Swiss Regulatory Update Banking 2018

Swiss and international regulatory developments, observations and impacts in the banking industry
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A great deal has been done in the wake of the financial crisis both globally and in Switzerland to correct weaknesses in the financial system. Banks have scaled back their trading books in response to new regulations, shored up their equity and gradually implemented more stringent liquidity and derivatives trading guidelines. They have also improved their resolvability, i.e. their ability to isolate risks through emergency planning. These are just a few of the areas where regulators exerted a direct influence in order to create more stability in the financial system.

In the opinion of Swiss banks, the regulatory agenda has had its desired effect: 87% of banks are of the conviction that the financial market is more stable today than it was before the financial crisis.

The environment remains characterized by VUCA - volatility, uncertainty, complexity and ambiguity. The efforts to implement the remaining high number of regulatory requirements are reflected in banks’ margins and cost structures. Proven business models are questioned in combination with the challenging macroeconomic environment with record low (negative) interest rates and a demanding investment environment. Despite these difficult frame conditions, the banks’ challenges are to deal with future-orientated innovations, digitalization and strategies for growth.

The purpose of the EY Swiss Regulatory Update Banking is to serve as an overview of the landscape of current standards and norms that apply to the Swiss market. It delivers up-to-date facts and a comprehensible overview of legal changes.

We hope you enjoy reading our take on the subject and trust that our regulatory update inspires some interesting discussions.
Automatic Exchange of Information in its implementation - and awaiting first exchanges of data

Observations & consequences
- Whilst 2017 has seen banks, insurance companies and other financial institutions prepare and implement AEI regulations (in particular starting the client due diligence), 2018 will be the first year for an actual exchange of information.
- High value accounts (> CHF 1 m) held by individuals will need to be classified as reportable or non-reportable until end of 2017. Entity accounts (and in particular trust structures and other legal arrangements) as well as lower value individual accounts must be identified by end of 2018 and will be reported starting 2019.
- The first reports on accounts identified by the end of 2017 will need to be submitted to the Federal Tax Authorities by 30 June 2018. This applies to accounts with account holders or controlling persons resident in any country of the EU, Australia, Guernsey, Jersey, Iceland, Isle of Man, Japan, Norway, Canada, or South Korea.
- For further 41 countries data will first be exchanged in 2019, among them Russia, China, Brazil and Argentina. Some countries (in particular Caribbean countries) have renounced reciprocity. For example, the BVI will submit data to Switzerland (concerning Swiss resident individuals, entities, or controlling persons) but they do not expect Switzerland to furnish data on BVI residents.
- In the event of doubt on the tax residency of a client, information needs to be sent to multiple jurisdictions. In such cases, different data schemes might need to be adhered to. Double or multiple reports to various revenue authorities may also be required on a regular basis (in particular in the ambit of wealth management). The financial institution needs to be aware of these reporting lines and co-ordinate them.

Management agenda & prioritization
- Existing Swiss financial institutions must register with the SFTA as a “financial institution” under the CRS regulations by 31 December 2017 in order to be able to forward their reports to the SFTA by 30 June 2018. Specific consideration needs to be given to accounts that were closed or transferred in 2017.
- Clients that are subject to reporting in 2018 for the first time must be notified by the financial institution by 31 January 2018. The notification must contain information on the legal basis for the exchange of information, information on the data that is actually subject to exchange as well as on the permissible use of data by the receiving tax authorities and certain statutory rights of appeal for the reportable persons.
- The SFTA will audit adherence to the AIA law, ordinance and Swiss guidance in late 2018 or at the beginning of 2019.

Unlike FATCA, adherence to the AIA law, ordinance and guidances will be audited by the Swiss Federal Tax Administration
- Audits are likely to start either at the end of 2018 or in early 2019
- Adherence to due diligence rules for pre-existing and new accounts will be subject to audit as will be the actual reported data that is transferred to the partner countries through the SFTA

Antigua and Barbuda
Aruba
Barbados
Belize
Bermudas
BVI
Cayman Islands
Curaçao
Grenada
Montserrat
Saint Kitts and Nevis
Saint Lucia
Saint Vincent and the Grenadines
Turks and Caicos

Guernsey
Isle of Man
Jersey

Andorra
Faroe Islands
Liechtenstein
Monaco
San Marino

Cook Islands
Marshall Islands
Mauritius
Seychelles

AEI as from mid 2018
AEI as from mid 2019 (some countries not reciprocal)
No AEI agreements as of yet (status: December 2017)
Qualified Intermediary (QI) – A review needs to be conducted for the period 2016 or 2017

Background
On 30 December 2016 the IRS released the (new) QI Agreement (Revenue Procedure 2017-15) and the (updated) FFI Agreement (Revenue Procedure 2017-16). This introduced a number of changes for QIs.

Under the QI Agreement, the QI Responsible Officer (RO) must maintain a compliance program for QI purposes, which includes the following elements:

- Written Policies and Procedures
- Training
- Systems
- Monitoring of Business Changes
- Qualified Derivative Dealer (QDD) Tax Liability Determinations (if acting as QDD)
- QI Periodic Review
- Certification of Internal Controls

The RO has the obligation to make a certification of effective internal controls (QI certification). The factual information documented during the QI periodic review must also be provided to the US Internal Revenue Service at the time this certification is made. This QI certification is required in addition to the FATCA certifications. The QI certification is due by 30 June 2018 and needs to be made for the entire certification period, which includes the years 2015-2017.

Additionally, the RO must engage an internal or external reviewer with the execution of a QI periodic review. The review report has to be provided by the reviewer to the RO and may be requested by the US Internal Revenue Service. The RO may choose whether the period 2016 or 2017 should be reviewed during the QI periodic review. If a QI periodic review is performed in the year 2018 for the review period 2017, then the QI certification will be due by 31 December 2018 (additional six months time). Any errors need to be cured before a certification of internal controls can be made. The RO needs to determine if a certification of internal controls can be given or if a so called qualified certification is required.

For QDD purposes only, QDDs are relieved of the certification of internal controls and periodic review requirement for 2017.

A request for waiver for the performance of the periodic review may be made if certain requirements are met. However, it should be noted that even in case of such a waiver request the QI certification is still required by 30 June 2018 for the entire certification period.

Timeline

<table>
<thead>
<tr>
<th>Compliance Certification Period</th>
<th>Deadline</th>
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<tbody>
<tr>
<td>2014</td>
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<td>2015</td>
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<td>2016</td>
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<tr>
<td>2017</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td></td>
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</tbody>
</table>

Choose Review Period

A review needs to be conducted for the period 2016 or 2017 and the review report will be issued to the RO. This will be one element of the basis for the decision of the RO certification. The first RO certification is required before 30 June 2018 and it will be in respect to the period from 1 January 2015 to 31 December 2017.
The UK Corporate Criminal Offence (CCO) – Need for action by Swiss financial institutions

As an officer of a Swiss financial institutions you may be surprised to learn that the new UK Corporate Criminal Offence should be on your radar. Effective from 30 September 2017, the legislation provides for a new Corporate Criminal Offence (CCO) that is committed when a person associated with a business (such as an employee, agent, contractor or subsidiary) facilitates tax evasion. Unless organizations with a UK nexus can prove that reasonable prevention procedures are in place, they risk criminal prosecution.

Extraterritorial nature: A foreign organization which carries on any “part of a business” in the UK could be prosecuted under the new UK Corporate Criminal Offence for failing to prevent facilitation of tax evasion by any of its employees, agents or other third parties (“associated persons”), even if the offence takes place outside the UK and involves non-UK persons. The CCO legislation provides for two types of offence: (1) a taxpayer has criminally evaded UK tax(2) a taxpayer has criminally evaded non-UK tax and there is a UK nexus

Scope: The offence is wide ranging, applying to relevant bodies (typically companies and partnerships) not only in the UK but also to those based or operating overseas. It is closely modelled on the Bribery Act 2010 and holds the relevant body responsible for preventing those who act for, or on its behalf (“associated persons”), from criminally facilitating tax evasion.

Liabilities and consequences: Generally, any entity which is in scope will be liable for any criminal facilitation of tax evasion by an associated person of a relevant body. Consequences of non-compliance include a potentially unlimited fine for the corporation, and could include regulatory sanctions (such as the loss of a license) plus significant reputational.

Regulatory requirements: The entity in scope can defend itself only by implementing “reasonable prevention procedures”. HMRC has set out 6 “guiding principles” to help determine what procedures are reasonable: (See pages 10-11)

Under the new CCO rules, organizations need to address the following key challenges:

▶ It’s about facilitation: Unlike existing AML controls, the CCO is focused on facilitation risks, and therefore on the actions of dishonest employees or third parties. Financial institutions will need to consider how resistant controls are to circumvention and where associated persons may be able to facilitate evasion despite new measures.

▶ Managing third parties: Organizations will need to consider how the rules apply to third parties over whom they may have little control. Identifying associated persons risk is likely to be a key component of any risk assessment, and ensuring that controls cover all associated persons will be a substantial challenge.
The 6 Principles

1. Risk assessment

2. Proportionality of risk-based prevention procedures

3. Top management commitment

4. Due diligence

5. Communication (incl. training)

6. Monitoring and review
### What

“The relevant body assesses the nature and extent of its exposure to the risk of those who act for or on its behalf engaging in activity during the course of business to criminally facilitate tax evasion.”

### How

Assess the inherent risks that the organization might facilitate tax evasion through its employees and other associated persons.

Evaluate the extent to which current internal controls eliminate or mitigate the inherent risk.

“Reasonable procedures will be proportionate to the risk a relevant body faces of persons associated with it committing tax evasion facilitation offences. This will depend on the nature, scale and complexity of the relevant body’s activities.”

Adopt reasonable prevention procedures based on the nature, scale and complexity of the business and the risk rating determined by the yearly risk and control assessments.

“The top-level management of a relevant body should be committed to preventing persons associated with it from engaging in criminal facilitation of tax evasion. They should foster a culture within the relevant body in which activity intended to facilitate tax evasion is never acceptable.”

Establish the “tone from the top” by sending a clear message about zero tolerance of facilitation of tax evasion to the business; clearly define ownership and accountability within senior management, etc.

“The organization applies due diligence procedures, taking an appropriate and risk based approach, in respect of persons who perform or will perform services on behalf of the organization, in order to mitigate identified risks.”

Enhance the due diligence procedures and processes regarding third parties in order to capture facilitation risk; review and enhance third-party risk management processes and procedures (e.g., assess contractual arrangements).

“The organization seeks to ensure that its prevention policies and procedures are communicated, embedded and understood throughout the organization, through internal and external communication, including training. This is proportionate to the risk to which the organization assesses that it is exposed.”

Define and roll out additional top level commitment communication; define training needs for all associated persons (e.g., RMs, service providers) and either incorporate into existing (tax) trainings or establish new trainings related to criminal facilitation of tax evasion.

“The organization monitors and reviews its prevention procedures and makes improvements where necessary.”

Enhance monitoring and review processes and controls effectiveness as part of the controls landscape enhancement to capture facilitation risk of associated persons.
Corporate tax transparency - OECD Action Plan on Base Erosion and Profit Shifting (BEPS)

Background
- On 5 October 2015 the OECD issued its ‘final’ reports on the 15 Action points identified in its Action Plan on base erosion and profit shifting (BEPS). The Actions have been the subject of consultation and are supported by the G7 and G20 countries, the European Union (EU) has been working in parallel, and developing countries are involved as well
- For some Actions there is still more work to be done
- The recommendations are currently getting implemented in national law
- The changes have an impact not only on tax departments and tax compliance, but also on the manner in which many enterprises conduct business overall

Target areas of OECD Action Plan
- Challenges of the digital economy (Action 1)
- Establish international coherence of corporate taxation (Actions 2-5)
- Restore the full effects and benefits of international standards (Actions 6-7)
- Ensure that transfer pricing outcomes are in line with value creation (Actions 8-10)
- Ensure transparency (Actions 11-14)
- Enable swift implementation (Action 15)

Target areas of OECD Action Plan
- The BEPS Action Plan is the biggest change to international tax ever proposed
- Under the inclusive framework, over 100 countries and jurisdictions are collaborating to implement the BEPS measures and tackle BEPS
BEPS key potential impacts on Swiss banks and what we see in the market

- As part of the envisaged country-by-country reporting (CbCR), multinational groups are currently getting ready to submit their first CbCR wherein they have to report by country their revenues (split by third party and related party), profit, capital, headcount, taxes paid and other information; the data complexity and short reporting cycles will necessitate extensive automation of the reporting, hence may require overhaul or modifying financial reporting systems
- The OECD recommendations lead to significantly lower thresholds for deeming a taxable presence (permanent establishment) in cross-border business: cross-border activities and the location of servers/platforms/data may give rise to a multitude of additional taxable presences, thereby heavily increasing the compliance burden and requiring banks to review their cross-border business activities
- Restrictions on tax deductibility of interest expense, both on internal and external debt, increased cost of funding; any group-internal hybrid financing arrangements need to be carefully reviewed
- Increased risk of reputational damage, especially when the EU implements the public disclosure of CbCR
- Operating models, incl. digital strategies, may need to be reassessed or restructured in order to mitigate tax costs

New reality for global economy

- More attention by governments, media and nongovernmental organizations on the international tax profile
- More complexity in tax laws and information reporting obligations
- More information sharing between governments
- More robust audits and more controversy

Potential Areas impacted by BEPS

- TP Models, Substance and interpretation of decision making and risk control
- Treaty access-efficient trading / investment structures
- WM relationship models, traveling bankers
- Cost of funding and funding structures / pricing
- TP Models and business and locational strategies
- TP compliance, documentation and transparency - master and local files, and CbCR
- Cost allocations
- Digital channels, and potential PEs
- Heterogeneity of implementation with impact on audit defense, APA / MAP

Government issues

- Balancing investment stimulus and fiscal demands following the global financial crisis
- Political concerns about perceived tax avoidance
- Public questions about the fairness of tax burdens
Anti-Money-Laundering (AML) – Further implementation requirements

Background
The Anti-Money-Laundering (AML) requirements continue to be current and challenging. Following the last regulatory push on 1 January 2016, further adjustments to the pipeline have already been made, both internationally and nationally.

Swiss AML-framework and its regulation environment

International Regulatory Developments

Efforts for a 5th EU Money Laundering Directive

4th EU Money Laundering Directive
Important points:
- Introduction of national and European risk assessment
- Reinforcement of risk based customer due diligence
- Financial crimes as predicate offences for money laundering
- Extension of the definition of politically exposed person (PEP)
- National register of beneficial owners of companies and trusts (with limited access rights)
- Group wide strategies to data protection and information exchange
- Strengthen international cooperation of authorities and bodies

The European Commission’s proposal includes inter alia:
- Inclusion of platforms for virtual currencies
- Restrictions on the use of anonymous pre-paid instruments
- Public access to central register on beneficial owners of companies and trusts
- Strengthen information access for Financial Intelligence Unit by means of central register for holders of bank and payment accounts or the like
- Harmonization of the EU’s approach towards high-risk third countries

The FATF (Financial Action Task Force) is the standard-setter for regional (e.g. European) and national (e.g. Swiss) legislation in connection with combating money laundering and terrorist financing.
- A country assessment by FATF (or MONEYVAL, depending on the country’s membership) measures the implementation of the standards set by the FATF and can require adjustments at country level.

The 4th EU Money Laundering Directive incorporates the 40 FATF recommendations. It is supplemented by guidelines and reports from the European Supervisory Authorities (ESA).
- The Directive entered into force on 25 June 2015 and implementation was due by 21 July 2017.
- A draft proposal for amendments to the 4th Directive is established: 5th Directive.
- Drivers are new technologies, fight against terrorism and the reports on Panama Papers.
Anti-Money-Laundering (AML) - Adjustment of the FATF Country Report Switzerland

National Developments

- The revised AMLA and related regulation adopted the 40 FATF recommendations.
- The new regulations entered into force on 1 January 2016.
- FATF performed a country assessment for Switzerland with report from 7 December 2016.
- As a result, AMLA as well as the AMLO-FINMA and correspondingly the CDB will have to be adjusted.

Adjustments to Swiss AML rules and regulations

- Revised AMLA and ordinances / CDB of 2016
  - Important points:
    - Qualified tax offences as predicate offence of money laundering
    - Increased transparency regarding bearer shares
    - Obligation to identify the controlling person
    - Extension of the PEP definition
    - Separation of reporting obligation and asset freeze

Acknowledgement of the FATF-Country Report December 2016:
- Overall good quality of the Swiss Anti-Money Laundering and Terrorist Financing dispositive
- Insufficient number of suspicious activity transactions in relation to the importance of the Swiss financial center
- Lack of adequacy of sanctions imposed for breaches of supervisory law
- Limited international cooperation of Financial Intelligence Unit

In June 2017, the Federal Council instructed the Federal Department of Finance to prepare a draft consultation paper

- AMLA
  - Due diligence obligations for specific non-financial intermediary activities
  - Measures regarding associations to increase transparency
  - Amendments for precious metal and precious stone traders, the purchase of old precious metals as well as in the area of the reporting system

- Partial revision AMLO-FINMA (Draft from 4 September 2017)
  - Verification of beneficial ownership even for normal risk customers
  - Regularly updating of customer information for all business relationships
  - Global monitoring in the group
  - Due diligence obligations in the case of domiciliary companies and complex structures as well as in relation to high-risk countries
  - Thresholds for cash transactions and subscription of unlisted collective investment schemes

- CDB 16
  - Amendments planned in coordination with AMLO-FINMA

The risk-based approach is intended to allow institutions to monitor their business activities and thus their customer relationships in a risk-oriented manner and to use their resources efficiently. However, the individual or institution-related risk assessments and active risk management also increase the documentation requirements. Robust processes and infrastructure throughout the entire customer lifecycle, from onboarding to maintenance and netting, are key factors for efficient and effective implementation.
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Capital & Liquidity Agenda
Basel III - Update: CAO and FINMA Circular 2017/7

Key points
Basel III represents wide-ranging changes to the minimum standards for bank capitalization, including changes to the definition of eligible capital and required capital, along with the introduction of global leverage and liquidity standards.

Implementation in Switzerland
- Minimum requirements of the Basel III international standard are embedded into Swiss regulation (abolishment of “Swiss finish” on 31 December 2018 at the latest)
- CAO (Federal Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Dealers), based on the Basel III standard, has been effective since 1 January 2013, acknowledging international transition periods, but has undergone various amendments since then (latest CAO dated 1 January 2018)
- Countercyclical buffer on domestic residential mortgages invoked since September 2013 (1%) and increased to the currently effective 2% in June 2014
- Additional domestic loss-absorption buffer required (gone-concern requirements) super-equivalent with international conservation buffer for global systemically important financial institutions (G-SIFIs)
- For non-internationally active, systemically important financial institutions, it has yet to be decided what form their contingency plans for the gone-concern scenario will take. The specific need for gone-concern requirements for these banks is addressed in the Swiss Federal Council’s evaluation report published at the end of February 2017 pursuant to art. 52 BA (Federal Act on Banks- and Saving Banks).
- Changes pursuant to FINMA Circular 2017/7 “Credit risk - banks” as of 1 January 2017 with a transition period until 1 January 2018 (respectively until 1 January 2020 in regard of):
  - Derivative exposures (counterparty credit risk, CRR). Standardized approach (SA-CCR) replaces previous mark-to-market method
  - Change in capital charge for banks’ fund investments in the banking book (four approaches), although the simplified approach is only applicable to banks belonging to supervisory categories 4 and 5.
    - Look-through approach (LTA)
    - Mandate-based approach (MBA)
    - Fall-back approach (FBA)
    - Simplified approach
  - Revised capital charge for securitizations in the banking book
  - Reinclusion of life insurance policies as risk mitigating coverage
  - Simplified rules for “small banks” (supervisory categories 4 and 5): Simplified approaches for derivative exposures and fund investments
Standardized Approach – Counterparty Credit Risk (SA-CCR) – overview

Key points
- The SA-CCR can be seen as the simplified model approach to counterparty exposure
- The close-out risk will be calculated based on stressed volatilities and correlations
- Improved recognition of close-out netting and collateralization
- Net independent collateral amount (NICA): bankruptcy remote NICA does not count as additional exposure
- Data requirements are increasing (e.g., product details like put/call, strike, underlying data and margining/netting data like margining frequency, threshold, minimum transfer amount, margin period of risk, independent collateral)
- Higher standards for processes (e.g., proof of bankruptcy remoteness, determination of margin period of risk)

The counterparty credit risk capital charge applies to derivatives in the trading book and in the banking book.
Capital requirements (FINMA capital floors pursuant to CAO)

Components of Basel III capital requirements

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<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
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<tbody>
<tr>
<td>Countercyclical capital buffer</td>
<td>0 - 2.5%</td>
<td>0 - 2.5%</td>
<td>0 - 2.5%</td>
<td>0 - 2.5%</td>
</tr>
<tr>
<td>Capital conserv. buffer</td>
<td>0.625 %</td>
<td>1.25 %</td>
<td>1.875 %</td>
<td>2.5 %</td>
</tr>
<tr>
<td>Total capital</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Tier 1 capital</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
<td>6%</td>
</tr>
<tr>
<td>Common equity</td>
<td>4.5%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Tier 1</td>
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- Additional capital conservation buffer of 2.5%, consisting of Common Equity Tier 1
- Core capital ratio (Tier 1) totaling no less than 7%

Swiss domestic concept of capital buffers, broken down by category

<table>
<thead>
<tr>
<th>Category according to Annex 3 BankV</th>
<th>1 and 2</th>
<th>3</th>
<th>4</th>
<th>5</th>
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<tbody>
<tr>
<td>Minimum capital requirement</td>
<td></td>
<td>8.0%</td>
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<td></td>
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<tr>
<td>- thereof CET1</td>
<td></td>
<td>4.5%</td>
<td></td>
<td></td>
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<tr>
<td>- thereof AT1 or better</td>
<td></td>
<td>1.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- thereof T2 or better</td>
<td></td>
<td>2.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital buffer</td>
<td></td>
<td>4.8%</td>
<td>4.0%</td>
<td>3.2%</td>
</tr>
<tr>
<td>- thereof CET1</td>
<td></td>
<td>3.7%</td>
<td>3.3%</td>
<td>2.9%</td>
</tr>
<tr>
<td>- thereof AT1 or better</td>
<td></td>
<td>0.5%</td>
<td>0.3%</td>
<td>0.1%</td>
</tr>
<tr>
<td>- thereof T2 or better</td>
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<td>0.6%</td>
<td>0.4%</td>
<td>0.2%</td>
</tr>
<tr>
<td>Total capital ratio</td>
<td></td>
<td>12.8%</td>
<td>12.0%</td>
<td>11.2%</td>
</tr>
</tbody>
</table>

Swiss implementation of the countercyclical capital buffer (max. 2.5% CET1)
SNB applied the countercyclical capital buffer for the first time on 30 September 2013. As of 30 June 2014, this was raised to a 2% capital requirement (RWA) for loans on domestic residential properties.
Too big to fail (TBTF) / Total loss absorbing capacity (TLAC) – requirements for systemically relevant banks

TBTF requirements for G-SIBs and D-SIBs

The TBTF regime for systemically important banks applies in parallel to the provisions of Basel III. The following requirements must be met by the end of 2019.

1) G-SIBs (global systemically important banks)

The capital requirements for G-SIBs increase on a straight-line basis until the end 2019. For the G-SIBs, the gone-concern requirements generally correspond to the going-concern requirements. FINMA may grant individual rebates to the two large banks in recognition of implemented measures to improve their global resolvability. However, taking into account international standards they may not fall below 10% of RWA.

<table>
<thead>
<tr>
<th>TLAC requirement</th>
<th>RWA ratio</th>
<th>Leverage Ratio</th>
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<tbody>
<tr>
<td>Going-concern requirement</td>
<td>14,3%</td>
<td>5,0%</td>
</tr>
<tr>
<td>Minimum CET1 requirement</td>
<td>10,0%</td>
<td>3,5%</td>
</tr>
<tr>
<td>Maximum eligibility for AT1 capital with high trigger</td>
<td>4,3%</td>
<td>1,5%</td>
</tr>
<tr>
<td>Gone-concern requirement (conversion capital and debt instruments for loss absorption in the event of insolvency measures)</td>
<td>14,3%</td>
<td>5,0%</td>
</tr>
</tbody>
</table>

2) D-SIBs (domestic systemically important banks)

As is the case with the G-SIBs, the gone-concern capital requirements correspond to the going-concern capital requirements, but are reduced to 40% thereof. No additional rebates will be granted for these institutions. The Swiss Federal Council commissioned the Federal Department of Finance to draft a consultation paper on the gone-concern capital requirements for D-SIBs until 28 February 2018. The basis for this consultation paper is the Swiss Federal Council’s evaluation report dated 28 June 2017:

<table>
<thead>
<tr>
<th>TLAC requirement</th>
<th>RWA ratio</th>
<th>Leverage Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>RAI</td>
<td>ZKB/PF</td>
<td>RAI</td>
</tr>
<tr>
<td>Going-concern requirement</td>
<td>18,5%</td>
<td>18,1%</td>
</tr>
<tr>
<td>Minimum CET1 requirement</td>
<td>13,2%</td>
<td>12,9%</td>
</tr>
<tr>
<td>Maximum eligibility for AT1 capital with high trigger</td>
<td>8,9%</td>
<td>8,6%</td>
</tr>
<tr>
<td>Gone-concern requirement (conversion capital and debt instruments for loss absorption in the event of insolvency measures)</td>
<td>4,3%</td>
<td>4,3%</td>
</tr>
</tbody>
</table>

Countercyclical capital buffer (max. 2.5% of domestic RWA) in Switzerland

- The countercyclical capital buffer must be met by the systemically important banks in addition to the TLAC requirements.

RAI = Raiffeisen, ZKB = Zürcher Kantonalbank, PF = Postfinance

The minimum requirements for the total loss absorbing capacity (TLAC) of systemically important banks were adopted by the Swiss Federal Council on 11 May 2016 and entered into force on 1 July 2016. The gone-concern capital requirements for domestic systemically important banks (D-SIB) were not defined at this time as the emergency plans for these institutions were not yet ready to determine the gone-concern capital requirements.

The gone-concern capital requirements for D-SIBs were assessed for the first time in the evaluation report of the Swiss Federal Council on 28 June 2017. In addition to the TLAC requirements, a countercyclical capital buffer requirement exist to soften a possible “overheating” of the Swiss real estate market.
**Leverage ratio**

Key points

- In April 2016 the BCBS proposed the following revisions to the leverage ratio framework:
  - Revision of the treatment of derivatives incl. CCR measure, IM from clients for centrally cleared client transaction, FX Haircut on CVM and the specific wrong way risk in written credit derivatives
  - The treatment of regular-way purchases and sales of financial assets
  - Revisions to the treatment of provisions
- The Swiss Federal Council announced on 22 November 2017 the revisions to the CAO including the Pillar 1 (minimum capital requirement) requirement of 3% in the leverage ratio for all banks effective on 1 January 2018. For G-SIBs a buffer that needs to be met with Tier 1 capital and equates to 50% of a G-SIBs risk weighted higher-loss absorbency requirements will be implemented additionally

**Leverage ratio elements**

- Capital
  - CET 1 (Common Equity Tier1) after deductions
  - > 3%

- Exposure
  - On-balance sheet items
  - Off-balance sheet items

The Basel III leverage ratio is defined as the Capital Measure (the numerator) divided by the Exposure Measure (the Leverage Ratio Denominator (LRD)), with this ratio expressed as a percentage.
Liquidity risk management

- The supervisory authorities have revised the Circular 2015/2 "Liquidity risks - banks" as well as the Liquidity Ordinance. The changes, which primarily provide for clarifications and various exemptions for smaller banks, are expected to come into force on 1 January 2018.
- The introduction of the NSFR has been postponed and will not become binding before 2019. Current provisional reporting will continue until then.
- Observation ratios will be submitted by all banks starting in 2018. Data is for informational purposes, there are no minimum levels to be met.

Liquidity requirements in Switzerland

<table>
<thead>
<tr>
<th>Liquidity coverage ratio - LCR</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>In force since 1 January 2015. Starting in January 2017, SIFIs must calculate the average figures to be published based on daily closing values</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net stable funding ratio -NSFR</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provisional reporting with all banks Monthly for cat. 1&amp;2 banks Quarterly for cat. 3-5 banks</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Disclosure</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>New 2016/1 Circular in force</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Observation ratios</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Test reporting cat. 1-3 + certain cat. 4 banks</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Minimum reserves</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>No changes</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Qualitative liquidity requirements</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>In force since 1 January 2014</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Liquidity coverage ratio (LCR)

\[
\text{LCR} = \frac{\text{Stock of high quality liquid assets (HQLA)}}{\text{Net cash outflow over a period of 30 days}} \geq 100\%
\]

<table>
<thead>
<tr>
<th>Min. ratio SIFIs</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Min. ratio other banks</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>80%</td>
<td></td>
<td>90%</td>
<td></td>
<td>100%</td>
</tr>
</tbody>
</table>

- Outflows of retail deposits
- Outflows of unsecured funding on the money or capital market
- Outflows of secured funding
- Additional outflows,
  - i.e., other contingent funding liabilities (such as guarantees, letters of credit, revocable credits and liquidity facilities)
- Contractual cash inflows due within the next 30 days:
  - Maturity of secured lending transactions
  - Inflows from collateralized transactions (unless closed out)
  - All other assets due within the next 30 days

Limitation of cash inflow to a maximum of 75% of the cash outflow
Net stable funding ratio (NSFR):

- Ensure that long-term and illiquid assets are funded with stable liabilities
- Frequency of reporting is tied to the bank category. Category 1 and 2 banks are required to submit the NSFR report on a monthly basis while banks in the categories 3 to 5 must submit it on a quarterly basis

\[
\text{NSFR} = \frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} \geq 100\%
\]

Available stable funding (ASF)

Defined as reliable sources of funds over a one-year time horizon under conditions of extended stress, which include:

- The more stable the regulars consider the source of funding to be, the higher is the weighting (ASF) in the numerator
- E.g.: Capital + long-term funding (maturity > one year) may be included at a rate of 100%. Less stable funding arrangements, e.g. unsecured, short-term capital market funding, are allocated lower factors.

Required stable funding (RSF)

- Required funding is a function of the liquidity characteristics of the assets and off-balance sheet (OBS) contingent exposures.
- Exposures which are more liquid and assets which tie up capital in the short term only are given more advantageous (heavier) weightings (RSF) in the formula.
- Assets considered less liquid require more stable funding, so the RSF factor is higher
Qualitative liquidity requirements
Banks must have a liquidity risk management framework in place which is effectively integrated into the bank’s overall risk management process. General principle: “Ensuring a bank’s continuous solvency, even in situations of liquidity stress.”

Key elements of the liquidity framework:
- Setting of liquidity tolerance by the Board of Directors and periodic review thereof
- Definition of strategies for the management of liquidity risk
- Identification, assessment, measurement, management and monitoring of liquidity risks
- Liquidity buffer: a bank should hold assets, which can be monetized quickly and without any significant losses in value in times of liquidity stress
- Risk reduction: implementation of a limit system
- Definition of stress scenarios and implementation of stress testing (including for intraday liquidity)
- Steering function (transfer price system): Consideration of liquidity costs and risks in business activities (fixing prices, profitability measurement)
- Creation of an emergency plan

For smaller banks (defined as category 4 and 5 banks in the revised circular), the principle of proportionality applies (less stringent requirements for certain matters).

Observation ratios (Liquidity Monitoring Tools - LMT)
- Part of the new liquidity regulations set out in Basel III, complementing the short-term liquidity (LCR) and structural liquidity (NSFR) ratios
- No minimum requirements need to be met (data is for informational purposes only)

Template contains three spreadsheets requiring the following information:
- Monitoring tool I: breakdown of the bank’s cash flows (similar fields as in LCR, but data needs to be provided by maturity buckets)
- Monitoring tool II: exposure to largest funding counterparties (broken down by maturity)
- Monitoring tool III: unencumbered collateral/potential liquidity generation capacity

Reporting
- All banks in supervisory categories 1 to 3 and selected institutions from category 4 have had to submit test reports since 30 September 2015
- The general reporting obligation applies to all banks starting from 2018. Category 3 to 5 banks are allowed to submit a simplified form compared to category 1 and 2 banks
- Submission requirements: Category 1 and 2 banks: monthly, 30 days after month-end. Category 3-5 banks: quarterly, 60 days after quarter-end
- Relevant forms can be found under: https://www.snb.ch/en/emi/LMT
Basel III – Disclosure requirements for capital

Key points of the revised pillar III disclosure requirements
Implementation of the new disclosure requirements according to FINMA Circular 2016/1:

- Category 1 banks have to publish the revised capital disclosure requirements for the first time for year-end 2016
- Category 2 and 3 banks have to publish the revised capital disclosure requirements for the first time for year-end 2017
- Category 4 and 5 banks have to publish the revised capital disclosure requirements for the first time for year-end 2018

Minimum disclosure:
- Minimum disclosure for group companies (consolidation discount) and foreign-controlled banks

Partial disclosure:
- Partial disclosure is only applicable for category 4 and 5 banks

Large banks
- Banks with an average minimum capital requirement for counterparty credit risk of more than CHF 1 billion also have to disclose quantitative information after each set of half-yearly interim financial statements
- Specific disclosure requirements for large banks (banks with a minimum capital requirement for counterparty credit risk of more than CHF 4 billion)

SIFIs
- Specific capital disclosure requirements for systemically important financial institutions or groups (G-SIFI, D-SIFI)

Disclosure according to FINMA Circular 2008/22
Partial disclosure for banks which meet the following requirements:
- The minimum capital required for credit risk is less than CHF 200 million
- The Basel standardized approach (SA-BIS) is used to calculate the minimum capital requirements for credit risk (or the Swiss standardized approach (SA-CH) during the transition period up to and including 31 December 2018)
- The basic indicator approach (BIA) or the standardized approach is used to calculate the capital adequacy requirements for operational risk
- Only applies if securitization transactions as per FINMA Circular 2008/19 “Credit risk – banks” are not used

Qualitative capital disclosure requirements
- Equity interests and scope of consolidation
- Eligible capital and capital requirement
- Credit risk
- Market risk
- Strategy, processes and organization for the management of operational risk

Quantitative capital disclosure requirements
- Eligible capital and capital requirement
- Specific information (tables) for counterparty credit risks
**Basel III – Large exposure rules**

**Specific treatment of global SIFIs (G-SIFIs) and domestic SIFIs (D-SIFIs) under large exposure rules**
- Global SIFIs are announced on a yearly basis by the Financial Stability Board (FSB) and published on its homepage.
- Domestic systemically important financial institutions (D-SIFIs) are defined by the SNB.
- So far SNB has declared three banks as domestic systemically important financial institutions (D-SIFIs): ZKB, Raiffeisen and PostFinance.

**Counterparty corporates and public-sector entities (including governments)**
- For all counterparties which are not banks or securities dealers, the upper limit is always 25% of total of eligible capital.
- All exposures are in general risk-weighted with 100%.
- Except for public sector entities with a risk class of 1 and 2 (0% or 20% risk weight, respectively).
- TBTF: SIFIs and D-SIFIs have to measure and limit concentration risks not against the total of eligible capital but in relation to the Common Equity Tier 1 (CET1).

**Large exposures to counterparty banks and securities dealers:**
- All exposures to banks and securities dealers are weighted at 100% (regardless of maturity and rating).
- The upper limit will be 100% of the eligible capital if this is less than CHF 250 million.
- CHF 250 million if eligible capital amounts to between CHF 250 million and CHF 1 billion.
- A flat rate of 25% of the eligible capital if this exceeds CHF 1 billion.
- For all institutions, the upper limit for exposures to systemically important financial institutions (G-SIFIs and D-SIFIs) is 25% independent of the institution’s level of eligible capital.

**FINMA Circular 2019/1 “Risk distribution – banks”: Significant changes to the present rules**
- To limit large exposures, Tier 1 capital will be used as the measurement base rather than the eligible capital under the new rules.
- Under the new rules, large exposures of more than 25% of Tier 1 capital will no longer be permitted. This also applies to interbank exposures with the exception of intraday exposures. Freely available capital can therefore no longer be used to cover large exposures.
- Discontinuation of the preferred risk weight for sight- and overnight positions.
- For larger residential property financing arrangements of category 1 – 3 banks, the limit applies to the full loan amount. Previously, up to half the fair market value was excluded from the limit for these financing arrangements.
- Swiss mortgage bonds will be probably given a preferential weighting of 20%, having previously been given a weighting of 0% (or 25% under the regime which will expire at the end of 2018). FINMA supports a look-through approach as an option for Swiss mortgage bonds.
- For category 4 and 5 banks institutions, the new large exposure rules remain proportional. However, a large exposure risk may not exceed 100% of Tier 1 capital.
- Comprehensive reports will not only have to be submitted to the audit firm and the Bank’s management board, but also to FINMA under the new rules.

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- FINMA Circular 2013/7 “Intragroup exposure – banks”
- Limitation of intragroup exposure for relevant financial institutions being part of a foreign banking group, which are not under the consolidated supervision of FINMA.
- A potential mismatch in regard of an intragroup risk exposure when the intragroup exposure exceeds CET1 capital of the financial institution.
- If FINMA comes to the conclusion that the consolidated supervision of a foreign banking group – of which a Swiss subsidiary is part of – is not adequate, FINMA has the power to order a reduction of the intragroup exposure or prohibit it, or to increase the capital requirement by an additional institution-specific capital buffer.
IRRBB: Interest rate in the banking book

Regulatory foundation and status update:
- BCBS Standard “Interest rate risk in the banking book” dated April 2016: “The banks are expected to implement the standards by 2018.”

Implementation timeline for the new FINMA Circular 2018/xx “Interest rate risk - banks”

<table>
<thead>
<tr>
<th>FINMA planning for IRRBB project (as of June 2017)</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information as part of the national working group on liquidity and IRRBB</td>
<td>February 2017</td>
</tr>
<tr>
<td>Consultation (official treatment) as part of the national working group on liquidity and IRRBB</td>
<td>July to Dec. 2017</td>
</tr>
<tr>
<td>Adoption of the draft of a new FINMA circular “Interest rates banks”</td>
<td>April 2018</td>
</tr>
<tr>
<td>Implementation for all banks</td>
<td>January 2019</td>
</tr>
</tbody>
</table>

Extended disclosure (scope, frequency) relating to interest rate risk:
- Category 1 and 2 banks (SIB): Half-yearly disclosure of certain tables (for the first time as of 30 June 2018 and annual disclosure of all tables (for the first time as of 31 December 2018)
- Other banks: Annual publication of all IRRBB tables from 31 December 2018
- Structured and therefore comparable disclosure of the underlying model assumptions and parameters

Revised interest rate risk reporting:
- Test run of revised reporting as of 31 March 2018 (mandatory for categories 1 to 3)
- Final reporting date for the current SNB interest rate risk report 31 December 2018
- Revised interest rate risk reporting enters into force from 31 March 2019

Significant changes based on the BCBS paper “Standards - interest rate risk in the banking book” dated April 2016
- Specification of the expectations for the ALM process (formulation of a risk appetite statement, development and update of interest rate scenarios, stress tests and reverse stress tests, documentation and update of model assumptions, model governance, definition of responsibilities by the Board of Directors, reporting requirements, etc.)
- New disclosure standards for the effect of interest rate changes on value and earnings based on standardized scenarios
- The threshold for identifying outlier banks will be changed from a value effect of 20% of the entire eligible capital (Tier 1 + Tier 2) in response to a parallel interest rate change of +/- 200 bp to a value effect of 15% of Tier 1 capital from the maximum loss from six predefined standard interest rate scenarios
Basel III: Finalizing post-crisis reforms

Standardized approach for credit risk

Key points

Due diligence:
- Banks must perform due diligence to ensure that they have an adequate understanding of the risk profile and characteristics of counterparties
- Where external ratings are used, due diligence is necessary to assess the risk of the exposure and whether the risk weight applied is appropriate and prudent (not necessary for "Sovereigns")

Haircuts
- Supervisory haircuts must be used, removal of option to use internal models and own estimates for the calculation of haircuts
- SA haircut formula revised to obtain more risk sensitive results given the above prohibition
- Haircuts (irrespective of external ratings allowed) range from 0.5% to 30%

Currency mismatch
- Risk weight multiplier of 1.5 for unhedged exposures with different currencies between the loan and the counterparty’s main source of income
- Applies to retail and residential real estate exposures

Banks
- External credit risk assessment approach (ECRA) – jurisdiction that allow external rating (if available)
- Risk weight between 20% and 150%, including short-term exposures
- Standardized credit risk assessment approach (SCRA) – all other cases
- Banks classify exposures in three newly defined risk categories (lowest to highest risk weight: grade A, B and C)
- Risk weight between 20% and 150% depending on risk categories, including short-term exposures

 Corporates
- Same as for banks, is applicable for non-SME corporates if basis is external
- In jurisdictions not permitting external ratings or unrated exposures, risk weight between 65% and 100%
- 85% risk weight for SME exposures (75% risk weight for corporates that qualify for retail regulatory definition)
- Corporate risk weights apply to project finance, object finance and commodity finance, if issue-specific external ratings are available. If unavailable, risk weights between 80% and 130% for project finance and 100% for object and commodity finance apply

- On 7 December 2017 BCBS published the final document “Basel III: Finalising post-crisis reforms”
Key points

Retail (non-real estate):
- 75% risk weight for retail exposures meeting regulatory definition
- 45% risk weight for retail exposures to “transactors” (e.g. credit cards)
- 100% risk weight for all other retail exposures

Real estate:
- Loan-to-value ratio as main risk weight driver
- Distinction between residential and commercial real estate
- New exposure class for “land acquisition, development and construction exposures”
- Risk weight generally higher where repayment is dependent on cash flow from the property

<table>
<thead>
<tr>
<th></th>
<th>Dependent on cashflows generated by the property</th>
<th>Independent of cashflows generated by the property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>30% - 105%</td>
<td>20% - 70%</td>
</tr>
<tr>
<td>Commercial</td>
<td>70% - 110%</td>
<td>60% - 150%</td>
</tr>
<tr>
<td>Land acquisition, development and construction</td>
<td>100% - 150%</td>
<td></td>
</tr>
</tbody>
</table>

Impact

Capital
- Potential increase of risk weighted assets, depending on the bank’s business activities and specifics of its credit portfolio

Operational
- Revised calculation of risk weights and additionally required data fields will trigger operational changes within the IT infrastructure

Objectives:
- BCBS aims to improve the granularity and risk sensitivity while reducing mechanistic reliance on credit ratings
- BCBS aims to strike an appropriate balance among simplicity, risk sensitivity and comparability
Internal ratings-based (IRB) approach for credit risk

Objectives:
- Address shortcomings of the IRB approaches
- Reduce the complexity of the regulatory framework
- Improve comparability
- Increase robustness in modelling certain asset classes

Remove option to use A-IRB approach
- Remove A-IRB option for asset classes that are seen as not feasible to model in a robust or prudent manner
- Large and mid-sized corporates (consolidated revenues ≥ EUR 500 million): Foundation IRB or Standardized Approach only
- Banks and other financial institutions: Foundation IRB or Standardized Approach only
- Equities: Standardized Approach only

Parameter floors
- Floors for PD, LGD and EAD parameters based on asset and collateral type
  - PD: 5bp (Qualifying Revolving Retail Exposure at 10bp)
  - LGD: 25% to 50% for unsecured depending on product, 0% to 15% for secured depending on product
  - EAD: Sum of on-balance sheet plus 50% off-balance sheet multiplied with CCF under Standardized Approach

Additional changes
- Specialized lending can remain under A-IRB
- Amendments to Foundation IRB
- Removal of 1.06 scaling factor requirement

Output floor
- RWA floor of 72.5% of Standardized Approach RWA
  - RWA is the higher of the approved approaches and 72.5% of the Standardized Approach
  - Replaces existing Basel I floor
  - Output floor to be phased in until 2027

Disclosure requirements
- Requirement to disclose RWA and capital ratios on two basis
  - Disclosure without output floor and disclosure with output floor applied
- More details to be published at a future point

<table>
<thead>
<tr>
<th>Date</th>
<th>Output floor calibration</th>
</tr>
</thead>
<tbody>
<tr>
<td>01.01.2022</td>
<td>50%</td>
</tr>
<tr>
<td>01.01.2023</td>
<td>55%</td>
</tr>
<tr>
<td>01.01.2024</td>
<td>60%</td>
</tr>
<tr>
<td>01.01.2025</td>
<td>65%</td>
</tr>
<tr>
<td>01.01.2026</td>
<td>70%</td>
</tr>
<tr>
<td>01.01.2027</td>
<td>72.5%</td>
</tr>
</tbody>
</table>

Objectives:
- Ensuring minimum capital level
- Mitigating model risk (due to too little model specification, unsuitable data, etc.)
- Combating incentive-compatibility issues of over optimistic models
- Reducing excessive variability and enhancing comparability
Fundamental review of the trading book (FRTB) – Overview and timeline

BCBS rules published on 14 January 2016

- Prescriptive standards designed to limit implementation interpretations and promote consistency across firms and jurisdictions
- A revised trading book/banking book boundary with more explicit requirements for inclusions and exclusions of positions and limitations on reclassifications to reduce the scope for arbitrage
- An overhaul of the internal models approach (IMA) to focus on tail risk, varying liquidity horizons, constrained diversification and risk factor observability standards
- Stringent trading desk level IMA approval standards including model performance Profit and Loss (P&L) attribution tests to assess the risk factor alignment between risk management and pricing models
- An overhaul of the standardized approach (SA) to make it more risk sensitive, explicitly capture default and other ‘residual’ risks, and serve as a floor to IMA charges

The FRTB overhauls the market risk capital framework to meet the Basel Committee’s objectives of addressing shortcomings of the current Basel 2.5 framework and reducing the variability of market RWA across firms and jurisdictions

FINMA pushed the timeline by one year to December 2020 as first reporting date
FRTB – The capital charge components at a glance

<table>
<thead>
<tr>
<th>Scope</th>
<th>Trading Book</th>
<th>Trading Desk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inclusions</td>
<td>Internal risk transfers - credit and equity</td>
<td>Definition</td>
</tr>
<tr>
<td>Exclusions</td>
<td>Internal risk transfers - interest rates</td>
<td>Criteria</td>
</tr>
</tbody>
</table>

### Capital components

<table>
<thead>
<tr>
<th>Baseline 2.5</th>
<th>Internal model approach (IMA)</th>
<th>Standardized approach (SA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected Shortfall (ES)</td>
<td>modelable risk factors (NMRF)</td>
<td>Default risk charge (DRC)</td>
</tr>
<tr>
<td>VaR(^1) + Stressed VaR(^1)</td>
<td>Partially addressed through RNIVs in certain jurisdictions</td>
<td>Incremental Risk Charge (IRC) (^2)</td>
</tr>
<tr>
<td>Sensitivity based risk charge</td>
<td>Default risk charge (DRC)</td>
<td>Residual risk add-on</td>
</tr>
<tr>
<td>Standardized Charge(^3)</td>
<td>Standardized Charge(^3)</td>
<td></td>
</tr>
</tbody>
</table>

### Additional requirements

- Intraday limit monitoring
- Stress-testing
- Market liquidity
- Disclosures
- P&L reports
- Inventory aging reports

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1 Securitization positions are included in the Value-at-Risk and stressed Value-at-Risk measures under Basel 2.5. FRTB requires that securitization positions are excluded from the IMA and only included in the SA.

2 Modeled default risk charges for correlation trading positions (CPT) are measured through the Comprehensive Risk Measure under Basel 2.5. FRTB requires CTPs to be capitalized under the standardized approach.

3 Certain jurisdictions apply Basel 2.5 standardized charges only for products with specific risk. Additionally, certain jurisdictions provided De Minimis charges for positions not included in VaR.
FRTB – What banks should consider now

**Final rule analysis**
- Developing rule interpretations and assumptions that will impact the bank’s view of implementation requirements prior to launching projects

**RWA impact analysis**
- Updating RWA impact analyses to reflect the updated liquidity horizons, risk weights and other changes to enhance the estimate of projected RWA impact from FRTB at various levels (e.g. top of the house, specific lines of business, trading desks)

**Business impact and program strategy discussions**
- Forming business strategy and capital optimization working groups or projects to understand the drivers of FRTB pro-forma RWA to allow for early identification of priority work streams, and assessment of future potential impacts of the FRTB (e.g. market liquidity, bid-ask spreads, pricing, profitability) to support taking actions in advance of the effective date, as necessary, to rebalance portfolios and business strategies

**Gap analysis**
- Executing high level and targeted gap analysis efforts, to assess the bank’s current state infrastructure and in-flight programs, against the FRTB key requirements to identify critical gaps. Identify areas with the longest implementation lead times such as modelling, data and overall risk infrastructure enhancements that will not only be needed for minimum compliance but also for RWA optimization strategies e.g. through pursuing model approval

**FRTB Communication program**
- Increasing FRTB communication with senior management and the front office as to the implementation timing of the FRTB, the national supervisory rulemaking status, the anticipated RWA impacts, business strategy considerations and the anticipated size and scale of the bank’s FRTB program and related resource needs

**Launching strategic FRTB programs**
- Launching strategic FRTB programs, migrating from tactical working groups and QIS execution teams, formalizing the governance, oversight and accountability of stakeholders, and developing resource and budget needs across the bank
New standard approach for operational risk

**Standardized approaches:** Basic indicator approach, standardized approach

- **Basic indicator approach (BIA):** Derived from multiplier α and three-year average of the annual income indicator
- **Standardized approach (SA):** Product of the business line-specific multiplier β and the three-year average of the annual business line-specific income indicator

**Institution-specific approach:** Advanced Measurement Approach (AMA)

Model-based approach including certain regulatory requirements based on
- Internal and external loss data
- Scenario analyses
- Key business environment and internal control factors

**From 2022 onwards**

**One approach for all banks:** Standardized measurement approach (SMA)

- Derived from business indicator (BI), a factor which increases progressively in line with the business indicator (BIC) and an internal loss multiplier (ILM)
- The business indicator is composed of the three-year average of income, expense and balance sheet items, in some cases broken down by banking and trading book
- The internal loss multiplier is derived from the ratio of historical internal losses to the business indicator. There are clear requirements for the historical internal losses to be used: 10 years (transition period: at least five years), all losses exceeding EUR 20,000

**Reasons for the regulator to abandon the AMA**
- Banks cannot be compared with each other as no uniform standard has emerged

**Arguments against the current standardized approach**
- Not risk-based
- As it is linked to gross income, the capital charge tends to decrease in times of crisis

**What is the future capital charge?**
- AMA banks: The picture is unclear; capital requirements will tend to be higher for Europe and lower for the US
- BIA/former SMA banks: The capital charge will tend to rise
- Specific rules are planned for banks which have a high interest margin/predominantly generate commission income

**Outlook**
For medium-sized banks, the question arises as to whether all data required are available in the granularity required.
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Markets in Financial Instruments Directive II (MiFID II) - Creating a single rulebook

Objectives

- Ensuring market equality through a level playing field between market participants
- Increase market transparency for market participants
- Strengthen regulatory powers and regulatory coordination at European level
- Raise investor protection
- Reduce organizational deficiencies and improve internal control functions of market participants

MiFID II is the evolution of the already existing MiFID I regime
- The countries of the European Economic Area (EEA) had to transpose the MiFID II requirements into national law by 3 January 2018

Regulatory timeline

Published in Official Journal & in force (2 July '14)
Consultation on national implementation
ESMA draft ITS to Commission (11 Dec '15)
Application of new rules (3 January '18)
Delegated Acts
ESMA advice to Commission (3 January '15)
ESMA draft RTS to Commission (3 July '15)
National transposition (3 July '17)
ESMA and Commission consultations on Level 2 measures
Markets in Financial Instruments Directive II (MiFID II) - Strategic challenges and trends in private banking

Key topics

- Advised services: advisory model + value proposition + pricing strategy need to be re-assessed locally and globally
- Inducements: Payment from and to third parties have to be analyzed, adapted or disclosed to the client respectively
- Market access: financial advisors with operations in third countries need to analyse potential changes in their operations and business model initiated by revised MiFID II requirements and assess the interplay with corresponding local 3rd country regulation
- Capital markets: re-evaluation and adaption of product offering and partnering due to cost considerations; trading processes and trading data management will require adoptions

Challenges and trends

What are the key strategic challenges and related questions in private banking?

<table>
<thead>
<tr>
<th>Advised services</th>
<th>Inducements</th>
<th>Market access</th>
<th>Trading &amp; execution</th>
</tr>
</thead>
<tbody>
<tr>
<td>What are the benefits and the downsides of independent advice?</td>
<td>What fees are potentially at risk and what is the impact?</td>
<td>How is the cross-border business affected (direct vs. delegated model)?</td>
<td>How significant is the derivative business as part of own offering?</td>
</tr>
<tr>
<td>What is the impact on the product shelf and open architecture?</td>
<td>Is the current distribution model fit for MiFID II?</td>
<td>What happens with Inter Company (IC) outsourcing?</td>
<td>What services will clients request in future when trading derivatives?</td>
</tr>
</tbody>
</table>

What trends are we observing in private banking?

<table>
<thead>
<tr>
<th>Distinct value proposition</th>
<th>Inducement free offering</th>
<th>Reducing complexity</th>
<th>Extended services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brand for best advice</td>
<td>Inducement free offering in waves</td>
<td>Review of the operating model and service delivery model</td>
<td>Large players with full capability vs. small players assessing alternatives</td>
</tr>
<tr>
<td>Introduction of advisory pricing combined with modular and enhanced advisory offering and experience</td>
<td>Development of alternative provider fee models</td>
<td>Harmonization with no/low country-specific solutions</td>
<td>Increased use of trading platforms by professional participants in the future</td>
</tr>
<tr>
<td>Distinct value proposition by segment</td>
<td>Review of remuneration schemes</td>
<td>Clear and distinct market offering</td>
<td></td>
</tr>
<tr>
<td>Full transparency</td>
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</tr>
</tbody>
</table>

Successful financial service providers recognize upcoming regulations as an innovation trigger for the operating model transformation and do not perceive this as a pure compliance exercise.
FIDLEG - The strive for equivalent Swiss law generally aligned to Europe’s MiFID objectives

Key topics

1. Scope of supervised entities: financial service providers including banks and asset managers

2. Corporate governance: adequate organizational measures also regarding collaboration with intermediaries, conflicts of interest and employee transactions

3. Cross-border regulation: market access rules for foreign financial institutions providing services within or into Switzerland

4. Client classification: classification of clients into retail, professional and institutional clients

5. Key rules of conduct: including duties in the advisory process regarding the suitability assessment and the best execution principle

6. Documentation: documentation of products (prospectus and basic information sheet) and services (advisory minutes) ensuring transparency and comparability

The upcoming Swiss Financial Service Act (FIDLEG) will be aligned with MiFID I and MiFID II to a large extent; however, differences regarding the Suitability and Appropriateness (S&A) concept, treatment on inducements and product governance requirements exist.

Internationally oriented Swiss banks will need to integrate the FIDLEG set of requirements into ongoing projects, while locally oriented market players will have to start from scratch.
The legislation process of FIDLEG has experienced some delays.

The political debate about the regulation is now close to final.

**Key points**
- Dispatch and draft legislation published by Federal Council on 4 November 2015
- Second chamber of Parliament (National Council) is debating the draft in autumn 2017
- Entry into force planned for 2019
### MIFID II vs FIDLEG

<table>
<thead>
<tr>
<th><strong>MiFID II specifics</strong></th>
<th><strong>MiFID I</strong></th>
<th><strong>FIDLEG</strong></th>
<th><strong>MiFID II</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Product governance requirements</td>
<td></td>
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<tr>
<td>Narrowed</td>
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<tr>
<td>„execution only“ exemption</td>
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<tr>
<td>Execution-only services not possible in combination with loans</td>
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<tr>
<td>Dependent vs. independent advice</td>
<td></td>
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<tr>
<td>Ban on inducements for independent advice and portfolio management</td>
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<tr>
<td>Information re costs/charges of components of packaged products</td>
<td></td>
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<tr>
<td>Enhanced fee transparency</td>
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<tr>
<td>Enhanced documentation/reporting requirements</td>
<td></td>
<td></td>
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<tr>
<td>Relationship Manager (RM) education/registration</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Third country access</td>
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<tr>
<td>Suitability</td>
<td></td>
<td></td>
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<tr>
<td>Appropriateness</td>
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<td></td>
</tr>
<tr>
<td>Client classification</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Duty to inform client on firm, licence and scope of services</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial research/marketing material</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Best Execution</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Key points

In general, FIDLEG is aligned with MiFID I/II especially regarding consumer protection rules such as:

- Client classification
- Suitability of investment advice
- Best execution
- Disclosure and information requirements
- Key investor document similar to PRIIPS
- RMs to be adequately trained and registered (in certain cases)
The Protocol Requirements pursuant to CISA – A foretaste of the profiling standards under the upcoming FIDLEG

Key points
- Duty to establish written protocol - protocol requirements pursuant to the Swiss Collective Investment Schemes Act (CISA)
- The Swiss Bankers Association drafted guidelines on how to interpret and implement the protocol requirements (see diagram “Elements”); these guidelines set a minimum standard recognized by FINMA
- The duty to establish a written protocol is triggered in case of a distribution activity, a personal recommendation regarding the acquisition of units of a specific collective investment scheme

Scope

Distribution activity
- =any offering or advertisement, except
- advice with a mandate
- discretionary asset management
- execution only upon the customer’s own demand

Personal recommendation
- addressed to a specific investor (≠ public)
- takes the specific needs of that investor into consideration
- ≠ financial research, sales lists, recommendation lists etc.

Acquisition
- ≠ keep or sell
- ≠ re-investment (unless the target investment is a collective investment scheme)

Specific collective investment scheme
- ≠ shares, bonds, derivatives, structured products etc.
- ≠ the mere indication of an investment category
- ≠ comparison of two collective investment schemes

Elements

Client needs = investment profile
- Contains the investment objectives and the risk profile
- To be established prior to the first recommendation and amended if needed

Personal recommendation
- Reason for the personal recommendation regarding the acquisition of a certain collective investment scheme
- To be established with regard to every recommendation
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Product regulation
AIFMD - Harmonized rule set for managers of alternative investment funds in the EU

Background and timeline
- The Alternative Investment Fund Managers Directive (AIFMD) establishes a regulatory regime for entities (AIFMs) managing alternative investment funds (AIFs) in the EU.
- AIFMD covers the management and marketing of AIFs in the EU. Third country market actors (non-EU AIFMs) are also in scope if the AIF is set up in the EU or distributed to investors in the EU.
- In addition to management and marketing, the harmonized rule set deals with the topics of custody, disclosure and reporting, risk and liquidity management, professional liability, delegation as well as remuneration.
- AIFMD entered into force on 22 July 2011. The national implementation was due on 22 July 2013. By 21 July 2014, existing EU AIFMs had to apply for authorization.
- On 30 July 2015 and 19 July 2016, ESMA published opinions and advice stating that for Switzerland, there are no significant obstacles impeding the application of the AIFMD passport.
- On applying the AIFMD marketing passport to non-EU AIFMs and AIFs. Non-EU AIFMs may use the national private placement regimes (NPPRs) to market AIFs in the EU, which may exist until 2018 or later.

Experiences with AIFMD from a third country perspective
- As third country AIFMs are not eligible for the pan-European marketing passport, non-EU AIFMs approach EU investors under the national private placement regimes or on a reverse solicitation basis (and thus are not in scope of AIFMD). However, the marketing passport might be extended to third countries; the respective assessment of ESMA is currently on-going.
- The NPPRs vary widely. Some EU member states have decided to implement the minimum AIFMD NPPR requirements only, while others have imposed additional requirements such as the “depositary-lite” regime.
- The notification or registration process of non-EU AIFs with the local regulators under the NPPRs is equally diverse. Whereas marketing in some jurisdictions is allowed upon filing a notification, in other jurisdictions the non-EU AIFM needs to await a (written) confirmation from the relevant supervisory authority prior to undertaking any marketing activities.

Implications for the asset management industry
- Significant compliance cost: due to the increased regulatory requirements, the initial and ongoing compliance costs for AIFMs are significant.
- Increase in operational burden: onerous disclosure obligations for AIFMs will have time and cost implications.
- Lack of clarity: despite numerous publication of ESMA (technical advice, guidelines and Q&As) addressing different AIFMD relevant topics, there are some risks arising from the lack of clarity and guidance.
- Reduction in the number of funds: firms may close or merge funds which are no longer economically viable under AIFMD.
- Potential for greater demand: alternatively, the regulatory framework put forth by AIFMD may encourage investments from investors who have thus far remained on the sidelines due to apprehensions about the lack of adequate disclosures and investor protection.
MiFID II - Strategic challenges and trends in the asset management industry

Important points
- MiFID II - mainly aiming at enhancing consumer protection and market structures’ regulations - heavily impacts the AM industry and change operational models
- One of the greatest challenges is the ban on inducements for independent financial advice or discretionary portfolio management, indirectly impacting asset managers and forcing them to rethink their distribution and remuneration models
- MiFID II introduced enhanced cost transparency duties when distributing financial products. In particular, it requires transparency both ex-ante, before the service is provided, on the costs to be expected and ex-post, notably on the concrete costs with at least yearly frequency during the whole life of the product.

Challenges and trends

What are the key strategic challenges and related questions in asset management?

<table>
<thead>
<tr>
<th>Distribution</th>
<th>Target market</th>
<th>Research</th>
<th>Transparency</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Development of new remuneration models</td>
<td>• New obligation to define target market</td>
<td>• Free research is considered as conflict of interests</td>
<td>• Enhanced disclosure duties on product level</td>
</tr>
<tr>
<td>• Transparency duties for retrocessions</td>
<td>• Target market and suitability assessment to be aligned</td>
<td>• Need to re-develop pricing models</td>
<td>• Transparency on retrocessions and inducements</td>
</tr>
<tr>
<td>• Adaptation to the requirements for independent advice</td>
<td></td>
<td>• Billing and remuneration of research</td>
<td>• Detailed and aggregated costs disclosures</td>
</tr>
</tbody>
</table>

What trends are we observing in asset management?

<table>
<thead>
<tr>
<th>Changing distribution models</th>
<th>Standardised definition of target market</th>
<th>Revenue flow review</th>
<th>Transparency leverages margin reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Offering of retro free shares to meet the increasing demand for inducement-free products</td>
<td>• Definition of standardised rules</td>
<td>• Trend to pay research costs on own account</td>
<td>• Rising demand for inducement-free products</td>
</tr>
<tr>
<td>• Trend to non-independent advice</td>
<td>• Rather liberal definition of target market</td>
<td>• Partial implementation of research payment accounts</td>
<td>• Cost transparency increases competition and margin pressure</td>
</tr>
</tbody>
</table>
PRIIPS – Harmonization of product documentation for packaged investment products in the EU

Key points
The European Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPS) was published in the EU’s official Journal on 9 December 2014 and entered into force 20 days later. The PRIIPS regulation requires a Key Information Document (KID) to be provided to retail investors ahead of their investment in a product.

KID objectives are:
- To help retail investors to make a more informed decision as to whether an investment is right for them or not
- To increase comparability between PRIIPS

Content
KID is a three page document which addresses:
- What is this investment?
- What is it for?
- Could I lose money?
- What are the risks and what might I get back?
- What are the costs?
- How has it performed in the past?
- What might I get when I retire?

Challenges
- Data of underlying instruments are partially not available or not in the necessary granularity
- Interpretation of the rather general rules for the estimation of costs
- Cost calculation can lead to counterintuitive results in relation to performance scenarios
- The calculation and presentation of the four scenarios does not always allow to take in consideration special product features
- PRIIPS KID has to be distributed to the client before the transaction is executed.

- 29 December 2014: new PRIIPS regulation entered into force
- 1 January 2018: the regulation is directly applicable in the EU Member States and since then a Key Information Document (KID) needs to be provided for packaged retail and insurance-based investment product
- 31 December 2019: Transition period for UCITS KIID ends
Asset Management UCITS V - Undertakings for the collective investment in transferable securities

Key points
The EU adopted Directive 2014/91/EU on 23 July 2014; the UCITS V Directive addresses certain issues that have arisen during the financial crisis, and focuses on three areas:

- Clarification of the UCITS depositary function and amendments to liability provisions (as well as oversight functions and conditions that govern delegation)
- Introduction of rules on remuneration policies which must be applied to key members of UCITS managerial staff (management company, group structures and individual compensation)
- Harmonization of the minimum sanctions available to supervisors in case of violation of UCITS rules

Other areas of the UCITS framework, such as the use of collateral, liquidity management and the use of derivative financial instruments will be addressed at a later stage, as more work and consultation is required to assess the robustness of the existing framework. A new regulation for money market funds has been published on 14 June 2017.

Key considerations

<table>
<thead>
<tr>
<th>Depositary Liability</th>
<th>Introduction of enhanced liability will require pricing to be revisited</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Expanded responsibility of depositaries to effectively monitor the fund administrators’ activities (e.g. valuation, NAV calculation, etc.)</td>
</tr>
<tr>
<td></td>
<td>- How will depositories respond to new liability requirements/ manage their sub-custody networks?</td>
</tr>
<tr>
<td></td>
<td>- Who will be the key players in the value chain?</td>
</tr>
<tr>
<td></td>
<td>- Depositaries to revisit overall service offering and pricing</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Remuneration</th>
<th>Three areas of concern</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Remuneration based on performance exposes investors to higher potential losses as managers chase returns</td>
</tr>
<tr>
<td></td>
<td>- Remuneration structures might be skewed so managers participate in materialized returns but not in materialized losses</td>
</tr>
<tr>
<td></td>
<td>- Remuneration structures seldom disclosed in fund offering documents</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>National Sanction Regimes</th>
<th>Consultation differences across EU member states</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Differences in size of fines for same breach</td>
</tr>
<tr>
<td></td>
<td>- Different criteria to determine amount of administrative sanctions</td>
</tr>
<tr>
<td></td>
<td>- Differences in the application of sanctions</td>
</tr>
<tr>
<td></td>
<td>- Harmonization of regimes with minimum levels to be specified</td>
</tr>
</tbody>
</table>
### Key points

The Federal Council adopted the dispatch on the Financial Services Act (FinSA) and on the Financial Institutions Act (FinIA) at the start of November 2015. These are currently still under discussion at the legislative level and will not enter into force before mid-2019.

Among others FinIA will regulate the following financial service providers: trustees, portfolio managers, managers of collective assets, fund management companies, and securities firms.

There will be no material change in the requirements set to these financial service providers, with the exception of managers of individual client assets and trustees, who are newly subjected to the authorization requirement. These are subjected the supervision of an authority authorized and supervised by the FINMA.

Furthermore an authorization chain is foreseen, so that higher tier authorization encompasses an authorization to operate as an institution requiring a lower tier authorization (with the exception of fund management companies and fund management companies, which require an own authorization). Representatives of foreign collective investment schemes will be further regulated in CISA.

A key information document (KID) for all financial instruments offered to private investors (with the exception of shares and shares-like instruments) is newly required. Equivalent documents (e.g. PRIIPs-KID) are recognized.

The public offering of securities require a prospectus according to FIDLEG. This will be reviewed by a specialized entity authorized by FINMA.

<table>
<thead>
<tr>
<th>SESTA</th>
<th>Security firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>CISA</td>
<td>Managers of collective investment schemes</td>
</tr>
<tr>
<td>...</td>
<td>Trustees</td>
</tr>
</tbody>
</table>

- Harmonized requirements
- Authorization chain
- Harmonized definitions
- Two tier supervision
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Markets & Infrastructure
EMIR – Global regulatory reforms are fundamentally reshaping the OTC derivatives industry

Key points
The European Market Infrastructure Regulation (EMIR) entered into force on 16 August 2012. It has since been gradually implemented.

Reporting obligation (effective as of 12 February 2014):
• All derivative trades have to be reported to an ESMA approved trade repository by each party within one day
• Cost and infrastructure associated with reporting even for NFCs
• Delegated reporting services are offered by some market participants
• Revised EMIR reporting rules apply from 1 November 2017

Clearing obligation (phased-in starting from 21 June 2016)
• FCs and NFCs above the clearing threshold (NFC+) are required to centrally clear OTC derivatives subject to clearing obligation
• Classes of derivatives subject to clearing mandate are progressively defined by ESMA, with the first mandate adopted for G4 IRS and proposed for EEA IRS and iTraxx CDIs

Risk mitigation measures
• Non-cleared OTC contracts require processes to measure, mitigate and monitor operational and counterparty risks
• NFCs are only subject to basic risk mitigation requirements of timely confirmation, portfolio reconciliation, dispute resolution and compression, while FCs and NFCs+ are additionally subject to daily valuation

Margin requirements (phased-in from September 2016):
• NFCs are exempt
• FCs and NFCs+ above an annually decreasing threshold shall calculate, exchange and segregate initial margin
• All FCs and NFCs+ shall exchange daily variation margin according to detailed requirements

Requirements of different counterparties

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Clearing through CCP</th>
<th>Risk mitigation (if not cleared)</th>
<th>Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Basic risk mitigation</td>
<td>Extended risk mitigation</td>
</tr>
<tr>
<td>FC</td>
<td></td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>NFC+</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>NFC-</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>NP</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
</tbody>
</table>

Do requirements apply?

- Yes
- No

FC  Financial counterparty, e.g. bank, insurance
NFC+ Non-financial counterparty above threshold
NFC- Non-financial counterparty below threshold
NP  Natural person
CCP  Central counterparty

The illustration outlines the obligations/requirements a specific counterparty may be subject to. The requirements to be applied by the counterparties to a specific contract depend on the obligations both counterparties are subject to (e.g. a contract between a FC and a NFC- does not need to be cleared).
Key points
- The Swiss Parliament passed the Financial Market Infrastructure Act (FMIA/FinfraG), adjusting the regulation of financial market infrastructures and derivatives trading in line with market developments and international requirements on 19 June 2015
- The implementing ordinances were adopted by the Federal Council on 25 November 2015 (FMIO/FinfraV) and by FINMA on 3 December 2015 (FMIO-FINMA)

FMIA addresses the regulation of:
- Financial market infrastructures (FMI)
  - Exchanges, Multilateral Trading Systems (MTF), Organized trading facilities (OTF)
- Post-trade infrastructures
  - Central Counterparties (CCP), Trade Repositories (TR), Central Securities Depositories (CSD), Payment Systems
- Specific insolvency provisions
- Trading in derivatives
  - Mandatory clearing via CCP
  - Risk mitigation (timely confirmation, reconciliation, dispute resolution, daily valuation)
  - Reporting to TR
  - Mandatory trading on exchanges
- Market conduct (as insider dealing, market manipulation)

Status and outlook (Trading in derivatives focus):
- In 2017, risk mitigation requirements were implemented, reporting compliance dates announced whereas the clearing duty and execution mandate are still pending
- Although aligned to EMIR to a large extent, there is no equivalence decision while a regulatory gap remains in some key areas, preventing full application of a single operating model for cross-border transactions
- Margin requirements and reporting will require further efforts in 2019 for smaller Swiss entities

Timeline:
- 1 January 2016: entry into force
- Phased-in implementation dates depending on counterparties classification:
  - 1 January 2017/1 July 2017: risk mitigation techniques
  - 4 February 2017/1 September 2017: Variation Margin
  - 4 February 2017 – 1 September 2020: Initial Margin
  - 1 October 2017 – 1 January 2019: TR reporting
- Clearing, trading execution subject to further implementing acts by FINMA and 6 to 18 months implementation deadlines thereafter

Challenges:
- Cost of infrastructure and liquidity for margin exchange
- Reporting of cross-border trades by Swiss NFCs
- Absence of EMIR equivalence
- Ongoing OTC re-documentation efforts

The illustration outlines the obligations/requirements a specific counterparty may be subject to. The requirements to be applied by the counterparties to a specific contract depend on the obligations both counterparties are subject to (e.g. a contract between a FC and a NFC- does not need to be cleared).
# FMIA – Alignment with the European EMIR initiative

## High-level comparison FMIA-EMIR

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<thead>
<tr>
<th>Area</th>
<th>FMIA</th>
<th>Alignment</th>
<th>EMIR</th>
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<tbody>
<tr>
<td>Scope:</td>
<td>Financial counterparties (FC)</td>
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<td>Clearing</td>
<td>FC+ and NFC+</td>
<td>FC and NFC+</td>
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<td>Risk mitigation:</td>
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<td>• Compression</td>
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<td></td>
<td>• Portfolio reconciliation</td>
<td>All FC and NFC+</td>
<td>All counterparties</td>
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<td></td>
<td>• Daily valuation</td>
<td>FC+ and NFC+</td>
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<td>All FC and NFC+</td>
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<td>Reporting</td>
<td>All counterparties</td>
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<th>Comments on differences FMIA versus EMIR</th>
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<td>Classification</td>
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<td>Products</td>
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<td>Intragroup exemption</td>
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<td>Risk Mitigation</td>
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<td>Trading obligation</td>
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<td>Supervision</td>
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EMIR/FMIA - Adapting the current operating model is key to respond to new OTC regulations

Counterparty classification and scoping of applicable duties
- Firms require representation from their counterparties to determine EMIR/ FMIA classifications and scope of applicable duties
- Changes to legal documentation and the on-boarding process are required
- NFCs and Swiss FCs must have a process in place for threshold calculation and monitoring
- Front-to-back /pre- & post-trade processes must evolve to ensure compliance with relevant duties for relevant counterparty type and instrument

Trade reporting and trade repositories (TRs)
- All exchange-traded and OTC derivatives contracts must be reported to a TR
- Not all TR authorized or recognized by FINMA are also recognised or authorised under EMIR while there is no equivalence yet (so far, FINMA authorized SIX Trade Repository and recognized REGIS-TR under FMIA)
- Despite one-sided reporting rule under FMIA, the buy-side NFCs must report when facing a foreign FC not reporting to a FINMA recognised TR
- Cost associated with reporting to be considered

Non-cleared derivatives risk mitigation
- Firms must have processes and agree with counterparties on procedures for timely confirmations, dispute resolution, portfolio reconciliation and compression
- FCs and NFCs+ should also ensure compliance with daily valuation requirements

Collateral and margin for non-cleared derivatives
- Timely, accurate and appropriately segregated exchanges of collateral for non-cleared OTC contracts are required
- Changes to margin models and processes must be implemented
- Daily exchange of variation margin is a key operational challenge for smaller entities
- New margin agreements have to be signed with derivatives counterparties
- Initial margin, operationally challenging and costly, may become relevant for a larger number of FC+ and NFC+ after 2020
- Types of acceptable, fungible collateral will need to be specified and eligibility monitored, access to quality assets will become critical

Clearing and CCPs
- Mandated derivative asset classes must be cleared via an approved central counterparty
- Firms must decide whether to become a clearing member, select clearing broker or utilize indirect clearing
- CCP, clearing broker and indirect clearer accounts must support omnibus and individual client segregation and portability, even for the existing exchange-traded products
- New requirements for CCP capital, margin, default waterfall and model review must be implemented

We observe...
- The economics of the derivatives business will change given the need to factor clearing and collateral into pricing
- Execution venue trading mandate covered by FMIA is treated outside of EMIR in the EU
- Analysis of connecting dots with other equivalent regulations regarding cross border trades
- Regulatory gap emerging from FMIA may force pan-European firms to revisit current EMIR compliant operating models
- Single-sided reporting and inclusion of hedging trades into threshold calculation for NFCs proposed under EMIR review

OTC documentation requires amendments in light of the regulatory change
- SBA FMIA Agreement or representation clauses in the OTC documentation
- ISDA EMIR NFC Representation letter or Protocol
- TR account documentation
- Reporting delegation
- Confidentiality waiver
- SBA FMIA Agreement or risk mitigation clauses in the OTC documentation
- ISDA EMIR Protocol/FMIA top-up agreement
- 2016 VM ISDA Credit Support Annex (CSA)
- 2017 IM ISDA CSA (New York law annex)
- 2017 IM ISDA CSD (English law deed)
- ISDA VM Protocol
- Custody account, segregation and security agreements
- Margin self disclosure letters
- Cleared derivatives execution agreement
- CCP membership agreements
- Client clearing agreements
Contractual recognition of resolution stay under Swiss Banking Law and Ordinance

Key points
- In Switzerland, FINMA has power to order the stay of termination rights deriving from the art. 30a of the Swiss Federal Banking Act (SFBA).
- Since 1 April 2017, the amended Banking Ordinance (art. 12 para 2bis SFBO) requires Swiss banks and securities dealers (and in certain cases foreign affiliates) to obtain from their counterparties a temporary waiver of early termination rights upon a resolution stay exercised by FINMA (Resolution Stay Waivers).
- In scope are new “financial contracts” (i.e. including derivatives, repo, stocklending and interbank loans) entered into or amended after the compliance dates, i.e. 1 April 2018 with counterparties banks and securities dealers; 1 October 2018 with other counterparties.

Consequences
- Entering into new transactions or amending existing contracts without Resolution Stay Waiver after the relevant compliance dates is not allowed.
- The implementation has a wide-bank impact, affecting the whole product value chain:

<table>
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<tr>
<th>Product/Sales</th>
<th>ensure resolution stay compliant terms at structuring/sales phase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading</td>
<td>trading limitations may apply in absence of contractual recognition of stay (monitoring and controls); possible pricing impact due to watering down of counterparty's termination rights.</td>
</tr>
<tr>
<td>Client relationship</td>
<td>clients are likely to require information and «education» prior to recognizing a stay of their termination rights</td>
</tr>
<tr>
<td>Legal documentation</td>
<td>agreements and templates shall be adjusted, number of existing contracts may need to be renegotiated</td>
</tr>
<tr>
<td>Compliance</td>
<td>monitoring and controls of compliance processes, training of impacted employees to ensure compliance</td>
</tr>
<tr>
<td>Risk functions</td>
<td>operational and reputational risk</td>
</tr>
</tbody>
</table>

The above impacts concern multiple business areas/products, firm locations (foreign branches and potential affiliates) and client locations.

Solution - Large scale re-documentation
- ISDA has produced a number of “Resolution Stay” protocols, offering market participants an efficient way to amend the terms of certain agreements to reflect the requirements of the stay regulations implemented in the relevant jurisdictions. ISDA Jurisdictional Stay Protocol with Swiss module may be used to collect waivers from adhering counterparties.
- However, it is unlikely that all counterparties and clients will adhere. Therefore certain amount of bilateral amendments will be required.
- Swiss Banking Association is working towards a Swiss consensus regarding the approach and templates proposed to be used for the outreach.
IBOR benchmark transition

Transition background
Interbank offered rates (IBORs) play an integral role in the global financial markets. In the aftermath of the financial crisis, their reliability and robustness were undermined by alleged manipulation and liquidity decline in the interbank unsecured funding markets.

Since 2009, the official sector and market participants have undertaken a series of initiatives to restore the governance and oversight of major interest rate benchmarks and select alternative risk-free rates (RFRs) based on durable, liquid, underlying markets that conform to the International Organization of Securities Commissions (IOSCO) Principles for Financial Benchmarks.

Markets across the globe have taken steps to reform their existing rates in line with the Financial Stability Board (FSB) and the IOSCO Principles. Some jurisdictions have established RFR Working Groups (WGs) to conduct reviews and identify alternative RFRs1:

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<th>Jurisdiction</th>
<th>Current benchmark</th>
<th>Recommended alternative RFR</th>
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<tr>
<td>Switzerland</td>
<td>CHF LIBOR TOIS</td>
<td>The National WG on CHF Reference Rates recommended the Swiss average rate overnight (SARON)</td>
</tr>
<tr>
<td>Europe</td>
<td>EURO LIBOR, EURIBOR</td>
<td>Euro overnight index average (EONIA) is being considered as a potential alternative to replace EURO LIBOR, EURIBOR</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>GBP LIBOR</td>
<td>WG on Sterling RFR recommended the reformed Sterling overnight index average (SONIA)</td>
</tr>
<tr>
<td>United States</td>
<td>USD LIBOR</td>
<td>Alternative Reference Rates Committee recommended the secured overnight financing rate (SOFR)</td>
</tr>
<tr>
<td>Japan</td>
<td>JPY LIBOR, TIBOR</td>
<td>Study Group on Risk-Free Reference Rates recommended the Tokyo overnight average rate (TONA)</td>
</tr>
</tbody>
</table>

1 The scope of the IBORs listed are those in which an RFR WG is currently operative or being established. Regulatory reform initiatives are underway in other jurisdictions. For further information, please consult with the relevant trade association representatives.
The successful adoption of alternative RFRs is expected to be a multiyear process. The identification of potential solutions and the design of specific transition plans is at the forefront of the global regulatory community and the private and public sector agenda. The following milestones have been identified to date:

Transition challenges
IBORs are currently referenced in a broad range of financial contracts and are embedded in various business processes. Highlighted below are potential key challenges associated with the transition to alternative RFRs:

- **Valuation and risk management**
  - Value transfer, risk exposures, hedges and modeling

- **Legal**
  - Contractual triggers, amendments and client outreach

- **Operations and technology**
  - Operational and infrastructure enhancements

- **Market liquidity**
  - Liquidity in derivatives referencing alternative RFRs

- **Accounting and tax**
  - Fair value measurement, hedges and tax structures

- **Governance and controls**
  - Roles, responsibilities and internal control frameworks

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Source: Andrew Bailey’s speech on The future of LIBOR, July 2017.
Cross-functional impact areas
The transition to alternative RFRs will have a widespread impact across various functions, business processes and technology as shown below:

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<td>• Prepayment and decay regression factors</td>
<td>• Position and cash reconciliation</td>
<td>• Risk factor and time series generation</td>
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<td>• Earnings repricing curves and spreads</td>
<td>• Collateral management</td>
<td>• Value at risk, stress test and</td>
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<tr>
<td>• Economic value of equity</td>
<td>• Financial and regulatory reporting</td>
<td>sensitivity models</td>
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<tr>
<td>• Unsecured funding</td>
<td>• Front, middle and back-office technology</td>
<td>• Credit risk exposure models</td>
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<td>• Initial and variation margin models</td>
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<td>Tax</td>
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<td>• Deemed taxable exchanges</td>
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<td>• Book-to-tax differences</td>
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<td>• Accelerated payments</td>
</tr>
</tbody>
</table>
Eight topics for transition preparation

Program setup and impact assessment

- Board of directors and external communication

Impact assessment and program setup
- Establish a global, cross-functional program management plan to mobilize IBOR transition activities
- Conduct an assessment to identify cross-jurisdictional challenges
- Develop a comprehensive implementation roadmap for prioritized initiatives
- Create an enterprise-wide project management office toolkit, including a program charter, a stakeholder map and resourcing requirements
- Manage project planning, status reporting and escalation protocol

1. Project mobilization
2. Impact assessment
3. Roadmap
4. Program setup

Legal
- Conduct legal analysis through optical character recognition and deep learning techniques
- Perform contract reviews and draft enhanced language
- Manage the end-to-end client outreach and negotiation

Liquidity, valuation and risk management
- Enhance impacted models
- Develop proxies for historical time series data
- Bootstrap and test new curves
- Conduct testing to assess and validate enhanced models

Operations
- Inventory impacted functions, systems and processes
- Conduct gap assessment to identify downstream impediments
- Develop transition roadmap and implement activities

Accounting
- Inventory the impacted processes, policies and procedures
- Update fair value measurement and hedge accounting frameworks

Tax
- Analyze the impacts on revaluation of tax assets and liabilities
- Assess the impacts on acceleration of payments

Governance and control
- Review current governance models and existing controls
- Define an enhanced cross-functional governance model
- Document and implement changes to existing control framework

Technology
- Enable tooling to accelerate the impact assessment and support the transition
- Develop an end-to-end transformation support framework
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Risks and Data Security
FINMA Circular 2008/21 - New principle 4: Technology infrastructure - Handling of IT and cyber risks

Background
In response to the increasing cyber risks, FINMA also adopted new requirements in connection with IT risk management and cyber risk management in its revised circular 2008/21 “Operational risks - Banks” as of 1 July 2017. Principle 4 “Technology infrastructure” of the revised circular contains new requirements relating to qualitative aspects in respect of IT risks and cyber risks. With regard to cyber risks and the related measures to safeguard cyber security, FINMA refers to the internationally recognized NIST Cybersecurity Framework, which covers the following functions: «Identify», «Protect», «Detect», «Respond» and «Recover» (see figure on the right). FINMA addresses these five functions in marginal numbers 135.7 to 135.11.

The new requirements for IT risk and cyber risk management will be reviewed by the external audit firm engaged by FINMA in 2017/2018.

FINMA requirements for IT risk management
The IT risk management concept should, at a minimum, include the following aspects:
- Overview of the network infrastructure and IT landscape inventory (including interfaces with third parties)
- Definition of roles, tasks and responsibilities
- Systematic process to identify and assess IT risks (including in connection with outsourcing)
- Raising employees’ awareness of IT risks

The new requirements apply to all banks irrespective of their size and business activities. The measures in connection with the IT risk management concept must be in line with the business and IT strategy. The bank’s risk tolerance must also be taken into account in this context.

FINMA requirements for cyber risk management
The cyber risk management concept should include the following minimum aspects in particular:
- Identifying the threat of cyber attacks
- Protecting the business processes and technology infrastructure
- Timely recognition and documentation of cyber attacks
- Timely and targeted response to cyber attacks
- Timely restoration of normal business operations

With these adjustments to the circular, FINMA has set out requirements for explicit cyber security measures for the first time.

Banks must be able to demonstrate that they can identify potential cyber attacks, protect their key business processes and technology infrastructure against cyber attacks, recognize cyber attacks in a timely manner and initiate targeted measures in response to such attacks.
FINMA Circular 2008/21, Annex 3 - Client data management and confidentiality is a management responsibility

Key points
The revised FINMA Circular 2008/21 “Operational risks at banks” entered into force on 1 July 2017. Annex 3 contains only minor revisions and still comprises nine principles and a number of guidelines on proper risk management related to the confidentiality of client data processed and stored electronically. Those principles mainly deal with confidentiality incident risks that may occur also in view of the business models the financial organizations are running.

Data leakage prevention triggers
- Business drivers
  - Digitalization (internal and external)
  - New distribution channels
  - Consumerization in the banking and insurance industry
- Information and cyber security
- Regulatory requirements
  - Circular 2008/7 outsourcing
  - Circular 2008/21 operational risks at banks
  - Additional domestic and foreign regulatory requirements
- Legal and privacy requirements
  - Data Protection Act (Swiss and EU)
  - Additional domestic and foreign legal requirements

Data loss safeguards
- Data protection policies
- Asset/data management
- Data governance
- Technology in addition to people and process measures

EY’s conceptual data protection model

Data Protection Program Components

<table>
<thead>
<tr>
<th>Employees</th>
<th>Ex-Employees</th>
<th>Partners/Contractors</th>
<th>Hacker</th>
</tr>
</thead>
<tbody>
<tr>
<td>Data Protection Governance</td>
<td></td>
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<tr>
<td>Personnel Security</td>
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<tr>
<td>Awareness &amp; Training</td>
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<td>Privacy Management</td>
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<td>Configuration Management</td>
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<tr>
<td>Data in Motion</td>
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<tr>
<td>Perimeter Security</td>
<td>Data Leakage Prevention</td>
<td>Email Encryption</td>
<td>Auditing &amp; Monitoring</td>
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<tr>
<td>Data in Use</td>
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<tr>
<td>Rights Management</td>
<td>Data Leakage Prevention</td>
<td>Identity &amp; Access Management</td>
<td>Auditing &amp; Monitoring</td>
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<td>Public Key Operations</td>
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<td>Data Obfuscation</td>
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<td>Data-at-rest</td>
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<td>Database Encryption</td>
<td>Data-at-rest Encryption</td>
<td>Mobile Data Encryption</td>
<td>Data Leakage Prevention</td>
</tr>
</tbody>
</table>

Data Classification
- Data Management/Monitoring/Auditing & Reporting
- Data Governance/Compliance

Source: Data Leakage Protection (10/2012), Swiss Banking Association (SBA)
Client Data Management – Financial services organizations must improve infrastructure to secure and protect client data

Observations & consequences

- The list of regulations continues to grow, and in response, compliance initiatives expand and consume corporate resources.
- The increase in outsourcing of IT and business processes, as well as their management on behalf of third parties, entails new tasks and new rights, obligations and competencies; service providers are often unaware of the obligations to which their customers are subject and the impact this has on providing services.
- Wise segregation of client identifying data is a powerful internal control, minimizing the potential impact on regulatory compliance and the reputation of the organization.
- Appropriate segregation of duties is often not enforced and toxic combinations will continue to be a key (regulatory) issue for most (if not all) of the Swiss institutions in future years. Therefore, a well defined and pragmatic approach is necessary.
- Some FS organizations are leveraging organizational/technical safeguards as enablers to make the operational model evolve, fulfilling the call for optimization.
- Business, Legal, Compliance, and Security involvement will remain critical to ensure program success.

Management agenda & prioritization

- How exposed are you to risks due to the involvement of third parties delivering services to your organization?
- What are your most valuable data assets, where, in which format, and by whom are they stored?
- Are you applying a holistic view on data with data in motion, data in use and data at rest?
- What does your target data architecture look like and is it suitable to support your company’s future challenges?

- Start Client Data Management programs as soon as possible
- Make sure you get the scoping right
- Be mindful of third parties that are handling data on your behalf as compliance duties on client data management remain within the bank’s remit.
Risk Data Aggregation and Risk Reporting – component of the risk management framework in accordance with FINMA Circular 2017/1 – BCBS 239 principles offer guidance

Key points
- Reliable and targeted risk data aggregation and reporting are essential for a well-functioning risk management system. The new FINMA Circular 2017/1 Corporate Governance – Banks therefore requires rules to this effect in every bank’s integrated risk management framework
- For larger institutions, these rules must include, in particular, information on the data architecture and IT infrastructure that allows a timely risk analysis and assessment across all of the bank’s significant risk categories under normal conditions as well as in periods of stress
- Irrespective of the size of the institution, the principles for the effective aggregation of risk data and risk reporting (BCBS 239) offer valuable support in implementing the requirements for a framework pursuant to Circular 2017/1. The BCBS 239 principles are also mandatory for some institutions
- The 14 defined principles of BCBS 239 are designed to support banks and supervisory authorities in meeting the following objectives. These include:
  - Enhancement of the infrastructure for reporting key information, that is in particular used by the board and senior management to identify, monitor and manage risk. Ultimately, the goal is to reduce the probability and severity of losses resulting from risk management weaknesses
  - Ensuring faster availability of information and the capability of producing ad hoc reports and “slicing and dicing” (arbitrary selecting and filtering of data) since it is possible to maneuver flexibly within the various dimensions of the data universe
  - Improvement of the effectiveness and efficiency of the decision-making process throughout the banking organization, from strategic planning to operational management of the risks of portfolios, products and services

Observations
- The definition, recording and reporting of risk data and its components need to be diligently executed across the institution and down to the ultimate source
- Data precision of the risk data should be just as robust as that applicable to accounting data
- In order to ensure the adaptability of data views to address ad hoc data requests along arbitrary views, the dimensions by which data shall be aggregated and sliced needs to be determined

Prioritization
- Ensure that a consistent process regarding risk data is in place bank-wide
- Define clear success criteria in order to measure and report on the maturity of your risk data aggregation and risk reporting
- Plan an independent assessment of compliance with the BCBS 239 principles
Cyber threats/cybersecurity/cyber resilience

Key points
The advent of the digital world and its inherent interconnectivity has generated a new playing field of vulnerabilities. What we used to know and do are no longer sufficient to protect us from the onslaught of new and emerging cyber threats and attacks, which could lead to brand and reputation damage, loss of competitive advantage, legal/regulatory noncompliance and steep financial damage.

- Cybersecurity is far beyond an IT-only issue
- Organizations worldwide now recognize that cybersecurity risks are a top-three concern for organizations
- Business-as-usual activities, such as new product launches, mergers and acquisitions, and market expansion now have a cyber dimension
  The adoption of mobile and cloud-based operations and services dramatically increases and changes the risk landscape of our professional and personal lives
- We live and operate in an ecosystem of digitally connected entities, people and data, increasing the likelihood of exposure to cybercrime.

Financial authorities and regulators worldwide, including FINMA (see comments on FINMA Circular 2008/21), have recently placed more focus on cyber threats, the associated risks and the countermeasures FIs are taking.

In the UK, the Financial Authorities have defined the CBEST testing framework to deliver controlled, bespoke, intelligence-led cyber security tests. The tests replicate behaviors of threat actors, assessed by government and commercial intelligence providers as those posing a genuine threat to systemically important FIs.

Another example addressed to FIs is the NIST Cybersecurity Framework for improving critical infrastructures, which relies on a variety of existing standards, guidelines, and practices to enable critical infrastructure providers to achieve resilience. This framework is increasingly referenced and used as a basis by different regulators around the world, including FINMA (see also the comments on FINMA Circular 2008/21)

Can you answer “yes” to these five key questions?

![Diagram showing the relationship between Complicate, Detect, Educate, and Respond]

- Complicate
  Complicate an attacker’s ability to achieve their objective

- Detect
  Establish capabilities to detect the attack before meaningful business impact is accomplished

- Respond
  Effectively and efficiently respond to and remediate an attack

- Educate
  Maintain a security conscious workforce
Business Continuity Management

Key points

- The Swiss Bankers Association’s (SBA) self-regulatory guidelines are aimed at its members and contain best-practice recommendations to be used in the preparation of an institution-specific BCM policy; policies should take into account the specific circumstances of the institution in question, in particular its risk situation and systemic relevance.
- Three sections of these recommendations are recognized by FINMA in its Circular 2008/10 “Self-regulation as a minimum standard” and are regarded as binding minimum standards under supervisory law, compliance with which is verified by auditors; the definition of a Business Continuity Management Strategy (section 4.4), the completion of a Business Impact Analysis (BIA) (section 4.5.1) and the formulation of Business Recovery Options (BRO) (section 4.5.2) are binding.
- BRO are defined as follows: “Definition of the fundamental procedure for maintaining or restoring continuous business activity in the event of a loss of critical resources (including a definition of risk acceptance, analysis of potential courses of action and fundamental decisions on the provision of replacement resources); BRO are based on the BIA and form the basis for Business Recovery Plans.”
- Periodic review of the BIA is required: “Yearly review of the BIA, and the type and scope of this review should be geared in particular towards the institution’s specific risk situation.”

Relevant FINMA and SBA regulations

- FINMA Circular 2008/10 “Self-regulation as a minimum standard” Self-regulation of the Swiss Bankers’ Association
- Margin no. 7 “Recommendations for Business Continuity Management (BCM)” of August 2014, limited to subsections:
  - 4.4 “Business Continuity Management Strategy”
    - 4.4.1 “Business Impact Analysis”
    - 4.4.2 “Business Recovery Options”

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The updated FINMA Circular 2008/10
“Self-regulation as a minimum standard” with regard to the binding minimum Business Continuity Management (BCM) requirements has been in force since 30 September 2014.
Outsourcing/offshoring - Lack of risk prioritization leads to greater scrutiny for regulated institutions

**Key points**

- Offshoring or outsourcing to service providers continues to be on the rise. IT and infrastructure services, and increasingly business processes as well, are being partially or fully outsourced.
- Service providers are often unaware of the regulatory and legal obligations which their customers are subject to.
- Service recipients remain fully accountable for outsourced processes, but rarely have a full overview of what is outsourced to which party.
- With the number of outsourcing and offshoring activities increasing by the day, it is essential to have an overview of the service providers engaged across the organization and to assess and monitor the risks of each outsourcing arrangement (both for the service provided and the third-party provider as an organization).
- Many service providers themselves employ subcontractors to carry out the agreed service. Services are also increasingly performed by other group companies. These developments require organizations to establish an end-to-end overview of the interrelated outsourcing arrangements in order to take accountability for the outsourced services.

**Expected regulatory changes**

- Regulatory requirements for outsourcing are tightening. FINMA has recently updated its circular on Outsourcing (former Circular 2008/7, new Circular 2018/3). The updated circular includes a tightening of the rules for
  - outsourcing between group companies;
  - maintaining an inventory of outsourcing arrangements - also for sub-contractors;
  - reference to the Data Protection law for client data confidentiality;
  - Access to outsourced information abroad in case of a resolution; and
  - rights to audit at service providers.

The new requirements enter into force in April 2018 for all new or changed outsourcing agreements. Banks have to ensure compliance with the new requirements for existing outsourcing agreements within five years. See Chapter 8 for details of the expected changes. In addition, changes to FINMA Circular 2008/21 “Operational Risks” setting out requirements for IT and cyber risk management were adopted in mid-2017. These apply in addition to the requirements on the handling of customer data defined in Annex 3 of the circular. Both sets of requirements apply equally to outsourced services.

- The EU General Data Protection Regulation (GDPR) which will take effect in May 2018 will also apply to Swiss companies that process personal data of persons resident in the European Union. The requirements of the GDPR are wide-reaching with significant penalties for non-compliance. Accountability for compliance cannot be delegated. Therefore, if services are outsourced or moved offshore, a service recipient must ensure that its service providers also implement the requirements.

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**Have you asked yourself:**

- What is our approach to installing a common sourcing strategy and outsourcing and offshoring framework?
- Do we have a clear picture of the main objectives and drivers of our sourcing strategy?
- Do we have an overview of what services are provided to us by which party? Do we know our service providers’ subcontractors?
- Do we know the relevant risks associated with the outsourced processes and individual service providers?
- Do we have a clear view on how to mitigate those risks and control outsourced processes and the responsible service providers?
- Do we have sufficient confidence in our supervision of service providers in line with regulatory requirements such as FINMA Circulars 2018/3 and 2008/21 Annex 3?
- Do we have fallback scenarios in place in case third-party providers do not deliver as agreed or operations seize altogether?
Conduct risk - FINMA to make sustainable positive impact on the conduct of financial institutions

Key points

- Regulators world-wide continue to list conduct risk as one of the main contemporary risks within the financial services industry, with a clear trend to holding management and individuals accountable.
- Main objectives of the regulators are to:
  - secure an appropriate degree of protection for consumers;
  - protect and enhance the integrity of the financial system; and
  - promote effective competition.
- Conduct risk management remains in the spotlight for financial institutions:
  - from a customer conduct perspective as new compliance and conduct risks are derived from customer protection regulation and enhanced customer expectations; and
  - from a market conduct perspective as a result of the ongoing regulatory focus on MAR, MiFID II/ MiFIR, EMIR and SMR, all of which have significant conduct related elements.
- FINMA focus is on the holistic coverage across all lines of defense and more emphasis on responsibility of front office and risk culture. Anti Money Laundering, Cross-border, Market Integrity and Suitability are named priorities.
- One of FINMA’s the strategic goals for 2017 to 2020 is to make a “sustainable positive impact on the conduct of financial institutions, especially in AML prevention”.
- In September 2017 FINMA launched a consultation on the amendments to the Anti Money Laundering Ordinance. Under the proposals, the verification of information on beneficial ownership and the regular updating of client information will become mandatory.
- Firms continue to invest to improve their risk culture and to set aside substantial sums to cover potential penalties and associated redress costs. This demonstrates to all stakeholders that the culture within the industry is changing which is important to rebuilding and sustaining trust across customers and markets.

Challenges

- Demonstrate effective identification, management and mitigation of conduct risk.
- Firms (and management) are made responsible for failures.
- Holistic coverage across all lines of defense, more emphasis on responsibility of front office and risk culture.

Our holistic approach

EY is committed to helping companies integrate conduct risk into the wider framework, demonstrate how customers are being protected and meet demands based on:

- A sound risk culture of integrity and treating stakeholders fairly, which complements the existing risk framework by addressing the root causes and more dynamic aspects of risk.
- A robust, kept-fit-for-purpose set of controls to continually mitigate and monitor conduct risk.
- A risk framework that leverages predictive analytics in order to quantify conduct risk exposure and allow proactive identification of inadequacies and failures in business conduct and fraudulent behavior.
Conduct risk – Holistic approach to conduct risk

Three major risk culture challenges

EY is committed to helping companies integrate conduct risk into the wider framework, demonstrate how customers are being protected and meet demands based on:

- A sound risk culture of integrity and treating stakeholders fairly, which complements the existing risk framework by addressing the root causes and more dynamic aspects of risk

- A robust, kept-fit-for-purpose set of controls to continually mitigate and monitor conduct risk

- A risk framework that leverages predictive analytics in order to quantify conduct risk exposure and allow proactive identification of inadequacies and failures in business conduct and fraudulent behavior

Integrating conduct risk into everyday decisions and systems
Conduct risk - Risk culture in key situations

To identify, manage and monitor conduct risk effectively, companies must focus on the real source of the risk: the human behavior and decision-making processes of their employees.

The corporate culture, as a set of shared values, is the foundation on which risk decisions are based, regardless of the official risk management policies.

Since the start of the global financial crisis, risk management errors have resulted in banks being subject to substantial fines in excess of USD 100 billion. In addition to these settlement payments, various banks faced loss of reputation, regulatory sanctions, loss of confidence from stakeholders and a significant decrease in their enterprise values.

The risk that the way in which a firm and its staff carry out business results in unfavorable outcomes for consumers, market integrity or effective competition is defined as conduct risk.

**Relevant drivers of conduct risk**

**Inherent factors**
- Information bias
- Information asymmetry
- Inadequate financial capacity

**Structures**
- Conflicts of interest
- Culture and incentives
- Ineffective competition

**External factors**
- Changes in regulatory guidelines
- Technological advances
- Economic trends and market tendencies

EY can help companies integrate conduct risk into their wider framework on the basis of the following:

1. Determining a risk tolerance level in order to define an adequate risk appetite.
2. Identifying key situations or moments that matter (MtM), i.e., risk decisions that have a disproportionately high influence on the final results. These are instances your employees experience on a daily basis when they have to apply their own judgment to make risk-related decisions.
3. Assessing the current state and identifying influencing factors in order to pursue change efforts based on the underlying behavioral causes.
4. Elaborate the desired target behavior and decisions in MtM.
5. Establish organizational risk mechanisms to support appropriate risk behavior and correct decision-making in MtM:
   - Risk culture (integrity, fair treatment of stakeholders)
   - Management (rewards, employee careers)
   - Incentives (role model function of management, risk behavior standards)
   - Risk framework (quantification of the conduct risk exposure, identification of misconduct)
   - Organization (clear roles and responsibilities)
6. Continuous quantification and monitoring of the risk culture based on scorecard evaluations on risk reporting and performance and predictive analyses.
Conduct risk - risk and control enhancements

Firms need to identify the MtMs that are fundamental for their conduct risk exposure based on industry best practice analysis and leveraging existing approaches in the organization, such as risk and control self-assessments and process maps.

EY can help companies enhance their existing risk and control framework with effective controls in order to counteract conduct risk:

1. Analysis of the existing risk catalog for potential additional conduct risk aspects and their consequences for customers or the market
2. Identification of relevant additional risk categories and clear definition of potential risk scenarios
3. Evaluation of risk scenarios across the process landscape and identification and prioritization of MtMs
4. Revision of existing and definition of suitable additional key controls that are effective for the MtMs
5. Implementation of the defined controls across the process landscape

In order to manage conduct risk effectively and efficiently, we recommend using the existing risk and control framework enhanced by the inclusion of conduct risk aspects.
Conduct risk – Predictive analytics

Three major risk culture challenges
Analyses based on individual human expertise are often subjectively biased, susceptible to tunnel vision and can lead to the misassessment of risks. In contrast, EY’s powerful analytics approach will enable you to preemptively protect your organization and your clients from conduct risk and to take advantage of new business opportunities:

- Data-driven analytics can provide independent, deeper insights that tell you where to expect your next conduct risk case or exposure
- With predictive analytics, you can make more timely and accurate decisions about what policies, processes and systems you need to implement or enhance based on more precise impact assessments
- Advanced analytics can help you expose networks of perpetrators who have so far outsmarted conventional controls and escaped detection

EY’s predictive analytics solution approach

- Are you mainly relying on individual human expertise to interpret data and draw conclusions about risk?

Factor selection/Fine-tuning

Collect potential factors
- Autonomous or manual
- Trades
- Behavioral profiles
- Compliance breaches etc.

Apply predictive engine
- Scoring model
- Output

Auto-learning/Self-calibrate

Assess & transfer results

- Calculate a white-box score using
- Rules
  - Machine learning algorithms
  - Ensemble methods
  - Regression statistics
  - ...
- Optimize the analytics model
- Update profiles

- Obtain as much data as possible and potentially relevant for predictive analysis, internal, external, structured or unstructured
- No expert-based pre-weighting of factors required
- Labeled or unlabeled data

- Interpret scoring results
- Evaluate the white-box calculation rationale
- Display output to users using dashboards, reports or other apps
- Calibrate model parameters
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Reporting and Accounting
IFRS 9 - Financial instruments

Key points for classification
- Classification is a matter of fact and is not based on intentions
- Only relatively simple instruments in the right business model qualify for amortized cost measurement
- Liquidity buffers might not qualify for the amortized cost model as they are in a hold to collect and sell business model
- Derivatives embedded in financial assets are no longer bifurcated; instead, the entire financial asset is measured at FVTPL
- The classification of liabilities as well as most criteria for applying the fair value option (FVO) remain the same
- For liabilities to which the FVO is applied, fair value changes due to an entity’s own credit risk are recognized in OCI unless it creates or enlarges an accounting mismatch

<table>
<thead>
<tr>
<th>Contractual cash flow characteristics</th>
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<tr>
<td></td>
<td>yes</td>
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<tr>
<td>Hold financial assets in order to collect contractual cash flows</td>
<td>Amortised cost</td>
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<td>Hold to collect contractual cash flows and sell financial assets</td>
<td>FVOCI</td>
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<tr>
<td>Neither of the above</td>
<td>FVPL</td>
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</table>

Key points for hedge accounting
- IFRS 9 hedge accounting aims to better reflect the impact of risk management in the financial statements
- No quantitative retrospective bright line tests for the hedge effectiveness; however, the hedge ineffectiveness still has to be measured and recognized
- IFRS 9 broadens the scope of eligible hedged items, for example in the area of risk components and groups of items
- Option to continue applying the hedge accounting requirements of IAS 39 until the IASB has finished its macro hedging project

Risk management strategy and objective

| Economic relationship | Credit risk does not dominate | Hedge ratio does not create ineffectiveness |

In July 2014, the IASB issued the final version of IFRS 9 ‘Financial Instruments’. The standard will be effective on 1 January 2018 with early adoption permitted
- IFRS 9 concludes the IASB’s projects to replace IAS 39, bringing together the three aspects of accounting for financial instruments (classification and measurement, impairment, and hedge accounting)
- In October 2017 the IASB has amended IFRS 9 to allow for certain financial instruments to be measured at amortised cost or fair value through comprehensive income, even if it contains an early repayment clause that can give rise to negative compensation from the perspective of the issuer.
The IASB has published the following webcasts focusing on the application of the IFRS 9: incorporating forward-looking information in the application of the Expected Credit Loss impairment requirements; application of impairment requirements for revolving facilities under IFRS 9.

In December 2015 the Basel Committee on Banking Supervision (BCBS) issued the Guidance on credit risk and accounting for expected credit losses, which aims to set out supervisory guidance on sound credit risk practices associated with the implementation of ECL accounting models for banks’ lending exposures.

In March 2017 the BCBS issued the final standard for the Regulatory treatment of accounting provisions — interim approach and transitional arrangements for expected credit loss (ECL) models.

Key points for impairment

- The incurred loss model of IAS 39 was criticized for its lack of timely recognition of credit losses and the absence of useful and relevant forward-looking information
- The expected credit loss (ECL) model of IFRS 9 seeks to address those weaknesses by requiring the recognition of a credit loss allowance for all financial assets based on ECLs, as well as through enhanced disclosures on ECLs and related credit risk
- On initial recognition, an entity will recognize a loss allowance based on ECLs from default events possible within the next 12 months
- IFRS 9 likely increases the loss allowance on transition
- If the credit risk increased significantly since initial recognition, an entity will then recognize ECLs resulting from all default events that are possible over the entire life of the asset
- The Transition Resource Group, which has been set up by the IASB, has held three meetings during 2015 to discuss implementation challenges arising on the new impairment requirements following the issue of IFRS 9.

The Enhanced Disclosure Task Force and the Basel Committee for Banking Supervision have issued recommendations and guidelines that entities should consider

FINMA is looking into the new model as a potential requirement for all Swiss banks
IFRS 15 - Revenue from contracts with customers

Key points
- The IASB and FASB (the Financial Accounting Standards Board) have issued a converged, principles-based revenue standard
- IFRS 15 is more prescriptive and contains more application guidance than the current revenue standard
- Specifically, the standard provides more guidance on multiple element contracts and variable consideration
- There is no one-size-fits-all approach for transition

Banking & Capital Market considerations
Services that are in scope of the standard (not exhaustive):
- Asset management services
- Portfolio management and custody services
- Cash management and payment processing services
- Administration services for customer deposit accounts (for example ATM fees)
- Credit card interchange and reward programs

Applying IFRS 15 may bring the following challenges:
- Fees, specifically performance and some asset based fees, may be classified as variable consideration; variable consideration will not be recognized as revenue until it is highly probable that a significant reversal in the amount of cumulative revenue will not occur
- The recognition of upfront fees, for example for the issuing fund units, depends on whether the fees relate to a separate performance obligation, for example separate from asset management fees
- Incremental costs of obtaining a contract will be recognized as an asset if the costs are expected to be recovered

Step 1: Identify the contract(s) with a customer
Step 2: Identify the performance obligations in the contract
Step 3: Determine the transaction price
Step 4: Allocate the transaction price to the performance obligations
Step 5: Recognise revenue when (or as) each performance obligation is satisfied
IFRS 16 – Leases

Key points
- Lessees will have a single accounting model for all leases, with exemptions for leases of ‘low-value assets’ and short-term leases
- Under this model, all leases, including those currently classified as operating leases, will be on balance sheet as right-of-use assets with corresponding lease liabilities
- Sale-and-leaseback transactions will also result in the recognition of a right-of-use asset with a corresponding lease liability
- Lessor accounting is substantially unchanged
- A contract is, or contains, a lease if:
  - There is an identified asset (explicit or implicit)
  - The contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration, i.e. throughout the period of use the customer would have the right to direct the use of the identified asset and obtain substantially all of the economic benefits from directing its use

Main impacts
The main impacts for lessee accounting are summarized below:
- The recognition of right-of-use assets and corresponding lease liabilities will increase total assets; this will likely have an impact on debt/equity and other balance sheet related KPIs.
- The right-of-use asset for tangible assets needs to be included in the risk-based capital and leverage ratio denominator which results in a decrease in capital ratios.
- Operating expenses for leases will decline, however amortization and interest expenses will increase
- Amortization and interest expense are separately recorded; a front-loading impact may decrease net profit in the early stages of a lease
- Principal payments are shown within financing activities, interest payments are presented according to chosen policy in line with IAS 7; this presentation will generally increase operating cash-flow

Lessees and lessors will have additional disclosure requirements compared to current accounting.
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Prudential and Supervisory Authority
FinIA - Financial Institutions Act

Background
The Federal Council has stated¹: “With the FinIA, supervision of all financial service providers who operate an asset management business in any form whatsoever is to be governed in a uniform piece of legislation. In principle, the rules for financial institutions that already require a license under existing law will be taken over from the applicable pieces of legislation without any material changes being made, but they will be harmonized in a differentiated manner according to their activity. The managers of individual client assets as well as those who manage the assets of Swiss occupational benefits schemes will also require a license in the future.”

Subject Matter and purpose from the Federal Act on Financial Institutions²
Article 1 Object and purpose
1. This Act governs the requirements for acting as a financial institution.
2. Its purpose is to protect the investors and clients of financial institutions, and the proper functioning of the financial market.

Plan

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| Planned set into force | 2019 |

Key points
- Supervision over all financial institutions in asset management
- Asset management regarding assets of people with whom the asset manager has business or family ties as well as solely within the context of employee participation schemes are not in scope of this act
- Supervision
  - By FINMA: Securities firms, manager of collective assets, fund management companies
  - By an oversight authority according to the Financial Supervision Act: Asset managers, trustees
- Grandfathering clause
  - FIs already possessing authorization for the corresponding activity are not required to obtain new authorization (fulfilment of FinIA’s requirements within one year of its entry into force)
  - Asset managers for individual portfolios who have performed their activity for at least 15 years shall not be required to obtain new authorization if they do not accept new clients

¹ Source: http://www.admin.ch/aktuell/00089/index.html?lang=de&msg-id=53561
² Source: http://www.news.admin.ch/NSBSubscriber/message/attachments/41570.pdf
No major material changes (compared to today’s BA, SESTA, CISA) for
• banks
• securities dealers
• fund management companies
• asset managers of collective investment schemes
• Securities dealers renamed to security firm (“Wertpapierhaus”/“maisons de titres”)

Approval cascade of financial institutions

Key terms
• The asset manager manages individual portfolios or only limited collective investment schemes (only for qualified investors or below specific thresholds)
• The trustee manages the separate fund, ensures its value is maintained and employs it in a restricted manner
• The manager of collective assets manages commercially asset on behalf and on the account of collective investment schemes and pension schemes
Introduction

Background
In view of the growing importance of outsourcing in the banking and insurance sectors, FINMA has revised the provisions of Circular 2008/7 “Outsourcing - banks”. FINMA’s principle-based technology-neutral approach to supervision has been maintained and the text of the circular streamlined. The requirements for banks, securities dealers and insurance companies have been harmonized. The completely revised circular has been published for consultation which ended on 31 January 2017. On 5 December 2017, FINMA published the final version of the new circular 2018/3 «Outsourcing - Banks and Insurers». It will enter into force on 1 April 2018. Outsourcing arrangement of banks and securities dealers that existed prior to the entry into force of the circular have to be adjusted within a transition period of five years.

Main Goal of Circular 2018/3 «Outsourcing - banks and insurers»
Harmonizing the regulatory requirements for outsourcings of banks, (re)insurance companies and securities dealers in a single circular.
The new FINMA Circular 2018/03, which will enter into force on 1 April 2018 now also applies to insurance companies. Outsourcing arrangements of banks and securities dealers that existed prior to the entry into force of the circular have to be adjusted within a transition period of five years to ensure that the requirements of the circular are complied with.

In general, the requirements of the new circular also apply to intra-group outsourcings. However, the requirements regarding the selection, instruction and control of the service provider as well as the requirements for outsourcing agreements may be limited within a group, provided that the risks typically attached to outsourcing do not exist or if specific requirements are not relevant or are taken into consideration in a different manner (risk-based approach).

Companies belonging to the supervisory categories 1 to 3 (have to) establish an independent risk control and compliance function that operate as independent control functions. Operational risk management and compliance tasks may be outsourced regardless of the supervisory category of the company.

An inventory of all outsourcings (including subcontractors) must be kept.

Data protection and banking secrecy topics have been deleted in order to avoid redundancies with the separate legislation on these topics.

A company may only outsource services abroad if the service provider can ensure that the company, its auditing company and FINMA can exercise and enforce its inspection and auditing rights (individual responsibility of the institutions).

The criterion of “materiality” of functions, which must be fulfilled for outsourcing to take place in accordance with the circular, is rephrased and examples are not listed anymore. The new circular defines a outsourced function as material, if compliance with it significantly depends on the objectives and regulations of the financial market supervision legislation.

Comments

- The new circular does not contain detailed regulation on numerous aspects (e.g. the definition of materiality of functions) and leaves this to practice in the future. FINMA thereby relies heavily on a principle-based approach and the individual responsibility of the institutions.

- The banking secrecy and the data protection regulation typically require certain organizational measures and the consent of the client to exchange his personal data. These provisions apply regardless of the qualification as an outsourcing arrangement according to the new circular. Since the reference to these provisions is deleted from the recitals of the new circular, it is questionable whether it will remain a regulatory duty to be audited according to the new circular under supervisory law.

- Drafting an inventory of all outsourcing arrangements and sub-delegates will be a challenge especially for larger institutions. Further, it will remain a challenge to integrate the sub-contractors into the overall outsourcing concept. This integration is expected by FINMA. The revised Circular states that the obligations and warranties of the service providers, which are necessary for the fulfilment of the circular, are binding upon them.

- FINMA-circular 2008/21 (operational risks) which has entered into force in a revised version in September 2016, is a separate regulation and therefore requires additional consultation.

- In the event of new outsourcing arrangements, the Swiss Data Protection Act (expected to enter into force in the course of 2019) and the European General Data Protection Regulation (entering into force on 24 May 2018) have to be taken into consideration.
Corporate Governance
FINMA-circular 2017/1

Introduction

Background
FINMA has revised its corporate governance requirements for banks by consolidating the provisions of circular 2008/24 ("Supervision and internal control - banks"), the associated FAQ, and requirements defined in other circulars into a new circular 2017/1 entitled "Corporate governance - banks".

The comprehensive revision was motivated by the fact that international standard-setting bodies such as the Basel Committee on Banking Supervision had updated their guidelines for modern corporate governance and effective risk management. Recommendations made by the International Monetary Fund as part of its 2014 Financial Sector Assessment Program were also taken into account.

The new "Corporate governance - banks" circular underlines the importance of modern corporate governance with an institution wide and effective risk management. The circular sets minimum requirements not only for the composition of boards and the qualifications of their members but also for the organization of internal control systems at banks.

FINMA has simultaneously also revised circulars 2008/21 ("Operational risks - banks") and 2010/1 ("Remuneration schemes"). Therein further regulations of governance related can be found. The revised "Operational risks" circular for example introduces new guidelines on managing IT and cyber risks and incorporates the principles from the FINMA position paper “Legal and reputational risks in cross-border financial services”.

Main goal of circular 2017/1 “Corporate governance - banks”
Consolidating the supervisory requirements relating to corporate governance, internal control systems and risk management for banks.

Timeline of circular 2017/1 “Corporate governance - banks”
- Entered into force on 1 July 2017
- Full implementation as at 1 July 2018
In connection with the total revision of FINMA circular 08/24, FINMA circulars 08/21 “Operational risks - banks” and 10/1 Remuneration schemes were partially revised.

The points to be included in the “Corporate governance - banks” circular as overarching requirements were removed from the section of FINMA circular 08/21 on qualitative risk management requirements and transferred to the new circular.

The risk management principle on technological infrastructure was expanded to include IT and cyber risks, and a new principle on risks in cross-border services was introduced.

In addition, the principle on business continuity was expanded to include requirements for maintaining critical services when resolving systemically important banks.
Corporate Governance
FINMA-circular 2017/1

Key implementation topics

1. Principle of proportionality
   - Development of an institution specific interpretation of the principle of proportionality in consultation with the functions risk management, compliance, legal, internal audit
   - This institution specific interpretation is subject to approval by the board of directors as well as the executive board

2. Committees
   - Staffing based on the institution specific top risks
   - For combined audit and risk committees: weighting of topics reflecting the risk profile shall be ensured especially with regard to risk management competencies
   - Regular review of the charter (tasks, suitability of members), of the annual plan as well as coordination between the committees
   - Regular benchmarking of the risk management function (e.g. peer review)

3. Institution-wide risk management framework
   - Regular risk inventory process and documentation of its results (identified items, categorization and assessment of the institution specific risks)
   - Consistent definition of the risk tolerance and risk limits for all key risk categories (among others also for non-financial risks)
   - Regular alignment of the business strategy (i.e. strategic goals) with the risk strategy (among others processes, final checks)

4. Three-Lines-of-Defense
   - Clear positioning of the role of the CRO
   - Definition of the roles and responsibilities of the functions in the 2nd LoD (e.g. Compliance and Risk) as well as their demarcation vis-a-vis the 1st LoD (e.g. Legal and Finance)
   - Strengthening of the risk and control responsibilities in the 1st LoD

Comments

- The main reason for the reshuffling in the three lines of defense risk framework is the new focus on the 1st Line of Defense, which should again take over more responsibility for the overall process (incl. checks).

- The 1st LoD needs easily understandable and efficient checks that can be applied preferably broadly (i.e. also by persons that are not experts).

- In the upcoming transformation process (focus on the 1st LoD), on the one hand risk control and compliance have to be independent, on the other hand they have to maintain appropriate closeness to business. This way they will remain in a position to critically challenge (“credible challenge”). Other key success factors are e.g. education of staff and incentivization of front and compliance.
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