

foreign banks . in switzerland .

Eidg. Finanzmarktaufsicht FINMA
zHv Herrn Daniel Joos
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Zürich, 28 February 2018

FINMA Circular Audit – AFBS Comments

Dear Mr Joos

On 30 November 2017, the FINMA published the draft revision of its Circular Audit for comments. We are pleased to comment on aspects relevant for foreign banks and foreign financial institutes in Switzerland. We do not express ourselves on issues concerning Cat 1 and 2 institutes; our comments reflect the opinion of small and medium sized institutes in Switzerland. We understand our Comments as complementary to those made by the SBA, to the drafting of which our Association contributed.

General Appreciation

The draft Circular addresses many concerns raised in previous discussions with the FINMA on the supervision of Cat 4 and 5 institutes. The AFBS welcomes the initiative to better align the audit activities to the size, business activities, and risk profile of the individual institute.

The revision (in particular the very welcomed proposals in Recitals 86-90 on a reduced audit activity for smaller banks) should not be finalised before the concerns and findings of both the FINMA Kleinbankensymposium and the Swiss Bankers' Association's WG Proportionality have been duly discussed. These initiatives are likely to further affect the regulatory and supervisory framework, and therefore impact risk analysis, audit strategy and audit depth. It will be beneficial to the consistency of the regulatory, supervisory and audit regime if the findings in the Kleinbankenforum, the SBA WG Proportionality on regulatory simplifications, and the comments on the proposed revision of the audit process are discussed by all parties concerned. We recommend putting in place such a discussion forum.

Also, the AFBS stresses that the audit system may be holistically revised, but not fundamentally altered. There is no need to depart from the dualistic system, which is also known in other countries (e.g. Singapore or Luxembourg).

Specific Comments

Deviations from the Standard Audit Strategy for the Base Audit and Additional Audits (Recital 30-31; recital 87, 87.1)

The SBA WG Proportionality and the FINMA Kleinbankenforum recognise the need for a regulation and supervision which concentrates on business activities, risk profile and effective risks of an institute. The "standard audit strategy for the base audit", and the audit requirements for documentation, reports, and disclosure should be aligned to those proposals.

The AFBS agrees that both deviations from the standard audit strategy for the base audit and additional audits are necessary. We invite the FINMA to apply these instruments with moderation and suggest reflecting the extraordinary nature of additional audits in the wording of Recital 31. Deviations from the standard audit strategy and the additional audits are conceived exclusively as add-ons to the base audit. As they increase complexity and cost, they may – if not applied moderately and in a focused manner – undermine the current efforts for cost reduction and enhancement of the efficiency of the audit process.

The draft revision confirms the dual supervisory system. The AFBS welcomes this confirmation. Also not explicitly touched upon in the Circular we recommend that additional audits should be performed in principle by the institute's external auditor unless specific reasons suggest otherwise. Employing a different auditor for an additional audit increases cost and/or lowers the value of the additional audit, as the new auditor needs substantial resources to get acquainted with the institute's activities, internal organisation, policies and procedures and corporate culture. As the number of audit firms is limited, in particular when very specific or highly technical know-how is required, the formal obligation to choose another auditor may lead to weaker audit quality when auditors do not have the necessary know-how.

We suggest amending the wording of Recital 31 accordingly: "Zusatzprüfungen sollen in der Regel von der Prüfgesellschaft durchgeführt werden."

We understand that the FINMA's concern for entrusting an additional audit to a different auditor may be due to the relation between the auditor and the financial institute becoming too close. However, in such a case, the FINMA should take appropriate measures. Auditors are supervised by their own authority, which should address this issue within their supervisory mandate. The FINMA should always (and not only if possible) inform the institute in advance on additional audits and their scope. Recital 31 should be re-formulated accordingly.

Independence (Recital 44.7)

The applicability of the independence requirements (recital 44.1ff) needs to be clarified with respect to financial institutes in Switzerland. The foreign group entity of an international audit firm may advise a foreign mother or sister company of the Swiss institute. This should not fall under the restrictions of recitals 44.3-44.7, if no conflicts of interest are identified.

Cooperation with Internal Audit (Recitals 47.1-49)

The AFBS welcomes the suggestion of recital 47.1 that the external auditor coordinates its work with the internal auditor.

Financial institutes in Switzerland, which are a branch or a subsidiary of a foreign financial institute, are typically audited extensively by the group internal audit. The Circular should also highlight the principle that such a coordination should, on a best effort basis, avoid duplications in the audit coverage.

Notices of Reservation and Recommendations (Recitals 75-76)

The revision of the audit process in 2013 included the obligation of the auditor to report any notices of reservation, irrespective of their materiality, and to abstain from discussing them with the audited institute.

The revised Circular should recognise that, while being relevant to the institute's management (and its audit committee), minor weaknesses in processes and procedures should not be included in the body of the long form report. Low risk notices of reservation according to recitals 75.5 do not affect the bank's reputation nor threaten its financial stability.

While we welcome the more accurate definition of the notices of reservation and recommendations, as well as their levels of materiality in the revised Circular, we believe there is still room for interpretation in the definition, which could lead to an inconsistent output across financial institutions. With the foreseeable multiplication of notices and recommendations, we suggest that the reporting of low risk notices in the long form report should be explicitly excluded by the new Circular. This can be justified as follows:

- For small institutes with limited resources, focus should remain on medium and high risk notices and recommendations;

- For larger banks/groups, more heavily organised in terms of internal rules, policies and regulations, it is likely that the number of notices and recommendations will increase exponentially. Focus should be kept on medium and high risk notices and recommendations also for these categories of institutes.

The formerly known "pre-audits" should be explicitly recognised. Pre-audits are a welcome element of support for the management of a bank, especially in the context of introducing new processes and procedures. They are not a source of conflicts of interest, but can reduce the number of notices of reservation on violations that would be classified as "low". It is sufficient to make the respective recommendations in the pre-audit which allows the bank to react immediately. The FINMA may want to require documentation of such pre-audits.

Audit Strategy Reduced Audit Frequency – Banks (Recital 86-90)

The AFBS welcomes the proposal of the FINMA to reduce the excessively dense audit for Cat 4 and 5 institutes. It nevertheless believes that an efficient audit process requires a continuity of co-operation between the auditor and the institute. Long audit intervals may lead to a loss of important information and an interruption of the inter-temporal audit process. Audit points need then to be reviewed from the beginning, which neutralises the intended cost effect.

Other important questions remain to be discussed related to the responsibility of the auditors and the board of directors during the years in which no audit is made and the international recognition of the system. The suggested approach should also be revised in the light of conclusions of the SBA WG Proportionality and the discussion with the FINMA Kleinbankenpanel.

Recital 103.1

The recital requires the auditor to review the consolidated financial institute's compliance with Swiss and foreign regulations. It needs to be clarified that the recital applies to the group entities of a Swiss bank, located abroad, but not to the foreign group to which a bank in Switzerland belongs.

Recital 106 and 119.1: Cost Budget

The AFBS welcomes the proposal to request audit firms to submit to the FINMA a cost estimate of their audit activities. However, the relevance of budget figures is limited; the final amount due should therefore also be disclosed. A budget's validity is particularly limited in cases where the budget for the Swiss entity is included in a group-wide audit budget.

Apart from the final invoice according to key areas, the human resources invested should also be disclosed. This gives the FINMA a better base to analyse the adequacy of audit bills.

Recital 113.1-120: Audit Strategy Reduced Audit Frequency – CISA firms

The AFBS fully supports the proposed amendments.

We thank you for taking note of our proposals and comments. In case that the FINMA follows our suggestion to postpone the revision and to set up a mixed group discussing a more focussed audit in detail, we would be very happy to participate.

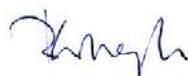
For any questions, please do not hesitate to contact us.

Best Regards

ASSOCIATION OF FOREIGN BANKS IN SWITZERLAND



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