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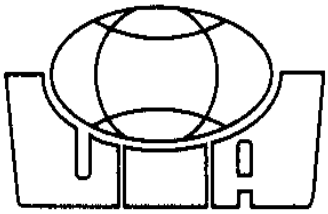

# BANKING LAW COMMISSION

**Sunday, October 31, 2010**

# BACK TO REGULATION (« LE RETOUR DE LA REGLEMENTATION »)

# SWISS NATIONAL REPORT

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# I. INTRODUCTION

## 1.1. Banks and Bank-Like Entities

Under Swiss law, "**banks**" shall cover all institutions that accept deposits from the public on a professional basis or solicit these publicly in order to finance in any way, for their own account, an undefined number of unrelated persons or enterprises, with which they form no economic unit, or who refinance themselves in substantial amounts from a number of banks which are not significant shareholders and with which they form no economic entity in order to provide any form of financing for their own account to an undefined number of unrelated persons or institutions.

The Swiss banking system is based on the concept of universal banking, whereby all banks can offer all kinds of banking services. Nevertheless, it has seen the development of **various categories of banks** that have come to specialise in specific areas. Banks can thus be divided into six main categories[1]:

1. **Cantonal banks**: Cantonal banks are defined as banks with a statutory basis under cantonal law, with a canton holding a minimum of one-third of the bank's capital and voting rights. With the revised Banking Act of 1st October 1999[2], the state guarantee is no longer a constitutive characteristic of cantonal banks. It should however be noted that save for the Canton of Berne, which plans to phase out its cantonal guarantee in a gradual process terminating in 2012, the Canton of Vaud (no cantonal guarantee) and the Canton of Geneva (limited cantonal guarantee[3]), all other cantonal banks provide an unlimited cantonal guarantee to depositors. Most cantonal banks operate in all fields of business, although they are mainly active in the savings and mortgage business. In a few cases, they also provide asset management services mainly for domestic customers. Cantonal bank operations are largely focused in their own canton, although some of them have branches outside the cantonal territory or even offices abroad. Cantonal banks may be established either as public institutions or public limited companies: sixteen out of the twenty-four cantonal banks are public legal entities in their own right. Six cantonal banks are mixed joint-stock companies or entities under special law: Banque Cantonale Vaudoise, Zuger Kantonalbank, Banque Cantonale du Jura, Banque Cantonale du Valais, St. Galler Kantonalbank and Banque Cantonale de Genève. The cantonal banks of Berne and Lucerne are joint-stock companies under private law.

2. **Big banks:** Big banks are joint-stock companies covering all types of business, in particular, investment banking (namely capital market transactions, securities trading, money market transactions, financial engineering, securities lending, consulting services for company mergers and acquisitions). Big banks operate globally, with a network of branches and subsidiaries around the world. Since the merger in 2005 of Credit Suisse and Credit Suisse First Boston, there are only two big banks remaining, i.e. UBS AG and Credit Suisse Group.

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[1] See Statistics of the Swiss National Bank in: *Banks in Switzerland 2009*, Zurich 2010, p. 20 *et seq.* (available under http://www.snb.ch/ext/stats/bankench/pdf/deen/Die_Banken_in_der_CH.book.pdf); see also *The Swiss Banking Sector, Compedium 2010*, Swiss Banking Association, Basel, April 2010, p. 35 *et seq.* (available under http://www.swissbanking.com/en/home/shop.htm).

[2] See Section I, Subsection 1.2 below.

[3] Maximum CHF 500'000.- pursuant to Article 3 (a) of the *Règlement du Conseil d'Etat de la République et Canton de Genève concernant la garantie accordée aux dépôts d'épargne auprès de la Banque cantonale de Genève du 10 novembre 1993*.

3. **Regional and savings banks:** They primarily operate on the savings and mortgage sectors. Around half of their liabilities and amounts due to customers take the form of savings deposits and investments; mortgage loans account for some three-quarters of their assets[4]. Their geographical scope of activities is regional only. They are mostly private joint-stock companies, although there are also cooperatives or other legal forms.

4. **Raiffeisen banks:** Raiffeisen banks are the only group of banks structured as cooperatives. They are associated in the Raiffeisen Switzerland cooperative. At the end of 2009, the Raiffeisen Group consisted of 350 independent, regionally rooted co-operative banks with a history that goes back more than a century. The group cooperates with Helvetia Group in the area of pension schemes and insurance, with Vontobel in the areas of trading and investment services, and with the Aduno Group in the area of consumer lending. They focus mostly on traditional interest rate business with mortgages and corporate loans, on the one hand, and customer savings and deposits, on the other hand. Raiffeisen Switzerland operates the strategic management function for the entire Raiffeisen Group and is responsible for the group-wide risk diversification, liquidity and equity holding and refinancing. Furthermore, it coordinates group activities, creates favourable business conditions for the regional Raiffeisen banks and provides general consulting services and support to its members. Raiffeisen Switzerland also takes the role of a "central bank" in providing treasury, trading and transaction services to its cooperatives. This comprehensive support enables local Raiffeisen banks to concentrate on their core business – i.e. providing advice and selling banking services to their clients. Raiffeisen banks engage almost exclusively in domestic business and focus primarily on the interest income business.

5. **Private banks:** The 14 private banks are among the oldest institutions in Switzerland. Most of them were founded in the 18th century. Private bankers primarily engage in asset management and banking services related thereto (issuing and fiduciary business, securities trading), but conduct barely any interest income business. Private bankers are structured as individual companies, general or limited partnerships and their owners have unlimited private liability in respect of their own personal assets. If they do not solicit deposits from third parties, private bankers are not required to build statutory reserves or publish annual financial statements. However, they are subject to all other provisions of Swiss banking legistlation, in particular requirements in respect of equity capital. Private bankers have been associated in the Swiss Private Bankers Association (SPBA) since 1934.

[4] *The Swiss Banking Sector*, *Compedium 2010*, Basel, April 2010, p. 35 *et seq.* (available under http://www.swissbanking.com/en/home/shop.htm).

6. **Other Banks:** This category can be subdivided into stock exchange banks, other banking institutions and foreign banks. *Stock exchange banks* operate mainly in the field of asset management at national and international levels. They usually take the form of joint-stock companies. Other banks cover all *banks that cannot be included under another category* or subcategory. *Foreign banks* include foreign controlled banks as well as subsidiaries and branches of foreign banks. A bank is deemed to be foreign-controlled if foreigners with a qualified participation in the bank directly or indirectly hold more than half of its voting shares, or if they exercise a controlling interest in any other manner[5]. They operate in all fields of business with a special focus on asset management or investment banking for foreign individuals or companies and usually take the form of joint-stock companies, save for branches of foreign banks, which are not legal entities *per se*. It should be noted that a license is required for any foreign bank wishing to establish a registered office, branch office or agency in Switzerland.

Pursuant to the statistics of the Swiss National Bank[6], the number of banks in Switzerland declined in 2009 from 327 to 325. A total of 13 banks were taken over by other banks, with two of them being subsequently re-established under a new name, while 12 new banks were established. In addition, one bank was declared bankrupt (i.e. Kautphing Bank Luxemboug S.A., Luxembourg, Geneva branch, which was declared bankrupt on November 17, 2008[7]). Acquisitions occurred mainly within the regional and savings bank category, while other changes affected stock exchange banks, foreign-controlled banks and branches of foreign banks.

| Bank Category | Total at December 31, 2008 | Additions | Removals | Total at December 31, 200 |
|---|---|---|---|---|
| **Cantonal banks** | 24 | - | - | 24 |
| **Big banks** | 2 | - | - | 2 |
| **Regional banks and savings banks** | 74 | 2 | 7 | 70 |
| **Raiffeisen banks** | 1 | - | - | 1 |
| **Stock exchange banks** | 48 | 4 | 3 | 49 |
| **Other banking institutions** | 9 | - | - | 9 |
| **Foreign controlled banks** | 123 | 5 | 5 | 123 |
| **Branches of foreign banks** | 31 | 2 | - | 33 |
| **Private banks** | 14 | - | - | 14 |
| **Total** | **327** | **13** | **15** | **325** |

[5] Article 3bis para. 3 of the Swiss Banking Act.

[6] Statistics of the Swiss National Bank in "Banks in Switzerland 2009", Zurich 2010, p. 15 and 26 (available under http://www.snb.ch/ext/stats/bankench/pdf/deen/Die_Banken_in_der_CH.book.pdf)

[7] See also Section IV, Subsection 1.2 below on the mechanism applicable under Swiss law for depositor protection.

In addition to the above-mentioned bank categories, one should also consider **PostFinance**, a business unit of Swiss Post, which is not strictly speaking a bank subject to the banking legislation but is a financing intermediary with bank-like services. In particular, PostFinance engages primarily in domestic and international payment transactions. Its activities comprise increasingly also investments, pension schemes and lending. Moreover, PostFinance offers selected financial products such as investment funds and insurance policies, in co-operation with banks as its external partners. In this respect, PostFinance partners with Valiant Bank and Münchner Hypothekenbank in providing mortgages to finance home ownership for the customers' personal use. PostFinance cooperates with UBS as a custodian for investment funds. The Swiss Postal Law and the Postal Ordinance provide the legal basis for the business activities of the Swiss Post and PostFinance. The Postal Ordinance enables the Post to offer services and products, which can be distributed to third parties via the Post's own infrastructures. PostFinance may however only directly offer financial services, which are not subject to a license from the financial supervisory authority. For the distribution of financial services that are subject to such a license, PostFinance must enter into a partnership with a bank or an insurance company. As an institution under public law, PostFinance has a special permission to accept customer deposits[8]. Discussions are currently being held at the political level to submit PostFinance to the supervision of the Swiss Financial Market Supervisory Authority (hereinafter, the "**FINMA**")[9].

### 1.2. Relevant Legislation and Regulation

Swiss banks are mainly regulated by the Swiss Federal Law of November, 1934 on Banks and Savings Bank (hereinafter, the "**Banking Act**") and its implementing ordinances:

- The Ordinance of the Swiss Federal Council of May 17, 1972 on Banks and Savings Banks (hereinafter, the "**Banking Ordinance**");
- The Ordinance of the Swiss Federal Council of September 29, 2006 on Capital Adequacy and Risk Diversification for Banks and Securities Dealers (hereinafter, the "**Capital Adequacy Ordinance**");
- The Ordinance of FINMA of October 21, 1996 on Foreign Banks in Switzerland (hereinafter, the "**FINMA Foreign Banks Ordinance**" or "**FBO-FINMA**");
- The Ordinance of FINMA of June 30, 2005 on the Bankruptcy of Banks and Securities Dealers (hereinafter, the "**FINMA Bank Bankruptcy Ordinance**" or "**BBO-FINMA**").

In their capacity as "*financial intermediaries*", banks are also subject to the Federal Law dated October 10, 1997 on the prevention of money laundering (hereinafter, the "**Money Laundering Act**" or "**MLA**") and the implementing Ordinance of FINMA dated December 18, 2002 on the Prevention of Money Laundering and Terrorist Financing in the Banking, Securities Trading and Collective Investment Schemes Sectors (hereinafter, the "**FINMA Anti-Money Laundering Ordinance 1**" or "**AMLO-FINMA 1**").

Given the submission of Swiss banks to the supervision of FINMA, they are also subject to the Federal Act on the Swiss Financial Market Supervisory Authority dated June 22nd, 2007 (hereinafter, the "**Financial Market Supervision Act**" or "**FINMASA**").

[8] Article 1 of the Banking Act in conjunction with Art. 3a para. 1 Banking Ordinance.

[9] See namely http://www.news.admin.ch/message/index.html?lang=fr&msg-id=27000.

Depending upon the scope of their activities, banks are also often (without limitation) governed by the following legislation:

- Federal Act dated June 23, 2006 on Collective Investment Schemes (hereinafter, the "**Collective Investment Schemes Act**" or "**CISA**"), the Ordinance of the Swiss Federal Council of November 22, 2006 on Collective Investment Schemes (hereinafter, the "**Collective Investment Schemes Ordinance**" or "**CISO**") and the Ordinance of FINMA of 21 December 2006 on Collective Investment Schemes (hereinafter, the "**FINMA Collective Investment Schemes Ordinance** or "**CISO-FINMA**");
- Swiss Federal Act on Stock Exchange and Securities Trading (hereinafter, the "**Stock Exchange Act**" or "**SESTA**") and its implementing Ordinance of the Swiss Federal Council of December 2, 1996 on Stock Exchanges and Securities Trading (hereinafter, the "**Stock Exchange Ordinance**" or "**SESTO**").

**Regulatory circulars** form the lowest level of supervisory regulation (not to be confused with self-regulation). FINMA uses these circulars to describe how the financial market laws are to be implemented. The nature of such circulars is not as directly binding as a decree, which imposes responsibilities or confers rights on the supervised companies in a general and abstract manner. Hence, a supervised bank may challenge a circular in court if the bank deems it contrary to the law or inappropriate. Circulars are thus rather used as a description of supervisory practices. FINMA has issued so far some twenty regulatory circulars applicable to banks, such as:

- FINMA-Circ. 08/1 dated November 20, 2008 (amended on January 1, 2009) on matters requiring authorisation and notification for stock exchanges, banks, securities dealers and audit firms;
- FINMA-Circ. 08/2 dated November 20, 2008 (amended on November 19, 2009) on guidelines on accounting standards under Art. 23 to 27 of the Banking Ordinance;
- FINMA-Circ. 08/4 dated November 20, 2008 on maintenance of securities journals by securities dealers;
- FINMA-Circ. 08/6 dated November 20, 2008 on measurement, management and monitoring of interest-rate risks within the banking sector;
- FINMA-Circ. 08/7 dated November 20, 2008 on outsourcing of business areas within the banking sector;
- FINMA-Circ. 08/8 dated November 20, 2008 on public advertising under the Collective Investment Schemes legislation;
- FINMA-Circ. 08/9 dated November 20, 2008 on supervision of large banks;
- FINMA-Circ. 08/10 dated November 20, 2008 (amended May 10, 2010) on self-regulation recognised as a minimum standard by FINMA;
- FINMA-Circ. 08/11 dated November 20, 2008 on reporting obligation for stock exchange transactions;
- FINMA-Circ. 08/14 dated November 20, 2008 on supervisory reporting for annual and semi-annual financial statements within the banking sector;
- FINMA-Circ. 08/19 dated November 20, 2008 on capital adequacy requirements for credit risks within the banking sector (hereinafter, the "**Capital Adequacy for Credit Risks Circular**" or "**CACR**");
- FINMA-Circ. 08/20 dated November 20, 2008 on capital adequacy requirements for market risks within the banking sector (hereinafter, the "**Capital Adequacy for Market Risks Circular**" or "**CAMR**");

- FINMA-Circ. 08/21 dated November 20, 2008 on capital adequacy requirements for operational risks within the banking sector (hereinafter, the "**Capital Adequacy for Operational Risks Circular**" or "**CAOR**");
- FINMA-Circ. 08/22 dated November 20, 2008 on disclosure obligations regarding capital adequacy within the banking sector (hereinafter, the "**Capital Adequacy Disclosure Circular**");
- FINMA-Circ. 08/23 dated November 20, 2008 on risk diversification within the banking sector (hereinafter, the "**Risk Diversification Circular**");
- FINMA-Circ. 08/34 dated November 20, 2008 on determining regulatory capital using internationally accepted accounting standards within the banking sector.

In line with the new standards of the Basel Committee on Banking Supervision and of the EU, FINMA recently opened a consultation on the **amendment of its circulars governing capital adequacy** on credit and market risks as well as on disclosure obligations and risk diversification within the banking sector[10]. A separate consultation is also taking place for amending **the Capital Adequacy Ordinance**[11]. Both consultations ended on August 20, 2010. With this reform package, the Swiss Government as well as FINMA aim at achieving a significant and sustainable improvement in risk-oriented capital adequacy in those areas that generated the largest losses during the latest financial crisis. On the other hand, the reformatory measures also focus on improving interbank market regulations. The foreseen regulations will particularly affect Swiss big banks in terms of capital adequacy. The tightening in regulations is, however, applicable to all financial institutions. The entry into force of the amended regulations was initially expected for January 1, 2011 but will now most likely be postponed until Fall 2011 or January 2012 (as is expected at the EU level).

Financial market legislation also leaves room for **self-regulation** by the industry via the issuance of rules of conduct. The rules of conduct form a traditional part of the banks' and securities traders' system of self-regulation, and play an important role in the Swiss banking sector. The essential advantages of self-regulation lie in the fact that it relates closely to business practice, is established by bodies with professional expertise and is therefore more readily accepted and implemented. Other positive aspects include the flexibility of self-regulation and the time-efficiency in passing new regulation or amending existing rules. There are different kinds of self-regulation: free or autonomous self-regulation, self-regulation that is accepted as a minimum standard and mandatory self-regulation.

The **free or autonomous self-regulation** is based on the principle of private autonomy and is usually designed without public interference. FINMA may also recognise **self-regulation as a minimum standard** (FINMA-Circ. 08/10). In this context, the Swiss Bankers Association issues self-regulation providing for rules of conduct, which are recognized by FINMA as minimum supervisory standards applicable to all banks in Switzerland. These private rules of conduct *de facto* rank as "ordinary" legislation and any infringements thereof are subject to the same sanctions than those provided by the banking laws. Finally, **mandatory self-regulation** is based on a statutory mandate to establish self-regulatory rules governing a specific topic. Such statutory self-regulation mandates include, for example, Article 37h of the Banking Act (bank deposit protection), or Article 25 of the Anti-Money Laundering Act (specification of due diligence).

[10] See http://www.finma.ch/e/aktuell/pages/mm-eigenmittel-risikoverteilung-20100714.aspx.

[11] See http://www.sif.admin.ch/dokumentation/00513/00548/00549/index.html?lang=en&msg-id=34288.

## II. REGULATORY FRAMEWORK

### 1.1. Swiss Regulator

Switzerland adopted the single regulator system. FINMA started its activities on January 1st, 2009. It replaced as sole financial regulator the following three former authorities: the Swiss Federal Banking Commission, the Federal Office of Private Insurance and the Anti-Money Laundering Control Authority.

In this context, in April 2010, FINMA approved the Guidelines on Financial Market Regulation submitted by the Executive Board and coordinated with the Federal Department of Finance[12]. The Guidelines are based on financial market legislation and define FINMA's regulatory and policy process. It sets down the various principles for FINMA's regulatory activities. In accordance with these principles, these Guidelines emphasize that FINMA may regulate only to the extent that this is necessary to fulfil the goals of supervision (protecting creditors, investors and insurance policy holders, safeguarding the operational efficiency of the financial markets and upholding the reputation and competitiveness of the Swiss financial centre). There are various aspects, which FINMA must take into account in its regulatory activities. These include the costs and impact of any regulatory measures, the various features specific to the institutions supervised (areas of business and risks) and minimum international standards. In addition, FINMA must ensure transparency in the regulatory process and the appropriate and adequate involvement of the parties affected. It must also support self-regulation. The central focus is on the rigorous, clear implementation of the regulatory process, transparency, and the adequate and appropriate involvement of those affected.

According to the Financial Market Supervision Act, the aim of FINMA is to ensure the protection of the investors, creditors, insured persons and to maintain the general functioning of the financial markets in accordance with the relevant Swiss regulation.

FINMA **supervises banks, insurance companies, securities dealers, stock exchanges, collective investment schemes as well as other financial intermediaries in Switzerland**. It is also combating money laundering and is the complaint body for decisions rendered by the Takeover Board in the area of public takeover bids for listed companies. FINMA may also submit a financial group as well as financial conglomerate to its supervision if they are effectively managed from Switzerland or control in Switzerland a bank or a securities dealer organized under Swiss law. The group or conglomerate supervision is carried out as a supplement to the individual supervision on a bank or a securities dealer. FINMA is also in charge with the certification of the independent auditors appointed by supervised companies. Finally, FINMA created a dedicated sector in charge with the supervision of the two big Swiss banks, UBS AG and Credit Suisse Group AG. These two banks are subject to a strict supervision due to their size, their cross-border activities and their importance on the Swiss banking system. FINMA's dedicated specialists monitor their risks on an ongoing basis.

FINMA **delivers licenses for companies subject to its supervision**. It is also in charge with **monitoring the supervised companies** with respect to the compliance with the Swiss regulation and ensures that they are compliant at all times with the conditions for the granting of licenses. The Swiss supervisory authority may also issue its own ordinances or circulars where it is authorized to do so and ensures that self-regulation issued by professional bodies is appropriate[13].

[12] Guidelines for Financial Market Supervision issued by FINMA on April 22, 2010 (available under http://www.finma.ch/e/aktuell/pages/aktuell-lt-finanzmarktregulierung-20100706.aspx).
[13] See Section I, Subsection 1.2 above.

As regards **cooperation with foreign supervisory authorities**, the Financial Market Supervision Act provides that FINMA may require from foreign supervisory bodies the necessary information and documents to ensure the implementation of the Swiss financial regulation. On the other hand, FINMA is also authorized to disclose such information and documents to foreign supervisory bodies, subject that they are bound to confidentiality obligation and that such information or documents are aimed only to supervisory purposes of foreign companies. Should the foreign supervisory bodies have to transmit such information and documents, FINMA has further to ensure that they are used for supervisory purposes. Should a foreign supervisory body require information and documents concerning a client of a Swiss supervised company, additional requirements apply: in particular, FINMA requires from the requesting supervisory authority a formal confirmation that such information and documents will not be passed on other authorities, including tax and criminal prosecution authorities, without its prior approval.

In order to facilitate the international cooperation and the exchange of information with foreign supervisory bodies, FINMA is allowed by the Financial Market Supervision Act to conclude agreements with foreign regulators in order to specify the procedures regarding such cooperation. Currently, FINMA concluded cooperation agreements with the most strategic countries in a Swiss point of view and with whom the most extensive exchange of information occurs. In particular, but without completeness, FINMA concluded cooperation agreements with various US supervisory bodies, including the SEC, as well as German, French, Chinese, Dubai, English, Luxembourg, Singapore and Hong Kong supervisory authorities.

To achieve its supervisory purposes, the Financial Market Supervision Act provides FINMA with general **monitoring instruments**. FINMA may conduct prudential or accounting audit, order investigation or revoke the granted license. It may also take measures against directors and middle management of a supervised company. Further provisions of financial market legislation offer more specific monitoring instruments to FINMA.

Audit may be conducted by FINMA, the independent auditor of the supervised company or any third party appointed by FINMA. The independent auditor must be first certified by FINMA. Audit may concern the accounts of the supervised company as well as any prudential point and compliance with the applicable law. The supervised companies are compelled to disclose any information or document necessary for the audit. FINMA may also conduct audit concerning an entity of a financial group or conglomerate located abroad but subject to the supervision of FINMA.

Should FINMA be aware of indicators of infringement by a supervised company, FINMA may conduct an investigation or appoint in this purpose an expert. Depending on the result of the investigation, FINMA may order the supervised company to comply with the Swiss law or, in case of gross infringement, may revoke the license to operate and order the liquidation of the involved supervised company. The final decision of FINMA can be published as a "shaming measure". Should FINMA consider that a manager of a supervised company gravely committed a breach of the Swiss regulation, it may prohibit the author to perform management functions in any supervised company up to a five-year period. In case of infringement, FINMA is also allowed to sequestrate the gain arising from the infringement and realized either by a supervised company or one of its manager.

## 1.2. Activities Carried Out by Banks and Other Financial Enterprises

### 1.2.1. Activities Carried Out by Banks

According to Article 2a of the Banking Ordinance, banks **can be defined** as companies who accept deposits from the public on a professional basis or solicit these publicly in order to finance in any way, for their own account, an undefined number of unrelated persons or enterprises, with which they form no economic unit, or who refinance themselves in substantial amounts from a number of banks which are not significant shareholders and with which they form no economic entity in order to provide any form of financing for their own account to an undefined number of unrelated persons or institutions.

The Banking Ordinance further specifies that those who accept on a continuing basis **more than 20 deposits from the public** are considered to be acting on a professional basis. Furthermore, public advertising has to be understood as any advertisement that is direct towards the public, including prospectuses, circulars or electronic media.

Any entity which therefore intends to accept deposits from the public or to refinance itself from banks to provide for its own account any form of financing to an undefined number of unrelated persons or institutions is compelled by law to obtain from FINMA a **banking license** to operate before carrying on activities in Switzerland. Banks incorporated under Swiss law as well as branches of foreign banks having a place of business in Switzerland have to obtain a banking license first. The **terms "bank" or "banker"**, alone or in combination with other words, may only be used in the company name, in the designation of the business purpose and in the business advertisement by companies that have obtained such a banking license from FINMA[14].

A banking license is not limited in time; it is valid as long as the requirements set out in the Banking Act are met by the banks. FINMA may withdraw the banking license as soon as the legal requirements are no longer met or if a bank commits a serious breach of the Swiss financial regulation.

As such, the Banking Act does not define the scope of **authorized activities** that may be carried out by Swiss banks. Under Swiss law, banks may perform any kind of banking activities (universal banks). In other words, the Banking Act does not make any distinction between commercial banking activities, investment banking business or even private banking activities. The Banking Act provides however that the scope of the business activities as well as the internal organization have to be precisely defined in the articles of association, by-laws and internal business rules issued by banks. Before granting a banking license, FINMA will carefully check the description of the planed activities of the banks. Banks have to disclose to FINMA subsequent changes in the scope of their activities and have to obtain FINMA's prior approval before running their new activities. The Banking Ordinance further specifies that the geographical scope of activities operated by banks has to be clearly defined. Banks have to adopt the financial and human resources necessary to comply with their activities.

### 1.2.2. Activities Carried Out by Other Financial Enterprises

Other financial enterprises can carry out any financial business, except banking activities and subject to the prior obtaining of the necessary license, if any, granted by FINMA. In this respect, it should be noted that:

[14] Art. 1 of the Banking Act.

- **Asset management** is not a regulated business under the Swiss financial legislation, provided that the assets under management are deposited with a third party. Therefore, this activity is not subject to a license from FINMA. However, asset managers are subject to the Swiss anti money laundering regulation. In addition, if asset managers wish that their clients, with whom they entered into a written discretionary management agreement, benefit from the "*qualified investor*" status within the meaning of Article 10 para. 3 lit. e of the Collective Investment Schemes Act, they must be affiliated with a professional organization having adopted regulations that are recognized by FINMA as meeting its minimum requirements[15]. As a matter of example, the Code of conduct of the Swiss Association of Asset Managers (ASG) dated April 27, 2009 is deemed to meet this test.

- **Securities trading** is subject to a license from FINMA. Securities dealers are natural persons or legal entities who buy or sell securities in a professional capacity, on the secondary market, either for their own account with the intent of reselling them within a short period of time or for the account of their clients. Natural persons or legal entities making public offers of securities to the public on the primary market or creating derivatives and offering them to the public are also subject to the supervision of FINMA and therefore have to obtain a license before carrying out their activities according to the Stock Exchange Act.

- **Forex trading** is nowadays also a regulated activity subject to a FINMA license. Swiss financial legislation does not define the notion of forex dealers. However, forex dealers should be understood as physical persons or entities maintaining deposits in their name in order to carry out forex operations on behalf of their clients. Further to an amendment of the Banking Ordinance dated April 1, 2008, forex dealers acting on behalf of their clients are now required to obtain from FINMA a banking license. Most of former forex dealers operating in Switzerland prior to the amendment of the Banking Ordinance had to stop their activities, whereas three of them have applied for a banking license. At the date hereof, there is to the best of our knowledge only one applicant which was granted such a banking license.

- **Public offering of collective investment schemes** is also subject to FINMA's prior approval (Art. 19 CISA). Swiss and foreign investment funds publicly offered in or from Switzerland are subject to such authorization. Public advertising is considered to be the utilization of any type of advertising media that serves the purpose of directly or indirectly offering or distributing specific collective investment schemes[16]. There is no public offering if the collective investment schemes are exclusively offered to so-called *qualified investors*[17]. Qualified investors within the meaning of Article 10 para. 3 CISA include (a) regulated financial intermediaries such as banks, securities dealers and fund management companies, (b) regulated insurance institutions, (c) public entities and retirement benefits institutions with professional treasury operations, (d) companies with professional treasury operations, (e) high net worth individuals who confirm to regulated financial intermediaries that they own, directly or indirectly, at least two million Swiss Francs in financial placements at the time of the acquisition of the collective investment scheme[18] and (f) investors who have concluded a written discretionary management agreement with a

[15] Art. 6 para. 2 of the Collective Investment Schemes Ordinance.

[16] Circular 08/2008 describing the term "*public advertisement*" as relates to collective investment schemes as well as authorization criteria for distributors issued by FINMA on November 20, 2008

[17] Art. 3 CISA.

[18] Art. 6 para. 1 CISO.

regulated financial intermediary, including independent asset managers, provided they are subject to the Money Laundering Act, they are subject to a code of conduct adopted by a professional organization that is recognized by FINMA as meeting its minimum requirements and the discretionary management agreement complies with the rules adopted by such professional organization[19]. Distributors, fund management companies, custodian banks, asset managers of Swiss collective investment schemes and representatives of foreign collective investment schemes are also subject to both authorization and supervision of FINMA. Finally, structured products such as capital-protected, capped return products and certificates may only be offered publicly in or from Switzerland if they are issued or distributed by a bank, an insurance company, a securities dealer or a foreign institution subject to equivalent standards of supervision.

- **Life insurance, non-life insurance, reinsurance and health insurance** are activities subject to FINMA's supervision[20]. Life insurance covers the financial risks linked with the duration of the human life. Non-life insurance covers risks related to wealth (in particular financial losses, civil liability, legal expenses), individuals (accidents or health) and objects (movable assets, property and premises, vehicles). In the field of health insurance, FINMA is only responsible for the supervisory of the supplementary health insurance, the Swiss Federal Office of Public Health being responsible for the mandatory health insurance as well as the voluntary daily benefit insurance. Finally, the reinsurance business is also subject to FINMA's supervision. For each form of insurance business, compliance with Swiss law as well as contractual obligations, risk monitoring and protection against abusive practices are subject to the supervision of FINMA, which grants an insurance license to insurance companies before they carry out any activity in this respect. [21]

- **Stock exchanges** shall cover any organization which is set up for the purpose of securities trading and which enables the simultaneous exchange of offers of securities among a number of securities dealers as well as the execution of transactions. Trading systems that facilitate the exchange of electricity are under Swiss law also deemed to be stock exchanges. Domestic stock exchanges are fully submitted to FINMA's supervision and have to be granted with an operating license that is delivered as soon as the stock exchange rule book and its internal operational and administrative organization have been approved by FINMA. Ongoing audits are conducted by the Swiss supervisory authority. Foreign stock exchanges are also subject to FINMA's supervision if they intend to allow securities dealers in Switzerland to access by electronic means to their trading systems. Furthermore, FINMA may decide to submit to the Stock Exchange Act modern trading systems and multilateral trading facilities similar to stock exchanges. Finally, jointly with the Swiss National Bank, FINMA is also responsible for the supervision of payment and securities settlement systems, FINMA being in charge of the prudential supervision of the system operators and the Swiss National Bank of the oversight of the settlement systems themselves. Foreign operators of such systems providing their services in Switzerland are also subject to license.

[19] Art. 6 para. 2 CISO.
[20] Art. 3 of the Swiss Federal Act of April 2, 1908 on Insurance Contracts (hereinafter the « Insurance Contract Act »)
[21] For regulation on so-called "life insurance wrappers", see Section IV, Subsection 1.3 below.

### 1.3. Authorization Requirements

As afore-mentioned, most of the financial activities are subject in Switzerland to the granting of a license by FINMA. Where the business of a financial intermediary is subject to an authorization of FINMA, such license must be granted by FINMA **prior to engaging in business operations in or from Switzerland**.

Initial authorization conditions are multiple and must be complied with at all times. It would not be possible to expose exhaustively hereunder all of these requirements so that only the most important ones are enumerated herein.

#### 1.3.1 Authorization Requirements for Banks

FINMA will grant a banking license **<u>if all of the following conditions are met</u>**:

a) The articles of association, by-laws and business rules of a bank provide for a clear definition of the bank's scope of business and establish an adequate organization corresponding to the scope of the banking activities. In case of significant business activities and to ensure the effective supervision of a bank's management, a bank must create separate bodies for the management on the one hand and for the direction, supervision and control on the other hand.[22] Upon granting of the license, any amendment to these documents have to be disclosed and submitted to the prior approval of FINMA[23]. Furthermore, Swiss banks have to notify FINMA before they establish a subsidiary, branch, agency or representation office abroad[24]. However, the notification to FINMA should not be regarded as a formal approval but rather like a check on the planed operations and transactions and to ensure that activities carried on abroad will be subject to supervision. Finally, outsourcing of every business area is authorized without the prior formal approval of FINMA, subject to compliance with FINMA – Circular 08/7 concerning outsourcing by banks.

b) Banks have the minimum fully paid-in share capital as determined by the Swiss Federal Council[25].

c) Directors and managers enjoy a good reputation and ensure the proper conduct of the business operations (so-called "*fit and proper test*")[26]. This has become a cornerstone of Swiss banking law. It applies not only to the bank's managers and corporate bodies but to the bank itself. FINMA has developed an extensive practice on this specific subject matter.

d) Shareholders of banks holding 10% of the capital or voting rights or whose business activities are such that they may influence the banks in a significant manner (so-called "*qualified participation*") have guaranteed that their influence will not have a negative impact on a prudent and solid activity[27]. Once the license granted, any natural person or legal entity has to notify FINMA prior to acquiring or selling, directly or indirectly, a qualified participation. The same applies to thresholds of 20, 33 and 50%. At least once a

[22] Article 3 para. 2 lit. a of the Banking Act.
[23] Article 3 para. 3 of the Banking Act.
[24] Article 3 para. 1 of the Banking Act.
[25] Article 3 para. 2 lit. b of the Banking Act; Article 4 of the Banking Ordinance (minimum capital requirement: currently CHF 10'000'000.-).
[26] Article 3 para. 2 lit. c of the Banking Act.
[27] Article 3 para. 2 lit. cbis of the Banking Act.

year, the banks have to disclose the identity of their principal shareholders. As a consequence, merger and demerger have also to be notified to FINMA for its prior approval.

e) Managers must have their domicile in a place where they may exercise the management in a factual and responsible manner[28]. Swiss banks must be managed from Switzerland. Additional requirements apply for foreign-controlled banks.

f) Banks must maintain individually and on a consolidated basis appropriate capital adequacy and liquidity. Requirements are in particular detailed in the Capital Adequacy Ordinance in order to ensure permanent and adequate ratios between their equity and their total liabilities. Swiss regulation in this respect complies with the international standards issued by the Basle Committee.

g) Banks have to maintain a proper and adequate organization, in accordance with the importance of the scope of their activities. In particular, where the business purpose or volume are significant, banks have to implement a special governing body responsible for direction, supervision and control. Banks have to provide for an effective internal segregation of functions between trading, asset management and back office; they also have to maintain risk management procedures for the approval of high-risk transactions as well as monitoring market, credit, default, settlement, liquidity, image, operational and legal risks.

h) Banks have to appoint external banking auditors, which are themselves authorized by FINMA.

#### 1.3.2. Authorization Requirements for Securities Dealers

Chapter 3 of the Stock Exchange Act provides most of the requirements to be complied with at the time of incorporation as well as at any time by securities dealers. In the event that the conditions for such license are altered subsequently, securities dealers have to seek the approval of FINMA to continue running operations. Main requirements can be summarized as follows:

a) Organization and internal rules of the securities dealers ensure compliance with the obligations provided by the Stock Exchange Act. The articles of association, by-laws and internal rules issued by the securities dealers have to describe the geographical scope of its activities and the nature of the planed transactions for the account of its clients. Within 60 days as from the close of financial year, they also have to disclose to FINMA the name of the stock exchanges where they are registered as member to operate. Securities dealers operating under Swiss law have to inform FINMA before they establish a subsidiary, branch or representation office abroad. However, the notification to FINMA should not be regarded as a formal approval but rather like a verification on the planed operations and transactions and to ensure that activities carried on abroad will be subject to supervision as well as to ensure the proper organization of the foreign office and an adequate diversification of risks. Subsequent amendment to the above-mentioned documents and any change in the requirement for authorization to FINMA or in the activities of foreign subsidiaries, branches and representation offices or the appointment of new external auditors by the foreign entities have to be reported to FINMA.

[28] Article 3 para. 2 lit. d of the Banking Act.

b) The securities dealers have a sufficient amount of own funds available and comply with the minimum capital as determined by the Swiss Federal Council[29].

c) Securities dealers have to provide for an effective internal segregation of functions between trading, asset management and back office. Therefore, for the purpose of identifying and monitoring risks, securities dealers have to issue internal directives, subject to the approval of FINMA, regarding the basic principles of risk management as well as the procedure and the responsibility for authorizing transactions involving risks.

d) Securities dealers must provide information on senior staff (in particular on nationality, domicile, significant interests in other companies, pending judicial and administrative procedures, a signed curriculum vitae, references and an extract of the criminal register[30]) and principal shareholders (identity as well as the percentages of the capital held). Principal shareholders are natural persons or legal entities who hold, directly or indirectly, at least 10% of the capital or voting rights of a securities dealers or who can otherwise exert a significant influence on the latter's business activities. Approval of FINMA is required before a principal shareholder acquires or sells a significant interest in a securities dealer. The same rules apply for thresholds of 20, 33 and 50%. Yearly disclosure of the principal shareholders has also to occur within the 60 days as from the close of the financial year.

e) Securities dealers are subject to daily record and reporting requirements. They must keep a daily record of orders received and of the transactions carried on. Recorded information has to enable the reconstruction of the transactions. In order to ensure a transparent market, they also have to report all the necessary information.

f) Securities dealers have to appoint external auditors, which are themselves authorized by FINMA.

g) Yearly accounts have to be published or made available to the public.

#### 1.3.3. Authorization Requirements for Stock Exchanges

Chapter 2 of the Stock Exchange Act provides the main requirements to be complied with at the foundation as well as at any time by stock exchanges. It should be however noted that self-regulation issued by stock exchanges deal with their organization, administration, supervision, as well as listing procedures and market organization and supervision. The main requirements can be summarized as follows:

a) Internal organization of stock exchanges allow them to comply with the Act and is appropriate for its activities. In particular, stock exchanges have to appoint a body for the admission of securities, where investors and issuers have to be adequately represented. Further, the management has to be independent from the body in charge with the supervision, the internal regulation and the control. Members of this unit have to be senior officials. The appointment of the head of the surveillance office is subject to the approval of FINMA.

[29] Minimum capital requirement is currently CHF 1'500'000.- in accordance with Art. 22 of the Stock Exchange Ordinance.
[30] Art. 23 par. 1 letter a of the Stock Exchange Ordinance.

b) Stock exchanges must be able to carry out the necessary investigations where FINMA or any other authority suspect breaches of the law or any other irregularities.

c) Stock exchanges have to inform FINMA before admitting foreign securities dealers as members or prior to the establishment of a subsidiary, a branch or a representative office abroad.

d) Self-regulation and any amendment thereof must be submitted to the approval of FINMA.

e) Self-regulation issued by stock exchanges has to ensure efficiency and transparency of the markets. Stock exchanges have to maintain daily records of all transactions executed and all the necessary information to enable the reconstruction of the transactions. They have to ensure that all information necessary to maintain transparency on the markets is made public, such as prices and volumes traded. They also have to supervise the price formation, execution and settlement of transactions to ensure that insider trading, price manipulation or other breaches of law may be detected. In case of suspicion of any breach of law or exchange regulation, stock exchanges have to inform FINMA.

f) Self-regulation subject to the approval of FINMA must also deal with the admission, duties and expulsion of securities dealers to ensure equal treatment. It also provides the conditions to the listing of securities and their negotiability. In case of rejection or admission of a securities dealer or the listing of securities, the stock exchanges have to set up an independent appeal board with which an appeal can be lodged in this regard. Organizational structure, rules, procedures and nomination of its members are subject to the approval of FINMA.

g) Stock exchanges organized under foreign law must seek authorization from FINMA prior to provide Swiss securities dealers with access to their systems. FINMA grants a license if the foreign stock exchange is subject to appropriate supervision and the foreign supervisory authorities authorize cross-boarder activities, guarantee that they will inform FINMA where it comes to their attention that a Swiss securities dealers is in breach with the law or the exchange regulation and grant FINMA with administrative assistance.

h) FINMA decides at its own discretion whether institutions similar to stock exchanges are subject to the provisions of the Stock Exchange Act.

#### 1.3.4. Authorization Requirements for Collective Investment Schemes

Under the Collective Investment Schemes Act, Swiss and foreign investment funds, distributors, fund management companies, custodian banks, asset managers of Swiss collective investment schemes and representatives of foreign collective investment schemes are subject to both authorization and supervision of FINMA.

As a general rule, licenses are granted if the persons responsible for the management and the business operations have a good reputation, guarantee proper management, possess the requisite professional qualifications ("*fit and proper test*"); principal shareholders are of good reputation and do not exert their influence to the detriment of a prudent and sound business practice; sufficient financial guarantees are available; and if the above-mentioned entities comply with the Collective Investment Schemes Act.

1.3.4.1. Swiss Collective Investment Schemes

Under the Collective Investment Schemes Act, Swiss investment funds may be either **open-ended** or **closed-ended**. Open-ended funds may take the form of a contractual fund or of an investment company with variable capital (SICAV), whereas closed-ended funds may take the form either of a limited partnership for collective investment or of an investment company with fixed capital (SICAF). Investment restrictions set out in the Collective Investment Schemes Act must at all times be respected.

The Collective Investment Schemes Act submit Swiss collective investment schemes to numerous conditions, which cannot be exhaustively enumerated in this document. The main requirements can be summarized as follows:

a) The designation of "collective investment scheme" must not provide any grounds for confusion or deception, in particular in relation to the investments. Designation such as "investment fund", "SICAV" or "SICAF" can only be used for the relevant collective investment schemes governed by the Collective Investment Schemes Act.

b) **Contractual funds** are based on a collective investment agreement under which the management company commits itself to involve investors in accordance with the number and type of units that they acquired in such funds and to manage the funds' assets in accordance with the provisions of the collective investment agreement at its own discretion and for its own account.

The collective investment agreement sets out the right and duties of the investors, the fund management company and the custodian bank. In particular, it contains provisions regarding the investment policy, risk diversification and risks disclosures linked with the investment in the fund, the calculation of the net asset value, the type and the calculation of the fees, the media of publication, the unit classes, the classes of units, the restructuring and the duration of the collective investment agreement. Any amendment of the collective investment agreement has to be submitted to FINMA by the fund management company, with the consent of the custodian bank.

The management company must be a corporation with registered office and main administrative office in Switzerland. Its minimum paid-up capital amounts to CHF 1'000'000.-. Capital adequacy is calculated as a percentage of the assets under management but cannot exceed CHF 20'000'000.-. The primary object of the management company is the conduct of fund business but may perform additional services on an ancillary basis, such as asset management, investment advisory services and safekeeping or technical administration of collective investment schemes. Management companies have to appoint external auditors. Outsourcing of investment decisions or other specific tasks is allowed without the approval of FINMA, subject to the interest of efficient management. The rights and duties of a fund management company may be transferred to another fund management company, subject to the consent of the custodian bank and the approval of FINMA.

c) **Investment companies with variable capital** (so-called "*société d'investissement à capital variable*" or "SICAV") are subject to the general provisions of the Swiss Code of Obligations governing corporations. The Collective Investment Scheme Act provides however particular provisions and requirements for the SICAV. First, the company name must contain a description of the legal status or the abbreviation thereof (SICAV). Its sole object is the management of its assets. At incorporation of a self-managed SICAV, the company shareholders have to pay-in a minimum investment amount of CHF 500'000.-,

whereas for an externally managed SICAV, it shall be of at least CHF 250'000.-. These minima investment amounts have to be maintained at all times. Any shortfall has to be immediately notified to FINMA. Furthermore, capital adequacy is calculated as a percentage of the assets under management but cannot exceed CHF 20'000'000.-. Articles of association must contain provisions concerning the company name, its registered office, its object, the minimum investment amount, rules governing the convocation of the general meetings as well as the executive and governing bodies and the media of publication. They may also contain provisions regarding the duration of the SICAV, the restriction of shareholder eligibility to qualified investors and associated limitation of the transferability of shares, the categories of shares and rights associated therewith, the delegation of the management and the procedural details and the passing of resolutions by means of correspondence. Delegation of the administration of a SICAV is allowed only to a licensed fund management company. SICAV have to appoint external auditors. The directors holding executive powers at the SICAV and custodian bank must be independent of the other party. Finally, the board of directors is responsible for issuing the prospectus and the simplified prospectus.

d) A **limited partnership for collective investment** (so-called "*société en commandite de placement collectif*" or "*SCPC*") is a type of company whose sole object shall be collective capital investment. It can only conduct investments in risk capital. At least one member bears unlimited liability while the other members are liable up to a specified amount. Limited partnerships are subject to the general provisions of the Swiss Code of obligations unless provided otherwise in the Collective Investment Schemes Act. General partner must be a corporation under Swiss law with registered office in Switzerland and can only be active in one limited partnership for collective investment. The company name must refer to its legal status. The company agreement must deal with the object, the name, the duration and the registered office of the limited partnership for collective investment as well as the total limited partner's contributions and the conditions of their admission and exclusion, the delegation of management and representation and the appointment of the custodian bank, paying agent and external auditors. The prospectus specifically sets out the investment policy and restrictions.

e) **Investment companies with fixed capital** (so-called "*société d'investissement à capital fixe*" or "SICAF*")* are corporations pursuant to the general provisions of the Swiss Code of obligations, unless otherwise provided by the Collective Investment Schemes Act. Their sole object shall be the collective capital investment. The company name must contain the designation of its legal status or its abbreviation (SICAF). While the share capital must be fully paid up, the issuing of voting shares, participation certificates, dividend right certificates and preference shares is prohibited. A SICAF must appoint a custodian bank, a paying agent and external auditors. The articles of association as well as the prospectus provide the investment policy and restrictions, together with the risks associated with the investments.

1.3.4.2. Foreign Funds and Swiss Representatives

If foreign collective investment schemes are distributed in or from Switzerland to the public by means of public advertisement[31], those funds have to be registered with FINMA. Relevant documents such as articles of association, sales prospectus or collective investment agreements have to be filed with and approved by FINMA. The main requirements are as follows :

a) To be authorized in Switzerland, the foreign collective investment funds have to be subject to public supervision which is intended to protect the investors in the country of domicile of the foreign collective investment schemes.

b) Organization, investor rights and investment policy of the foreign collective investment schemes are equivalent to the provisions of the Collective Investment Schemes Act.

c) Designation of "collective investment scheme" cannot provide grounds for confusion or deception.

d) A Swiss representative and paying agent has to be appointed by the foreign collective investment schemes. The paying agent must be a bank subject to the Banking Act. The Swiss representative agent has to be appointed prior to public distribution of foreign collective investment schemes in or from Switzerland. The purpose of the Swiss representative is to represent the foreign collective investment schemes with regard to investors and FINMA. Such power of representation cannot be limited. It is the responsibility of the representative to comply with the reporting and publishing obligations as provided under the Collective Investment Schemes Act. Identity of the representative has to be disclosed in every publication concerning the foreign collective investment schemes. The place of performance for units of the foreign collective investment schemes publicly offered in Switzerland is the registered office of the representative.

e) The representative must have a minimum paid-up capital of CHF 100'000.- and benefit from an adequate professional indemnity insurance of at least CHF 1'000'000.-.

1.3.4.3. Distributors

Distributors are those natural or legal persons who offer or distribute units of collective investment schemes to the public by means of public advertisement in the meaning of the Circular 08/2008 describing the term "public advertisement" as relates to collective investment schemes as well as authorization criteria for distributors on November 20, 2008 issued by FINMA.

Before offering units in or from Switzerland, distributors have to be granted a license by FINMA.

Requirements can be summarized as follows:

a) Distribution activities are covered by an appropriate professional indemnity insurance amounting at least to CHF 250'000.-.

b) Distributors have to provide FINMA with evidence of procedural details in relation to the distribution of units.

[31] Circular 08/2008 describing the term "public advertisement" as relates to collective investment schemes as well as authorization criteria for distributors issued by FINMA on November 20, 2008.

c) Distributors have to provide FINMA with copies of distribution agreements with the fund management companies, the SICAV or the SICAF or the Swiss representative of foreign collective investment schemes.

1.3.4.4. Custodian banks

Swiss collective investment schemes have to deposit their assets with a bank pursuant to the Banking Act. Main duties of a custodian bank are as follows:

a) Custodian banks are responsible for the safekeeping of the funds' assets, the issue and the redemption of the units and the payment transfers on behalf of the funds. In case of collective investment funds comprising sub-funds, the same custodian has to perform all duties for each sub-fund. However, custodian banks may transfer the responsibility for safekeeping of the funds' assets to third-party custodians and collective securities depositaries in Switzerland or abroad.

b) Custodian banks have to ensure that Swiss collective investment schemes comply with the Collective Investment Schemes Act, in particular with investment provisions. In addition to the calculation of the net asset value and the issue and redemption prices, custodian banks have to verify that the investment decisions taken by the asset managers comply with the provision of the Collective Investment Schemes Act as well as those of the funds regulation. Custodian banks also have to verify whether the funds' incomes are allocated in accordance with the funds' regulation.

c) Custodian banks disclose to the external auditors of the Swiss collective investment schemes the identity of the persons entrusted with the management and the business operations as well as their above-mentioned tasks. Such persons have to be of good reputation, possess the requisite professional skills and guarantee proper management.

d) Change of custodian banks has to be approved in advance by FINMA. FINMA publishes its decision in the media of publication.

1.3.4.5. Asset Managers of Swiss Collective Investment Schemes

According to Article 18 of the Collective Investment Schemes Act, assets managers of Swiss collective investment schemes with registered domicile in Switzerland may be either natural persons or legal entities in the form of joint-stock companies, partnerships limited by shares, companies with limited liability or general and limited partnerships.

Asset managers must maintain at all time a minimum capital of CHF 200'000.-[32]. They also have to describe the geographical scope of their business as well as the operations to be carried on into their articles of association, the company agreement or the organizational regulations. Where they intend to operate a subsidiary, a branch or a representative office abroad, they have to provide FINMA with information such as the name of the foreign entity, the name of the persons entrusted with the management and the business operations, the appointed external audit firm in order to allow the supervisory authority to assess the compliance with their duties. Asset managers have to notify FINMA forthwith of any material change in relation with their foreign entities. Further, under their own responsibility, asset managers are allowed to outsource part of their activities without approval of FINMA,

[32] Art. 19 of the Investment Collective Schemes Ordinance.

provided that this is in the interests of efficient management. Finally, they are compelled by law to conclude written agreements with their clients to govern the rights and obligations of the parties thereof.

#### 1.3.5. Authorization Requirements for Insurance Companies

Business of life insurance, non-life insurance, reinsurance and health insurance are activities subject to the supervision of FINMA in accordance with the Insurance Contract Act. This Act applies to insurance companies with registered office in Switzerland, insurance companies with registered office abroad but carrying out insurance activities other than reinsurance in or as from Switzerland, groups or conglomerates of insurance and insurance intermediaries.

The Insurance Contract Act provides both general requirements applicable to all insurance companies and specific provisions regarding certain insurance activities. General conditions applicable to all insurance companies can be summarized as follows :

a) Geographical scope and types of business have to be defined by the articles of association and the business plan to be submitted for approval to FINMA.

b) The insurance companies have to be structured as corporations or cooperative companies under Swiss law.

c) Depending on the insurance activities, the paid-up capital has to amount between CHF 3'000'000.- and 20'000'000.-, as provided by the Insurance Supervision Ordinance. The same rules apply regarding the capital adequacy, based on criteria such as the geographical scope of activities, risks of insurance depending on the insurance activities and business volume.

d) Insurance companies have to dispose from organization funds to cover foundation and development fees corresponding up to 50% of the minimum capital.

e) The sole object of insurance companies is providing insurance services. FINMA may however authorize other activities, should they not alter the interests of insured persons.

f) Life insurances are not authorized to carry on other insurance activities other than health and accident insurances.

g) Foreign insurance companies have to be granted with a license in the country where they have registered offices. They can only have branches in Switzerland and capital as well as funds of organization of the foreign company have to comply with the Swiss requirements. Furthermore, foreign companies have to deposit a portion of the solvability margins.

h) Insurance companies have to provide FINMA with information on principal shareholders (identity as well as the percentages of the capital held). Principal shareholders are natural persons or legal entities who hold, directly or indirectly, at least 10% of the capital or voting rights of an insurance company or who can otherwise exert a significant influence on the latter's business activities. Approval of FINMA is required before a principal shareholder acquires or sells a significant interest in insurance companies. The same rules apply for thresholds of 20, 33 and 50%.

i) Actuarial provisions and tied assets have to be submitted to FINMA.

j) Insurance companies have to evidence that they maintain an internal organization as well as an internal control body to continuously assess and monitor the risks. They also have to appoint external auditors, which are licensed by FINMA.

## III. SUPERVISION OF PRUDENTIAL OPERATION – PERSONAL AND MATERIAL CONDITIONS OF BANK OPERATIONS

### 1.1. Regulatory Capital Requirements and Limitations on Taking Risks[33]

The balance sheet of a bank differs substantially from that of an industrial company. The assets of a bank are predominantly financial assets, while liabilities are primarily client deposits and borrowed funds (the majority of which are short- term). The Banking Act provides that banks shall have enough equity capital to ensure they can cover any losses before creditor claims are impaired. Equity is then used as a cushion for such losses. Presently, the weighted (at various rates) assets on the balance sheet that involve risk, certain off-balance sheet transactions, as well as open securities positions, foreign exchange and derivative transactions must be covered by **8% equity**. The rates are inversely proportionate to the security of the positions to be covered. The capital adequacy requirements must be met both individually and on a consolidated basis. Statutory equity capital covers market, credit and operational (e.g. business disruption) risks of banks.

Banks and securities dealers have for decades been required to adhere to statutory provisions on capital adequacy and risk diversification. Capital adequacy requirements define the minimum amount of equity capital banks and securities dealers must hold to sufficiently cover loss exposure from their business operations. The aim is to ensure that such financial institutions sustaining substantial losses do not become insolvent, which could in its wake lead to greater financial damage. On the other hand, risk diversification requirements regulate the maximum counterparty risk an institute may take. In particular, it is intended to avoid that an institute runs into financial difficulties and causes widespread financial damage should there be a default in credit payments relevant to the institute's equity capital.

The international minimum standards applicable to capital adequacy are set down by the Basel Committee on Banking Supervision of which Switzerland is also a member. At the beginning of 2007, the new minimum standards of the Basel Committee ("Basel II") were implemented in Swiss law, on the one hand, by the enactment of the Capital Adequacy Ordinance, and on the other hand, by the entering into force of the FINMA circulars, which contain the implementing provisions for the CAO, in particular the Capital Adequacy for Credit Risks Circular, the Capital Adequacy for Market Risks Circular, the Capital Adequacy for Operational Risks Circular, the Capital Adequacy Disclosure Circular and the Risk Diversification Circular.

Switzerland adopted all three pillars required under Basel II. These requirements pertain to capital adequacy (pillar 1), supervisory process for banks (pillar 2) and transparency and disclosure (pillar 3).

[33] See namely *The Swiss Banking Sector, Compedium 2010*, Swiss Banking Association, Basel, April 2010, p. 64 et seq. (available under http://www.swissbanking.com/en/home/shop.htm).

The objective of Basel II is to enhance equity capital regulation in general, in particular by increasing risk sensitivity – i.e. the correlation between risk (credit, market and operational risk) and statutory capital. Basel II subtly differentiates the types of risk and provides for individual methods of determining the appropriate equity capital that is needed in each respective case (menu approach). The implementation in Switzerland is generally deemed strict, yet differentiated and pragmatic and continues to be supported by the banking sector.

In December 2008, the former Swiss Federal Banking Commission agreed with Credit Suisse and UBS to raise the existing capital adequacy requirements and introduce additional elements to the regime. The new capital adequacy ratios were defined and communicated by the financial supervisor to the two big banks with a formal decree on November 20, 2008. First, requirements were raised substantially with regard to risk-weighted capital (Basel II). Both banks are now required to hold equity capital at 50% to 100% in excess of the international minimum requirement, with a target of 200% in times of economic prosperity (100% each for pillars 1 and 2). Second, a leverage ratio was introduced for both banks. The new non risk-weighted, nominal parameter will cap the sum of assets financed by debt. The leverage ratio defines the proportion of core capital to total assets and it will be set for both banks at a minimum of 3% at group level and at 4% for the individual institutions. The expected target leverage ratio in good periods is above the minimum level, thus countering the cycle. As both banks' domestic lending activities are important for the Swiss economy, this segment is exempted from the leverage ratio. Both banks have to comply with these tighter Basel II requirements as well as the leverage ratio requirements by 2013.

It should be noted that FINMA issued on July 23, 2010 information on the stress tests conducted on both Swiss big banks[34]. In its latest analysis, FINMA tested the resistance of these institutions to a global recession, accompanied this time by a deterioration in the finances of European states. It results from these stress tests that in the event a stress event arise, both banks would still have a solid capital base, with tier 1 capital ratios of at least 8% FINMA announced last autumn that it had been conducting various stress tests on Swiss banks since 2008. The tests are designed to assess the impact that a sharp deterioration in economic conditions might have on Swiss banks. In particular, FINMA has since the start of 2009 conducted regular stress tests (analyses of potential loss) on the country's two large banks. Analyses of this kind are a key component of its normal supervisory activities. FINMA requires Credit Suisse and UBS to have sufficient excess capital and liquidity to enable them to absorb unforeseen events at any time. The large banks should therefore have a tier 1 ratio of at least 8% even under such stress scenarios. If this requirement were not met, FINMA would work with the institution in question to consider reducing its risk positions and/or strengthening its capital base and then instruct suitable measures. The stress scenarios are developed in conjunction with the Swiss National Bank. The latest scenario covers different regions of the world over a two-year period. It assumes a global recession, accompanied by a slump in prices on the financial and real estate markets. Developments in Europe have also been added, with specific and very sharp shocks assumed for some European countries. In view of UBS and Credit Suisse's relatively low exposure to these countries, however, the impact of these particular shocks turns out to be small.

[34] Information issued by FINMA on stress tests, July 23, 2010 (available under http://www.finma.ch/e/aktuell/pages/mm-stresstesting-20100723.aspx).

Simultaneously to the publication of the results of the stress tests conducted by FINMA, ECOFIN Council and the Committee of European Banking Supervisors (CEBS) announced the results of a coordinated stress test analysis in the EU[35]. Although FINMA's approach is similar to CEBS approach in its design, the stress test results are not. Switzerland's specificity in having large banks of great systemic importance, requires the design of particularly severe scenarios. The latest analysis shows that the two large banks would have a tier 1 ratio of at least 8% under the stress events tested. It should be borne in mind, however, that such stress tests are based on estimates and cannot simulate all possible outcomes.

### 1.2. Revisions of FINMA Circulars on Market and Credits Risks, Capital Adequacy Disclosure and Risk Diversification[36]

The 2008 financial market crisis clearly demonstrated the shortcomings in the trading business and securitisations of banks and the fragility of the interbank market. Based on new standards of the Basel Committee on Banking Supervision and the European Union, FINMA intended addressing these defects and opened on July 14, 2010 a consultation phase to adapt four circulars regulating this area. The consultation is being conducted in agreement with the State Secretariat for International Financial Matters (SIF), which, at the same time, is also holding a consultation on amending the Capital Adequacy Ordinance. Both consultations should have ended on August 20, 2010[37].

Neither in "Basel II" nor in "Basel I", which was valid until the end of 2006, did the Basel Committee issue any detailed provisions on risk diversification requirements. Subsequently, since the 1990s, Swiss risk diversification requirements have essentially been based on EU regulations for large exposures. By integrating Basel II into Swiss law, the current provisions have been supplemented by an approach that comes very close to EU regulations: "the international approach to risk diversification." Alongside the implementation of Basel II in Switzerland, it was combined with the international approach to covering loss exposure from credit transactions in order to save internationally active institutes from having to make costly and time-consuming double-entry calculations, a concern which the institutes themselves had voiced. In the meantime, more than 40 Swiss banks and securities dealers, amongst which are also Switzerland's two big banks and numerous foreign bank subsidiaries, apply the international approach to risk diversification.

Prior to the financial crisis, the Basel Committee and the EU were actively making improvements to "Basel II" and the EU regulations on loss exposure (and risk diversification). The financial crisis considerably influenced these reforms, particularly in the case of Basel II, in terms of time and content. In July 2009, the Basel Committee published its first response to the financial crisis by tightening the provisions on covering loss exposure from trading operations and securitizations, which stood at the core of the financial crisis. Likewise in July 2009, the EU published its revised requirements for large exposures and risk diversification. In December 2009, the Basel Committee went on to issue its proposals for a further comprehensive revision of its minimum standards. This is unofficially referred to as "Basel III" and should be concluded in the course of 2010.

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[35] Information issued by CEBS on stress tests, July 23, 2010 (available under http://www.c-ebs.org/EuWideStressTesting.aspx).

[36] See in particular *Key points Revisions of FINMA Circulars on market and credit risks, capital adequacy disclosure, and risk diversification*, July 14, 2010 (see http://www.finma.ch/e/regulierung/anhoerungen/Documents/kp-eigenmittel-risikoverteilung-20100714-e.pdf).

[37] The results of public consultation were still unknown at the time of drafting this national report.

The proposed amendments concern the Capital Adequacy Ordinance and four FINMA circulars containing the relevant implementing provisions, i.e. the Capital Adequacy for Credit Risks Circular, the Capital Adequacy for Market Risks Circular, the Capital Adequacy Disclosure Circular and the Risk Diversification Circular. These changes aim to safeguard the continuing compatibility of Swiss regulation with the international reference standards applicable; even more importantly from a prudential viewpoint, it is intended that the new rules, which are to enter into force as planned at the beginning of 2011, will eliminate the deficits in the current regulations which emerged during the financial crisis.

The financial crisis has demonstrated abundantly clear that capital adequacy to cover loss exposure from trading operations and securitizations was too low. This was clearly the case for institutes with investment banking units whose equity capital for market risks was determined on the basis of a model approach (key word "value at risk"). The revised Basel prescriptions, which will cause these institutes to significantly increase their capital adequacy requirements for market risks (at least three times higher than is specified in the current requirements), will be adopted unchanged in the Swiss regulatory framework. Apart from the two big banks, there are four other institutes using the model approach that will be affected. Other institutes, which do not apply the model approach will only have a marginal capital adequacy increase of just under 5%.

The financial crisis additionally brought to light the fragility of the financial system. In many countries state intervention was necessary to avoid a chain-reaction collapse of institutes as a result of their credit relationships (interbank claims). The revised EU large exposures regime directly addresses this issue, in particular, by considerably limiting the volume of authorised interbank claims between institutes. The maximum credit authorised for other counterparties such as companies, regional administrative bodies, etc. has, however, not been changed. Although other items of the EU large exposures regime have also been amended, only substantial changes considered prudential from a national viewpoint have currently been integrated into Swiss regulations. The present amendment to the CAO focuses on the adjustments to the international approach to risk diversification which is being applied by a good 40 out of the over 300 banks and securities dealers in Switzerland. The “Swiss approach to risk diversification” used by the majority of Swiss banks will not be altered. Rather, within the framework of “Basel III”, this approach will be adapted in the coming years to keep in line with international developments. The extent to which regulations on the international approach will be tightened depends on the size of the institute. Here tightened restrictions refer to a reduction of the maximum amount or limit of an interbank claim: in terms of the current regulations, this implies a reduction of 20% for small institutes, 80% for big banks (including both big banks), and 20% – 80% for medium-sized institutes. Whether these restrictions, or rather reductions, are relevant in practice depends on the extent to which institutes have already come close to exceeding their limits under the current regulations. This issue has been examined in an empirical study conducted over a period of 5 quarters, in which 8 institutes participated. Only in the case of one (big) institute was the limit notably exceeded under the tightening of restrictions applicable (80%, i.e. a maximum limit that is 5 times lower than the limit currently prescribed).

The planned regulations outlined above should substantially affect the Swiss big banks and concern them and their international competitors equally. These tightened restrictions do not emanate from the too-big-to-fail debate, which is also being conducted at international level, but rather the whole issue involves regulations specific to system-relevant big institutes that go beyond the current regulations applicable to all institutes. In this regard, the particular size of a big bank in relation to the economy has to be taken into account in Switzerland.

In this context, it should be noted that a commission of experts was mandated by the Federal Council in November 2009 to examine the economic risks caused by large companies and propose solutions for containing the too-big-to-fail problem. The work of the commission of experts is now at an advanced stage. Its report will take account of the recommendations of the Basel Committee on Banking Supervision and is expected to be published at the end of September 2010.[38]

### 1.3. Ownership and Management

The Banking Act contains several provisions on the owners of banks, in particular holders of so-called qualified participations and foreign controlled banks.

Article 3 para. 2 lit. c bis of the Banking Act provides that the granting (and upholding) by FINMA of a banking license is subject to the express guarantee provided by natural persons or legal entities holding a **qualified participation**, i.e. those persons or entities which directly or indirectly participate in at least 10 percent of the capital or voting rights of a bank or otherwise whose business activities are such that they may influence the bank in a significant manner, that their influence will not have a negative impact on a prudent and solid business activity. The Banking Act further provides that each natural person or legal entity shall notify FINMA prior to acquiring or selling directly or indirectly a qualified participation (as defined above) in a bank organized pursuant to Swiss law. This duty to notify also exists whenever a qualified participation is increased or decreased in such a manner that the threshold of 20, 33 or 50% of the capital or voting rights is reached or exceeded or declines thereunder.

In addition, to the extent that they are known or should be known, shareholders or groups of shareholders linked by voting rights, whose participation at the balance sheet date exceeds 5% of all voting rights, are to be disclosed by name and percentage of capital held for each person in the Annex to the annual accounts[39].

According to Article 3bis of the Banking Act, FINMA can make the authorization to establish a bank, which is to be organized in accordance with Swiss law but whose case involves the existence of a controlling foreign influence, as well as the authorization to establish an office, a branch or an agency of a foreign or **foreign-controlled bank** and the license to appoint a permanent representative of a foreign bank, additionally dependent on the following conditions:

a) the country of residence of the foreign bank or of the foreign controlling corporate or individual shareholder shall guarantee reciprocity, as long as no contradictory commitments exist;

b) the corporate name of the foreign controlled Swiss bank shall in no way indicate or suggest that the bank is Swiss controlled.

A bank organized under Swiss law falls under this provision whenever a foreigner with a **qualified participation** directly or indirectly holds more than half of the voting rights or exercises a controlling influence in another manner. A foreigner is deemed to be:

a) natural persons who posses neither Swiss citizenship nor a branch permit in Switzerland;

b) legal entities and partnerships who have their registered office abroad or, if they have their registered office in Switzerland, are controlled by persons defined under letter a.

[38] See http://www.efd.admin.ch/00468/index.html?lang=en&msg-id=34777.

[39] Article 25c para. 3.10.2 of the Banking Ordinance.

If a bank is part of a financial group or financial conglomerate, FINMA can make authorization dependent on the agreement of the controlling foreign supervisory authority. The bank must inform the Swiss National Bank of the scope of its business activities and its relationships abroad.

Banks that fall under foreign control after their formation require additional authorization in accordance with Article 3bis[40]. A new additional authorization must be obtained if a foreign controlled bank experiences a change of its foreign shareholders holding a qualified participation. The members of the Board of Directors and the management of a bank are to notify FINMA of all matters which may lead one to conclude that the bank is foreign-controlled or that there has been a change in foreigners holding qualified participations.

The persons charged with the administration and the **management of a bank** must enjoy a good reputation and thereby assure the **proper conduct of the business operations**[41]. The notion of "proper business conduct" is a cornerstone of Swiss banking regulation and FINMA has developed an extensive practice on that subject matter. Financial market legislation requires the senior executive officers of supervised entities to give an undertaking as to the proper conduct of business. The purpose of such undertaking is to maintain public confidence in banks and institutions and safeguard the reputation of the financial sector. This undertaking extends to all personal characteristics and professional matters required for the proper management of a supervised entity. The key issue of this evaluation is the past and present business activity carried on by the person concerned as well as his or her professional project in the future.

## 1.4. Compensation and Bonus Structures

### 1.4.1. Usual Remuneration Principles

**Until recently**, general rules regarding compensation and bonus structures were mainly ruled by the Swiss Code of Obligations ("SCO"). Under this Federal Act, the employment contract is to be considered as concluded if the employer accepts work in his service for a given time, the performance of which under the circumstances is only to be expected against wage payment (Art. 320 SCO). On the basis of the employment agreement, the employer and the employee remain free to agree on the amount and the type of remuneration (Art. 322 SCO). The Swiss Code of Obligations offers the possibility to pay the remuneration as an ordinary and regular wage, as a participation in proceeds or in the form of commissions. The type of payment is agreed upon by the parties to the employment agreement. In addition, the employer remains free on certain occasions to pay the employee a special allowance by totting up the wages (Art. 329d SCO). This type of allowance is qualified as "bonus" or "gratification".

Two provisions were added to the Swiss Code of Obligations (i.e. Art. 663b bis and Art. 663c) in January 2007. Through these, the legislator required listed companies to be legally committed to transparency with respect to total compensation, including shares and options programs of managers and members of the board of directors.

Swiss legislation further provides that if the employer on certain occasions, such as Christmas or the end of the fiscal year, pays a special allowance in addition to the wages, the employee shall be entitled to such an allowance provided there is an agreement to that effect. This special allowance which is paid by the employer on top of the usual remuneration distinguishes itself from the base wage, inasmuch as the employer usually pays this allowance on a voluntary and discretionary basis.

[40] Article 3ter of the Banking Act.
[41] Article 3 para. 2 lit. c of the Banking Act.

It nevertheless appears that the qualification of this special allowance can vary depending on certain circumstances. At certain conditions, this allowance looses its voluntary and discretionary character and becomes part of the salary. This has for consequence that the allowance has to be paid, whether the employee fulfils or not the required conditions. The Swiss Federal Supreme Court has defined a few guidelines so as to help the parties to an employment agreement to qualify the nature, as salary or as discretionary bonus, of the special allowance. The following principles have been set by Swiss case law:

a) A fixed amount defined in the employment agreement must be considered as part of the base remuneration and therefore has to be paid out to the employee whether he is still employed or not on payment date.

b) If the bonus is regularly more important than the fixed wage, the bonus loses its accessory character and becomes an element of the fixed remuneration. The Swiss Federal Supreme Court considers that a bonus amounting to 20% of the fix annual base wage loses its accessory character and therefore has to be considered as part of the fix remuneration.

c) Furthermore, the Swiss scholars consider that the payment of a bonus during three consecutive years, without any explicit reserve made by the employer, creates a right to future payments for the employee. In other words, the recurrence of the payment changes the nature of the allowance, which becomes *de facto* an element of the basic salary and loses its discretionary nature.

d) The bonus may be defined as depending on overall company results or personal performance of the employee. However, if the discretionary allowance is also paid in years of poor results or low performance, it will be considered in the future as part of the fix salary.

#### 1.4.2. Circular FINMA 2010/1 on Remuneration Schemes

##### 1.4.2.1. General Presentation and Scope

As a result of the international financial crisis of 2008, bonus schemes and general remuneration of financial institutions' employees have been widely discussed and challenged at both national and international levels. FINMA decided in October 2009 of the implementation of new guidelines (Circular 2010/1) governing minimum standards for remuneration schemes of financial institutions. Their main scope is increasing risk awareness and insuring incentives for sustainable business decision and investments.

Circular 2010/1 applies to banks, securities traders, financial groups and conglomerates, insurance companies, and insurance groups and conglomerates that are subject to Swiss financial market supervision. It also applies to persons and firms authorized under Article 13 para. 2 and 4 of the Collective Investment Schemes Act (e.g. SICAV, SICAF, asset managers of Swiss collective investment schemes, Swiss custodians, Swiss representative agents, Swiss distributors, etc.). Circular 2010/1 is applicable to financial institutions' domestic and foreign subsidiaries and branches, which are mandatorily included in consolidations. If mandatory foreign regulations conflict with the application of Circular 2010/1 or if a financial situation is seriously disadvantaged by this Circular in a foreign labour market, it shall inform FINMA. FINMA may exempt a firm, in part or in full, from implementing Circular 2010/1 provisions in the foreign labour market in question.

The Circular shall mandatorily apply to the following financial institutions:

a) Banks, securities traders, financial groups and conglomerates, who in their capacity as individual firm or at the financial group or conglomerate level, are required to maintain equity capital (minimum requirements pursuant to Articles 6 ss. and Article 33 of the Capital Adequacy Ordinance) in the amount of at least CHF 2 billion;

b) Insurance companies, insurance groups and conglomerates, which, in their capacity as insurance company, or at the insurance group or conglomerate level, are required to hold equity capital (required solvency margin pursuant to Article 22, Section 1 a, Article 199 and Article 206 of the Insurance Supervision Ordinance) in the amount of at least CHF 2 billion.

For financial institutions, which do not meet these thresholds, implementation of Circular 2010/1 shall not be mandatory. It is, however, recommended that they take the principles of this circular into account for their remuneration schemes as best practice guidelines. In justified cases, FINMA may require a financial institution, which does not meet the thresholds to implement some or all of the provisions hereof. This may be appropriate, for example, in light of a given firm's risk profile, its business activities or its business relationships, or where its remuneration scheme entails inappropriate risks.

Circular 2010/1 applies to all persons who are employed by a firm or by an affiliate of such firm and who are remunerated for work performed in respect of the firm. Circular 2010/1 also applies to persons entrusted with the executive management ("senior management") and to persons responsible for the overall direction, oversight and control ("Board of Directors"). It does not apply, however, to the remuneration of associates of the firm who are wholly liable in their personal capacity, nor to persons who directly or indirectly hold at least 10 percent of the firm's capital.

For financial institutions, Circular 2010/1 serves to supplement the rules contained in the Swiss Code of Obligations[42] as well as the disclosure provisions concerning remuneration applicable under stock exchange regulations, albeit without replacing them. Circular 2010/1 applies regardless of the legal form of the financial institution and whether or not said institution is publicly listed.

The principles set out in the Circular are dictated by a strong desire of prevention and have for purpose to avoid excessive short-term risk taking. In accordance to these values, new bonus schemes will have to be structured on a long-term sustainable basis as to circumvent excessive rapid economical profit for the Company and the individuals which could jeopardize the stability of the economy. To achieve this scope, FINMA has set up ten principles, which are meant to encourage companies to obtain sustainable performance. The more the performance is sustainable the more the employee will be entitled to benefit from the variable compensation earned on a long term basis.

The main criteria emphasized by FINMA for a sound and healthy remuneration are the following: responsibility, transparency, sustainability and loyalty.

#### 1.4.2.2. Responsibility

Board of directors and human resource departments will now have enhanced responsibilities inasmuch as they will be in charge of issuing clear regulations on remuneration and will have to exercise strong control on the functions involved in the compensation system. The new system must enhance risk awareness. Remuneration will be granted proportionately to the strategic and operational liability of the employee.

[42] See the usual remuneration principles set out under Section 1.4.1 above.

Furthermore, the board of directors will be accountable for the issuance of an annual report regarding the amount and the nature of the paid compensation.

#### 1.4.2.3. Transparency

The remuneration schemes must respect transparency, simplicity and be enforceable on a long term perspective. Any derogation to the defined principles will have to be duly motivated and will have to figure in the company's annual report.

#### 1.4.2.4. Sustainability and Risk Awareness

Variable compensation will be granted according to sustainable criteria and will be based on long term performance. To be entitled to differed remuneration, the employee must participate in future developments of the financial institution and support its inherent risks.

#### 1.4.2.5. Loyalty

The remuneration granted to the employees in charge of quality and quantity asset management must not raise conflict of interest and should not directly depend of the result generated by the specific assets controlled by the latter.

#### 1.4.2.6. Entry into Force and Outstanding Uncertainties

The provisions of Circular 2010/1 shall basically be implemented within all financial intermediaries to which they mandatorily apply by January 1, 2011 at the latest. At this stage, the principles, which are suppose to protect on a long term the sustainability of the economy, could raise concerns with regard to current labour provisions of Swiss law. These principles might also appear in some circumstances as being contradictory to the decisions of the Swiss Federal Supreme Court. Given the general principle of separation of powers, it is further generally admitted by the majority of the legal scholars that any provisions of Circular 2010/1, which would constitute a breach of the existing legislation, will be hardly enforceable before Swiss courts. Time will thus show whether a formal change of the labour law provisions contained in the Swiss Code of Obligations will be required.

## IV. OTHER BUSINESS CONDUCT REQUIREMENTS

### 1.1. Rules Regulating Information Obligation

Save for private bankers who do not publicly solicit customer deposits, Swiss banks shall prepare for each business year an **annual report** consisting of annual financial statements and a business report[43].

Should a bank hold, directly or indirectly, more than half of the voting rights of one or more companies or exercises in another manner a controlling influence thereover (banking group), it is to prepare in addition consolidated financial statements (**consolidated accounts**), unless the controlled companies are immaterial to the objectives of consolidated accounts in which case an exemption applies[44]. Banking groups which have total assets of less than one billion Swiss francs and less than 50 employees are exempted from the obligation to prepare consolidated accounts. Consolidated accounts must nevertheless be prepared whenever:

a) the bank has its own bonds in circulation;

b) the equity securities of the bank are listed on the stock exchange;

c) persons representing at least 10 percent of the bank's capital require them;

d) they are necessary for the most reliable possible assessment of the net assets, financial and profitability situation of the bank;

e) by holding the majority of voting rights or in another manner, the bank controls one or more banks, and financial or real-estate companies with registered offices abroad.

Banks with a balance sheet total of at least CHF 100 mio. must draw up **semi-annual interim accounts**, and banks which are obligated to prepare consolidated accounts, consolidated interim accounts.

Save for private bankers who do not publicly solicit customer deposits, Swiss banks must adequately **inform the public on their risks and on their own funds** according to Article 35 of the Capital Adequacy Ordinance. The implementation rules are set out by FINMA in the Capital Adequacy Disclosure Circular. When calculating capital adequacy requirements on the level of a finance group or conglomerate, the disclosure obligations are only to be applied on a consolidated basis (consolidation rebate). Foreign-controlled banks are exempt from disclosure if comparable information is published abroad at Group level.

[43] Article 6 para. 1 of the Banking Act.
[44] Article 23 *et seq.* of the Banking Ordinance.

### 1.2. Relevant Consumer Protection Rules or Measures: Enhancement of Depositor Protection

In the event of bankruptcy, the bank's creditors are compensated from the bankruptcy estate in line with their statutory ranking. Collateralised claims are settled first, by disposition of the pledge. Other claims are categorised in three bankruptcy classes. The claims of first-class creditors are settled first, followed by second and then third-class creditors, naturally presuming that there are sufficient assets to cover the liability. Third-class creditors usually account for the largest part of the total claims, and may be compensated only partially. However, pursuant to the Banking Law, certain third-class claims up to a maximum of CHF 100'000.- per creditor are upgraded to a special category of second-class rank. These claims are privileged vis-à-vis third-class claims and are practically guaranteed, considering the stringent equity requirements. The banks' depositors are in an even better position, as clients' deposits are treated separately in the event of a bank's bankruptcy, i.e. such deposits are excluded from the bankruptcy estate in the first place, and are paid out to the clients in full.

The Swiss Depositor Protection Agreement (self-regulation) serves the purpose of protecting client deposits and is supported by a separate association. The Agreement ensures that, in the event of a bank's failure, depositors will rapidly receive their statutory privileged claims. The deposits are paid out to the maximum amount available from the respective bank's liquid assets. The depositor protection fund complements the remaining amount due, up to a maximum of CHF 100'000.- per client of the failing bank.

As and when such a case arises, the Swiss Banks' and Securities Dealers' Depositor Protection collects from the signatories to the agreement contributions based on a quota. The depositor protection association assumes the role of the benefiting creditors in the further course of the liquidation procedure, for the amount it paid out to the creditors.

As an **urgent measure** in response to the financial and economic crisis, the maximum amount of privileged deposits was raised from CHF 30'000.- to CHF 100'000.- per depositor **in December 2008**. Moreover, the system ceiling was raised from CHF 4 billion to CHF 6 billion. This immediate measure will remain in place for the time being.

The uncertainty in financial markets has also prompted several other countries to expand the scope of their depositor protection provisions. The simultaneous increase of privileged deposit amounts resulted in a strong tendency toward harmonisation among individual countries. Such harmonisation was particularly evident within the EU, where the amount of privileged deposits was raised with immediate effect from a minimum of EUR 20'000.- to a minimum of EUR 50'000.-, and in another step as of December 31, 2010 to EUR 100'000.-. In addition, the payment terms were reduced considerably to 20 business days. The concept of risk sharing used to be permissible and has now been abolished.

On March 24, 2010 the Federal Department of Finance issued the results of a consultation phase concerning a new envisaged law governing deposit guarantee schemes. Six weeks after, the Federal Council issued a **Message on a draft amendment of the Banking Act**[45]. The consultation held in Spring 2010 showed that the draft law on deposit guarantee schemes that had been sent into consultation could not be implemented as such insofar as it provided a guarantee fund deposit of public law with an ex-ante payment and a second level of security provided by the Swiss Confederation. However, some of its proposals as well as the urgent measures decided in December 2008 were praised. Therefore, the Federal Council proposes to adopt these changes in two stages. During Phase A, the validity of the urgent measures strengthening the protection of depositors (adopted in December 2008) would be extended until

[45] FF 2010 3645.

December 2011. At a later stage (Phase B), these provisions would be definitely incorporated into the Banking Act together with other amendments of the banking legislation concerning *inter alia* remediation process, continuity of banking services during insolvency proceedings (in particular payment services), deadline for payment of the deposit guarantee (from three months to twenty business days), recognition of measures taken by foreign authorities in Switzerland and abandonment of the privilege of Swiss-based customers in relation to bank assets held in Switzerland.

### 1.3. Excursus: Insurance Wrappers

FINMA issued on April 27, 2010 a communication (FINMA Newsletter 9 (2010)) aiming at clarifying the handling of so-called "**insurance wrappers**" by financial intermediaries pursuant to Art. 2 para. 2 and 3 of the Anti-Money Laundering Act[46].

An insurance wrapper is an insurance product that may be characterised as follows: an insurance company maintains an investment account with a bank or securities dealer for the purpose of holding the investments of a given client of the insurance company under a life insurance agreement; the client can exercise influence over the management of the investments or the investments are managed according to an individualised investment strategy. The investments in question are usually securities investments the client already owns. Following conclusion of the life insurance contract they act like a single premium paid into the life insurance. Ownership of the securities is transferred to the insurance company.

Given the way in which the insurance wrapper product model is structured, it is hardly any different from a traditional asset management facility of a bank or independent asset manager from the point of view of money laundering risk. Hence, corresponding due diligence requirements should apply.

Furthermore, Swiss law provides for an exception to the identification of the beneficial owner if the contracting party qualifies as a financial intermediary under Article 2 para. 2 of the Anti-Money Laundering Act and has its domicile or registered office in Switzerland or is subject to a comparable supervisory authority abroad. However, in FINMA's view, this exception does not apply for insurance wrappers. This privileged treatment is based on the international standard of the Basel Committee on Banking Supervision regarding the exercise of due diligence by banks when determining the identity of clients, which stipulates that a client must be identified if the bank knows or has reason to assume that a client account opened by a professional intermediary is for the sole use or benefit of the client in question. Therefore, FINMA requires banks, securities dealers and asset managers (hereinafter collectively referred to as "financial intermediaries") to identify the beneficial owner of a custody account associated with an insurance wrapper in the following three cases:

a) The financial intermediary has a pre-existing relationship with the client of the insurance company and thus has already identified the client.

b) The client of the insurance company holds a power of attorney or information rights towards the financial intermediary.

c) The financial intermediary is instructed by the insurance company to apply an individualised investment strategy in managing the custody account, except in instances where the investment strategy corresponds to a pre-defined standardised client profile.

[46] See http://www.finma.ch/e/finma/publikationen/Documents/finma-mitteilung-09-2010-e.pdf.

These rules apply to both new and pre-existing insurance wrappers. In the case of a pre-existing contractual relationship between the financial intermediary and the client of the insurance company, the financial intermediary may copy the existing documentation and add it to the records for the new business relationship. This eliminates the need to complete Form A (official form serving to identify the beneficial owner pursuant to the Code of Conduct of the Swiss Bankers Association) for the client relationship with the insurance company.

Under all circumstances the insurance companies shall remain responsible for fulfilling the identification obligations incumbent on them under supervisory regulations in connection with the insurance wrappers business model, even if the insurance contract is submitted through a financial intermediary. They are responsible for duly identifying the client, determining who the beneficial owner is as necessary and fulfilling all other obligations relevant to the business relationship as prescribed by the Anti-Money Laundering Act.

FINMA will monitor compliance with the requirements formulated above for insurance wrappers on a case-to-case basis.

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Geneva, August 31, 2010.