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2008

Annual Report
Key themes

Eidgenössische Bankenkommission
Commission fédérale des banques
Commissione federale delle banche
Swiss Federal Banking Commission

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There are events in history which change the world. Sometimes they are predictable and the impending changes can be planned ahead. Often, however, they appear out of the blue, which results in the change processes being rushed.

Both the extent and the rapid development of the turmoil and subsequent crisis in the financial sector came as a surprise. The signs of the previous year were followed by raging storms that swept aside independent investment banks and brought once proud firms to their knees. The total collapse of the global financial system was only prevented thanks to massive assistance from central banks and government intervention on a hitherto unseen scale. Further shocks cannot yet be ruled out – the losses continue to be reported and the final knock-on costs are still unknown. The failure of the American dream of home ownership for all, even the less well-off, based on cheap money and growing levels of debt set off a chain reaction: plummeting real estate prices were followed by rating downgrades, frozen securities markets, valuation problems, important write-downs, losses, a general loss of confidence, the collapse of the interbank market and ultimately forced capital raising by financial institutions.

Switzerland, with two major international banks, was unable to escape the impact of these developments. Well-prepared steps were taken at an early stage in the form of a package of measures drawn up by the Federal Department of Finance, the Swiss National Bank and the Swiss Federal Banking Commission designed to strengthen the Swiss financial system. However, the individual institutions themselves remain primarily responsible for restoring their credibility in the eyes of their clients. The milestone events of the past year have further consequences, namely that banks' business models have to change. Remuneration structures must be revised to remove incorrect and inappropriate incentives, and banks of systemic importance will be required to carry much higher levels of regulatory capital.

The Swiss Federal Banking Commission passed a special milestone of its own at the end of 2008 with the culmination of well-laid plans for its integration into the Swiss Financial Market Supervisory Authority (FINMA) after 73 years of independence. It has merged with the Federal Office of Private Insurance and the Anti-Money Laundering Control Authority to create a new independent supervisory authority that aims to strengthen confidence in the smooth functioning, integrity and competitiveness of Switzerland's financial centre.

Eugen Haltiner
Chairman

December 2008

On 1 January 2009 the Swiss Federal Banking Commission, the Federal Office of Private Insurance and the Anti-Money Laundering Control Authority were merged to form the Swiss Financial Market Supervisory Authority (FINMA). This means that state supervision of banks, insurance companies, stock exchanges, securities dealers and other financial intermediaries has now been brought under one roof.

The three merging authorities

The legal basis for the new integrated supervisory authority is the Federal Act on the Swiss Financial Market Supervisory Authority (FINMASA), which was approved by parliament on 22 June 2007.

Legal basis

As an independent supervisory authority, FINMA protects the clients of financial markets, namely creditors, investors and insured persons, thereby strengthening confidence in the smooth functioning, integrity and competitiveness of Switzerland's financial centre.

Profile

FINMA has been structured as a public law institution with its own legal identity that has functional, institutional and financial independence. As an autonomous authority it is no longer part of the central federal administration but a legally independent organisation with separate powers. It is financed entirely by the fees and charges levied on the institutions it supervises.[1] FINMA has a modern organisational structure with a Board of Directors, Management Board and audit unit. The Board of Directors is FINMA's strategic body and therefore takes responsibility for strategy development, makes judgements on matters of substantial importance, issues the ordinances delegated to FINMA, decides on circulars and also oversees the Management Board, while itself being responsible for the overall management of FINMA.

Organisation

The partial entry into force of FINMASA's organisational provisions on 1 February 2008 gave FINMA its own legal identity, making it independently responsible for implementing the necessary steps for its further development.

Partial entry into force

At the same time as the partial entry into force of FINMASA on 1 February 2008, the Federal Council appointed seven members to FINMA's Board of Directors. The Board of Directors is chaired by Eugen Haltiner (formerly Chairman of the Banking Commission). The committee was subsequently expanded to nine members as of 1 January 2009 in line with a Federal Coun-

Board of Directors

[1] see Art. 15 FINMASA

cil Decree of 21 May 2008. Exceptionally, two vice-chairmen have been appointed for the period of office between 2009 and the end of 2011.

Director and Management Board

The Board of Directors appoints the director, subject to the approval of the Federal Council. In order to identify a suitable individual for the challenging role of director of FINMA, a recruitment process for the position was launched with a public advertisement in December 2007. The Board of Directors made its decision on 8 May 2008 and appointed Patrick Raaflaub as Director. The Federal Council approved this appointment at its meeting of 21 May 2008. The recruitment process at FINMA Management Board level began at the start of March 2008. The Board of Directors appointed the members of the Management Board on 8 May 2008. Federal Council approval was not required.

Recruitment process

Once the director and the Management Board had been appointed, the internal recruitment process began. All posts were advertised internally, and the FINMA employment contracts were issued in the fourth quarter of 2008.

Project work

The Board of Directors monitored the implementation work carried out during the development phase leading up to the operational launch of FINMA and took any decisions that were required. For example, the Board of Directors defined the primary management level of the organisational structure. It is made up of the Large Banking Groups, Banks / Financial Intermediaries, Integrated Insurance Supervision, Insurance / Sectors, Markets, Legal / Enforcement / International and Services domains. The departments within the individual domains were defined in consultation with the FINMA Management Board. The Board of Directors also approved the Organisational and Business Regulations, the Code of Conduct, the HR directives and the 2009 budget. The balancing act required to combine the project work with day-to-day supervisory activities in the three former authorities presented a particular challenge. Managing the interfaces and coordinating the content and timeframes of the various projects was a very demanding task, which is why the process was closely monitored under the stewardship of the Chairman of the Board of Directors.

Project costs

The three merging authorities contributed a total of CHF 3.5 million in 2008, in proportions relative to their size, to cover project costs. The project costs were at the level envisaged. The Finance Administration loaned FINMA an additional CHF 7.5 million for preliminary investments. These were largely in the area of IT.

Under Art. 13 para. 1 FINMASA, FINMA employs its staff under public law. The legislator has authorised FINMA to issue its own personnel regulations. Under Art. 13 para. 2 FINMASA, the Board of Directors sets out the employment relationship in an ordinance that was approved by the Federal Council on 27 August 2008. The Board of Directors designed the FINMA staff ordinance to have a stronger focus on performance compared to the Federal Administration, coupled with flexibility in terms of remuneration.

Personnel regulations

The Federal Council issued two implementing ordinances relating to FINMASA that entered into force on 1 January 2009. These are the ordinance governing the levying of fees and charges by FINMA and the financial market audit ordinance. Fees and charges are largely based on the previously applicable fee arrangements of the Banking Commission, the Federal Office of Private Insurance and the Anti-Money Laundering Control Authority. FINMA's finance and accounting unit seeks to allocate costs by applying the "originator pays" principle wherever possible. The financial market audit ordinance groups together the provisions governing financial market auditing in a single ordinance.

FINMASA executing ordinances

With the full entry into force of FINMASA on 1 January 2009, FINMA took over operational supervisory activities at the existing locations of the three merging authorities. The move to a joint FINMA location at Einsteinstrasse in Bern is scheduled for the second quarter of 2009.

Operational launch of FINMA

II. Banking Commission is history

Key issues the same then as now

The Banking Commission passed into legal history on 31 December 2008 when it was replaced by FINMA, thereby missing out by just over a year on its 75th anniversary and the celebrations this landmark would otherwise have involved. And who knows, perhaps there are economic historians who will one day recognise its achievements and actions or its failings and inactions. The financial world has changed radically since the Banking Commission was founded, and the financial centre has developed and expanded on a huge scale. Not everything has changed, however. Coincidence or not, some of the key issues facing the financial centre when the Banking Act was created remain relevant to this day.

Global banking crisis and chaos then

The main driver behind the creation of the Banking Act was the global banking crisis that followed the 1929 crash. The crisis also hit Switzerland and the large Swiss banks, which had to post massive write-downs on the value of their foreign assets. As a result, the Swiss Confederation had to supply Swiss Volksbank with liquidity and finally support it at the end of 1933 by rushing through emergency legislation to provide capital amounting to 20% of government spending at that time. In 1985 Federal Councillor Otto Stich, a former member of the Banking Commission, commented on the circumstances surrounding the establishment of the supervisory authority in his foreword to the Commission's 50th anniversary publication: "The Swiss Federal Banking Commission was a child of necessity: almost as soon as it came into being it had to play its part, under difficult conditions, in maintaining the Swiss banking system." The seriousness of the situation is clear from the brief statement with which Federal Councillor Edmund Schulthess, the first Chairman of the Banking Commission, welcomed the members to their first meeting in April 1935: "Our task will not be easy, particularly if the economic situation should become even more acute. We must do everything in our power to maintain our banking system. We must also have the courage to intervene whenever and wherever appropriate, but in a circumspect and cautious manner; otherwise we could do more harm than good."

Global banking crisis and chaos now

The end of the Banking Commission's activities is also marked by a global banking crisis. The triggers were different this time and the crisis spread more rapidly, but the similarities are striking. All over the world, globally operating banks are the first to be heavily impacted and have to be backed with previously inconceivable amounts by government funding. The large Swiss banks are again affected and in October 2008 one of the two remaining large banks, UBS, had to be supported in a concerted action of the Swiss Confederation, the Swiss National Bank and the Banking Commission.

Protection under criminal law against breaches of "bank-client confidentiality" was also enshrined in the 1934 Banking Act and has remained in place ever since (Art. 47 BankA). It protects bank clients (not the banks) against the disclosure of their banking relationships to third parties provided there is no legal justification for it. The motivation behind the newly introduced protection were encroachment and snooping by finance and tax officials from neighbouring countries. Bank-client confidentiality has since gained almost mythical status, and as a result has repeatedly been the subject of debate. The Swiss authorities have made huge efforts over the last 30 years to maintain the privacy protection of bank clients. At the same time, however, they have sought to open up legal paths to meet the legitimate information requirements of domestic and foreign authorities. The Banking Commission has also played its part, for instance with regard to the issue of administrative assistance under the Stock Exchange Act or in extraordinary situations such as the debates over the assets of foreign dictators or dormant assets belonging to victims of the Holocaust.

Concerns over bank-client confidentiality then

Nevertheless, the discussions over the proper scope and structure of bank-client confidentiality are still ongoing. Foreign authorities were prepared to pay for stolen data on bank clients. The scope of administrative and legal assistance is the subject of constant debate, not least with regard to taxes or the supervision of securities markets. These debates are set to continue and involve a complex constellation of interests. It is not merely about the interests of foreign authorities in obtaining banking information versus those of bank clients in preserving their privacy. The financial industry's interest in having the best possible competitive conditions internationally and conversely in enjoying the most unhindered access possible to foreign markets is also essential, while this does give rise to legitimate information requirements on the part of the foreign authorities concerned. In addition, the interests of the same players can change rapidly depending on how circumstances develop. This was the juggling act that the Banking Commission attempted to perform.

Concerns over bank-client confidentiality now

1 Financial market crisis
1.1 Continuation of the crisis in 2008

Escalation of the crisis

The international financial crisis worsened further in 2008. What began in the second half of 2007 as a crisis in the US real estate market, particularly in the subprime segment, expanded in 2008 to become a general credit and liquidity crisis that will culminate in a global recession.

Collapse of the interbank market

The year's first major incident came in spring 2008 when the US authorities orchestrated the fire sale of investment bank Bear Stearns to J.P. Morgan Chase. The situation escalated, when Lehman Brothers went bankrupt in September 2008 since the US authorities had not taken any rescue measures. The remaining confidence the banks had had in each other prior to this event fell further and brought the interbank market – crucial for obtaining liquidity – to the brink of collapse. There were also major upheavals on the international financial markets, which had and will continue to have a negative impact on earnings and hence the capital situation of a number of financial institutions. The fact that the crisis had reached Europe became apparent with the collapse of the Fortis financial group and its rescue by the governments of the Netherlands, Belgium and Luxembourg.

Government and central bank measures

The central banks and governments of numerous countries implemented a series of measures to combat the systemic crisis. These included coordinated interest rate cuts, providing additional liquidity even against lower-quality collateral, increasing guarantees for savings deposits, (part) nationalising financial institutions by injecting capital and providing government guarantees for bank liabilities to improve the liquidity situation. Some of these measures had not yet been planned in any great detail at the time they were announced or were dropped again at a later stage, and the resulting uncertainty did little to reassure market participants. On the whole, the measures did help to stabilise the situation, but have not brought about any real turnaround.

Package of measures prepared by the Federal Council, the SNB and the SFBC

The Federal Council, the Swiss National Bank and the Banking Commission jointly prepared a package of measures designed to stabilise the situation – particularly at UBS – and thereby strengthen the Swiss financial system. The package was the product of intensive cooperation between the three bodies, with the individual steps being closely coordinated at every stage.

Focus on UBS

The main features of the package of measures were the transfer of up to USD 60 billion in illiquid UBS assets to a special purpose vehicle controlled by the Swiss National Bank connected with the subscription by the Swiss Confederation to mandatory convertible notes increasing UBS's capital base by CHF 6 billion. These were accompanied by other measures such as conditions imposed regarding remuneration systems, a general increase in the level of protected deposits and more stringent capital requirements for both major banks. Following the announcement of the package of measures on 16 October 2008 it was officially handed over to the Swiss Parliament in the Federal Council Dispatch of 5 November 2008[2]; Parliament approved the financing of the UBS recapitalisation and the revision of the depositor protection provisions in the Banking Act[3] in December 2008. However, the purchase of UBS's illiquid assets lay within the competence of the Swiss National Bank.

1.2 Measures relating to the supervision of large banking groups

Multiple capital increases at UBS

In response to its continuing losses, UBS had to increase its capital on several occasions at the firm insistence of the Banking Commission. In December 2007 the bank placed mandatory convertible notes worth CHF 13 billion with foreign sovereign wealth funds. A further ordinary capital increase of CHF 16 billion was secured through a public offering underwritten by a consortium of banks at the end of the first quarter of 2008 and implemented in June 2008. Finally, in mid-October 2008, the Swiss Confederation decided to subscribe to mandatory convertible notes worth CHF 6 billion. The notes will be converted into shares within no more than two and a half years and represent capital that can be used to bear losses while business operations are continued. With the notes and the ordinary share capital, CHF 35 billion in core capital was raised by UBS in just under a year.

Personnel implications

The Chairman of UBS's Board of Directors was replaced at the second general meeting of shareholders in mid-2008. This was in line with the personnel changes demanded by the Banking Commission, as was the replacement of other Board members in order to increase the Board's expertise in financial matters. The disbanding of the Chairman's Office by the new Chairman of the Board represented a much appreciated organisational measure in the area of corporate governance as well.

[2] see *"Botschaft zu einem Massnahmenpaket zur Stärkung des schweizerischen Finanzsystems"* [Dispatch on a package of measures to strengthen Switzerland's financial system; only in German/French] and *"Bundesbeschluss über einen Kredit für die Rekapitalisierung der UBS AG"* [Federal decree on a loan for recapitalising UBS AG; only in German/French] (http://www.efd.admin.ch/dokumentation/gesetzgebung/00570/01288/index.html?lang=de#)

[3] see *"Botschaft zur Änderung des Bundesgesetzes über die Banken und Sparkassen (Verstärkung des Einlegerschutzes)"* [Dispatch on the amendments to the Federal Act on Banks and Savings Banks (improvement in depositor protection); only in German/French] (http://www.efd.admin.ch/dokumentation/gesetzgebung/00570/01287/index.html?lang=de)

Banking Commission report on the causes of the UBS write-downs

The Banking Commission investigated the causes of UBS's large write-downs on positions whose risks are linked to subprime mortgages in the USA.[4] Its investigations were based on UBS's internal investigations, its own enquiries and countless interviews with the bank's management. The Banking Commission's extensive investigations essentially confirmed UBS's own conclusions.

Inadequate risk recognition

UBS had not been aware of the extent and nature of its risk exposure to the US subprime sector and related markets until the beginning of August 2007 and was therefore unable to implement appropriate countermeasures at an early stage. Above all, the bank did not recognise the enormous risks posed by the super senior collateralised debt obligations (CDOs) held in its trading book. "Super senior" refers to securitised paper that is in the lowest risk category, generally has an AAA rating and therefore offers a lower rate of interest. In holding such security UBS was pursuing a carry trade strategy to generate earnings from the difference between these yields and UBS's lower funding costs, even including hedging costs.

Uncritical confidence in existing systems

The bank also underestimated the risks involved, and in an extraordinary market environment this had devastating consequences. The Banking Commission concluded that the lack of attention paid to the risks associated with balance sheet growth and overconfidence in existing risk identification mechanisms were serious failures on the part of the bank. However, the Banking Commission's investigation uncovered nothing to suggest that the bank's current corporate bodies could no longer provide a guarantee of fit and proper business conduct. The Banking Commission supported a set of measures drawn up and published by UBS to rectify the deficiencies identified and monitored its implementation very closely.

Regulation of remuneration systems

The recapitalisation of UBS by the Swiss Confederation was linked to requirements in the area of corporate governance. In particular, UBS engaged itself with the Swiss Confederation and Swiss National Bank to comply with rules on remuneration systems, which are in line with both the best practice guidelines drawn up in consultation with the Banking Commission and international industry standards. In addition, UBS was instructed to agree the size, composition and distribution of the group-wide bonus pool in 2008 with the Banking Commission and have it approved by the supervisory authority. UBS was also required to fully disclose all relevant information to

[4] see "Subprime crisis: SFBC Investigation Into the Causes of the Write-downs of UBS AG", 30 September 2008 (http://www.finma.ch/archiv/ebk/e/publik/medienmit/20081016/ubs-subprime-bericht-ebk-e.pdf)

the supervisory authority. FINMA will look to issue expanded general guidelines on remuneration systems for the entire financial sector.

Agreement on higher target levels

In the fourth quarter of 2008 the Banking Commission and the large banks agreed higher capital adequacy targets and the introduction of a leverage ratio.[5]

Capital increase at Credit Suisse

Prior to the announcement of the increase, Credit Suisse was very keen to avoid any investor uncertainty associated with these requirements. It aimed to comply with the new requirements at an early stage, and to this end it increased its core capital by around CHF 10 billion thanks to foreign investors.

1.3 New capital adequacy regime for large banking groups

Previous capital requirements inadequate

The financial crisis underlined the realisation that the two large banking groups now require considerably more capital than they did in the past. Swiss banks' capital buffer of 20% above the minimum requirements of Basel II proved to be insufficiently robust for them. Even the moderate additional increase in the target level specifically for the large banks imposed by the Banking Commission at the end of August 2007 turned out to be inadequate.

Crisis resistance increased

The Banking Commission developed the new capital adequacy regime in close cooperation with the Swiss National Bank. It will increase the resilience of Switzerland's two large banks and hence of the financial system as a whole. The higher capital requirements and the introduction of a leverage ratio will leave the banks better equipped to deal with future crises. The higher capital buffer will not prevent crises, but it will help absorb any losses incurred. A marked increase in this safety buffer was essential for Switzerland, whose two large banks are of systemic importance to the financial centre and the economy as a whole. No changes are planned for Switzerland's other banks, which already of their own volition hold on average twice the amount of capital required by regulators.

Flexibility with regard to timeframe

The higher capital adequacy targets were defined and communicated to the two large banks via a formal decree on 20 November 2008. Apart from allowances made for different structures and the international accounting standards chosen, the new regime is identical for both banks. The Banking

[5] see 1.3

Commission is aware that the financial markets are going through an extremely difficult time. Accordingly, the large banks have until 2013 to adjust gradually to the new capital adequacy requirements. The deadline may also be extended should the situation on the financial markets or the earnings of the large banks make it impossible to achieve the target levels by 2013.

Two complementary instruments

At the heart of the new capital adequacy regime are two complementary instruments: the increase in risk-weighted capital requirements and the introduction of a leverage ratio, in other words a nominal cap on debt levels regardless of the risk involved.

Increase in risk-weighted requirements

The new requirements for the increase in risk-weighted capital for the large banks will be between 50% and 100% above the minimum international requirements under Pillar 1 of Basel II. This flexibility is possible because the additional capital requirement is being implemented under Pillar 2 of Basel II (bank-specific supervisory process). This room for manoeuvre is necessary to ensure that the measures can have a stabilising influence while at the same time exerting an anticyclical effect. In good periods the banks should build up their capital to a target level of 200%. This buffer will then be available to the banks during periods of crisis and can be run down to an intervention level of 150%.

Leverage ratio

The new leverage ratio clearly limits the portion of the balance sheet that is financed by debt. A certain proportion of core capital is required regardless of the relative risk assessment of a transaction. The leverage ratio defines the proportion of core capital to total assets for both banks at a minimum of 3% at group level and 4% for individual institutions. The supervisory authority expects both large banks to exceed this minimum level in good periods. To avoid restricting the large banks' domestic lending business, which is important for the economy, it has been excluded from the leverage ratio.

Banking Commission acts as forerunner – support at international level

The Banking Commission felt compelled to implement appropriate measures as quickly as possible given the specific importance of the large banks to Switzerland. International standards are also moving in the same direction, however, with massive increases in capital adequacy levels for global banks and the use of robust parameters such as the leverage ratio to supplement problematic model approaches.

1.4 Cooperation between the Banking Commission and the Swiss National Bank

The longstanding cooperation between the Banking Commission and the Swiss National Bank, which was formalised in a Memorandum of Understanding in 2007, intensified in the wake of the crisis on the financial markets. The cooperation primarily takes the form of working groups that draw up measures relating to financial stability and banking regulation.

Close cooperation

For example, the close relationship between the two institutions enabled them to draft a concept for stricter capital requirements. This resulted in the decrees issued by the Banking Commission requiring the two large banks to introduce a leverage ratio and increase their risk-based capital levels.

Development of stricter capital requirements for the large banks

A joint Swiss National Bank and Banking Commission working group is also redesigning the liquidity rules for the large banks. The current requirements as laid down in the Banking Ordinance are inadequate for the large banks in a number of respects.

New liquidity regime for the large banks

Under the new regime, which is set to be introduced in the first half of 2009, the banks must prove with the aid of stress scenarios that their business structure gives them the capacity to cope with a serious liquidity crisis. Firstly there must be sufficient liquid assets available to quickly compensate for potential outflows of funds, and secondly any necessary sales and pledges of assets must under no circumstances impair the bank's solvency. The underlying assumptions and models used by the banks must be approved by the Banking Commission.

Stress scenarios

Under the new rules the two large banks will also have to comply with liquidity management requirements that will closely follow the principles for sound liquidity risk management and supervision published by the Basel Committee.

Requirements in respect of liquidity management

1.5 Consequences for small and medium-sized banks

In contrast to the large banks, Switzerland's other banks are not really directly affected by the international financial crisis – particularly the problems in the US real estate market. The negative global trend on the financial markets does have indirect consequences, however, with banks seeing a more marked impact on their earnings and the performance of the assets they manage. The economic slowdown is also likely to hit the Swiss credit market. Deteriorations in credit quality and greater difficulties with regard to loan affordability lead to a higher proportion of non-performing loans, more write-downs and a rise in the number of loan defaults. The crisis of

Indirect consequences are likely to become more acute confidence in the interbank market also affected all banks. Both a shortage and a surfeit of liquidity can create huge challenges for banks. Many small and medium-sized banks recorded high inflows of client funds in 2008, but it is unclear how sustainable this trend is. As a result, the consequences of the turbulence on the financial markets for small and medium-sized banks are likely to become more acute. However, generally good levels of capitalisation can lessen the impact of the crisis.

1.6 International network

Links with foreign regulatory authorities

The Large Banking Groups division's longstanding links with foreign regulatory authorities provided a vital starting point for coordinating activities at international level. One example of this was the mutual exchange of information on how the overall situation was developing and the Banking Commission's involvement in the Senior Supervisors Group (SSG), a group of supervisory authorities responsible for the soundness of global investment banks from seven countries.

Report of the Financial Stability Forum

In April 2008 the Financial Stability Forum (FSF), in which Switzerland is represented by the Swiss National Bank, published a constructive appraisal of the subprime crisis in the shape of a report on enhancing market and institutional resilience. The report contains 67 recommendations for national authorities and other market participants. The Banking Commission reviewed all the recommendations, and the following key points emerged with regard to the corresponding action required: measures to increase capital at the large banks, bank-specific liquidity monitoring for the large banks, risk-adjusted remuneration systems and cross-border cooperation and crisis management. The Banking Commission has already implemented measures for all these key points or is conducting an in-depth analysis of the recommendations.

2 Enforcement of disclosure rules under stock exchange law

Responsibility of the Banking Commission

The Stock Exchange Act (SESTA) requires shareholders to disclose their holdings in listed companies domiciled in Switzerland when these reach, exceed or fall below certain thresholds. This is intended to increase transparency over the ownership structure of listed companies and create an early warning system with regard to potential takeovers. In the event of any breach of disclosure obligations the Banking Commission – as the supervisory authority responsible for disclosure law – carries out its own investigation of the situation and where applicable files a criminal complaint with the Department of Finance. At the beginning of 2008 the Banking Commission decided to extend the scope of declaratory rulings to include disclosure obligations. In so doing it underlined its desire to enforce the applicable rules, investigate any breaches of disclosure obligations in an efficient and consistent manner and present its findings. Accordingly, it can formally declare a party subject to reporting requirements to be in breach of its disclosure obligations and if necessary order it to provide any missing disclosure notices. Since 1 December 2007 the Banking Commission has also been able to petition the relevant civil court judge to suspend voting rights.[6]

Major proceedings by the Banking Commission

In 2007 the Banking Commission launched several investigations, some of them wide-ranging, based on suspicions that investors had been violating disclosure rules by secretly building up large holdings in Swiss issuers. The Banking Commission paid particular and urgent attention to the acquisition of a holding in Implenia, a Swiss construction and real estate company, by UK hedge fund Laxey in the first quarter of 2007. It also investigated the acquisition of holdings in Sulzer by Everest Beteiligungs GmbH and other major investors in late 2006 early 2007.[7]

Implenia

In the Implenia case, the Banking Commission – after completing comprehensive investigative and administrative proceedings – issued a declaratory ruling stating that in building up its holding in Implenia Laxey had breached its disclosure obligations under Art. 20 SESTA by de facto placing Implenia shares with counterparties (parking) while reserving the right to get them back at any time through contracts for difference (CFDs). As Laxey had thus retained potential control over the voting rights pertaining to these shares, the shares actually had to be attributed to Laxey. This strategy constitutes indirect share acquisition under stock exchange legislation and is subject to disclosure obligations. The Banking Commission issued a media release informing market participants of the results of its investigation. This was of huge importance for the transparency and integrity of the market given that Laxey was in the process of attempting to take over Implenia.[8] Laxey subsequently lodged an appeal against the Commission's declaratory ruling with the Federal Administrative Court. The Federal Administrative Court rejected

[6] see Annual Report 2007, key themes, p. 15f
[7] see Annual Report 2007, key themes, p. 16
[8] see Annual Report 2007, key themes, p. 16

Laxey's appeal in full with its judgement of 18 December 2008.[9] Laxey appealed against the judgement of the Federal Administrative Court before the Supreme Court.

Sulzer

In the Sulzer case, the Banking Commission commissioned investigators to intervene simultaneously at three banks. The investigators worked closely with the Banking Commission, which subsequently conducted parallel administrative proceedings with both investors and the banks involved. The scope of the case and the volume of evidence to be processed created an enormous amount of work. The entire investigation was then delayed due to appeals lodged by the investors involved with regard to procedural issues. These appeals were rejected by the Federal Administrative Court in its judgements of 11 December 2008.

Ruling vs investors

After that, FINMA issued on 22 January 2009 a declaratory ruling stating that Ronny Pecik sen. especially purchased respectively controlled Sulzer AG shares by misusing formal cash settled options and that he converted cash settled options into physical settled options. As Ronny Pecik sen. and his co-investor, Georg Stumpf, retained in this way potential control over the voting rights associated with these shares and physically settled options, the latter must be attributed to Ronny Pecik sen. and Georg Stumpf. This strategy corresponds to an indirect acquisition according to the stock exchange legislation and is therefore subject to disclosure obligations. Investors such as Ronny Pecik sen. and Georg Stumpf are partially regulated by FINMA and can be prosecuted in a limited manner under supervisory provisions. By issuing a declaratory ruling against investors, FINMA can retain authority over its investigations and the procedure resulting from those investigations. Thus FINMA can make a ruling stating that disclosure obligations were infringed and communicate this ruling to the interested parties, including affected market participants, in order to uphold market transparency and integrity.

Ruling vs ZKB

FINMA has issued a second ruling on 22 January 2009 and found that the Bank of the Canton of Zurich (ZKB) seriously infringed its obligations while issuing and trading Sulzer AG securities. ZKB assisted Ronny Pecik sen. especially in an illegal manner when building the stake in Sulzer AG. Moreover FINMA has found several breaches in its organization with regard to this stake building. The ZKB remedied in the meanwhile to those breaches.

[9] see Federal Administrative Court judgement of 18 December 2008 B-2775/2008

3 Collective investment schemes

Financial centre dialogue

In September 2007 the associations of the financial sector developed a master plan designed to make the Swiss financial centre more competitive. Under the aegis of the Federal Department of Finance, the authorities and the financial sector subsequently created a framework for a more detailed examination of the issue. A high-level Strategy Committee chaired by the Director of the Federal Department of Finance established the according guidelines. At the same time, an operating committee known as the Swiss Financial Centre Dialogue Steering Committee has been charged with defining measures to promote the financial centre and presenting them to the Strategy Committee. The Steering Committee has set up working groups charged with identifying specific questions and drawing up concrete proposals. The Banking Commission is represented at all levels; its Chairman is on the Strategy Committee and its Director on the Steering Committee. Representatives of the Banking Commission have also been actively involved in a number of the working groups, and various of the Commission's proposals have been taken up, in particular those relating to the improvement of the framework conditions regarding collective investment schemes (via the *Promoting Switzerland as a production location for investment funds* working group) and the managers of such investment schemes (via the *Hedge Funds/Private Equity* working group).

Voluntary subordination for asset managers

The Banking Commission put forward a proposal to the *Hedge Funds/Private Equity* working group whereby asset managers could voluntarily submit to its supervision. The applicable Art. 13 para. 4 of the Collective Investment Schemes Act (CISA) allows asset managers domiciled or resident in Switzerland who manage foreign collective investment schemes to voluntarily apply for a licence from the supervisory authority, subject to restrictive conditions. However, a licence may only be granted if these asset managers are required to be supervised due to foreign regulation and if the foreign collective investment scheme is subject to supervision equivalent to the Swiss supervision. This provision was introduced to bring Swiss investment fund legislation back into line with EU rules (the UCITS directive). Although it is geared primarily towards competition policy rather than prudence, in the opinion of the Banking Commission, which addressed the issue of supervision for the managers of foreign collective investment schemes and other institutional assets many years ago, the provision does not go far enough.

Revision proposal from the Banking Commission

As a result, after reviewing a range of options the Banking Commission drew up a proposal for an amendment to the CISA. The proposed changes included deleting the relevant Art. 13 para. 4 CISA and introducing a new Art. 13a CISA enabling all asset managers of foreign collective investment schemes

(UCITS, section II funds, offshore hedge funds, etc.), but also managers of other institutional assets, to apply for a licence.

Steering Committee decision

The Banking Commission submitted its proposal to the Steering Committee via the relevant working group. The Steering Committee then incorporated it in its concluding report for the Strategy Committee, albeit after removing the section on managers of other institutional assets.

Promoting Switzerland as a production location for investment funds working group

The investigations of the *Promoting Switzerland as a production location for investment funds* working group, in which the Banking Commission is also represented, showed that the new Collective Investment Schemes Act is mainly a liberal and flexible framework law with only occasional weak spots.

Complete suppression of the "Swiss finish"

To promote Switzerland as a production location for investment funds, the Banking Commission submitted a proposal to this working group calling for the complete suppression of the "Swiss finish" for collective investment schemes. The Commission had already taken initial steps towards this by choosing not to regulate performance fees in February 2008. In the context of collective investment schemes, the "Swiss finish" denotes all areas in which Swiss regulation goes beyond minimum European standards.

Consultation

The Steering Committee decided to support the Banking Commission's initiative to promote Switzerland as a production location for collective investment schemes, and the Commission subsequently opened a consultation on the proposal to abolish the "Swiss finish" for collective investment schemes.

No quantitative rules for designating collective investment schemes

As well as removing formal requirements, the complete abolition of the "Swiss finish" would in particular mean that in the future, there would be no quantitative rules for designating collective investment schemes (regulation based on case law). Market participants themselves are therefore responsible for ensuring that the designation of a collective investment scheme is not misleading for investors. Of course, the Banking Commission will intervene in the event of abuses as part of its normal supervisory activities.

Amendment of the ban on double dipping

In consultation with the Department of Finance, the Banking Commission also proposed that the ban on double dipping set out in Art. 31 para. 4 of the Collective Investment Schemes Ordinance (CISO) should be amended to comply with the minimum European standard.

Entry into force

Based on the positive results of the consultation, the Banking Commission decided that the aspects of the "Swiss finish" for collective investment schemes which fall within its remit are to be abolished by amending the relevant guidelines. To prevent Swiss collective investment schemes from being placed at any disadvantage as a result of the amendments, the entry into force of the amended guidelines is to be timed to coincide with the entry into force of Art. 31 CISO, which was determined by the Federal Council for 1 March 2009.

4 Asset management framework

Retrocessions and distribution commissions

Following a Federal Supreme Court ruling of 22 March 2006, in 2007 the Banking Commission set up an internal project group to analyse retrocessions, distribution commissions and other relevant forms of distribution compensation. The group's task was to examine the topic from a potential conflicts of interest point of view and underpin the Banking Commission's quest for increased transparency where such conflicts arise as well as in respect of distribution costs. Based on a report prepared by the group, in September 2008 the Banking Commission published a detailed discussion paper on "Incentive systems and conflicts of interest regarding the distribution of financial products". In it, the Commission affirmed that action was required in certain areas from a supervisory law perspective. It proposed increased non-product-specific transparency of distribution compensation for end clients (point of sale disclosure). Asset managers should inform their clients in advance of the calculation parameters and ranges of possible third-party distribution compensation for the various product classes. Where requested by clients, amounts already received by third parties would also have to be disclosed, provided that they could be clearly attributed to a specific client relationship with reasonable effort (e.g. retrocessions on brokerage or custody fees). This step would also be largely in line with the regulations laid down in the Markets in Financial Instruments Directive (MiFID) and would justify the decision not to seek increased transparency of distribution compensation at the level of individual products, such as investment funds. The Banking Commission opened a consultation process on its proposals.

Benchmarks for asset management

The Banking Commission can recognise self-regulatory asset management norms as minimum standards. The asset management industry has so far been unable to agree on a uniform code of conduct that covers the management of both individual and collective assets. When it opened the consultation process on the above-mentioned discussion paper in September 2008, the Banking Commission at the same time also opened a consultation process on benchmarks for minimum self-regulatory standards in the asset management industry. The benchmarks are intended to serve as a reference for all codes of conduct submitted to the Banking Commission by asset management professional organisations for recognition as minimum standards. The Commission defined minimum requirements with regard to fiduciary duties, due diligence and duties to inform, as well as remuneration of asset managers. It also demanded binding processes for self-monitoring by professional organisations in respect of members that are not subject to prudential supervision. The proposals put forward by the Banking Commission met with a generally positive response in both consultations. Comments related largely to specific details. The benchmarks were approved by FINMA in December 2008 already and came into force at the beginning of 2009, thereby paving the way for codes of conduct issued by the asset management industry to be recognised as minimum standards by FINMA.

Code of conduct for securities dealers

The code of conduct for securities dealers issued by the Swiss Bankers Association (SBA), which is based on Art. 11 of the Stock Exchange Act (SESTA) and constitutes delegated self-regulation, is also designed to be a code of conduct in dealings with clients. The long-awaited review of these guidelines could be completed in the third quarter of 2008 and recognised by the Banking Commission.

Securities lending and borrowing/repo

The Banking Commission held a number of meetings with banks on the extent of their securities lending and borrowing programmes. Its main area of concern was unsecured securities lending, which entails risks that inexperienced private clients in particular may underestimate. The Commission still intends to issue a circular on this topic.

Legal risks in cross-border private client business

The investigation into UBS's cross-border business with US private clients revealed once again the legal risks associated with the cross-border private client business. While it is not the Banking Commission's mandate to monitor compliance with foreign regulations and enforce them based on supervisory law, it does, however, fundamentally expect global banks to observe the rules of the countries in which they operate. Failure to do so can result in legal risks that in a worst-case scenario could threaten the existence of a bank.

EBK CFB