINMA. Every amendment within the organization of the custodian bank is subject to FINMA’s prior authorization and any amendments within the Fund Management company’s Board of Directors or Executive Committee is also subject to FINMA’s authorization. Therefore, we are of the opinion that compliance with the relevant requirements is sufficiently reviewed.

116. Regarding the lack of coverage by the deposit insurance scheme for losses that are caused by non-segregated securities holdings (principle 32), the Swiss authorities are of the opinion that the Swiss solution provides equivalent protection to the clients of securities dealers: In case of failure of a securities dealer and if the segregated securities do not suffice to cover the claims of the clients, non-segregated securities are segregated ex-post for the clients benefit. The theoretical possibility of the total of available securities being insufficient to cover the clients’ claims is of no practical relevance.

117. The Swiss authorities have already launched a process to systematically evaluate all IMF recommendations in order to assess in detail how, within which timeframe and to what extent the recommendations can and should be implemented.