



EUROPEAN COMMISSION

Internal Market and Services DG

FINANCIAL INSTITUTIONS

Banking and financial conglomerates

General guidance from the European Financial Conglomerates Committee to EU supervisors: the extent to which the supervisory regime in Switzerland is likely to meet the objectives of supplementary supervision in Directive 2002/87/EC

General guidance from the European Banking Committee to EU supervisors: the extent to which the supervisory regime in Switzerland is likely to meet the objectives of consolidated supervision in Directive 2006/48/EC

1. INTRODUCTION

Article 143 of Directive 2006/48/EC states that "the Commission may request the European Banking Committee to give general guidance as to whether the consolidated supervision arrangements of competent authorities in third countries are likely to achieve the objectives of consolidated supervision as defined in this Chapter, in relation to credit institutions, the parent undertaking of which has its head office in a third country. The Committee shall keep any such guidance under review and take into account any changes to the consolidated supervision arrangements applied by such competent authorities." Article 143 requires that this guidance is taken into account by the competent authority which would be responsible for exercising consolidated supervision when verifying whether a credit institution, with its parent headquartered outside the Community, is subject to equivalent supervision in its home country.

Article 21(5) of the Financial Conglomerates Directive (2002/87/EC) states that the European Financial Conglomerates Committee ("EFCC") "may give general guidance as to whether the supplementary supervision arrangements of competent authorities in third countries are likely to achieve the objectives of the supplementary supervision as defined in this Directive [...]. The Committee shall keep any such guidance under review and take into account any changes to the supplementary supervision carried out by such competent authorities." Article 18(1) requires that this guidance is taken into account by the competent authority (the 'coordinator') which would be responsible for exercising supplementary (i.e., group-level) prudential supervision when verifying whether a group, with its parent headquartered outside the Community, is subject to equivalent supervision in its home country.

Recital 13 of Directive 2002/87/EC describes equivalent supervision in terms of the objectives and results achieved from it. The recital states that regulated entities should be subject to "equivalent and appropriate supplementary supervisory arrangements which achieve objectives and results similar to those pursued by the provisions of this

Directive." Recital 14 makes it clear that such equivalent supervision can, however, only exist where "third-country supervisory authorities have agreed to co-operate with the competent authorities concerned on the means and objectives of exercising supplementary supervision of the regulated entities of a financial conglomerate."

The EFCC and EBC have decided to give general guidance on the supervisory arrangements in Switzerland and in the USA, given the economic importance of Swiss and US financial groups to the European Union. In 2004, they published their first guidance on third countries' equivalence. The following guidance is updating the assessments of 2004.

The following guidance relates to the supervision of financial conglomerates and banking groups in Switzerland. It is based on technical advice prepared by the Interim Working Committee on Financial Conglomerates (IWCFC) and approved by the Committee of European Insurance and Pension Funds Supervisors (CEIOPS) and the Committee of European Banking Supervisors (CEBS). It was published on 22 February 2008. In our view the objectives of supplementary supervision under Directive 2002/87/EC and the objectives of consolidated supervision under Directive 2006/48/EC are sufficiently close that this guidance addresses both topics.

The EBC is giving guidance as to whether the arrangements of the Swiss supervisory authorities concerned are likely to achieve the objectives of consolidated supervision in Chapter 4 of Directive 2006/48/EC, identifying individual authorities where appropriate. This guidance is intended to facilitate the making of equivalence decisions, as required by Article 143 of Directive 2006/48/EC, by EU supervisors.

The EFCC is giving guidance as to whether the arrangements of the Swiss supervisory authorities concerned are likely to achieve the objectives of supplementary supervision in Directive 2002/87/EC, identifying individual authorities where appropriate. This guidance is intended to facilitate the making of equivalence decisions, as required by Article 18 of Directive 2002/87/EC, by EU supervisors.

This guidance was based on the publication of CEBS and the IWCFC on www.ceiops.org and www.c-eps.org and approved by the EBC on March 14, 2008, and the EFCC on April 11, 2008.

2. OVERVIEW OF THE SWISS REGULATORY SYSTEM

Supervision in Switzerland is conducted by three main agencies with regulatory powers: the Swiss Federal Banking Commission (SFBC) for banking, securities and investment funds, the Federal Office of Private Insurance (FOPI) for insurance and reinsurance and the Federal Social Insurance Office (FSIO) for pension funds. The objects of supervision are institutions, conduct of business, products and markets. Due to the focus of this review only the SFBC and FOPI have been considered.

Since July 2003, the Federal Department of Finance has undertaken initiatives to reform financial supervision. A first draft law - the "Federal Act on Financial Market Supervision" (the FINMA Act - 'FINMAG') - was put under consultation in October 2003 and approved by the Parliament in June 2007. The law contains the basic organisation of a new supervisory authority, resulting from the merger of the Swiss Federal Banking Commission, the Federal Office of Private Insurance and the Anti-Money Laundering Control Authority. It will enter into force on the first of January 2009, at which time the new authority (to be called Financial Market Authority) shall be established as an institution under public law with its own legal personality and become

operational. It should be noted that the effects of the approval of this merger on both the current financial legislation and the current supervisory practices cannot be anticipated yet.

Whilst the SFBC does not currently supervise any financial conglomerates, the legislative framework provides for this possibility and the SFBC anticipate that it would operate in a similar fashion to its current supervision of large complex financial institutions and to the way it has supervised financial conglomerates in the past. However, the legal framework is less prescriptive for financial conglomerates and gives more powers of discretionary treatment to the supervisory authority. In this regard article 3g of the Banking Law explicitly provides that, while SFBC has to issue general guidance on own funds, liquidity, large exposures, group-internal exposures and accounting for banking groups, it may alternatively proceed with specific decisions (decrees) and renounce to abstract guidance for financial conglomerates. In respect of this article, the SFBC have said that they do not anticipate issuing general guidance for a "conglomerate population of less than a handful" and that financial conglomerate supervision will be tailor-made.

2.1. Swiss supervisory arrangements as at end 2007

At the time of the 2004 assessment, the general legal framework on conglomerates was still to be drafted and supervision of Swiss based banking and insurance dominated financial conglomerates was exercised through the issuance of ad-hoc supervisory decrees.

Since 2004, there have been significant changes to both banking and securities and insurance group regulation in order to enhance the supervisory framework. Furthermore, general provisions on financial conglomerates have been included in the Swiss financial legal framework. In particular, the implementation of a new legal framework for the supervision of insurance groups and insurance dominated financial conglomerates will enhance FOPI's ability to come to a group-wide view of the financial soundness of the supervised institutions.

These developments are bound to reinforce the Swiss authorities' supervision of sector groups and financial conglomerates.

For the banking and securities sector the major changes since 2004 are:

- (1) The introduction in the Banking Law of articles 3b – 3h (7 articles), which extended banking group rules to financial conglomerates, which entered into force on January 1, 2006.
- (2) The partial revision of the Banking Ordinance introducing articles 11 – 14a which implemented guidance on internal controls and risk management for banking group and conglomerate supervision. These changes in the Banking Ordinance came into force on January 1, 2007.
- (3) The Implementation of Basel II into the Swiss supervisory framework, which resulted in a new, separate Ordinance on own funds and large exposures (to be applied to both banking groups and conglomerates), which entered into force on January 1, 2007 as well. A transitional period allows for the deferral of compliance with Basel II standards until 1 January 2008.

There have also been major developments in the supervision of the insurance sector, the most significant of which are:

- (1) The adoption of the Insurance Supervision Law (ISL) which entered into force on 2006. As envisaged in 2004, the ISL provides for an explicit legal basis for the supervision of groups and insurance conglomerates and results in the group-wide supervision of insurance groups. Supporting directives issued by FOPI have strengthened solvency requirements and enhanced its approach to risk management supervision. These measures should enhance FOPI's ability to form a group-wide view of the financial stability of the institutions supervised.
- (2) The conclusion of an MOU with all EU/EEA insurance and pension funds supervisors in February 2006, which has led to an intensified co-operation between EU/EEA insurance supervisors and FOPI.

3. CONCLUSIONS

In 2004 it was concluded that, on balance, there was broad equivalence in the Swiss supervisory approaches to both consolidated and supplementary supervision, notwithstanding some caveats in the area of supervisory cooperation and information exchange, especially regarding the legal system and the practical consequences thereof, and the use of group specific decrees rather than a general approach. The expected changes in the supervisory regime were also flagged as an issue which should be kept under review.

The key observations and conclusions of the 2007 analysis in respect of each of the Swiss supervisory authorities are set out below.

3.1. SFBC

It is the IWCFC and CEBS' opinion that the supervisory arrangements of the SFBC would meet the objectives and deliver similar outcomes to those provided for by the CRD and FCD. The caveat of 2004 (reliance on ad hoc case by case decrees) has now been addressed by the significant changes detailed above and therefore no longer applies. The caveat of 2004 (features of the legislative regime limiting information exchange with non-Swiss supervisors) remains although, as in 2004, this does not harm the level of cooperation from Swiss authorities deemed essential for any finding of equivalence. When assessing the equivalence of the Swiss supervisory regime, EEA member states' supervisory authorities should take account of possible changes due to the envisaged unification of the supervisory authorities in 2009 and the absence in 2007 of practical experience in the supervision of predominantly banking financial conglomerate.

When taking individual equivalence decisions supervisors may wish have regard to the following:

There are currently no financial conglomerates supervised by the SFBC. The new regime is therefore untested in practice for conglomerates. The observations below should therefore be assumed to be tentative and, in the event that a financial conglomerate does fall under the SFBC's remit the co-ordinating supervisor must verify whether the approaches outlined below have been implemented.

3.1.1. Supervisory cooperation and information sharing

The SFBC has the authority to cooperate and to share information with other supervisory authorities, and has shown the willingness to do so. Supervisory information provided to the SFBC is adequately protected. However, as in 2004, the so-called “private banking carve-out” (i.e.: Swiss rules on professional secrecy) – that is applicable to banking groups, insurance groups and (banking and insurance) financial conglomerates - still has an impact on the extent and speed with which certain kind of information can both be provided by the Swiss authorities to other countries’ supervisors and be verified on-site in Switzerland by foreign authorities exercising consolidated supervision over banking and conglomerate groups with Swiss components.

The SFBC's approach to "common assessment" (i.e. shared evaluation) should be verified if and when a Swiss based financial conglomerate becomes subject to SFBC overall supervision.

3.1.2. Qualitative group assessment

Major amendments to the Swiss banking legislation have strengthened the supervisory regime for banking groups and financial conglomerates. As regards the supervision of financial conglomerates, the legal framework is more discretionary than for banking groups.

The SFBC does not have (as in 2004) direct powers to prohibit undesirable group structures, however it does have indirect powers.

The SFBC assesses the fitness and propriety of a group's management, as well as the suitability of shareholdership.

3.1.3. Quantitative group assessment

As regards capital requirements for banking groups, the reference standard that has been implemented is the Basel II framework. As regards pillar 2 requirements, the technical implementation measures are still pending. However, the SFBC, while having already opted for a quantitative capital surcharge, is going to formalise a full fledged Pillar II supervisory process only for a restricted number of very significant banking groups (LCFI).

In theory the SFBC envisages that capital requirements for financial conglomerates would be calculated according to the method of consolidation plus deduction of insurance participations. It is worth noting, however, that the SFBC has now been given the discretionary power to impose to financial conglomerates, when needed, either an additional capital charge or adopt the insurance requirement instead of deduction.

The SFBC is monitoring significant risk concentrations at group level as well as intra-group transactions/exposures. For banking groups, the rules are the same as in the EU.

Banking groups, and by extension financial conglomerates, are expected to have in place internal capital management processes, which are subject to SFBC review. However, a fully fledged Pillar II supervisory process will only apply to the LCFIs.

3.1.4. Disclosure

The SFBC is applying to banking groups the Basel II “pillar 3” requirements. In principle, similar provisions should apply to financial conglomerates.

3.1.5. Enforcement

The SFBC has the authority to take appropriate enforcement measures, including the right to withdraw the domestic licence.

3.2. FOPI

It is the IWCFC and CEBS’ opinion that the supervisory arrangements of the FOPI would achieve the objectives and achieve similar outcomes to those provided for by the CRD and FCD. The caveat of 2004 (reliance on ad hoc - case by case decrees; difference in outcome of insurance supervision) has been addressed by significant changes to the insurance supervision regime (including both qualitative and quantitative measures) and therefore no longer applies. The caveat of 2004 (features of the legislative regime limiting information exchange with non-Swiss supervisors) remains although, as in 2004, this does not harm the level of cooperation from Swiss authorities deemed essential for any finding of equivalence. When assessing the equivalence of the Swiss supervisory regime, EEA member states' supervisory authorities should take account of possible changes due to the envisaged unification of the supervisory authorities in 2009.

When taking individual equivalence decisions supervisors may wish have regard to the following:

3.2.1. Supervisory cooperation and information sharing

FOPI has the authority to cooperate and to share information with other supervisory authorities, and has shown the willingness to do so. Supervisory information provided to the FOPI is adequately protected. As in 2004, the Swiss rules on professional secrecy – that are applicable to banking groups, insurance groups and (banking and insurance) financial conglomerates - still have an impact on the speed with which certain kind of information can be provided by the Swiss authorities to other countries’ supervisors. However, the conclusion of an MOU with all EU insurance and pension funds supervisors in February 2006 has led to an intensified co-operation between EU insurance supervisors and FOPI.

3.2.2. Qualitative group assessment

With respect to 2004 there has been substantial progress concerning certain qualitative aspects of the FOPI approach. Explicit legal provisions relating to the supervision of insurance groups and insurance conglomerates enhanced FOPI's powers in relation to qualitative aspects of the insurance groups and insurance conglomerates, such as: shareholders assessment, review of the group structure, organization, and risk management assessment.

FOPI assesses the fitness and propriety of a group's management, as well as the suitability of a group's shareholdership.

3.2.3. Quantitative group assessment

The new detailed legal framework in place for insurance supervision has improved FOPI quantitative supervision regarding financial conglomerates. As regards capital adequacy requirements, group capital for financial conglomerates is prudently measured and monitored, comparable to international standards. In addition, the application of the so called Swiss Solvency Test to insurance dominated conglomerates makes FOPI's supervision even more advanced, with regard to risk sensitivity of the quantitative supervision, than that currently exercised by most EU insurance supervisor.

FOPI monitors risk concentrations on a conglomerate level, as well as intra-group transactions within a conglomerate.

FOPI requires financial conglomerates to have in place appropriate risk management systems and internal control mechanisms at group level, which are proportionate to the group's business level and risks

3.2.4. Disclosure

FOPI does not currently require conglomerates to disclose externally quantitative data on their risk based solvency calculations, although it intends to request disclosure of risk management practices in the conglomerate's annual reports or internet homepages.

3.2.5. Enforcement

FOPI has the authority to take appropriate enforcement measures.