Financial Stability in Switzerland: A Health Check

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Switzerland 2019 FSAP

20 Years Financial Sector Assessment Program

1999 established after Asia Crisis

2009 mandatory for some economies

2014 “systemic risk” focus

Three FSAP Components

Financial System Vulnerabilities and Resilience

- risks assessment
- stress testing

Financial Stability Policy Framework

- conventional: banking, insurance, securities
- since 2009: MaPP
- emerging: fintech; climate change, cyber risk

Financial Safety Net

- liquidity support
- deposit insurance
- crisis preparedness and management, including early intervention, recovery, and resolution

Switzerland FSAP Workstreams

Methodology & Workstreams

IMF methodology	Macrofinancial / Macroprudential
IMF methodology	Stress Testing (banking + insurance)
BCBS Core Principles	Banking Supervision
IAIS Core Principles	Insurance Supervision
CPSS/IOSCO Principles for FMIs	FMI Supervision
IOSCO Principles for Securities Regulation	Asset Management
FSB Key Attributes & IADI Core Principles	Safety Net / Crisis Management
IMF/WBG Bali Fintech Agenda	Fintech Law, Regulation, Supervision

published material on IMF website:
https://www.imf.org/external/np/fsap/fsap.aspx?CountryName=Switzerland#Switzerland

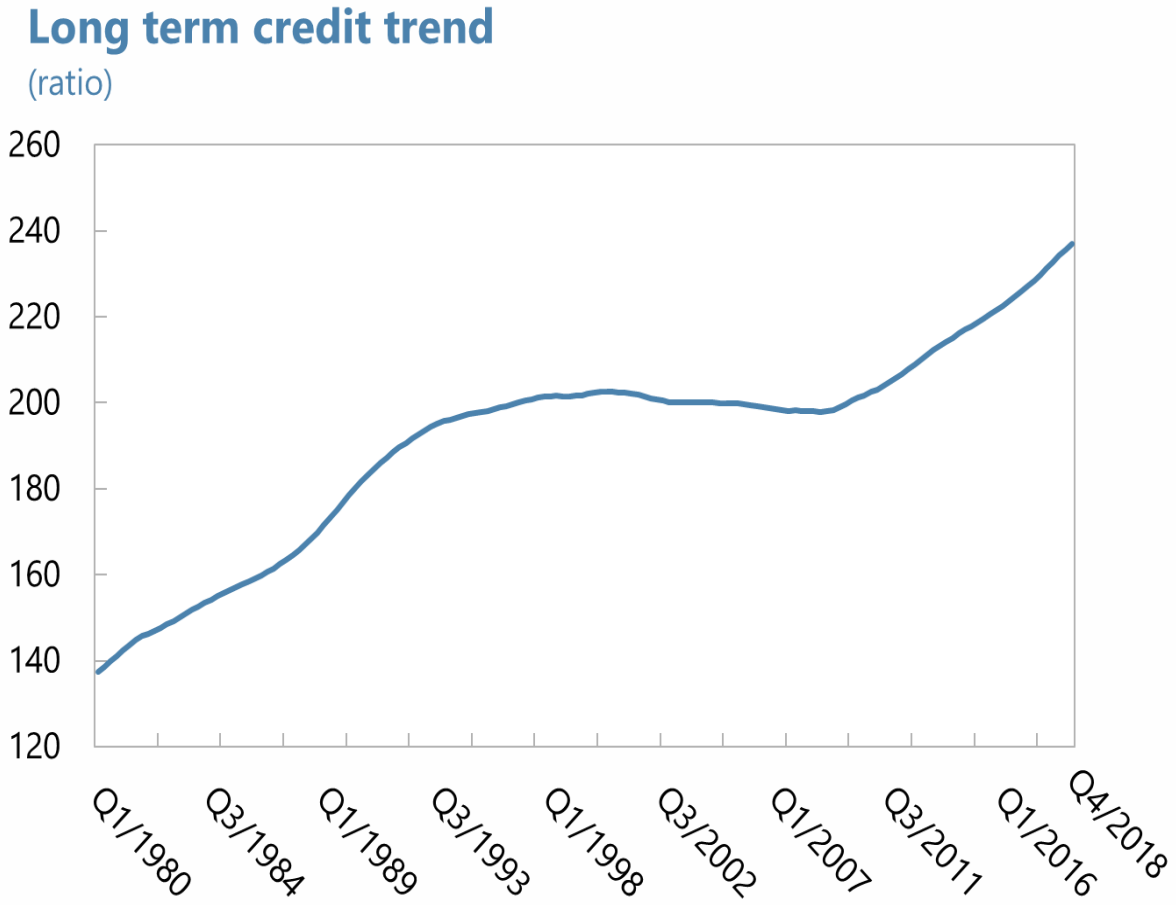
Switzerland 2019 FSAP—main findings

1.	financial institutions well capitalized, but macrofinancial vulnerabilities are deepening
2.	important reforms since 2014, but several critical recommendations and emerging challenges have yet to be fully addressed
3.	capital buffers increased across all banks, and the 2 GSIBs downsized and deleveraged significantly
4.	MaPP framework is constrained and no measures since 2014 (until very recently)
5.	FINMA has developed into a trusted supervisor, but it relies heavily on external auditors to conduct on-site supervision, needs enhanced governance and more resources, and should address data gaps
6.	combination of ex-post funding, low cap on banks' contributions, and a private deposit insurance agency run by active bankers, weakens crisis management arrangements

…for panel discussion

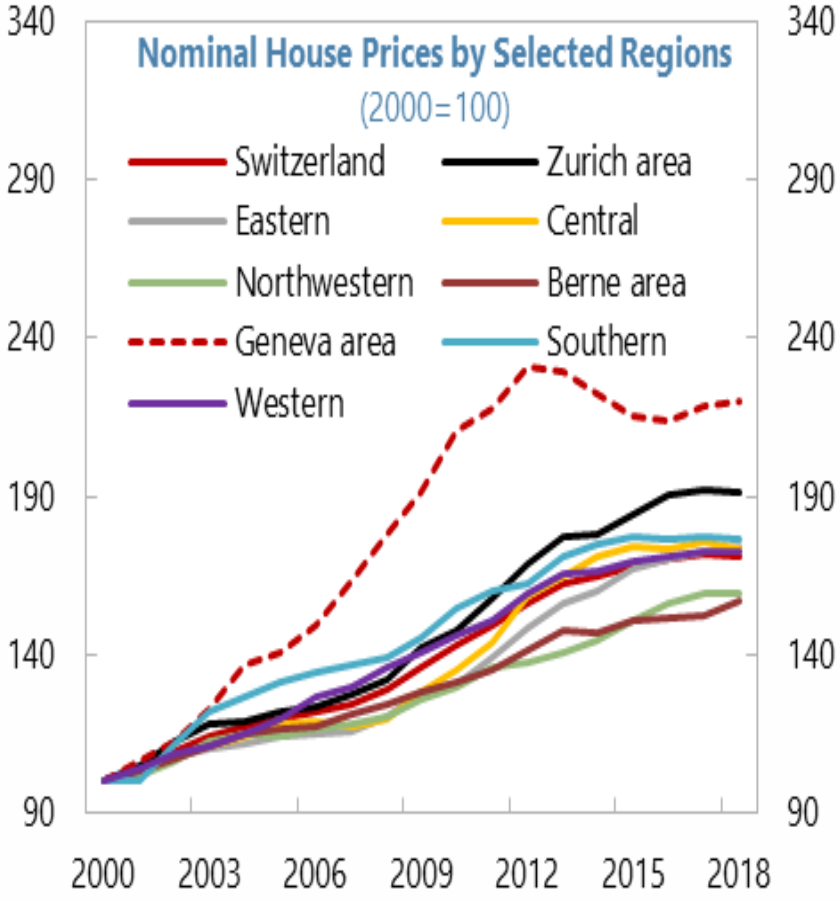
Macro-financial risks are high

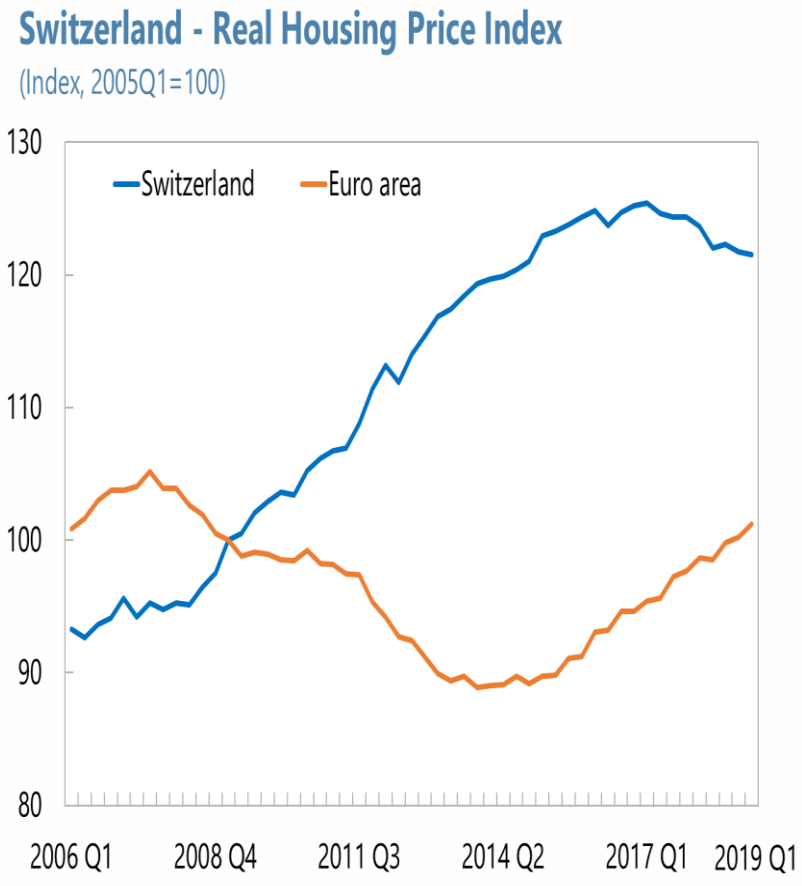
A persistently rising credit to GDP ratio, high asset prices, and a prolonged external and domestic low-yield environment represent risks for the financial system.

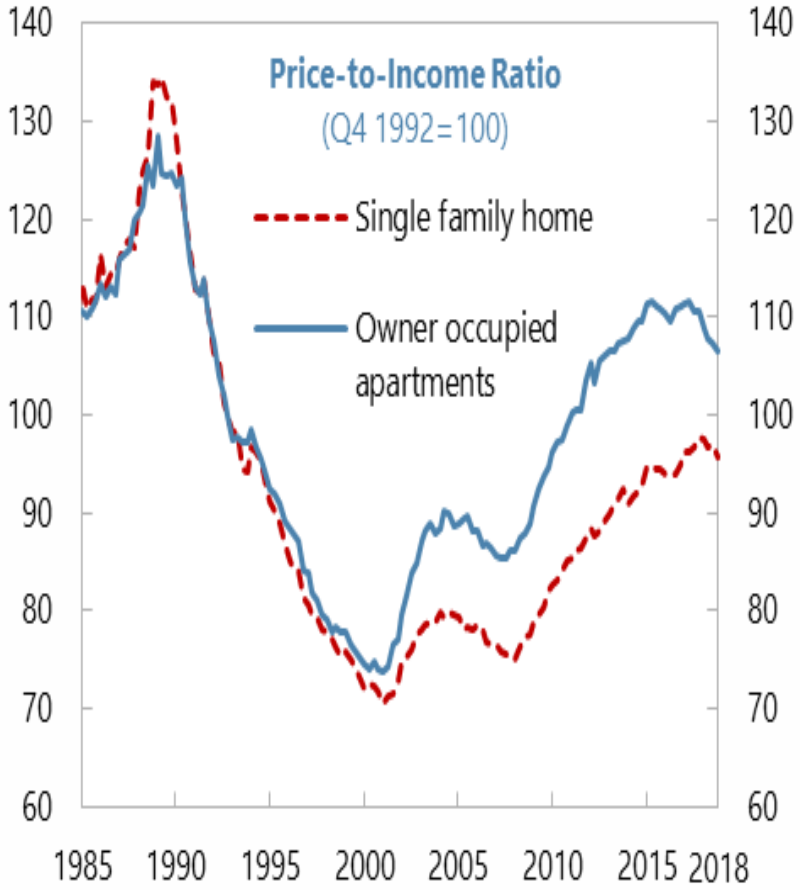


Sources: Haver, BIS

Historically High House Prices

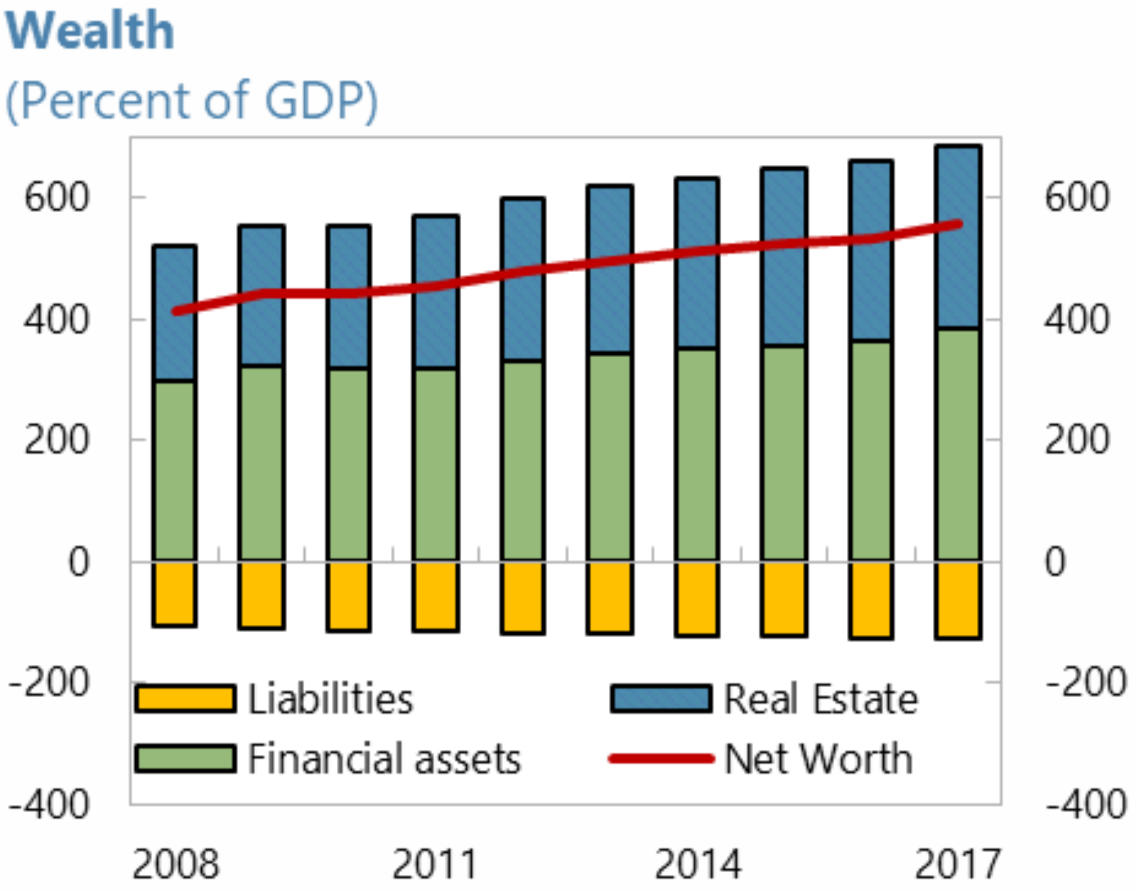






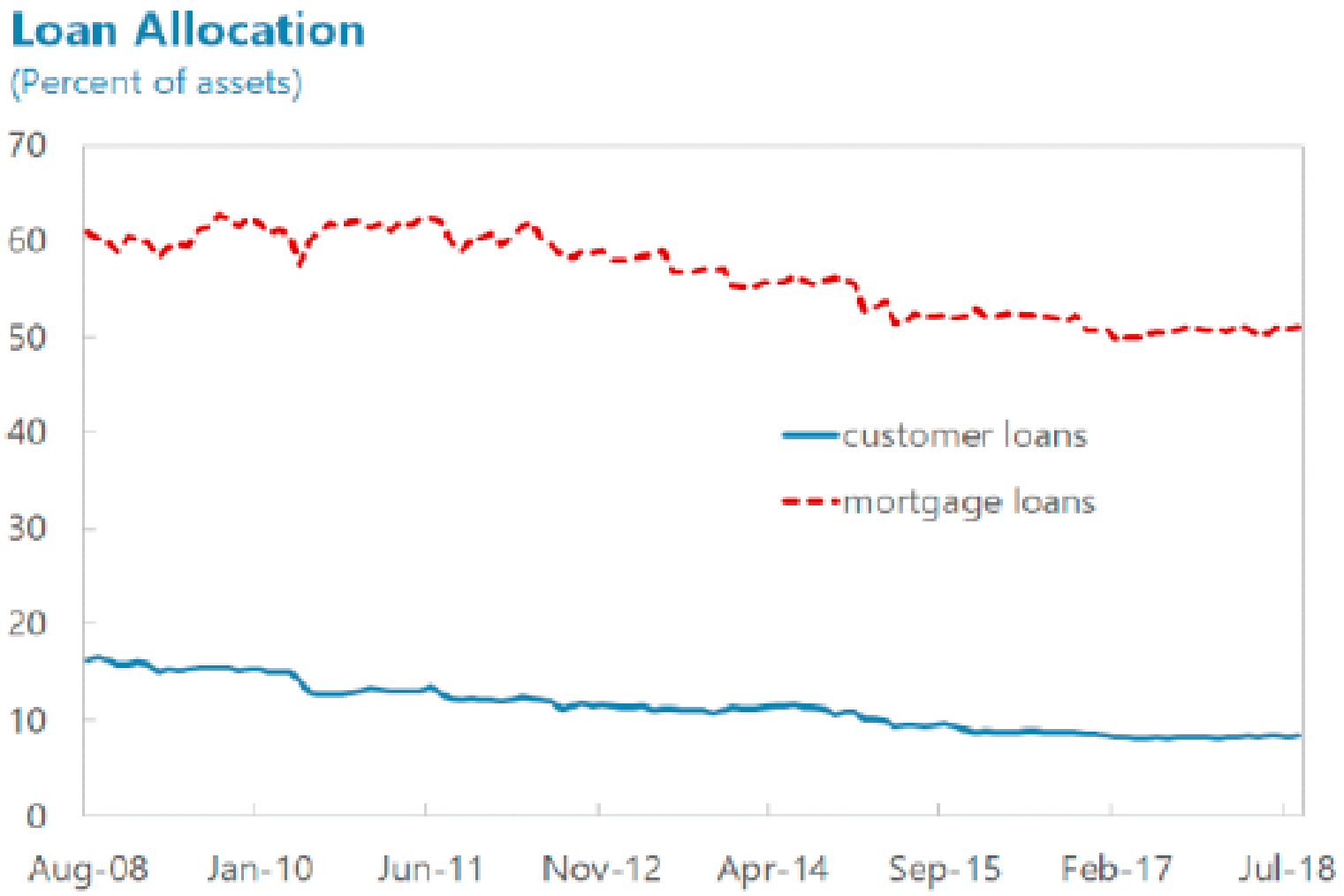
Sources: Haver Analytics

Households Highly Exposed to Real Estate



Sources: SNB; and IMF staff calculations.

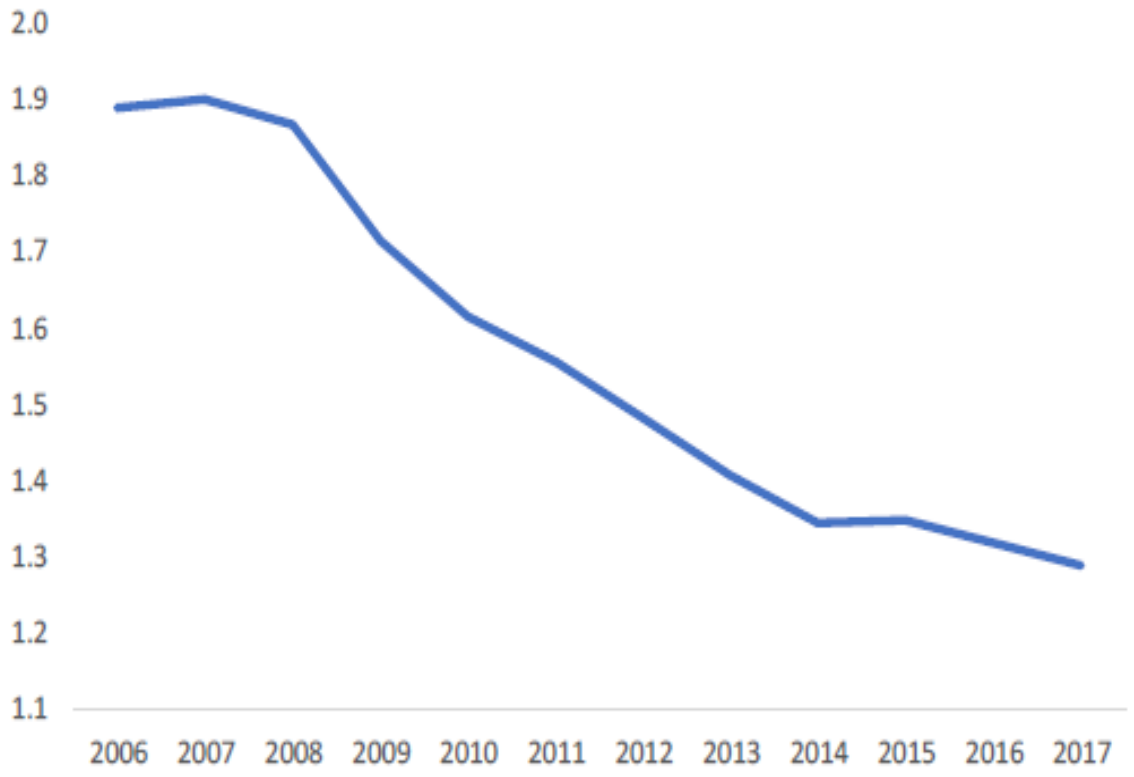
Banks are still highly exposed to real estate



Declining Net Interest Margin on Loans

Net Interest Margin on Loans [1] by domestically Focused Commercial Banks Weighted Average [2] (In percent)

The interest margin on loans has declined as loans issued in the past are renewed at lower rates.

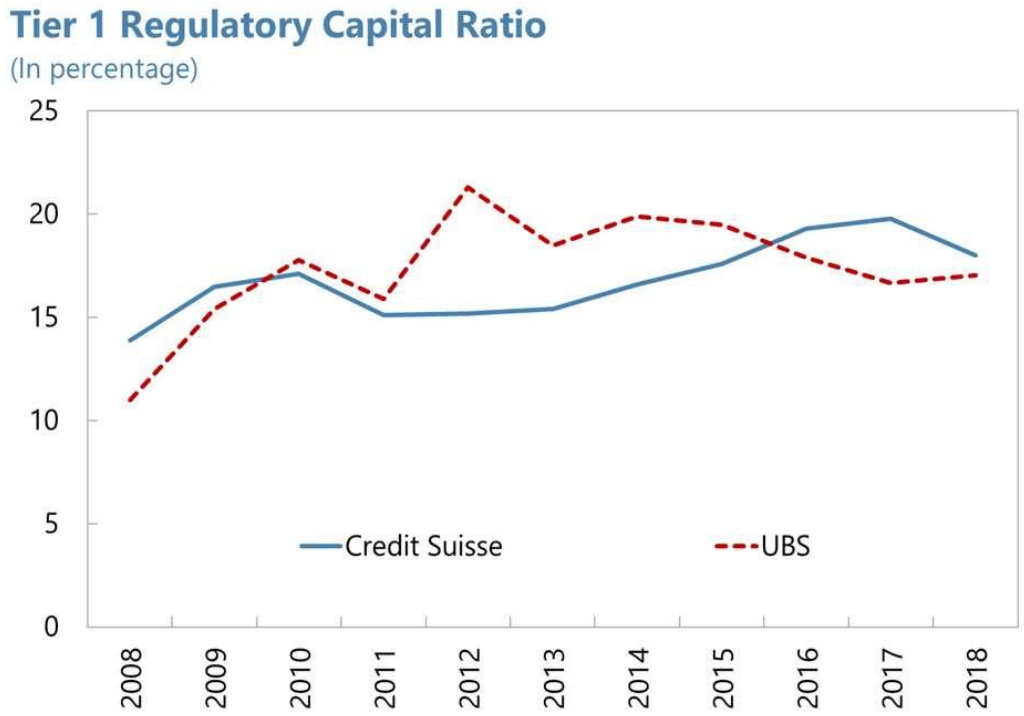


Sources: SNB and IMF staff calculations.

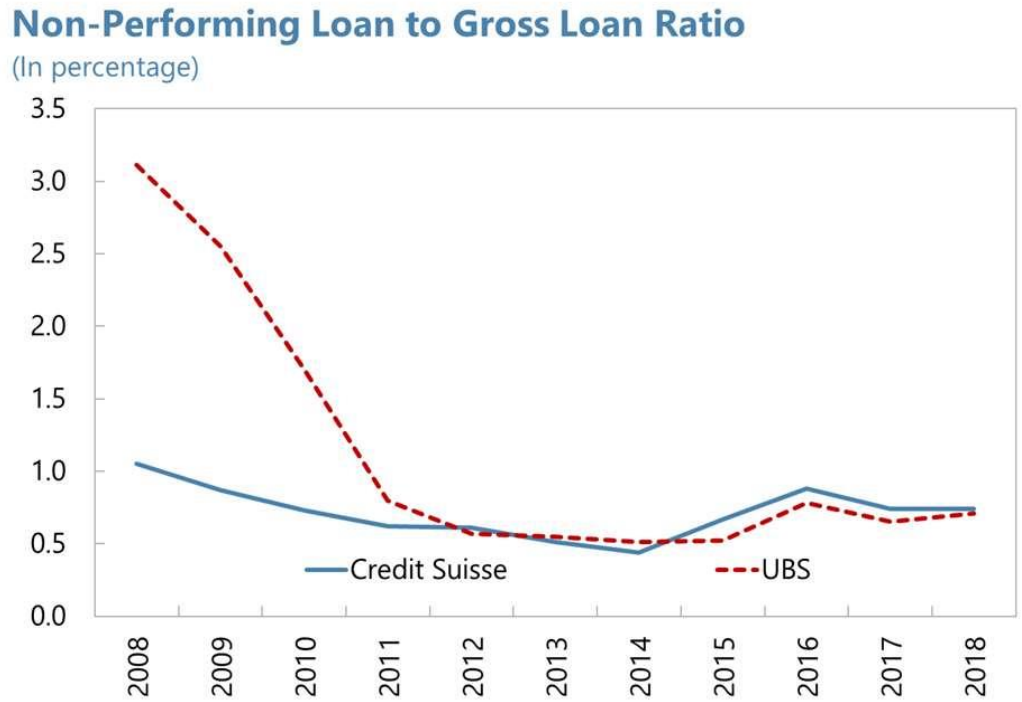
[1] The interest margin is net interest rate operations divided by the sum of mortgage claims and claims against customers.

[2] Domestically focused commercial banks include cantonal banks, Raiffeisen banks, and regional and savings banks.

G-SIBs: Improved Capital Base, lower NPLs



Sources: Fitch.



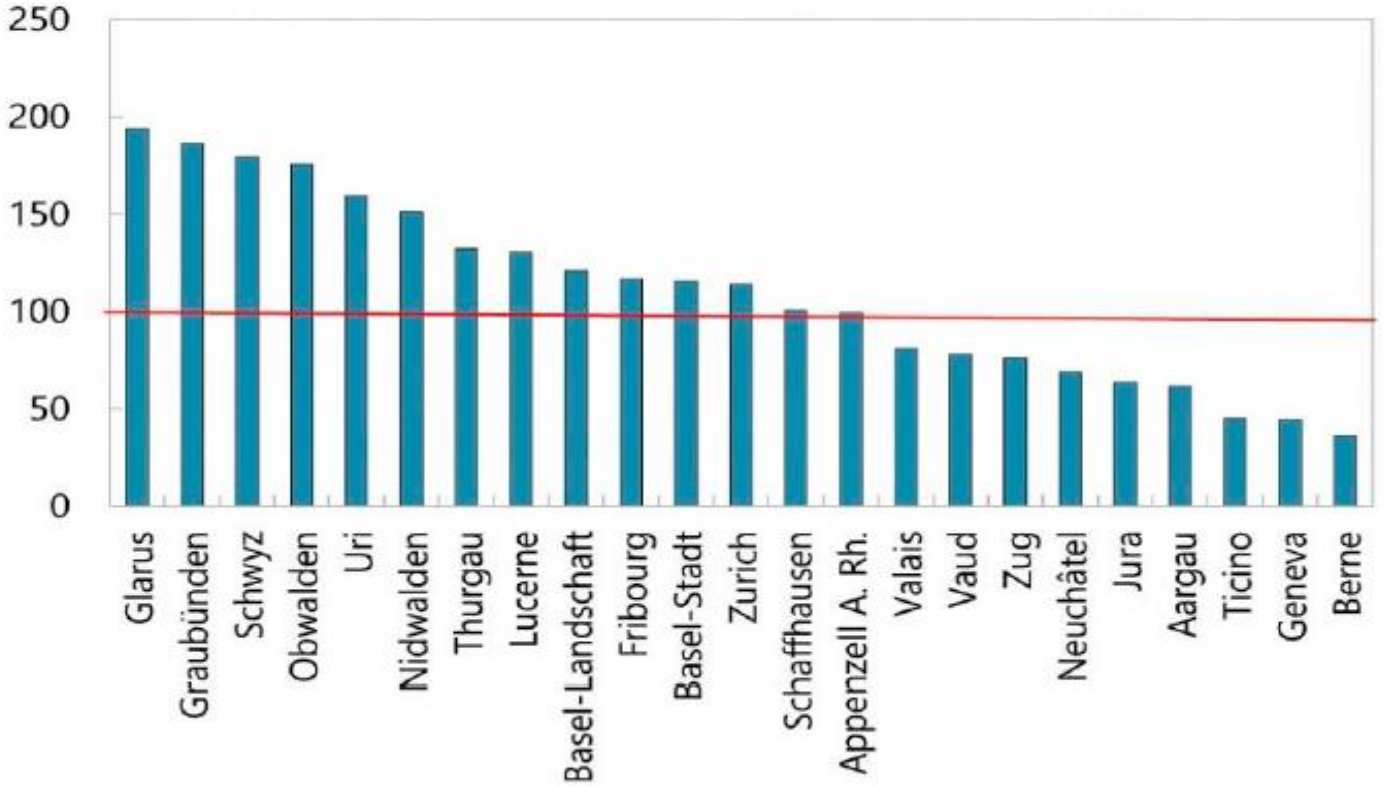
Sources: Fitch.

Cantonal banks

Figure 4. Switzerland: Cantonal Bank Total Assets to Cantonal GDP Ratio

(In percent, in 2016)

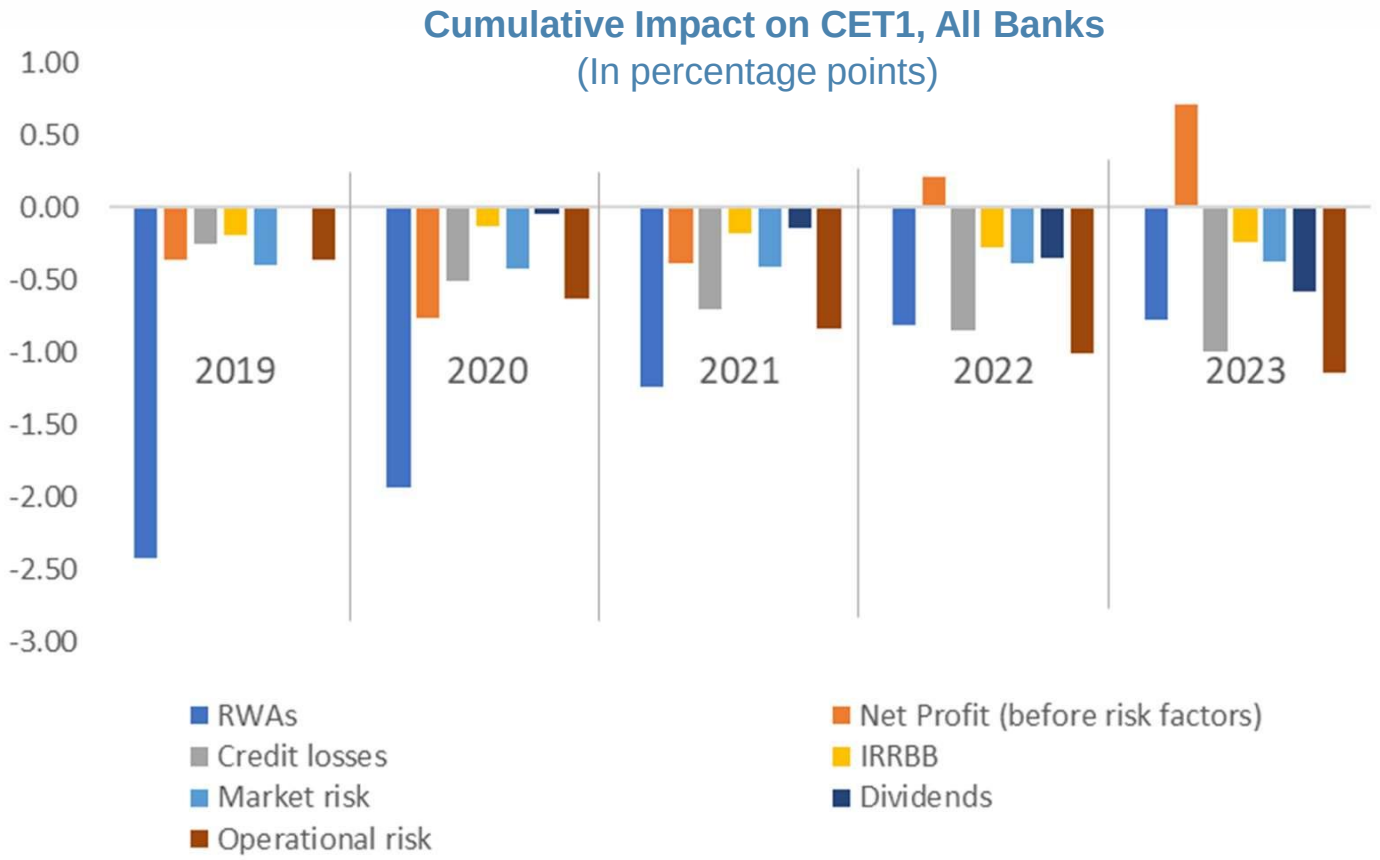
12 out of 24 cantonal banks' assets exceed their respective cantonal GDP.



Source: Swiss Bundesamt für Statistik; S&P Global Ratings.

A Few Banks Breach Capital Buffers in Stress Tests

The shortfall of 440 basis points in aggregate capital ratios at the low point of stress in 2020 is driven by RWA expansion, stressed earnings, operational risk, credit risk losses, and market risk.



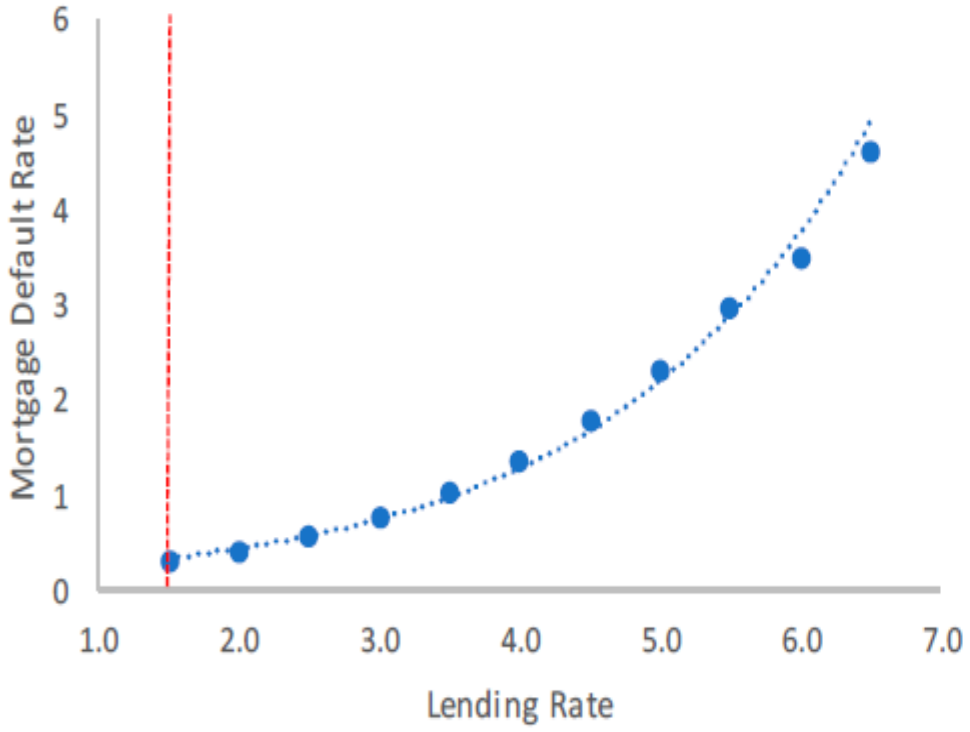
Source: IMF staff estimates.

Mortgage risk sensitivity test

Mortgage default risk rises exponentially with shocks to lending rates.

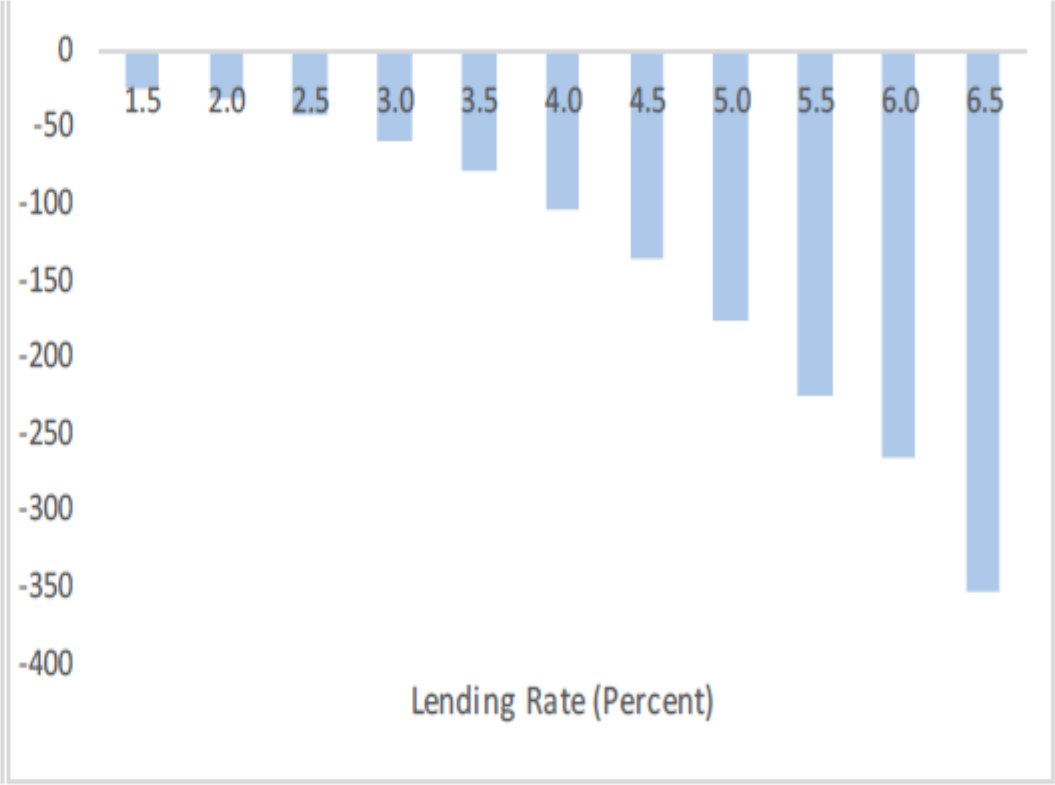
Lending Rate Sensitivity

(In percent)



ΔCET1 Ratio

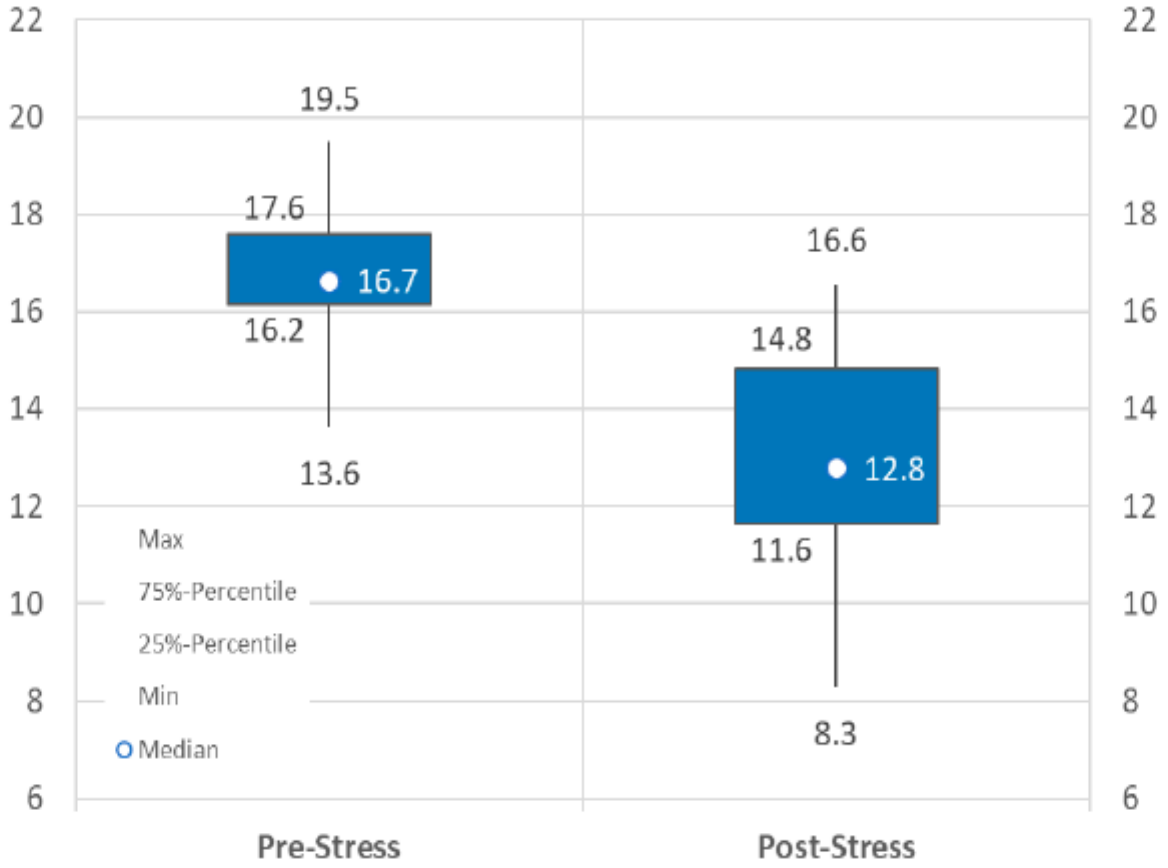
(In basis points)



Source: IMF staff estimates.

Real Estate Stress tests

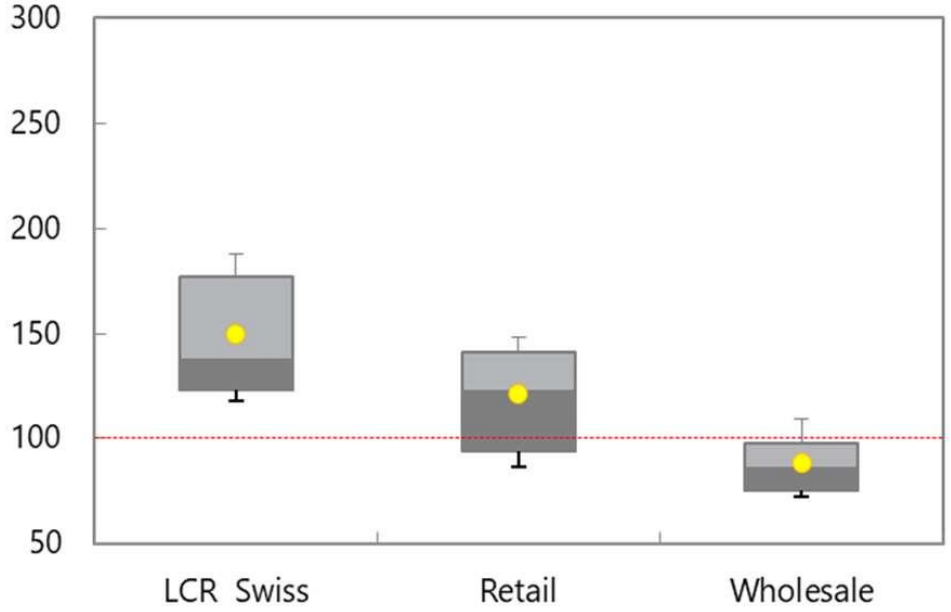
Bank total capital ratios could fall on average by about 400bps as a result of an extreme scenario.



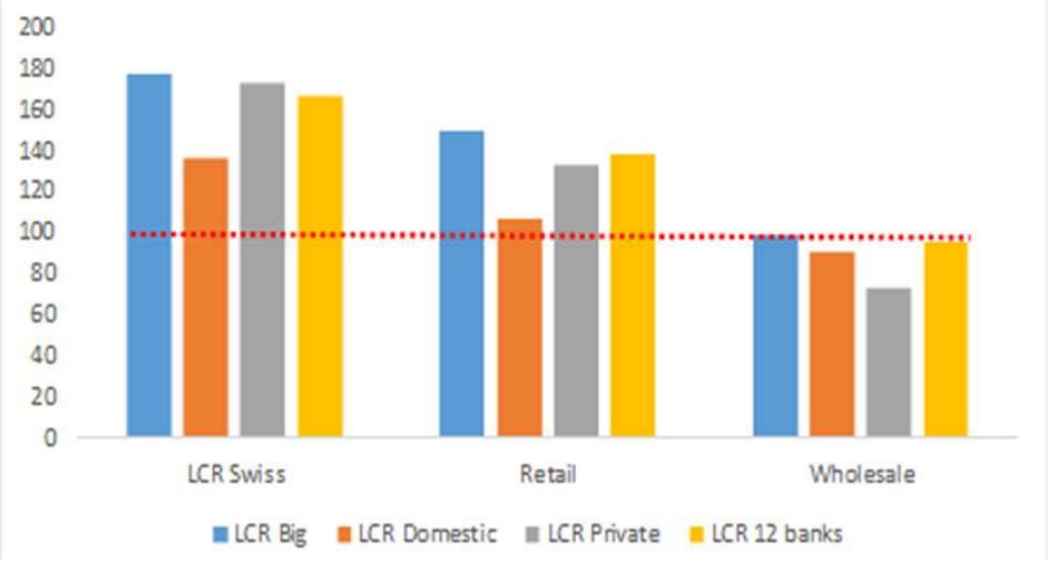
Source: FINMA. Note: The chart compares the post-stress total capital ratio to the pre-stress capital ratio as of 2017 year-end. The median post-stress total capital ratio would fall by about 400bps.

Liquidity: Wholesale More Risky Than Retail Event

LCR, 12 Banks
(In percent)

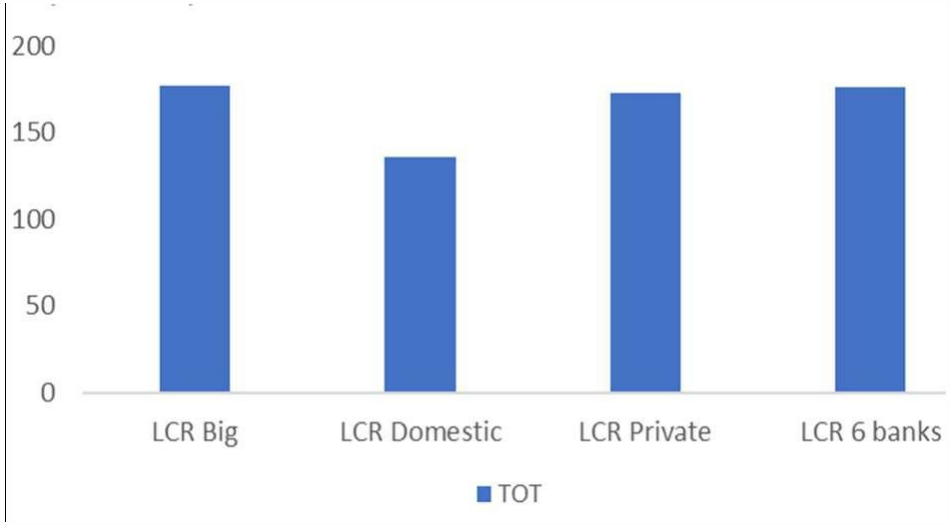


LCR Total Currency
(In percent)



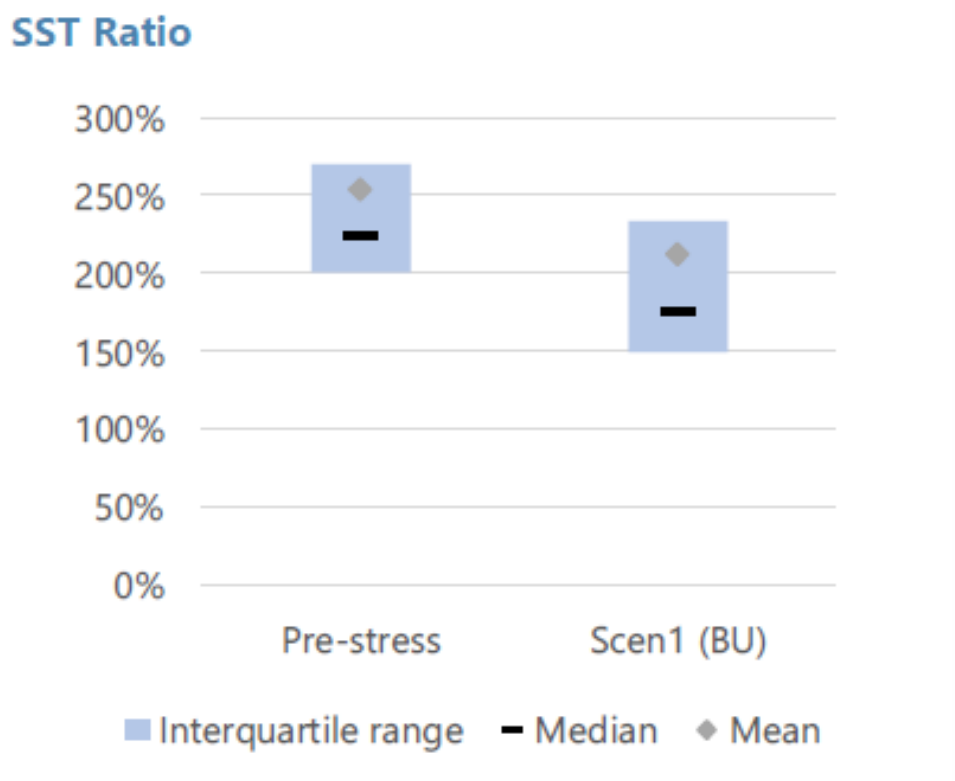
LCR in USD More Volatile

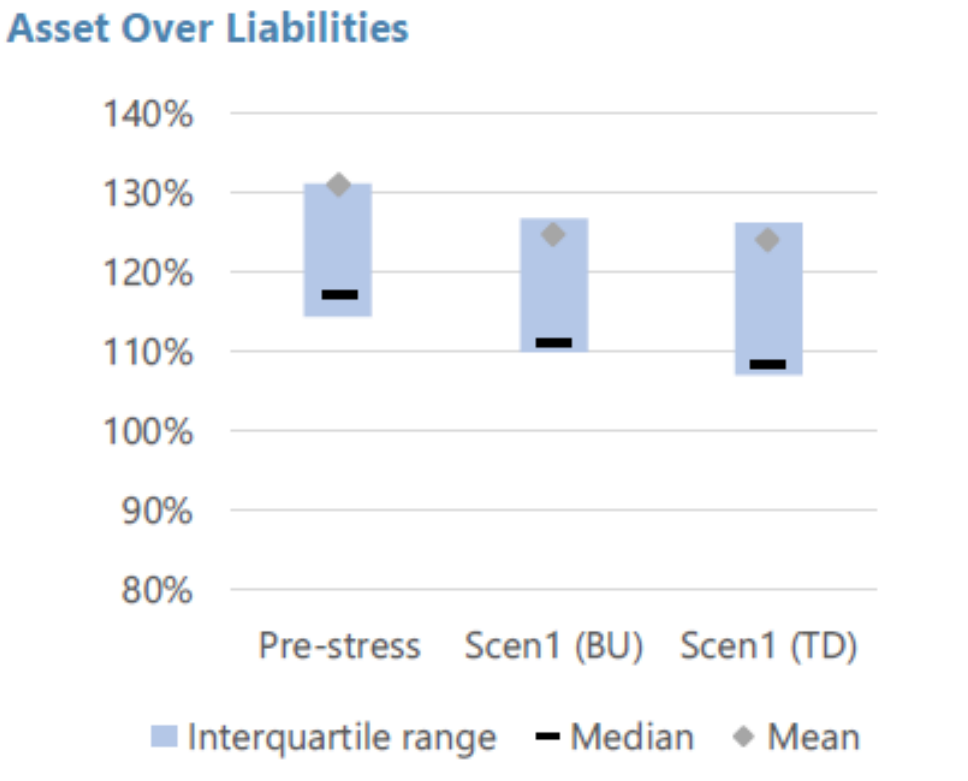
LCR Swiss Total Currency
(In percent)

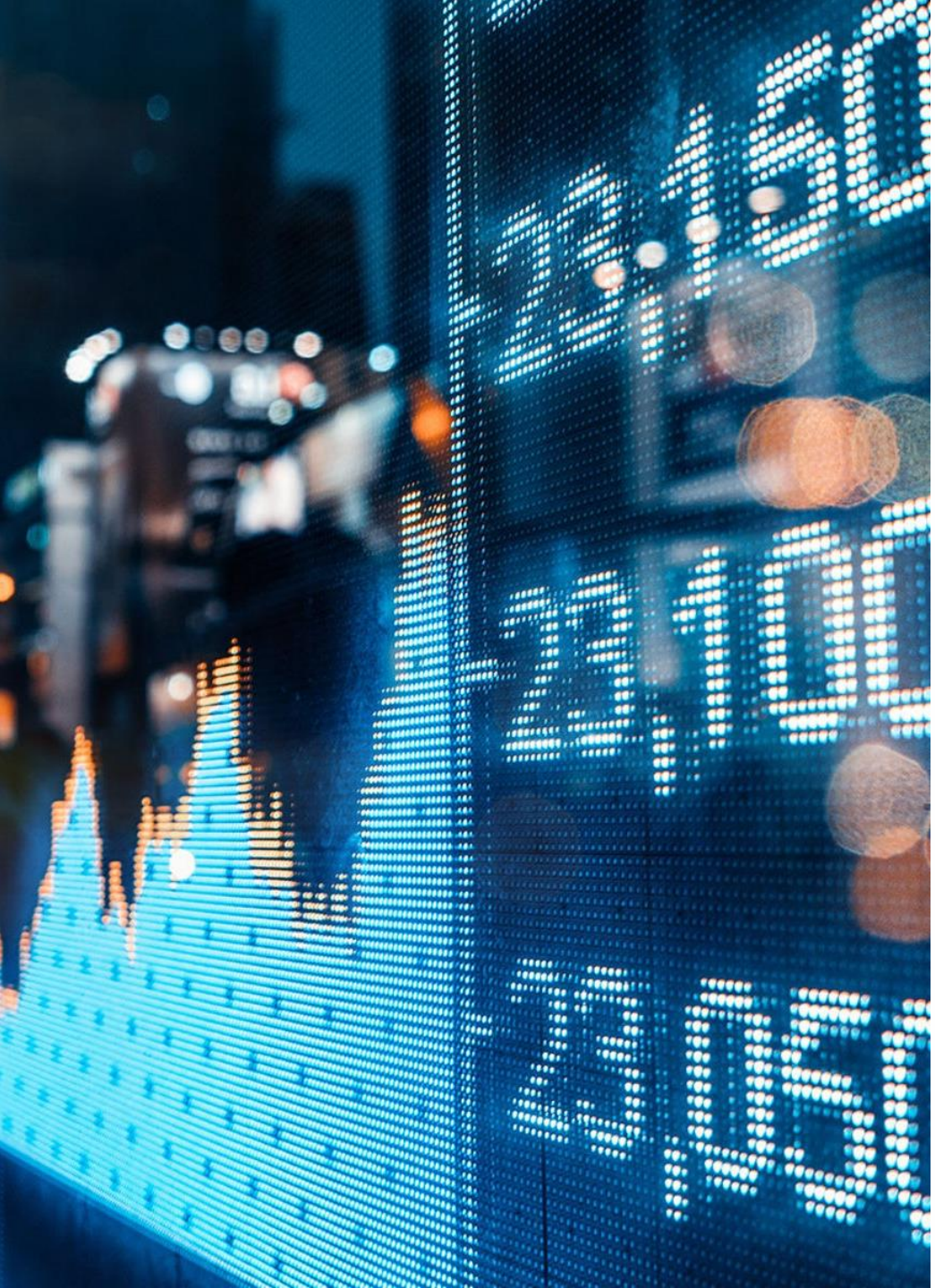


LCR USD
(In percent)

Robust Insurance Stress Test Results







Macroprudential Inaction Bias

- despite increasing risks, no MaPP measures have been taken since 2014 (until very recently)
- toolkit constrained with one mandated tool and one self-regulation agreement with banks

Vulnerabilities and Recommendations

…to be continued on Panel I

FINMA Is Trusted (and Trusting) Supervisor

Since the 2014 FSAP, FINMA has:

- clarified expectations for risk management and corporate governance
- provided greater clarity on expectations for firms and supervisory audits in risk areas
- decided on improvements to strengthen supervisory effectiveness

Vulnerabilities and Recommendations

…to be continued on Panel I

Sophisticated Insurance Regime

- regulatory framework highly sophisticated
- SST contributed to better risk management
- room for improvement in oversight of operational risk management and conduct regulation

Effective supervision should complement SST

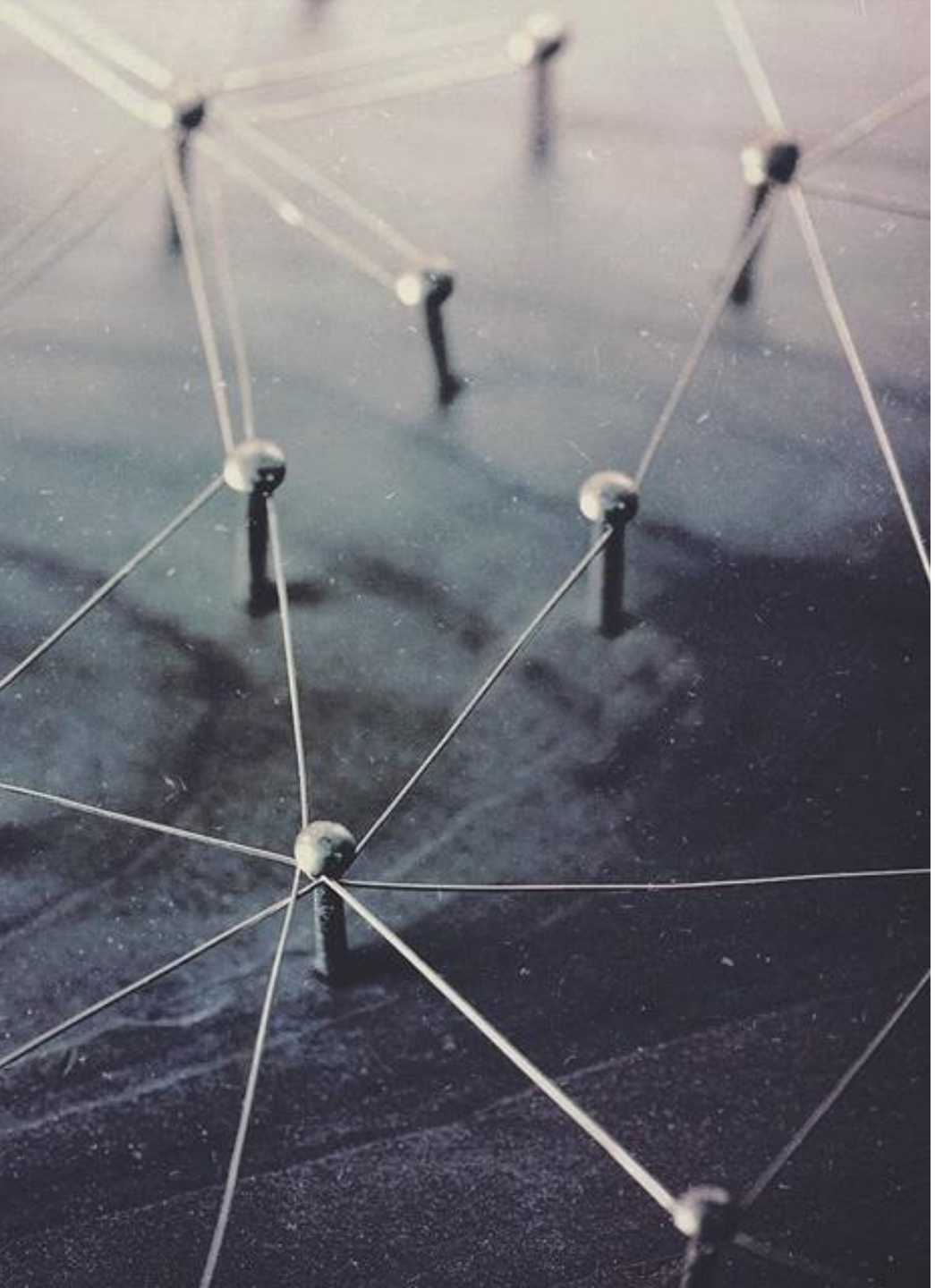
- codify more key SST features in legally binding ordinances, and improve regulatory transparency
- increase assessment frequency of FINMA's operational effectiveness
- strengthen regulation, and FINMA competencies and staffing on business conduct supervision

Asset Management Growing (Pains)

- industry is growing but facing increasing challenges
- constraints on data, IT system, and regulatory perimeters on FINMA's cross-border activities

Recommendations

- improve FINMA's analytical capacity by addressing data gaps and updating IT systems
- concentration risk should be better monitored and managed
- empower FINMA to impose administrative fines



Financial Market Infrastructures

- Swiss FMIs generally observe international standards
- SIX Group operates in competitive environment
- SIX embarking on major projects

Recommendations

- increase dedicated FMI resources at FINMA for supervision, recovery, and resolution, and address data gaps
- improve governance of SIX x-clear and SIX SIS, and monitor effectiveness of new governance arrangements for SIC
- enhance FMI crisis management

Fintech Flies High (Under the Radar)

- globally, CH at the forefront of providing a foundation of legal clarity and certainty
- globally, CH fintech has higher linkages with other financial entities (banks, asset managers)
- risks in this rapidly growing space may not be well understood due to data gaps, resource constraints, and a liberal approach
- potential reputation risk for the government and FINMA

Recommendations

- prefer tech-agnostic over tech-neutral approach
- enhance monitoring of non-regulated entities and supervision of crypto activities of regulated entities
- close regulatory gaps causing unacceptable risk, including appropriate regulation of crypto-brokers

Deposit Insurance (Sans Assurance)

Since the 2014 FSAP, the Swiss authorities have:

- enhanced the arrangements to address the potential failure of the two G-SIBs, with
  - a new FINMA Recovery and Resolution Division;
  - progress on recovery and resolution planning and emergency planning; and
  - intensified cross-border cooperation in crisis management groups; and
- strengthened the legal framework for resolution

Vulnerabilities and Recommendations

…to be continued on Panel II

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Contact Info and References

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Switzerland 2019 FSAP—**Financial Safety Net and Crisis Management Arrangements**
https://www.imf.org/~/media/Files/Publications/CR/2019/1CHEEA2019011.ashx

Panel I: Prudential Policies

Macroprudential Policies

"*…there is need for an expanded, mandated, and more agile and accountable macroprudential framework to address inaction bias and rising risks.*"

- full, mandated toolkit → e.g., LTV, DTI, DSI
- greater expectation to act → SNB triggers use of tools; FINMA calibrates the tools

Prudential Supervision

"…a more robust FINMA-led supervision is needed"

- strengthen FINMA's autonomy, governance, and accountability
- manage conflict of interest concerns that may affect supervisory objectivity
- address banks' material risk management and control weaknesses

Panel II: Financial Safety Net

"The combination of an ex-post funding mechanism, the statutory CHF 6 billion cap on banks' joint contribution for deposit insurance, and the lack of a formal public backstop could leave doubts that the DIS would always be able to fulfill its mandate, leaving taxpayers to pay what is required beyond the CHF 6 billion cap."

Recovery & Resolution:

- prioritize removing the G-SIBs' resolvability impediments
- enhance, expand, and expedite RRP

Deposit Insurance:

- establish public deposit insurer without active bankers
- allow deposit insurer to fund resolution
- remove cap on banks' contribution
- ensure fully funded ex ante deposit insurance with an effective target level, backed by government and ex post recovery from industry