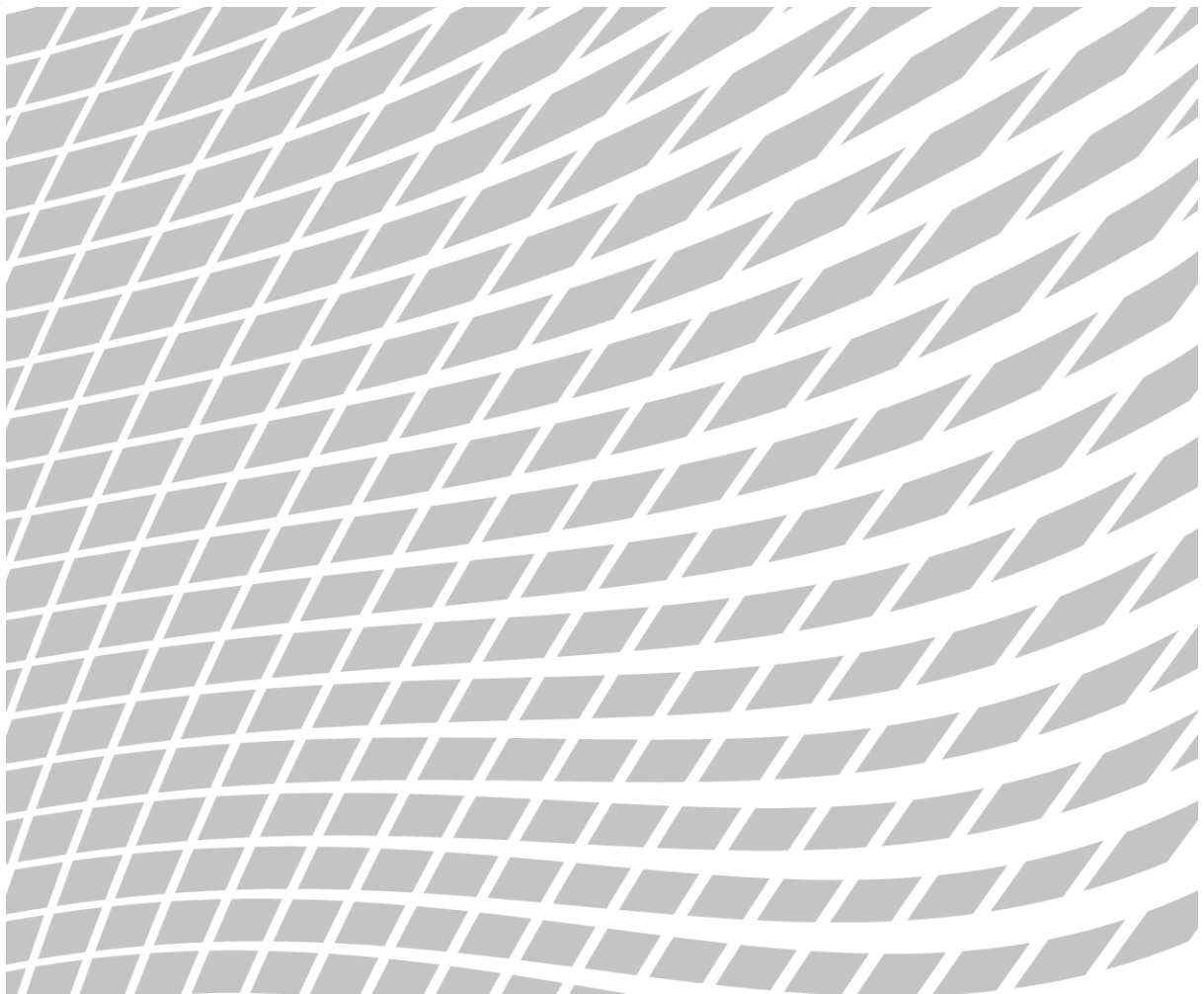


24 November 2010

---

## **Client protection – working together against illegal financial intermediaries**

---



# Contents

1	Key points.....	3
2	FINMA's activities .....	4
3	Two real-life cases .....	5
4	Gold transactions.....	6
5	Shares in start-up companies .....	7
6	Investment companies and investment clubs.....	8
7	Foreign exchange dealers .....	9
8	Rental deposit insurance.....	9
9	What does FINMA do for investors? .....	10
10	What can investors do to protect themselves? .....	10

## 1 Key points

FINMA's purpose in issuing the summary report, "**Client protection – working together against illegal financial intermediaries**" is threefold. Firstly, it wants to provide information about the action it is taking in the fight against illegal and fraudulent financial intermediaries. Secondly, it wants to raise awareness about key areas and the methods used by illegal financial intermediaries, and, thirdly, it wants to urge investors to consider their purchase decisions carefully and only conclude transactions after thorough examination of the offer and the provider.

- FINMA's mandate is to protect creditors, investors and policy holders and ensure the smooth functioning of the financial markets. To that end, it monitors that institutions and service providers subject to licensing fulfil the licensing requirements at all times.
- FINMA is also tasked with enforcing compliance with financial market law for unauthorised institutions, i.e. those that do not have a licence from the supervisory authority. The fight against financial intermediaries operating illegally is a central issue in this report.
- Since 2009, FINMA has instigated legal proceedings in 103 cases against unauthorised financial intermediaries and has either liquidated or initiated bankruptcy proceedings against a total of 66 companies operating illegally.
- In the last couple of years, FINMA has identified five areas in which investors heavily invest funds with financial intermediaries operating illegally: gold transactions, shares in start-up companies, investment companies and investment clubs, foreign exchange dealers, and rental deposits.
- A common feature of the offers made by illegal providers is that the returns and performance they promise are sometimes far in excess of comparable offers from conventional providers. This is particularly significant in an environment in which returns on traditional investments such as savings accounts, government bonds and even shares and investment funds are relatively weak.
- Since FINMA does not monitor these companies on a systematic and regular basis, intervention by FINMA usually comes as a response to having been notified of irregularities and potential illegal activities, e.g. by investors who have suffered losses. Frequently the investors have already incurred losses and the assets invested can no longer be recovered. The losses caused by illegal activities uncovered by FINMA since 2009 amount to a total of CHF 220 million.

FINMA is appealing to investors to consider their purchase decisions carefully and to thoroughly examine offers and providers. The last section of this report contains ten warning signs that may help prevent investors from concluding transactions with illegal and fraudulent providers when making their investment decisions.

Clarifying whether a company is properly licensed or whether a service has already been criticised in online forums or on consumer websites is always worth the effort, because it can prevent investments being made with an illegal or fraudulent financial intermediary.

## 2 FINMA's activities

**FINMA's mandate:** FINMA's mandate is to protect creditors, investors and policy holders and safeguard the smooth functioning of the financial markets. To this end, it monitors the authorised institutions, in particular banks, stock exchanges, securities dealers, collective investment schemes and insurance companies. Other financial service providers are also supervised for the purposes of money laundering prevention if they operate on a professional basis (asset managers, credit companies and leasing companies). FINMA is also responsible for enforcing licensing requirements under financial market law.

**Actions taken by FINMA in the area of unauthorised institutions:** FINMA imposes the measures necessary to enforce compliance with financial market law against companies or persons that engage in activities requiring a licence but that do not actually hold one. FINMA is alerted to potential breaches of the law by clients, foreign regulatory agencies and criminal authorities, for instance.

If there is reason to suspect that a company is engaging in an activity for which it is not licensed under financial market law, FINMA investigates and clarifies the facts of the case with the objective of protecting the creditors and investors. FINMA is entitled to appoint an independent expert to investigate the institutions directly. It issues an order to this effect which describes the tasks of the investigator and stipulates the extent to which the investigator may act in place of the officers of the company. If it is determined that a company which has not been licensed by FINMA is engaging in an activity requiring a licence, FINMA instigates the necessary measures. If there is no prospect of the activity being licensed retrospectively or of a change of activity, the company must be wound up. When FINMA liquidates a company, it appoints the liquidator and monitors their activities. If the company is over-indebted or illiquid, liquidation takes the form of bankruptcy proceedings ordered by FINMA.

**Black list:** FINMA places companies not actually present in Switzerland (engaging in issuer activity, SICAFs and similar) on the black list published on its website (<http://www.finma.ch/e/sanktionen/unbewilligte-institute/pages/default.aspx>). To avoid the impression that the company in question is a Swiss company, FINMA may block the homepage and Swiss phone numbers.

**Figures:** Since FINMA was founded on 1 January 2009, it has instigated legal proceedings against 103 persons and companies because of unlicensed financial market activity. In 22 cases it ordered the liquidation of the entity, and in 44 cases it ordered bankruptcy proceedings to be initiated. The potential loss amounts to a total of CHF 220 million, and the number of investors affected is in excess of 12,700.

**Cooperation with criminal authorities:** FINMA supports the work of the criminal prosecution authorities and coordinates proceedings with them as far as possible. FINMA is obliged to file criminal charges if it receives knowledge of crimes within the course of its checks and investigations. However, if fraudulent activities are suspected, investors should also contact the police or the competent public prosecutor's office as soon as possible.

### 3 Two real-life cases

When someone invests money, they expect to earn a return. For some time now, however, many asset classes (savings accounts, government bonds, equities) have yielded virtually nothing. How the markets will fare is unclear; low interest rates could persist for a long time to come. There is therefore a great temptation for investors to entrust their assets to providers that promise to achieve significantly higher returns. It is a fact that no investment is completely without risk, and as a general rule the higher the return, the higher the risk. The greater the return promised on an investment, the more carefully an investor should examine the offer, and also the provider. Providers offering such tempting returns are frequently dubious or unprofessional. Two recent real-life examples encountered by FINMA illustrate how unscrupulous and brazen financial service providers abuse the trust of their investors:

**Infina Group – pyramid investments:** The brothers Milan and Milos S. ran the Infina Group, with its head office in St. Gallen, promising investors annual returns of up to 40% on their asset management agreements. Nearly 600 investors placed assets with the Infina Group and fell prey to a pyramid scheme. Following a voluntary disclosure by the brothers, the St. Gallen public prosecutor initiated an investigation on grounds of suspicion of investment fraud involving a pyramid scheme, and FINMA intervened simultaneously due to the possibility of unauthorised receipt of client deposits. It secured the remaining assets and put an investigator in charge of investigating the group's activities. The suspicion was substantiated, at which point FINMA ordered several Infina Group companies to be liquidated/declared bankrupt. This included the fashion boutique of the wife of Milan S., which had substantially benefited from the scheme, and Fina Vested Benefits Foundation. The latter was used as a vehicle within the group to acquire funds under the cloak of "vested benefits" and then transfer them to Infina GmbH or the brothers themselves. Fina Vested Benefits Foundation is heavily indebted and is not linked to any security reserves, making the circumstances even more dire for the policy holders. FINMA investigated about a dozen involved companies. The investigations extended over a period of several months, involved various administrative bodies and were very complex. The loss to the investors is likely to be at least CHF 50 million.

**VBenefit – "Scrapped" life insurance policies:** VBenefit gained authorisation from its clients to cancel their existing investments (for example, life insurance policies, annuity insurance and mortgage savings plans) and to transfer the freed assets directly to VBenefit. The company promised to place the assets in a "secure and lucrative investment", such as "shares or related products". It recruited investors by promising them an annual return of up to 25% plus a premium for "scrapping their life insurance", which consisted of a "gift basket of speciality foods". Responding to public tip-offs, FINMA launched an investigation into VBenefit and asked the company to answer a questionnaire and to submit documents. This request went unanswered. Instead, shortly afterwards, VBenefit declared in its online advertising that FINMA was its supervisory authority and gave the dossier number of the FINMA investigation as its licence number. FINMA quickly appointed investigators, who found that the client assets wrongly acquired by VBenefit had not been invested at all. For the most part they had been

spent by the persons responsible, Andreas C. and Reimund B., or paid out in remuneration to the agents they had employed. FINMA ordered that bankruptcy proceedings be initiated. It also lodged a criminal complaint with the Federal Department of Finance (FDF) and the cantonal criminal prosecutors against the persons behind VBenefit.

FINMA has a long list of examples where companies have induced investors to make investments through seemingly attractive offers and promises of spectacular returns. Investors cannot be warned enough to beware of offers that seem just too good to be true. These are often pyramid schemes or other forms of embezzlement or fraud which promise high returns and frequently even pay high returns at the beginning. However, the common denominator in these scenarios is that the investments cannot be repaid at the end. By the time at which these cases become known to the authorities, there are usually hardly any assets left. Investors often ultimately lose the majority of their investments. It is then incumbent on the authorities to at least criminally prosecute the persons responsible.

Important information on how investors can protect themselves against falling victim to suspect providers is given in section 10.

## **4 Gold transactions**

Clients are increasingly being lured by investments in gold (by talk of high security and soaring gold prices) or other precious metals. Investors are frequently promised physical delivery of precious metals (such as bars or coins in gold or silver) in return for the money they invest. Some precious metal dealers claim that the metal is stored with third parties abroad or in Switzerland, which is particularly difficult for investors to check. Others demand a high set-up fee from their clients, which they promise to reimburse to the investor in the form of gold or a discount when a given level of turnover is reached. Some providers sometimes even have their clients authorise them to cancel the life insurance policies they hold with insurance companies so that the freed-up funds can instead be invested in gold. The funds that investors pay in are often left for a long time on the account of the gold trader without any gold being bought. FINMA's experience shows that all the scenarios described here entail large risks for investors. Furthermore, many of the cases described represent an infringement of financial market law requiring its intervention.

Investors are therefore advised to exercise heightened caution with all such business models. It is important to determine whether the precious metal dealer does in fact have physical possession of the gold and, if so, whether the client has a right to segregation of assets in the event of the bankruptcy of the dealer. Only if these conditions are fulfilled is the precious metal dealer not required to hold a banking licence. A licensing requirement does apply, however, where gold accounts are offered that use gold only as a reference value, without it being held physically. It often transpires, though, that other companies engaging in precious metals trading also do not have physical possession of the precious metals in question, or only have partial possession – contrary to what they have told clients. The claim that the precious metal is physically held or will be produced as gold or silver bars proves to

be false. However, investors do not find this out until it is too late and the company is unable to supply the precious metal on request or must even be liquidated. The reimbursement of the set-up fee agreed when the purchase was made usually turns out to be an empty promise as well.

The institutions addressed in this report and discussed in the examples are companies which, unlike authorised institutions, are not subject to regular, systematic monitoring. As such, official investigations (by FINMA or criminal prosecutors) are frequently not initiated until losses have already been incurred and investors who have suffered losses, for example, draw attention to the company's dubious or illegal activities. When purchasing precious metals it is therefore recommended that, in addition to checking thoroughly that the provider is trustworthy, a careful examination is made of the offers, commission, custodian fees and, last but not least, the promised returns, and that comparisons are made with authorised providers such as banks before proceeding with a transaction.

Dealers that trade exclusively in precious metals must be subject to supervision for reasons of money laundering prevention. This can be accomplished through affiliation with a self-regulatory organisation (SRO) or direct supervision by FINMA.

## **5 Shares in start-up companies**

FINMA is increasingly being made aware of cases in which aggressive methods are used to sell shares in Swiss start-ups – shares which have no value. Usually the companies in question operate in fields currently seen as fashionable, such as commodities (e.g. gold mines), alternative energy and medical technology. The shares are often marketed particularly vigorously to German investors. It is not uncommon for the stock to be listed on the open market of German stock exchanges, which many investors mistakenly interpret as evidence that the company is above board. The companies never become operational. The money that flows into the companies is siphoned off, and the companies are subsequently liquidated. Since the people orchestrating these scams usually operate in the background, they can avoid being held accountable by supervisory and criminal authorities and are free to start the scam all over again with the next start-up company. Numerous tip-offs and inquiries from affected investors and large-scale interest by the media indicate how widespread this phenomenon is.

FINMA's hands are tied in most of these cases. Neither the sale of own shares nor the brokering of share purchases by itself require a licence (i.e. it is not prohibited). FINMA can intervene in two cases: 1) if shares are sold by third parties as part of a capital increase, which is an issuing activity subject to licensing requirements, or 2) if the sole object of the company is to engage in financial investing, which qualifies it as an investment company and thus makes it subject to licensing requirements.

When purchasing shares in an unknown start-up company, it is therefore recommended that the company be carefully researched in advance. The commercial register should be consulted as a first step. Frequent changes of information can be a warning signal (see section 10). The company's business figures should also be examined and it should be determined whether the share price is backed by a corresponding real value. Numerous cases handled by FINMA in this area relate to companies with alleged operations abroad. Examples include mining operations, gold mines and tree plantations in



South America. It is especially difficult in such cases for investors to find out if assets really exist or if the company is actually operating.

Concerning the regulated open market, it should be noted that stocks listed on the regulated open market of a German stock exchange are not subject to stock exchange supervision. The requirements applicable to the regulated unofficial market are far less strict than those on the regulated market. The market prices of these shares can change drastically and extremely fast, especially for “penny stocks”. It frequently becomes virtually impossible to sell these shares.

FINMA is receiving more and more reports from foreign regulatory agencies concerning companies which claim to be located in Switzerland and are brokering shares of questionable value in (new) foreign companies (often American) to German or UK investors. In most cases no evidence of any actual presence in Switzerland can be found (contact points frequently turn out to be a “hired” phone number and fictitious address).

## **6 Investment companies and investment clubs**

FINMA typically also has to intervene in connection with investment companies operating illegally. Since the new Collective Investment Schemes Act came into force on 1 January 2007, not only Swiss investment funds, but also collective investment schemes in the form of a company, are subject to licensing requirements. Exceptions to the licensing requirement are very limited and only apply under very special conditions. FINMA’s website provides a list of authorised Swiss and foreign collective investment schemes.

Assets which are provided by more than one investor for the purpose of joint investment and are managed for their account (“external management”) are regarded as a collective investment scheme. Investors are treated equally in proportion to their share of the assets. Exceptions to the licensing requirement only apply under strict conditions. For example, investment clubs are exempted provided they have no more than 20 members. In addition, the members themselves, or at least some of them, must make the investment decisions, and all members must be informed regularly (at least twice per year) of the status of the investments.

Collective investment schemes in the form of public limited companies (“investment companies with fixed capital”, or “SICAFs”) often claim to be operating companies, which would exempt them from the licensing requirement. FINMA examines whether this can be plausibly substantiated and corresponds to the way in which the company presents itself towards investors. If the company’s main purpose is to realise income or capital gains and the company advertises an investment product, then it is fundamentally an SICAF subject to licensing requirements. Exceptions to licensing requirements usually only apply to investment companies if they are listed on a Swiss exchange or if they offer their services exclusively to qualified investors. Foreign collective investment schemes are subject to licensing requirements if they are publicly advertised in or from Switzerland. It makes no difference for this purpose whether the foreign collective investment scheme is advertised in newspapers or magazines or



via the internet as long as reference is made in some way to Switzerland, for instance by indicating a contact address in Switzerland.

## **7 Foreign exchange dealers**

Currencies are traded around the clock on the foreign exchange (Forex) markets. Investors try to realise gains from movements in currencies. Since investors often borrow funds in order to work with larger volumes, giving them higher leverage, foreign exchange dealing entails a high risk of incurring losses. The leverage effect means that clients can lose large amounts in a short time.

Since 1 April 2008, foreign exchange dealers domiciled in Switzerland have required a banking licence to conduct their business. Existing foreign exchange dealers had to cease their activities by the end of March 2009 or apply for a banking licence. Before the change in the law was implemented, the number of foreign exchange dealers in Switzerland had greatly increased and with it, unfortunately, the number of complaints from clients and instances of abuse in the field. The FINMA website provides a list of authorised banks.

The hurdle for attaining a banking licence is high, for which reason the majority of existing foreign exchange dealers ceased foreign exchange dealing altogether and restricted their activities to brokerage or asset management, or shifted their activities abroad. Foreign exchange dealers from other countries also need a licence if they want to be physically present in Switzerland.

FINMA intervenes whenever it receives information that a company is operating without a banking licence in or from Switzerland, i.e. the company is operating illegally as a foreign exchange dealer. FINMA frequently has to order the liquidation of the company or the initiation of bankruptcy proceedings. FINMA repeatedly encounters foreign providers that claim on their websites and in their client documentation to be located in Switzerland but in fact are operating from abroad. In cases such as this, where FINMA cannot proceed directly against the companies, it orders the phone numbers in question to be blocked, contacts the internet service provider of the company's website and puts the company on its black list (see section 2).

## **8 Rental deposit insurance**

FINMA has observed an increase in the number of providers of rental deposit insurance operating without a licence. When a tenancy agreement is concluded, rental deposit insurance may be used in lieu of a deposit. The client pays the insurance company an annual fee (insurance premium). If the client fails to honour his/her obligations under the tenancy agreement, the insurance pays the landlord accordingly up to the insured amount (deposit). This is an insurance activity, for which a licence from FINMA is required.

If an unauthorised seller of rental deposit insurance gets into financial difficulty, this creates problems for both the tenant and the landlord. There are no restricted funds under the insurance policy available to the landlord to cover his/her claims, and the tenant will have to provide a new deposit and loses the premiums already paid. It is therefore in the interests of both landlord and tenant to be certain that the bearer of the risk of a rental deposit insurance policy is always an authorised insurance provider. There are now a large number of serious providers who cooperate with authorised insurance companies.

## 9 What does FINMA do for investors?

FINMA receives reports of potentially unauthorised activities in the financial market and examines them carefully. Such cases include suspected cases of products offered that are subject to licensing requirements or investments made with companies requiring a licence. Tip-offs from investors help FINMA identify illegal financial service providers and take action against them. As complainants, investors have no rights as parties, however, for which reason FINMA cannot provide investors with information about any proceedings that may be initiated or give its opinion on the legitimacy of any given product or service offered. FINMA does not generally provide any information on individual proceedings, nor does it confirm, deny or comment on its investigations, even when invited to do so. FINMA reserves the right, however, to correct information that is wrong or misleading.

FINMA maintains a list of supervised institutions. Investors can consult the FINMA website ([www.finma.ch/e/beaufsichtigte](http://www.finma.ch/e/beaufsichtigte)) to ascertain if a company or individual has been licensed by FINMA. In the event of uncertainty, please contact [info@finma.ch](mailto:info@finma.ch) for further information.

FINMA cannot comment on civil lawsuits, as these are a matter for the civil courts.

FINMA cooperates closely with domestic criminal authorities from time to time (cantons, Office of the Federal Prosecutor, FDF), coordinates its proceedings as far as possible with them and files criminal charges where necessary. FINMA also cooperates with other domestic authorities and foreign financial supervisory bodies in order to support them in the fulfilment of their duties and to receive support itself in return.

## 10 What can investors do to protect themselves?

FINMA has formulated ten recommendations that investors can follow to protect themselves against illegal and fraudulent providers when making their investment decisions:

- Take sufficient time when making investment decisions. Never let yourself be put under pressure.
- Conduct your own checks into providers and products before proceeding with an investment and do not be dazzled by fancy prospectuses or skilful telemarketing.

- Check whether the providers have the necessary licences from FINMA, at [www.finma.ch/e/beaufsichtigte](http://www.finma.ch/e/beaufsichtigte).
- Check whether the providers appear on FINMA's black list, at <http://www.finma.ch/e/sanktionen/unbewilligte-institute/pages/default.aspx>.
- If the provider is a Swiss company, check the company's excerpt from the Commercial Register for anything unusual (frequent changes of company name, address, authorised signatories) at [www.zefix.ch](http://www.zefix.ch).
- Use Google or other search engines to find information about providers and products. See for example [www.google.com](http://www.google.com).
- Consult appropriate online forums and consumer websites. Any evidence you find of investors who have already suffered losses or are feeling uncertain should be taken as a warning sign.
- Compare the products, returns and commissions with those of other providers, in particular with those of institutions licensed by FINMA.
- Always diversify your investments; do not put all your eggs in one basket.
- Remember the rule that high returns usually go hand in hand with a high risk of incurring losses.