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Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

ANNUAL REPORT 2009

FINMA'S MANDATE

As an independent supervisory authority, the Swiss Financial Market Supervisory Authority FINMA promotes the protection of creditors, investors and insured persons and ensures the general functioning of the financial markets in accordance with financial market legislation. FINMA thereby strengthens confidence in the smooth functioning, integrity and competitiveness of the Swiss financial centre.

On 1 January 2009, the Federal Office of Private Insurance (FOPI), the Swiss Federal Banking Commission (SFBC) and the Anti-Money Laundering Control Authority were merged to form FINMA. It operates based on the principles of the Federal Act on the Swiss Financial Market Supervisory Authority (FINMASA).

As a state supervisory authority, FINMA is endowed with sovereign authority over banks, insurance companies, stock exchanges, securities firms and collective investment schemes. It is responsible for combating money laundering and, where necessary, conducts financial restructuring and bankruptcy proceedings. FINMA grants operating licences for companies and organisations subject to its supervision. Through its supervisory activities, FINMA also ensures that the supervised institutions comply with the requisite laws, ordinances, directives and regulations and continue at all times to fulfil the conditions for the granting of licences. It imposes sanctions and provides administrative assistance to the extent permissible by law. Finally, FINMA also acts as a regulatory body. Where it is authorised to do so, it participates in the amendment of laws and corresponding ordinances, issues its own ordinances and circulars and is responsible for the recognition of self-regulation standards. In relation to public takeover bids for listed companies, FINMA also has supervisory powers in respect of the disclosure of holdings and acts as the authority to hear appeals against decisions of the Takeover Board.

In 2009, FINMA employed an average of 362 employees, across 333 full-time equivalent positions.

FINMA

Annual Report 2009

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Non-gender-specific language
To facilitate readability, this text does not use gender-neutral terminology. Any masculine terms shall generally be construed to infer the feminine and vice versa.

This English version is a translation of the first part of the Annual Report 2009, available in its entirety in German and French. The English version therefore does not cover the complete range of topics included in the full Annual Report.

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FOREWORD BY THE CHAIRMAN

'Leaning against the wind requires judgment and will always prove controversial.'

Martin Wolf, *Financial Times columnist*

These words from Martin Wolf are apt, describing one of the greatest challenges facing supervisory authorities in their monitoring of individual financial institutions just as much as central banks in their mission to ensure the stability of the global financial system. It takes deep insight and even greater powers of persuasion to counter at an incipient stage developments that harbour the potential for tremendous damage. Many different preconditions must be in place in order to meet this challenge: comprehensive information, expert knowledge, resolve and considerable independence on the part of the decision-makers.

The Swiss Financial Market Supervisory Authority FINMA is well on its way to achieving these prerequisites. The merger of the former Swiss Federal Banking Commission, the Federal Office of Private Insurance and the Anti-Money Laundering Control Authority with effect from 1 January 2009 brought together specialist knowledge from the various fields and created an attractive basis on which to recruit highly skilled professionals. The cooperation with the Swiss National Bank has been and continues to be built up – duly reflecting the different mandates of the two institutions – with the aim of increasingly incorporating macroeconomic considerations into the monitoring of supervised institutions.

FINMA has demonstrated resolve in many of its decisions. These include not only enforcement measures at licensed financial institutions to bring back their operations within the confines of the law. These decisions also ensure that providers operating without requisite licences that are, as a rule overindebted, are wound up. In terms of market supervision, various rulings have been issued and criminal complaints filed against market participants that, on the findings of investigations, have breached provisions under stock exchange law. FINMA is vigilant, takes consistent action and instigates proceedings with caution and respect for the rights of the parties. In this way, it ensures that the mandate conferred on it is fulfilled to the best of its knowledge and belief.

The final element to be examined is the independence of the supervisory authority. This issue is subject to continual critical scrutiny, and rightly so, be that by parties affected by rulings or when decisions confound the expectations of a dominant body of opinion. One cannot always meet everyone's expectations. It is inherent in the nature of the role of a supervisory authority that it will frequently come up against opposing viewpoints yet still have to reach a decision in the end. It is often only with hindsight that one can judge whether the view taken was correct and whether decisions were made appropriately and independently. We are not afraid of such scrutiny and hope that the results will further strengthen the necessary trust in this fledgling authority.

Dr Eugen Haltiner, Chairman
December 2009

‘OUR SUPERVISORY ACTIVITIES WILL KEEP EVOLVING’

Interview with Dr Patrick Raaflaub, CEO

FINMA has recently celebrated its first anniversary. What have been your personal experiences of the last year?

It has been an exciting and challenging 12 months. FINMA’s operational launch on 1 January 2009 came at a turbulent time. A lot of work needed to be done on the set-up and implementation of the merger, while at the same time FINMA had to contend with the tough financial market situation and the resulting demands on the supervisory authority. This meant that many FINMA employees had twice the usual workload on their hands. However, I see this phase primarily as an opportunity, as in this first year we set a lot of balls rolling and influenced the shaping of the new financial market supervisory regime.

FINMA’s strategic goals

- Reducing systemic risks and complexities
- Improving client protection
- Streamlining and optimizing regulation
- Increasing the effectiveness and efficiency of supervision
- Implementing sustainable market supervision and effective enforcement
- Positioning for international stability and close integration of markets
- Strengthening FINMA as an authority

Further details of the strategic goals can be found on FINMA’s website[1].

[1] See www.finma.ch/e/aktuell/Documents/strategische-ziele-finma-20090930-e.pdf

The first reorganisation took place after little more than half a year. Why was that?

In order to ensure the continuity of supervisory activities despite the merger, the structures of the three predecessor authorities were deliberately carried across with little change. The chosen organisational structure was always regarded as a starting point and not as a definitive solution. After a little over half a year, we took the second step and adjusted the structure to suit the needs of integrated supervision. The objective was to streamline the organisation and so reduce the burden on the Executive Board while simultaneously strengthening it. Strong cross-authority functions were also created, such as Risk Management and Enforcement, which apply to all parts of the organisation. This is a very important element, as there was not previously enough of interaction across divisions at the predecessor authorities.

Did the merger change the mandate of the supervisory authority in any way?

No, our statutory mandate is unchanged. FINMA’s core role is to protect creditors, investors and insured persons, and this forms the basis of its supervisory activity. As such, we ensure that financial service providers abide by the legal framework and do not jeopardise the interests of clients. The supervision of individual institutions is aimed at fostering their stability and performance over the long term and is therefore the most crucial element in client protection. Almost all financial market legislation has this as its objective. For example, we ensure that banks and insurance companies hold sufficient capital to be able to absorb future shocks without their clients suffering a loss. Or, where companies engage in activities requiring a licence but do not hold that licence, we remove them from the market as swiftly as possible. We also advocate creditor protection in the event that, despite all precautions, a financial services provider is declared bankrupt.

Dr Patrick Raaflaub, CEO

FINMA announced its new strategy last autumn. Doesn't this overstep your statutory mandate?

The seven strategic goals that we set flesh out our statutory mandate and prioritise it even further by means of key themes and specific initiatives. The aim is to set the long-term direction for FINMA's work and make this publicly known. By defining these strategic objectives, we wish to ensure that our supervisory approach continues to evolve and that it genuinely meets the needs of a changing market environment. Nevertheless, the ultimate purpose of all these initiatives is to keep improving client protection in Switzerland.

You say that the supervisory approach is to be developed further. Does this mean that we are facing a barrage of regulation?

Regulation alone cannot ensure the sensible development of a supervisory approach. We want to diversify our supervisory activities still further

and thus boost our effectiveness. Adjustments to regulation will be needed only in individual sub-areas, such as market supervision. One of our strategic objectives is to streamline regulation. As such, the existing regulation is to be simplified and, where possible, standardised. Continuing to pursue the proven risk-based approach and reinforcing it can make a major contribution to improving the efficiency of supervision without the need for a barrage of regulation.

How and in what areas will supervision be enhanced further?

In all areas. A supervisory approach cannot be static and must keep pace with developments on the financial markets. FINMA will strengthen its powers to capture and identify risks at an early stage in targeted areas. All supervised institutions will be divided into groups with specific risk-oriented supervisory regimes on the basis of their risk profile. The intensity of supervision and volume of work involved will therefore be suited to the supervised institutions and areas in question. Only comprehensive risk identification gives the supervisory activities the necessary effectiveness in terms of targeted supervision and implementation of the supervisory rules. Work on the defined strategy is already proceeding apace and should be implemented within three years.

What does this mean in reality for supervised institutions?

Dialogue with the supervised institutions will be stepped up further. In order to gain a timely picture of the risk situation, data provision from the supervised institutions will have to be improved and automated. We are developing new indicators and will undertake more cross-comparisons. This will enable problems to be detected at an early stage, and where necessary FINMA will be able to instigate institution-specific measures in good time.

The financial markets are international, but supervisory authorities are national. Shouldn't supervision therefore be internationalised?

Supervisory authorities will in all likelihood remain national bodies, as there is no international financial market legislation. However, FINMA actively participates in the key international bodies and has even taken a leading role in some areas, such as on capital requirements for large banks. International cooperation will be developed further in a targeted fashion, as that is the only way in which cross-border risks and irregularities can be detected early on. This means that all the world's major financial centres will in future have to pull together more than ever.

FINMA: AN OVERVIEW

KEY THEMES

Financial market crisis and financial market supervision

The 'Financial market crisis and financial market supervision'[2] report issued by FINMA on 14 September 2009 provided a comprehensive analysis of the financial market crisis and the ensuing decisions and actions taken by the Swiss Federal Banking Commission (SFBC). This analysis of the crisis was aimed at producing findings from the experiences and designing the necessary measures. The report also served as the basis for a response to two parliamentary initiatives (proposal by Eugen David, member of the Council of States, and motion by the Committee for Economic Affairs and Taxation of the National Council).

The scale and depth of the global financial crisis caught all financial market participants – from banks, financial analysts, rating agencies, auditors and investors to central banks and even supervisory authorities – by surprise. None of those involved recognised in time the causes of the crisis or the full extent of the dangers it posed. In addition to highlighting some specific shortcomings, the analysis showed that bank supervisors in some cases lacked sufficient assertiveness. The report also indicated, however, that the SFBC responded rapidly and decisively, and that fundamental decisions aimed at bringing about stability were made in a targeted and timely manner.

The main causes of the global crisis were identified as economic imbalances, increased levels of debt and opaque securitisation practices. The ultimate trigger for the downturn was the US subprime mortgage market. Over the course of the crisis, a number of accelerants intensified the negative trend. Forced sales and a loss of confidence in products with little transparency caused key securities markets to dry up, triggering sharp price falls. Many banks all over the world had to take large write-downs, increasing the need for capital and liquidity in the sector.

Swiss financial institutions, especially the major banks and insurance companies active on the capital markets, were directly affected by the crisis and in some cases suffered large losses. As the crisis has spilled over into the real economy, all banks and insurance companies in Switzerland have been affected by the downturn to a greater or lesser extent.

As one of FINMA's three predecessor authorities, the SFBC paid particular attention to the two major banks before and during the crisis. After the outbreak of the crisis in August 2007, the SFBC shifted into active crisis mode and stepped up monitoring of the two big banks, especially UBS. Parameters vital to the stability of the financial institutions, such as capitalisation and liquidity, were monitored continuously, and corrective measures such as capital increases were taken. If the big banks had been unable to raise the necessary equity capital on the market at an early stage, a much larger package of government measures would probably have been required.

With hindsight, however, it is possible to recognise weaknesses both in the early identification of risks and in the implementation of countermeasures. Nevertheless, the crisis management procedures functioned well due to the fact that the authorities were prepared to cope with a potential crisis and that targeted and consistent action was taken when the crisis erupted.

Fundamental weaknesses were identified in relation to the Basel II standards in particular, which in key areas were carried across unchanged from Basel I, such as the insufficient capital backing for proprietary trading positions and the pro-cyclicality of the market risk models applied. The Basel Committee on Banking Supervision (BCBS) is intensively engaged in developing proposals for improvement. As a BCBS member, FINMA is making an active contribution to these efforts at all levels.

Not all lessons have yet been acted on. By virtue of its independence, however, FINMA is in a good position to make the necessary changes

[2] See www.finma.ch/e/aktuell/Documents/Finanzmarktkrise-und-Finanzmarktaufsicht_e.pdf

rapidly, particularly as regards the quality of supervision. For instance, specific projects to enhance FINMA's approach to supervision have been launched as a direct consequence of the financial market crisis. FINMA has also begun to expand its technical expertise in specific areas.

FINMA's strategic goals, as approved by the Federal Council on 30 September 2009, also take account of the lessons learned during the crisis. The overriding aim of the strategic goals is to continue to improve client protection. FINMA's core role is to protect creditors, investors and insured persons, and this forms the basis of its supervisory activity. The focus of this remit is on increasing resistance to crises in the areas under supervision, protecting investors and insured persons from the repercussions of insolvency risks, and enhancing transparency with regard to trading and selling products. FINMA also wants to gain a better understanding of the risks arising from mutual interdependencies.

Cross-border private client business[3]

Various US authorities have been investigating UBS since autumn 2007. With regard to its cross-border business with US private clients, the bank has been accused of breaching provisions of US securities law and US tax law, as well as undertakings under the Qualified Intermediary Agreement. In summer 2008, there were increasing signs that individual client advisors had been helping a relatively small number of high net worth US clients to avoid disclosure and/or tax requirements arising from the Qualified Intermediary Agreement. It appeared that at the time of the introduction of the qualified intermediary regime, these advisors had created offshore structures for the clients in question, where they could hold US securities. There was also evidence of breaches of US securities law in the cross-border servicing of US clients. The US authorities therefore took the position that they would only reach an agreement with UBS to settle the ongoing investigations if a certain volume of client data was first submitted. Towards the end of the year, the US Department of Justice threatened criminal charges against the bank in the USA if client data were not disclosed within a few weeks. At that point, the administrative assistance proceedings in progress before the Swiss Federal Tax Administration (FTA) since summer 2008 had not shown any results to be forwarded to the US authorities.

When the US authorities threatened criminal charges in writing in February 2009, FINMA took protective measures in respect of UBS.[4] Specifically, it ordered UBS to immediately provide it with a data sample to be passed on to the US authorities. Under the prevailing circumstances, charges in the USA could have threatened the continued existence of the bank. This difficult decision was made under careful consideration of the interests at stake. Maintaining the stability of the Swiss and global financial system had to take top priority. No more lenient alternatives that would produce the desired outcome were available at the time. UBS finally reached a settlement with the US Department of Justice and US Securities and Exchange Commission (SEC) on 18 February 2009.

In parallel to this, the US Internal Revenue Service, which was not a party to the agreements concluded with UBS, pursued a John Doe summons issued in summer 2008, demanding data on more than 50,000 clients. Whereas US law required UBS to disclose this information, to do so would have been a criminal offence under Swiss law. This looming conflict between the legal systems of two sovereign states could be resolved by mutual agreement on 19 August 2009, following several rounds of negotiation. On the basis of the treaty concluded between Switzerland and the United

[3] See SFBC Annual Report 2008, p. 36ff (German version)
[4] within the meaning of Art. 25 and Art. 26 BA

States, the US authorities submitted a new request for administrative assistance under the applicable double taxation agreement, to be fulfilled within one year. In return, the pending enforcement action will gradually be withdrawn.

Brought about in part by the UBS case, FINMA embarked upon a project in March 2009 to reappraise the legal risks inherent in cross-border private client business and has since been conducting a stock-taking exercise with a selection of financial institutions.

Foreign legal risks exist in relation to supervisory, tax, criminal and civil law and to procedural provisions. Countries' anti-money laundering legislation, particularly reporting requirements, can also harbour legal risks for foreign institutions operating across international borders. Restrictions under supervisory law apply in particular to the cross-border provision of services and the offering and distribution of products. In terms of tax law, there is the risk that a financial intermediary or its employees may be accused of an offence under foreign law by assisting foreign clients in tax offences. The charges brought against those engaged in the Swiss banking industry in 2007 and 2008 illustrate the very real danger of criminalisation. In addition, cross-border activities in a market can, under certain circumstances, give rise to a tax obligation on the part of the financial intermediary itself.

Legal risks in cross-border private client business have increased over recent years and months, and foreign authorities are increasingly alert to such issues. There is also a greater will to effectively penalise breaches, and greater means to do so. The financial market crisis has intensified this trend further and given the enforcing authorities the necessary political backing.

The stock-taking exercise at financial institutions underlines the urgent need for action. It is a tough and time-consuming challenge for financial institutions to define a service model to suit each individual target market. Only an overarching approach that takes account of the major risks can ultimately minimise the risks involved. However, this places significant restrictions on cross-border business. The restricted market access to the EU member states and other countries represents one of the greatest hurdles facing the banking sector.

Switzerland as a financial centre has some major challenges to contend with because of the significance of its offshore business. It is the job not only of representatives of the sector, but also of politicians, FINMA and other authorities, to face up to these challenges. The initial need is for a legal framework that will form a suitable basis for the continued existence and long-term development of the sector. Appropriate solutions must be found to facilitate cross-border market access and ease the problem of criminality. At the same time, the interests of clients must be safeguarded, and their legitimate need for protection of privacy must be duly respected.

One of FINMA's tasks for 2010 will be to scrutinise the legal risks in the cross-border business of insurance companies and to identify any need for action.

Effective enforcement of financial market regulation

Enforcement Policy

In order to flesh out FINMA's strategic goal of implementing sustainable market supervision and effective enforcement, the Board of Directors in December 2009 approved an Enforcement Policy proposed by the Executive Board. Enforcement at FINMA is the forcible determination of facts where irregularities or abuse are suspected and the forcible implementation of financial market supervisory regulation.

This policy, which can be found on FINMA's website[5], comprises 13 principles laying down the central elements of FINMA's financial market enforcement activities. The policy states that enforcement is one of a number of methods available to the supervisory authority for the fulfilment of its statutory mandate. The foremost objective is to safeguard the integrity of the markets, which begins with the all-important fight against abusive practices and eradication of irregularities. However, FINMA strives to proceed with measured judgment in enforcing supervisory law. This means that it can opt for a more lenient approach where this can bring about the same outcome. FINMA endeavours to conduct its proceedings swiftly and with a clear focus, and to act fairly and transparently towards those involved. This includes in particular the strict respecting of parties' rights. In its administrative proceedings, FINMA examines whether its external agents[6] should be commissioned to perform specific duties. FINMA also cooperates closely with criminal and other authorities, as well as stock exchanges and self-regulatory organisations pursuant to the Swiss Anti-Money Laundering Act.[7]

FINMA does not generally disclose any information on individual proceedings, although in exceptional cases it will make announcements on the initiation, subject matter and conclusion of proceedings, but not on the individual stages of the proceedings.[8] FINMA may publish legally binding decisions, where it has made such provision in the ruling.[9] It publishes selected anonymised decisions in a separate compilation of decisions.

Proceedings against individuals

The Enforcement Policy places particular emphasis on proceedings against natural persons.[10] Such proceedings often have a far-reaching impact on the individuals involved, and FINMA therefore acts circumspectly in this regard, particularly as supervision in this sector focuses on the licence-holders, rather than their employees. However, FINMA does not hesitate to instigate proceedings against individuals where this is shown to be necessary for the enforcement of the protection granted by financial market regulation. FINMA gives careful consideration before deciding whether to instigate proceedings that could lead to an individual being banned from exercising a profession or activity.[11] It is guided in particular by the risk potential of the persons in question, which tends to be regarded as higher for those in positions of greater seniority.

Following in-depth examination, FINMA has confirmed that it will continue the practice of the SFBC of not normally instigating proceedings under supervisory law against persons no longer holding their functions.[12] However, FINMA is prepared to investigate the responsibility of such a person in relation to a potential irregularity where he has a real prospect of assuming a senior position at a supervised institution (office holder).

Enforcement procedure

The trigger is always an event or piece of information that raises the question of whether there has been a serious breach of supervisory law. Preliminary investigations ascertain as quickly as possible whether such suspicions – which in some cases can be fairly vague – are sufficiently substantiated as to raise the question of instigating administrative proceedings to enforce supervisory law.

Administrative proceedings applying the Swiss Federal Administrative Procedure Act are

[5] See www.finma.ch/e/sanktionen/enforcement/Documents/FINMA_Enforcement-policy_20100120_e.pdf
[6] See Art. 36 FINMASA and Principle 9 of the Enforcement Policy
[7] See Principles 11 and 12 of the Enforcement Policy
[8] See Principle 13 of the Enforcement Policy and Art. 22 FINMASA
[9] See Art. 34 FINMASA
[10] See Principles 6, 7 and 8 of the Enforcement Policy
[11] Art. 33 FINMASA and Art. 35a Swiss Stock Exchange Act (SESTA)
[12] See www.finma.ch/e/sanktionen/gewaehrserfordernis-watchlist/pages/gewaehrserfordernis.aspx

the core element in enforcement activities. The objective of these proceedings is to investigate the substantiated suspicion of irregularities in relation to supervisory law to court standards and to determine this such that the necessary corrective measures and administrative sanctions can be ordered. The parties must be notified of the initiation of administrative proceedings.[13] Under the Enforcement Policy, the instigation of such proceedings must be considered very carefully, as they can have drastic consequences for those involved. The parties to the proceedings must bear the costs, which can mount up given that the actual cost incurred is charged.

The foremost objective is to safeguard the integrity of the markets.

Once FINMA has made its rulings, defending its orders in appeals before the Federal Administrative Court or even the Federal Supreme Court can at times require exceptional efforts. Appeals are generally lodged after the final decision has been taken. In some cases, appeals are already launched against preliminary measures or in respect of a decision on other issues relating to proceedings. FINMA does not only act as respondent; however, in some cases FINMA may itself appeal to the Federal Supreme Court against appeal rulings by the Federal Administrative Court.

If a decision has taken legal effect, the person bearing responsibility for enforcement procedure has the task of ensuring that the decision is enforced in accordance with the orders laid down in the ruling. This can be very time-consuming in relation to liquidation decisions and declarations of bankruptcy in particular. Such proceedings can sometimes drag on for years and require specially trained experts.

Organisation

Organisationally, the conduct of enforcement proceedings is separated from line supervision functions.[14] Although preliminary investigations are in some cases carried out by line supervisors, responsibility passes to the department responsible for enforcement by the latest at the point at which administrative proceedings are initiated. An Enforcement Committee[15] appointed by the Executive Board from its own members is responsible for final decisions and for resolutions to initiate significant proceedings.

FINMA has divided its financial market enforcement activities into five specialist areas, i.e.:

- enforcement in relation to licensed institutions (supervision of institutions),
- enforcement in relation to non-licensed institutions (applicability proceeding),
- enforcement to penalise market abuse (market supervision),
- enforcement of disclosure obligations under stock exchange law, and
- enforcement of bankruptcy and financial restructuring proceedings in accordance with banking and stock exchange law.

Under FINMA's integrated approach, the first four areas fall within the remit of the Enforcement and Market Supervision section, whereas the fifth belongs in the Solvency and Capital section within the Banks division.

In all five areas, there are close interfaces with the monitoring functions of the divisions and with other outside bodies. For example, FINMA files criminal complaints with the competent criminal authorities when it finds evidence of crimes or of offences in its investigations.

[13] Art. 30 FINMASA
[14] See Principles 3 and 10 of the Enforcement Policy
[15] See 'Enforcement Committee' in the section 'Board of Directors and Executive Board', p. 37

Effectiveness and efficiency of supervision

On 1 January 2009, FINMA took over supervision of the entire financial market. Integrating all areas of supervision enabled FINMA to review and realign its core task of prudential supervision on the basis of the supervisory approaches of its predecessor authorities and of the initial lessons of the financial market crisis. In reviewing its supervisory approach, FINMA was guided by its core values. As such, FINMA demonstrates initiative, focused and effective action, and efficiency in its use of resources. It also takes into account the economic consequences of its actions. In accordance with these core values, FINMA's strategy development is aimed at boosting effectiveness and efficiency in supervision[16] over the next three years.

The assessment of the supervisory approaches and tools of the predecessor authorities in the first half of 2009, along with the legal framework under FINMASA, underlines the need to deploy the tools available to FINMA more consistently across the various specialist areas and take a more targeted approach to the major risks. Employees from all areas of supervision investigated the following issues in five projects:

- accessing the data and information needed for supervision and evaluating it,
- the possibilities and limitations of interaction with supervised institutions,
- the deployment of tools for the evaluation of quantitative and qualitative risk management as a key process at supervised institutions, and
- the extent of and potential for improvement in the supervisory frame of action.

On the basis of the project findings, FINMA introduced measures to build on the risk-based approach across all areas and apply it more rigorously. A team of economists was also formed, part of whose mandate was to devise the basis for improving risk analysis. The increased competence and capacity in risk analysis should also be used to study in greater detail, over and above the risks of individual institutions, the risks arising from their interdependence. This will enable the existing array of tools to be expanded in targeted fashion and intervention to be made at an early stage.

FINMA has also developed a concept that divides all supervised institutions into six supervisory categories on the basis of the risk posed to creditors and insured persons and to the entire system. These categories have been assigned different supervisory approaches of varying intensity. On this basis, FINMA will be able to deploy its supervisory resources with greater focus and effectiveness in future.

Specific supervisory regimes apply across these categories, with risk-oriented gradations also applying within a category. In the area of non-prudential supervision, FINMA is considering outsourcing further tasks to self-regulatory organisations. In order to improve direct contact with supervised institutions, FINMA is to introduce a system of key account management to suit the needs of each supervisory category.

The risk-based realignment of supervision is leading to the fine-tuning of proven supervisory tools and the introduction of new ones. For instance, the use of auditors and investigators will be extended to all areas of supervision, subject to the particular requirements. In insurance supervision, FINMA is developing, for example, non-risk-weighted capital adequacy requirements based on the balance sheet.

In order to improve the supervision of risk management at supervised institutions, FINMA has focused on gaps in the existing tools at its disposal. In insurance supervision, the emphasis is on examining instruments relating to systemic risks and on capturing liquidity risks in supervision. In relation to banking, the focus is on improving the supervisor's overview of total balance sheet risk. FINMA has also looked at qualitative tools, notably at methods of assessing risk management systems or corporate governance. These could complement the existing assessment of the risk associated with individual supervised institutions – which to date has been

[16] See section 'Our supervisory activities will keep evolving', p. 6

based largely on quantitative methods, especially in banking – with an independent qualitative evaluation. Experiences from the field of insurance are drawn on in this process.

The flow of information plays a key role for the supervisory authorities, which require precise, constantly updated information in order to assess the risk associated with the supervised institutions. FINMA wants to make fuller use of the technical possibilities in order to obtain all relevant information in good time and more frequently, where necessary. Its first step in this direction is the project to develop an electronic supervisory portal designed to facilitate the swift exchange of information, as needed.

Regulation of remuneration systems

The former SFBC began to look in depth at the issue of remuneration systems in the financial sector back in 2008. Two supervisory investigations examined the impact of remuneration practices on the behaviour of bank employees and the associated risks. As part of the package of measures to strengthen Switzerland's financial system, FINMA was also appointed to approve UBS's variable remuneration for the year 2008, that bank being one of the beneficiaries of the measures. Based in part on this preliminary work, the supervisory authority has begun to formulate general rules for remuneration systems throughout the entire financial sector. This has involved grappling with a problem that is perceived as one of the causes of the financial market crisis and is the subject of controversy and debate nationally and internationally, among experts, politicians and the public at large.

The regulatory project on remuneration systems has proved a major challenge. As with most issues of financial market regulation, an internationally harmonised approach is essential, as it makes regulatory arbitrage harder. This means preventing countries from circumventing the purpose of regulation, in that they set rules but also seek to avoid putting their own financial centres at a disadvantage in international competition. The national supervisory authorities coordinate their efforts in international committees such as the BCBS and the International Association of Insurance Supervisors (IAIS). There tends to be cross-country consensus within these bodies, thanks to the preliminary work of the individual supervisory authorities, and the solutions then being implemented at national level with adjustments for country-specific considerations. In view of the heavy time pressure and political expectations, this was not a feasible course of action in the case of remuneration systems. Although the Financial Stability Board (FSB) presented its Principles for Sound Compensation Practices in April 2009, this left too much freedom of interpretation to be able to constitute the basis for a level playing field. The supervisory authorities, which are also pulling out all the stops in their work on the issue, have adopted very different regulatory approaches in light of the lack of international agreement, which goes against the aim of a level playing field. Some major financial centres are also dragging their heels on examining the issue at all or are limiting themselves to largely symbolic measures of little real impact. FINMA has been circumspect in the planning of its regulatory process and has coordinated bilaterally with other supervisory authorities. It has also taken an active role on various international working groups. It was clear that rules that were too far removed from the international consensus would be impractical to enforce and not fit for purpose.

FINMA issued a draft circular on minimum standards for remuneration schemes in June 2009. As expected, the consultation that followed the publication of this draft met with a huge response.

Financial institutions, industry associations, audit and consultancy firms, employee representatives, political parties and individuals made more than 50 submissions stating their position on the draft document. Common complaints were that the regulation was too restrictive, that institution-specific needs could not be taken into account and that globally active groups would run into legal problems if they were implemented. Small and medium-sized companies, in particular, complained of the amount of work involved in implementing the circular and called for the emphasis to fall on those banks and insurance companies that represent a systemic risk for Switzerland or are especially important to Switzerland as a financial centre for some other reason. Parts of the insurance sector did not understand why insurance companies were included in the scope of the circular.

Taking account of international developments and submissions during the consultation period, FINMA approved a revised circular in October 2009, which entered into force on 1 January 2010. In this new version, FINMA was able to respond to most of the objections without diluting the core of the consultation proposal, in the firm belief that the rules put forward merely formalise what should already be best practice for the remuneration systems of financial institutions and any other companies.

FINMA's regulatory actions are in line with international initiatives. The circular should help ensure that remuneration schemes do not create incentives to take inappropriate risks and thereby potentially damage the stability of financial institutions. It also links variable remuneration with institutions' capital and liquidity planning and creates increased transparency by means of far-reaching disclosure requirements.

The regulation of remuneration systems is an area in which FINMA and foreign financial market supervisors alike are still gathering experience. FINMA will therefore monitor the effect of its circular and of comparable initiatives outside Switzerland, and will maintain dialogue with supervised institutions and other supervisory authorities in this regard. FINMA will make use of the knowledge gained to develop the circular further if necessary.

NATIONAL NETWORK

FINMA conducts its supervisory activities autonomously and independently of any Federal Council directives. In order to successfully perform its mandate, it does, however, rely on constructive relationships with the Federal Department of Finance (FDF) and other federal authorities, the Swiss National Bank (SNB), professional associations and other key stakeholders. FINMA nurtures these relationships with national stakeholder groups in various institutionalised forms and at varying levels, according to the frequency and importance of the issues to be tackled together. The following were particularly significant issues tackled in conjunction with national bodies in 2009.

Financial market crisis

The financial crisis was the subject that dominated FINMA's work with its stakeholder groups in 2009. The non-stop and close exchange of information with the FDF was continued, which included regular discussions with the head of the department. The chairman of FINMA met with the full Federal Council for the first time when FINMA's strategy was approved, which was itself emblematic of the crisis. FINMA's main objectives for the coming years are to implement the lessons learned in a targeted fashion and to act effectively as an integrated supervisory authority across all aspects of its mandate. The Federal Council has declared its support for FINMA's strategic direction.

The SNB was FINMA's most important partner in relation to the financial market crisis. Collaboration was close and based on mutual trust. In addition to a number of bilateral meetings at all levels, the SNB's Governing Board and FINMA's Board of Directors and Executive Board hold joint talks every six months. At operational level, FINMA meets regularly with the SNB under the auspices of the Standing Committee for Financial Stability. In addition, various joint working groups have been created to deal with particular issues, such as liquidity requirements for large banks, the definition of macroeconomic stress scenarios and the formulation of potential solutions to the problem of institutions being considered too big to fail.[17] Although they cooperate closely, FINMA and the SNB have different mandates. Further harmonisation is needed and is currently being elaborated under the Memorandum of Understanding (MoU), which is being revised.

The financial market crisis also led to an increased volume of enquiries from members of parliament and to close cooperation between FINMA and the parliamentary supervisory committees. FINMA provided the committees with extensive documentation and was regularly available to answer questions. The crisis was also a recurring topic in FINMA's meetings with various industry associations.

Remuneration systems

The issue of remuneration systems, including FINMA's circular on that subject, was closely linked to the financial market crisis. In addition to numerous parliamentary questions on this topic, the circular on remuneration systems was also discussed at meetings with industry associations and their members.

Tax dispute

There was much controversy over cross-border private client business, which centred on the tax dispute between UBS and the US authorities but in fact had implications for all financial institutions pursuing similar business strategies. The aggravated situation on the financial markets as a result of the crisis led many other countries besides the USA to take a tougher line towards Swiss banks. FINMA shared its assessment of the legal risks in these matters with the industry associations and affected federal offices.

The settlement ultimately reached between UBS and the US authorities, and in particular FINMA's order to immediately hand over a limited volume of client data, unsurprisingly attracted a great deal of attention. Specifically, the joint working group on financial market supervision of the Control Committees of the National Council

[17] See section 'Regulation of financial institutions that are globally active or of systemic importance', p. 24

and the Council of States subsequently provided FINMA with extensive documents on the cross-border issue. FINMA representatives were also invited to committee meetings on numerous occasions.

Working group on the strategic direction of the financial centre

Building on the dialogue already established between the authorities and the financial sector and under the Swiss Financial Centre Dialogue Steering Committee set up in 2007, a joint working group on the strategic direction of the financial centre was formed in May 2009. It consists of representatives of the authorities (Federal Finance Administration [FFA], SNB, FINMA, Swiss Federal Tax Administration [FTA]), representatives of the financial sector (Swiss Bankers Association [SBA], Swiss Insurance Association [SIA], Swiss Funds Association [SFA], SIX Group), the chair of the Expert Group on Administrative and Legal Assistance on Tax Offences and an academic. The mandate of the working group is to collate important information for future financial market policy and so contribute to the enhancement of the Swiss Financial Centre Master Plan.

Combating money laundering

In relation to the fight against money laundering, FINMA and its national partners are striving for improved information sharing and coordination between FINMA, the cantonal criminal authorities and the Office of the Attorney General of Switzerland. FINMA also spoke out on the status of the planned integration of FINMA's three money laundering ordinances, implementation of the revised Anti-Money Laundering Act and international developments within the Financial Action Task Force on Money Laundering (FATF).

Rules on FINMA's role as the authority to hear appeals against decisions of the Takeover Board

FINMA acts as both the independent authority to hear appeals against decisions of the Takeover Board and its supervisory authority. In view of this double function, both authorities set rules governing the relationship between them in a joint discussion. Under these rules, FINMA ensures that it keeps at arm's length from the TOB's day-to-day business because of its role as an appeal authority. In its capacity as supervisory authority, however, FINMA elects the members of the TOB and approves its ordinance and regulations. Other promulgations by the TOB, on the other hand, do not require FINMA's approval.

Dialogue with the Ticino financial centre

To meet demand from Italian-speaking Switzerland and at FINMA's initiative, the promotion of contact and the institutionalisation of dialogue with representatives and key players in the Ticino financial centre were stepped up in 2009. As well as deepening contact at the level of FINMA's Executive Board, FINMA also supported professional training, with various FINMA employees leading courses on topical issues in the region.

INTERNATIONAL INVOLVEMENT AND AGENDA

Introduction

As part of its strategy, FINMA fosters active involvement in the international arena with the aim of promoting global financial stability and positively influencing the development of international standards of significance to Switzerland as a financial centre. In view of the close ties between the Swiss financial centre and foreign markets, FINMA seeks to make a forward-looking, well grounded contribution to the creation of the best possible regulatory environment. The international strategy promoted bilaterally and multilaterally should enable FINMA to rapidly identify key developments and respond in a focused fashion to crises and challenges.

At the multilateral level, FINMA is involved through its membership of international organisations in efforts to strengthen financial stability and contain the risks that have come to light in the financial market crisis. In 2009, those activities related mainly to the recommendations of the G-20 and the Financial Stability Board (FSB). Switzerland is an FSB member, and the Board's work is of particular importance to FINMA. FINMA is also engaged in the work of the international standard-setters BCBS, IAIS and the International Organization of Securities Commissions (IOSCO).

Institutional ramifications of the financial market crisis

The G-20 countries agreed at their summit in London on 2 April 2009 to strengthen the Financial Stability Forum (FSF), which will have a broader mandate under its new name, the FSB. Its membership will be expanded to all G-20 states, Spain and the European Commission. Switzerland has two seats (formerly one) in the plenary of the FSB, and FINMA is represented on certain FSB committees.

The standard-setting bodies are also working towards reform in the wake of the financial market crisis. The expansion of the BCBS to 27 members in summer 2009 is emblematic of the changes in progress within the international financial system. In relation to bank supervision, the Basel Committee is of central importance for FINMA; in the area of insurance supervision, the activities of the IAIS are key. FINMA is represented in important positions on both bodies and participates actively in the work of their various committees. The IAIS has widened its scope of activity in response to the financial market turmoil, establishing the Financial Stability Committee (FSC) to deal with issues of systemic relevance to the insurance sector and macroprudential supervision. The IAIS is also conducting groundwork into the creation of an international framework for the supervision of insurance groups (Common Assessment Framework [ComFrame]), led by the Vice-Chair of the Board of Directors of FINMA. IOSCO has also begun to pay greater attention to issues related to the financial crisis. The main fruits of its work include initiatives to capture macroprudential risks and to limit risks arising from financial institutions, instruments and markets of systemic relevance.

The De Larosière Report[18], which evaluates weaknesses in global, European and national financial market regulation, is of key importance for reforms within the EU. The report contains a recommendation for a new European financial architecture with the aim of strengthening and better coordinating financial supervision. The implementation of this proposal has now been agreed upon and is in preparation. There are plans for:

- a *European Systemic Risk Board* (ESRB) – a macroeconomic institution,
- a *European System of Financial Supervisors* (ESFS) – to strengthen microprudential supervision, and

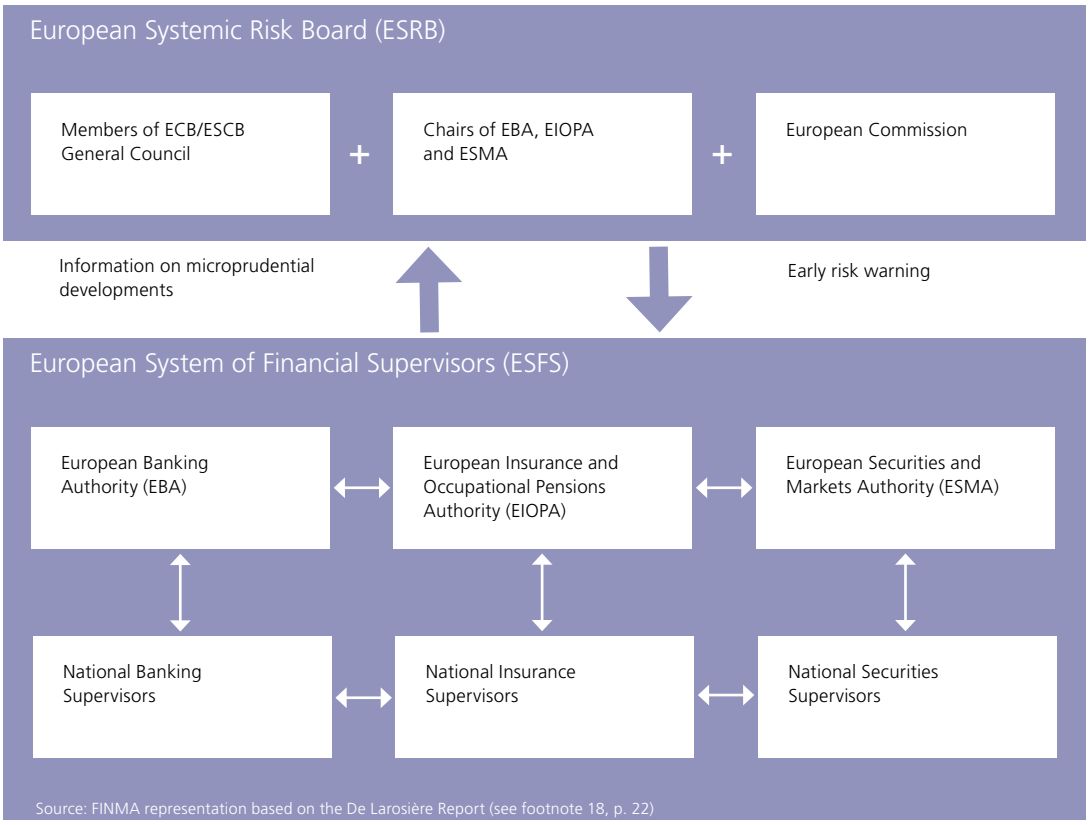
[18] Report of 25 February 2009 by the High Level Group on Financial Supervision in the EU, led by Jacques de Larosière (http://ec.europa.eu/commission_barroso/president/pdf/statement_20090225_en.pdf)

– three new European supervisory authorities:
  - the *European Banking Authority* (EBA),
  - the *European Insurance and Occupational Pensions Authority* (EIOPA), and
  - the *European Securities and Markets Authority* (ESMA).

The new authorities will take over all functions of the three existing EU-level committees, with additional areas of competence:

- *Committee of European Banking Supervisors* (CEBS),
- *Committee of European Insurance and Occupational Pensions Supervisors* (CEIOPS), and
- *Committee of European Securities Regulators* (CESR).

The new financial architecture is to enter into operation at the end of 2010. Incorporating third countries (other than EEA states) is not a priority.



Source: FINMA representation based on the De Larosière Report (see footnote 18, p. 22)

Tools for capturing macroprudential risk

In the aftermath of the financial market crisis, the G-20 and FSB issued recommendations aimed at promoting international cooperation in crisis situations, eliminating pro-cyclicality in the financial system and producing measures to foster financial stability. The international standard-setters are being called on to develop instruments for macroprudential supervision. These are primarily of a quantitative nature, measuring liquidity risk, margins, leverage and similar. FINMA is actively involved in working groups on macroprudential supervision at the BCBS, IAIS and IOSCO.

Regulation of financial institutions that are globally active or of systemic importance

One urgent item on the action plans of the G-20 and the FSB is the prevention of systemic crises, specifically the regulation of large financial institutions that by virtue of their complexity and activity in various markets and financial systems are considered of systemic relevance. In its declaration of November 2008, the G-20 called for a review of the existing rules, with the objective of enabling appropriate handling of complex financial institutions in future. The regulatory measures are therefore aimed at:

One objective is the prevention of systemic crises, specifically the regulation of large financial institutions.

- reducing the likelihood of bankruptcy and minimising the associated harm,
- strengthening the financial infrastructure and markets, and
- improving the capacity to handle companies of systemic relevance.

The first two of these points are preventative measures, whereas the last tackles the problem of institutions being considered too big to fail. 'Too big to fail' refers to large, complex institutions embedded in the international system, whose failure would entail (excessively) high costs for the financial system and the real economy and which therefore enjoy an implicit state guarantee. At the BCBS's Cross-Border Bank Resolution Group (CBRG), in which FINMA holds the chairmanship jointly with the US Federal Deposit Insurance Corporation (FDIC), FINMA collaborated in 2009 on a report containing recommendations for a suitable mechanism for dealing with large, internationally active institutions. In light of the high political expectations, the question of how to cope with cross-border banking crises is likely to remain on the international agenda in the near future, occupying FINMA's resources. FINMA is also working on the same issues in relation to the insurance sector, under the auspices of the IAIS FSC.

Strengthening of capital and liquidity

The BCBS has drawn on the experiences of the financial market crisis to develop a variety of measures at both microprudential and macroprudential level which should significantly boost the robustness of financial institutions. These principally involve improving the quality of regulatory capital, reducing the pro-cyclicality of minimum capital requirements, promoting the creation of provisions for potential future needs, holding capital buffers and applying macroprudential tools to safeguard the stability of the system. The relevant measures will be published in 2010. Many of these steps have been born out of the G-20 and FSB recommendations, which the BCBS has carried across into Basel II.

One main emphasis of the work is on the increased quality requirements for eligible capital of banks. The BIS tier 1 ratio, i.e. the level of core capital measured in terms of risk-weighted assets, is used to indicate banks' capital strength. The work has been guided by recent experiences in key respects. In particular, the losses suffered by banks, which in some cases were very sizeable, made plain the need for high quality of capital in order to help a financial institution absorb losses on a going concern basis. The focus is on equity capital and the respective reserves. At the end of 2009, consultation began into the proposed new requirements, which signal a move away from complex, mainly tax-optimised supplementary liable capital.

Other areas of emphasis include numerous revisions to parts of the rules on the calculation of risk-weighted assets and the capital that must be held in respect of market and credit risks. Back in mid-July 2009, the BCBS published tougher rules on the capital requirements for resecuritisations and market risks. These will probably enter into force at the end of 2010. The capital requirements for counterparty risks from off-balance-sheet transactions, particularly from OTC derivatives transactions, are also being enhanced. The revised regulations also provide that banks must hold substantially more than the minimum capital requirement, in order to be better able to absorb losses. A capital buffer of this kind is designed to be fed into and temporarily drawn upon in order to mitigate the pro-cyclical effects of risk-based capital requirements as far as possible. An SFBC ruling relating to the two big Swiss banks implemented the idea of an anti-cyclical capital buffer back in November 2008. The same ruling also provided that Switzerland's big banks would have to comply with a leverage ratio by 2013 at the latest. The BCBS is now considering how to design a leverage ratio as part of the overall package, with the aim of supplementing the risk-sensitive capital adequacy requirements with guidance on a flat-rate limit on leverage.

One main emphasis of the work is on the increased quality requirements for eligible capital of banks.

At the same time as updating the capital adequacy requirements, the BCBS is also working on quantitative liquidity requirements. These are to contain dynamic values based on stress tests and more straightforward, static values based on balance sheet indicators.

Studies into the effects of the measures announced by the BCBS

All the new requirements of the BCBS to strengthen banks' capital and liquidity have largely been sketched out, and a comprehensive quantitative analysis of the impact is now being carried out in the first half of 2010. Studies are being conducted in all member countries of the BCBS, with the innovations applied to the most affected and most representative banks' actual balance sheet and risk exposures to determine the impact on their capital and liquidity positions. Based on the findings, the BCBS will subsequently fine-tune the calibration of individual measures and finalise the package as a whole. In Switzerland, the analysis will cover the country's big banks and a selection of others. A team within FINMA will manage the coordination of the impact analysis. The BCBS will evaluate the findings of the comprehensive impact analysis in the second half of 2010 and incorporate these into the final formulation of the measures. The entire package should be signed off by the end of 2010.

Over-the-counter derivatives markets

A communication from the European Commission[19] cited the lack of transparency caused by the fact that derivatives transactions are generally executed over-the-counter (OTC) as one of the main weaknesses in the organisation of the derivatives markets. The lack of transparency over prices, transactions and positions makes it impossible for the regulatory authorities to supervise the derivatives markets efficiently in terms of system protection and market abuse. The European Commission regarded the regulation of credit default swaps (CDSs)[20] as a central element in achieving financial stability. A recommendation on the future regulation and supervision of the European financial markets[21] foresees:

- simplifying and standardising OTC derivatives and
- creating at least one central clearing office in the EU for CDSs and making its use mandatory.

As a result, the derivatives markets should move from their current mainly bilateral, OTC status towards more centralised clearing and transaction processes. Central counterparties (CCPs) act as clearing offices between the two parties in an OTC derivative transaction.

The European Commission wants to present the first draft on the regulation of derivatives in 2010. This will be in accordance with the objectives of the recent G-20 summit. The EU will work with its G-20 partners, the USA in particular, in order to avoid regulatory arbitrage. The US-proposed regulatory framework for OTC derivatives provides for a similar obligation, in that all standardised OTC contracts must be cleared via CCPs. Standardised contracts should become the rule. The intention is to bring non-standardised contracts under stricter supervision by the supervisory authorities.

In 2009, the following CCPs introduced CDS clearing, where necessary with the regulator's approval:

- ICE Trust US (IntercontinentalExchange), from 13 March 2009 for CDS indices and 29 December 2009 for CDS single-name contracts,
- ICE Clear Europe, London, from 31 July 2009 for CDS indices and 21 December 2009 for CDS single-name contracts,[22]
- Eurex Clearing AG, from 30 July 2009 for CDS indices and 27 August 2009 for CDS single-name contracts,[23]
- Eurex Clearing, recognised on 31 July 2009 by the US supervisory authority the Commodity

[19] See the European Commission communication: 'Ensuring efficient, safe and sound derivatives markets: Future policy actions', 20 October 2009, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0563:FIN:EN:PDF

[20] See the European Commission press release: 'Major step towards financial stability: European market for credit default swaps becomes safer', 31 July 2009, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1215&format=HTML&aged=0&language=EN&guiLanguage=en

[21] See footnote 18, p. 22

[22] See https://www.theice.com/marketdata/reports/ReportCenter.shtml

[23] Eurex Clearing is regulated on a tailored basis as a bank by the German Federal Financial Supervisory Authority (BaFin) under the German Banking Act. The UK FSA has recognised Eurex Clearing as a recognised overseas clearing house (ROCH; see http://www.eurexclearing.com/about/company_profile_en.html).

Futures Trading Commission (CFTC) as a multilateral clearing organisation (MCO) for the US CDS derivative market,[24]
- CME Group (Chicago Mercantile Exchange) with CME Clearing, from 15 December 2009 for CDS indices,[25]
- CME Group, which was at the end of the year in contact with the UK Financial Services Authority (FSA) to obtain a licence for the European market, and
- LCH Clearnet S.A., London, which began a test phase as an additional European clearing house for CDS indices;[26] LCH Clearnet S.A. also applied to the CFTC for MCO status under US regulation.

FINMA supports international efforts in relation to OTC clearing and settlement. Thus, FINMA participates in international meetings made up of bodies working on the future regulation of the OTC CDS market and the review of the applicable international minimum standards for securities settlement systems and of central counterparties, looking at OTC derivatives' transactions, mainly CDSs.

There is no central counterparty domiciled in Switzerland offering a clearing service for OTC CDSs and derivatives. As such – and unlike its partners in Germany and the UK – FINMA does not perform any direct supervision over any CCPs for OTC CDSs. Nevertheless, FINMA must be able to recognise, analyse and above all limit risks in relation to the central clearing of OTC products. Consequences for the Swiss financial system are possible, given that the Swiss market participants supervised by FINMA are actively engaged in OTC trading.

In 2009, the Swiss CCP SIX x-clear AG expanded its activities to include European stock markets and multi-trading facilities (MTFs). For example, SIX x-clear currently offers its services as sole CCP to Euromillennium NYFIX and also acts as an additional CCP within the Competitive Clearing alongside the existing central counterparty on the London Stock Exchange (LSE). It also plans further co-clearing activities on the Chi-X in London and Nordic OMX exchanges. SIX x-clear therefore made efforts to expand the assets eligible for clearing in 2009. Clearing for fixed-income securities was launched on the SIX Swiss Exchange.

Reform of fund regulation

One important topic that was pushed into the foreground by the financial market crisis and will remain on the agenda in Switzerland is the regulation of hedge funds. In its hedge fund report, IOSCO made recommendations on six general, globally applicable principles of hedge fund regulation, including requirements to register hedge funds and their managers and for information pertaining to systemic risks to be disclosed. The aim is to achieve international convergence in the regulation of hedge funds, which will prevent regulatory arbitrage. IOSCO is increasingly working with industry associations in order to bring regulatory principles and standards in line with the industry's best practice.

At the end of April 2009, the European Commission published a draft directive on Alternative Investment Fund Managers (AIFMs). The Commission's objective is to ensure that all relevant market participants in the fund business are subject to adequate regulation and supervision. Specifically, all managers of funds that are not harmonised under the Undertakings for Collective Investment in Transferable Securities Directive (UCITS Directive) should be subject to authorisation and to an extensive duty of disclosure. While AIFMs are to be

[24] See www.eurexclearing.com/about/press/press_645_en.html
[25] See www.cmegroup.com/clearing/
[26] See www.lchclearnet.com/Images/General%20Information%20CDS%20status%20update%20_21122009_tcm6-53108.pdf

subject to strict conditions when providing services and marketing their funds to professional investors within the internal market, third countries – including Switzerland – shall be excluded fairly rigorously from the European market. The draft directive has been heavily criticised by the European fund industry and some member states. It is not possible to say at this stage whether the European Parliament and European Council will pass the draft, and if so in what form.

Some regulatory projects were already in progress before the crisis broke. These included the UCITS IV Directive passed by the European Parliament and European Council in 2009, which fully revised the 2002 UCITS III Directive and expanded it in some areas. The UCITS III Directive needed overhauling primarily because of the US fund market. The objective was to safeguard the competitiveness of the EU fund market and cut costs for investors while ensuring a high level of investor protection. In particular, this entailed the following innovations: In order to boost the generally low fund volumes in Europe and unlock benefits of scale, cross-border UCITS mergers are now possible besides domestic mergers. The provisions on master/feeder structures create the European basis for pooling of UCITS. These structures allow a UCITS to invest 85% or more of its assets in a master UCITS. The combined management of fund assets make cost savings possible. A passport system for fund management companies was also introduced. This enables, for example, a Luxembourg fund management company to launch a UCITS in Germany, without the need for an administrator in the country. Finally, the simplified prospectus, which was often long and complicated, was replaced by the concise and harmonised 'Key Investor Information' document. The member states must transpose the UCITS IV Directive into national law by 1 July 2011.

Role of the rating agencies

FINMA recognises rating agencies for the assessment of the capital adequacy requirements under Basel II for banks and securities dealers. The basis for recognition is laid down in FINMA Circular 08/26 'Rating Agencies' and is in line with the international IOSCO Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO Code) and the BCBS requirements. FINMA's supervision covers all institutions subject to financial market legislation,[27] which means that rating agencies do not fall under the scope of FINMA's supervision and, because of the lack of a legislative basis, are not monitored by FINMA on an ongoing basis. Most recognised rating agencies are internationally active and do not have a registered office in Switzerland. In view of their role in the financial market crisis, specifically in the evaluation of structured products, they have come under public fire. In April 2009, the heads of government at the G-20 summit in London demanded tougher measures for the monitoring of agencies. The respective countries are responsible for the implementation of those measures. IOSCO consequently created a new standing committee (no. 6, Credit Rating Agencies), on which FINMA is represented. One of the tasks of this committee is to provide an overview of the existing regulation and provisions entering into force in the near future. The report published early in 2010 shows the extent to which national and supranational regulations comply with the principles of the IOSCO Code. In view of the global nature of major rating agencies' activities, communication between the national supervisory authorities is also to be promoted, and differences in regulation and legal loopholes between jurisdictions need to be investigated. Attempts are also underway to reach solutions in terms of best practice and international standards. At the request of the G-20 and the FSB,

[27] Art. 1 para. 1 FINMASA

the BCBS additionally analysed the (false) incentives in relation to external ratings and published its findings in a consultation report[28] at the end of 2009. In summary, the BCBS considered the following as negative incentives: The use of external ratings under Basel II led banks to neglect their own independent risk assessments. In addition, issuers, lenders and investors all had an interest in positive ratings, which spelled lower capital adequacy requirements and a greater selection of eligible products for investment or collateral security. The 'cliff effect' in capital requirement could also result in banks using ratings selectively.

Strengthening of accounting standards

The International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (US GAAP) were revised in 2009, under the influence of the G-20 and the FSB. The emphasis was put on provisions relating to the recognition and measurement of financial instruments. While the International Accounting Standards Board (IASB) opted for an incremental revision of IAS 39 'Financial Instruments: Recognition and Measurement', the Financial Accounting Standards Board (FASB) chose to completely revise its rules on financial instruments at one stroke. However, the IASB and FASB are still striving to achieve convergence between the two sets of accounting standards.

FINMA's membership of the BCBS and IAIS means that it has an indirect say in developments in international accounting standards. Both the BCBS and IAIS support the efforts of the IASB and FASB to achieve convergence between the sets of standards, which is welcomed by FINMA.

Corporate governance

The G-20 and the FSB recently have produced a very important recommendation on remuneration systems, which should be designed in such a way as to link incentives to the long-term profitability of the financial institution. The FSB drew up a set of Principles for Sound Compensation Practices, which many countries – including Switzerland – have used as the basis for developing national remuneration systems. The IAIS is also engaged in defining remuneration standards based on the FSB principles that take account of the particular characteristics of the insurance sector. IOSCO is also studying how greater transparency over remuneration practices can be incorporated into the Principles for Periodic Disclosure. FINMA is keeping a very close eye on international developments in remuneration policy, with a view to the consequences for national regulation.[29]

The BCBS revised its corporate governance principles for banks in 2009. FINMA is a member of the working group in question, which also includes representatives of the World Bank, the Organisation for Economic Cooperation and Development (OECD) and other international organisations. In relation to the supervision of investment banks, FINMA belongs to the Senior Supervisors Group (SSG).[30] Following the collapse of Lehman Brothers, 20 globally active financial companies were called on at the end of 2008 to compare their risk management processes and internal control systems against the findings of an SSG Report and against the recommendations in recent studies by supervisory authorities and the financial industry. Another report,[31] produced in 2009, identified a number of weaknesses in governance, business

[28] See the BCBS consultative document 'Strengthening the resilience of the banking sector', p. 55ff., December 2009
[29] See section 'Regulation of remuneration systems', p. 18
[30] See SFBC Annual Report 2008, p. 82f. (German version)
[31] See 'Risk Management Lessons from the Global Banking Crisis of 2008', www.financialstabilityboard.org/publications/r_0910a.pdf

management, risk management, internal control processes, and liquidity and funding management that had contributed to the financial and banking crisis. These weaknesses include the misjudgement by the board of directors or executive board of what risks could be tolerated, misguided remuneration systems, inadequate technical infrastructure and structural deficits that led to a lack of controls over risk-taking members of staff.

Remuneration systems should be designed in such a way as to link incentives to the long-term profitability of the financial institution.

Based on developments in corporate governance over recent years and the lessons learnt from the financial market crisis, the IAIS also revised its guidance for insurers in consultation with its members, including FINMA. The first fruit of this process was an issues paper on corporate governance, which defined the key factors for governance, risk management and internal control systems.

In the OECD's Insurance and Private Pensions Committee (IPPC), the Swiss delegation led by FINMA concentrated on the initiatives relating to effective and efficient regulation, corporate governance in the insurance industry, improvements to the international comparability of statistical data and the liberalisation and opening up of markets. In these areas, FINMA works closely with other standard-setting bodies, such as the IAIS, FFA and SNB.

FINMA was also actively involved in the work of the Joint Forum that produced a report on the regulatory differences between the banking, insurance and securities trading sectors. Cross-sector activities by financial institutions harbour risks that can jeopardise the stability of the financial system. The report uncovered a series of regulatory discrepancies and gaps between the different sectors. The report therefore also contained proposals on how to reduce regulatory arbitrage by international financial institutions operating across sectors.

FINMA also contributed to the Joint Forum's report on special-purpose entities (SPEs), which looked in detail at the forms that these entities take across the whole financial sector, the motives behind their use and the demands in terms of risk management. Eight recommendations for market participants and supervisory authorities were formulated in relation to the use of SPEs. The report also provided valuable background information to the debate on the regulatory treatment of structured financial transactions and securitisations.

International cooperation with foreign supervisory authorities

At a bilateral level, FINMA fosters good relations with the supervisory authorities of its most important partner countries. It strives to maintain regular dialogue with these authorities at the highest level. FINMA launched a country monitoring service in 2009 to keep abreast of the key developments on the financial markets and in supervisory systems in its partner countries. The information gathered is used to develop possible future courses of action for FINMA.

Regular meetings and ongoing dialogue between FINMA and the foreign authorities also take place at operational level. This communication deals with individual institutions or general important or topical supervisory issues. In respect of the supervision of large banks, trilateral meetings on Switzerland's big banks were held with the US Federal Reserve System (Fed) and the British FSA in 2009, in addition to meetings with the banking supervision authorities in Japan, Singapore and Hong Kong. In relation to insurance supervision, FINMA engages in dialogue concerning regulation with the European

Commission and the US National Association of Insurance Commissioners (NAIC). This takes place twice per year. In respect of market supervision, FINMA took part in international forums such as the CFTC's International Regulators meeting (Boca Raton, USA), the Futures and Options Markets Regulators Meeting (Bürgenstock, Switzerland) and the meeting of the four German-speaking countries, with Germany, Austria and the Principality of Liechtenstein. The annual meeting between FINMA and the Committee of European Securities Regulators (CESR) was also held.

The conclusion of memoranda of understanding is often important in supporting cooperation with national authorities. Multilateral agreements between the supervisors of financial institutions that operate across national borders also play a key role. The IAIS Multilateral Memorandum of Understanding (MMoU) entered into force in 2009, when it was signed by the first six insurance supervisory authorities. This marked an important step towards strengthening international cooperation in insurance supervision. FINMA applied to join the IAIS MMoU on 17 July 2009. IOSCO forged ahead with implementation of the IOSCO MMoU. FINMA and its predecessor the SFBC had for years been aiming at signing the IOSCO MMoU and achieving A-list status, in order to be recognised as a fully fledged partner in the cross-border exchange of information between stock exchange supervisory authorities. FINMA obtained A-list status in January 2010.

Relationship with the European Union

FINMA needs to manage its relationship with the EU and developed a strategy to that end in autumn 2009. The emphasis is on FINMA's efforts to secure recognition by the EU of the equivalence of the Swiss supervisory system. Efforts along these lines have been made for some time in insurance supervision. For example, in 2009 FINMA underwent a procedure to have its reinsurance supervision recognised as equivalent under the EU directive in question. FINMA is currently preparing for the process of examination for equivalence under the Solvency II Directive. As a first step, Switzerland was invited to present its system of insurance supervision at the meeting of CEIOPS members in January 2010. FINMA therefore drew up a comparison between Swiss reinsurance supervision law and the EU's acquis communautaire in relation to insurance. This produced important findings for the work of the Swiss Financial Centre Dialogue Steering Committee. The analysis of the EU acquis is to be built on further for other financial services in the future; the intention is to re-evaluate the existing comparison of legislation on banking, money laundering and capital market regulation. In addition to the ongoing work on the recognition of equivalence, FINMA also seeks to improve market access to individual member states at bilateral level. FINMA also aims to step up its links with the current EU bodies and to maintain these contacts when the switch is made to the future authorities under the new European financial architecture.

In the field of supervision of insurance intermediaries, the focus at European level at present is on the mutual recognition of intermediary qualifications. This initiative is proceeding apace: The board of the European Financial Certification Organisation (Eficert) recognised the first country-specific insurance intermediary qualifications for certification as a European insurance intermediary (EII) in October 2009. This related to the Swiss VBV Insurance Intermediary qualification and comparable qualifications in Germany and Austria. Further applications for recognition are pending and will be examined shortly. We also note that Matthias Stettler, Director of the Swiss Association of Vocational Education and Training in Insurance (VBV), became chairman of Eficert on 1 January 2010.

International administrative assistance[32]

There was a significant year-on-year rise in the number of requests for international administrative assistance received by FINMA, to 166 at the end of 2009, which represented a 36% increase versus 2008. The reasons for this trend are not obvious. The increase may be attributable to increased pressure being exerted by supervisory authorities, which are redoubling their supervisory efforts and as such making increased use of international administrative assistance. Another possible reason is the financial market crisis. Finally, the Madoff case may also have played a part, by making supervisory authorities generally more alert to market abuse.

Combating money laundering and terrorist financing

FINMA is part of the Swiss delegation led by the FFA, which is actively involved in the work of the FATF. One emphasis of debate about the fourth round of evaluations, due to begin in 2012, is on the expansion of the FATF's catalogue of principles on tax offences. A decision on how to proceed will be made in 2010. A list of countries demonstrating heightened risk in relation to money laundering and terrorist financing, and shortcomings in cooperation and transparency, will also be published in 2010. Switzerland is not affected by this initiative. A further FATF initiative is aimed at stemming the proliferation of weapons of mass destruction. In this regard, it is conceivable that financial intermediaries will have to add new duties to their due diligence requirements in future.

IMF and OECD country evaluations

Switzerland as a business and financial centre is subject to regular evaluations by international organisations. In 2009, FINMA took part in an Article IV consultation[33] by the International Monetary Fund (IMF), which looked in particular at supervisory elements. The IMF's country evaluation indicated that, thanks to tighter regulation and supervision and improved cooperation with international supervisory authorities, the Swiss authorities have fundamentally responded well to the weaknesses of the financial system. There is still room for improvement on some points. FINMA also took part in an OECD country review analysing the impact of the financial market crisis on the Swiss financial system.

[32] See also SFBC Annual Report 2008, p. 71f. (German version)

[33] The IMF's principal duties include regular dialogue with member states on the national and international ramifications of their economic and financial policy. The principles for such consultations with member states are laid down in Article IV of the Articles of Agreement of the IMF.

Experience with supervisory colleges and coordination committees

The financial market supervisory authorities around the world are called on by international bodies such as the FSB to better coordinate the monitoring of internationally active groups and conglomerates across borders and to work together more closely. The FSB has established supervisory colleges for around 30 large, complex financial institutions, with the objectives of harmonising group oversight across the countries in question and facilitating the exchange of information between authorities.

FINMA already coordinates its supervisory activities with key foreign supervisory authorities, specifically by organising coordination committees and supervisory colleges for insurance groups operating internationally. It has run global supervisory colleges for Swiss Re and Zurich Financial Services since 2008. The increasing complexity of insurance groups, which has created a need for closer and effective cooperation with other supervisory authorities, requires, along with other needs, the creation of a joint platform for cross-border supervision. The initial basis for this was outlined in the IAIS Guidance Paper on Supervisory Recognition. IOSCO's Supervisory Cooperation Task Force is also working on principles for the drafting of a MoU on cross-border cooperation between supervisory authorities.

The aim of the supervisory colleges is to share information on the group and its various units and to create a relationship of trust between the supervisory authorities involved. This cooperation can improve knowledge of insurance groups from a strategic, organisational and financial angle. The information shared relates to the group's structure and governance; its risk situation, risk management and internal control processes are also discussed together. Other topics include the financial situation of the group and intra-group transactions and interdependencies.

Against this background, and to support the implementation of its policy, FINMA will in the future organise colleges in relation to banking supervision as well. For Credit Suisse and UBS, FINMA has started to organise annual meetings of all the foreign supervisory authorities that it or the banking group in question considers particularly important. Such large colleges supplement the existing cross-border cooperation, which is mainly bilateral, or consists in regular trilateral meetings with the key US and UK supervisory authorities in the case of the two big Swiss banks. These core college meetings and the bilateral contacts enable more intensive cooperation and exchange of confidential information to take place than larger colleges. They should be continued.

FINMA: THE AUTHORITY

BOARD OF DIRECTORS AND EXECUTIVE BOARD

Board of Directors

Dr Eugen Haltiner	Chairman
Dr Monica Mächler	Vice-Chair
Daniel Zuberbühler	Vice-Chair
Prof. Anne Héritier Lachat	Member
PD Dr Sabine Kilgus	Member
Paul Müller	Member
Charles Pictet	Member
Dr Bruno Porro	Member
Prof. Jean-Baptiste Zufferey	Member

Committees of the Board of Directors

- The *Takeover Committee* performs FINMA's function as the body to hear appeals against decisions on takeovers, in order to assure an efficient process and swift decision.
- The *Appointment and Remuneration Committee* conducts the preparatory work on which the Board of Directors bases its personnel decisions.
- As an independent specialist committee, the *Audit Committee* provides support to the Board of Directors in its monitoring activities.

In order to achieve efficient management, the committees of the Board of Directors are composed of members of the Board of Directors. They consist of three or four members and are presided over by a chairman who maintains contact with the Board of Directors and the Executive Board.

Committees of the Board of Directors	Dr E. Haltiner	Dr M. Mächler	D. Zuberbühler	Prof. A. Héritier Lachat	PD Dr S. Kilgus	P. Müller	Ch. Pictet	Dr B. Porro	Prof. J.-B. Zufferey
Takeover Committee		●		Chair		●			●
Appointment and Remuneration Committee	Chair		●	●		●			
Audit Committee					●			Chair	●

Executive Board

Dr Patrick Raaflaub	CEO (and Head of Banks Division[34])
Dr Urs Zulauf	Deputy CEO Head of Strategic and Central Services Division
Dr René Schnieper	Head of Insurance Division
Franz Stirnimann	Head of Markets Division

Extended Executive Board

Dr Urs Bischof	Head of Risk Management
Kurt Bucher	Head of Supervision of Banks, Securities Dealers and Asset Managers
Hans-Peter Gschwind	Head of Supervision of Non-Life Insurance
Dr Urs Karlen	Head of Quantitative Risk Management
Daniel Roth	Head of Solvency and Capital
Daniel Sigrist	Head of Supervision of Life Insurance
Yann Wermeille	Head of Collective Investment Schemes
Andreas Wortmann	Head of Central Services
Dr David Wyss	Head of Enforcement and Market Supervision

Enforcement Committee

Permanent members:

Dr Patrick Raaflaub
Dr Urs Zulauf
Franz Stirnimann
Dr David Wyss
Daniel Roth

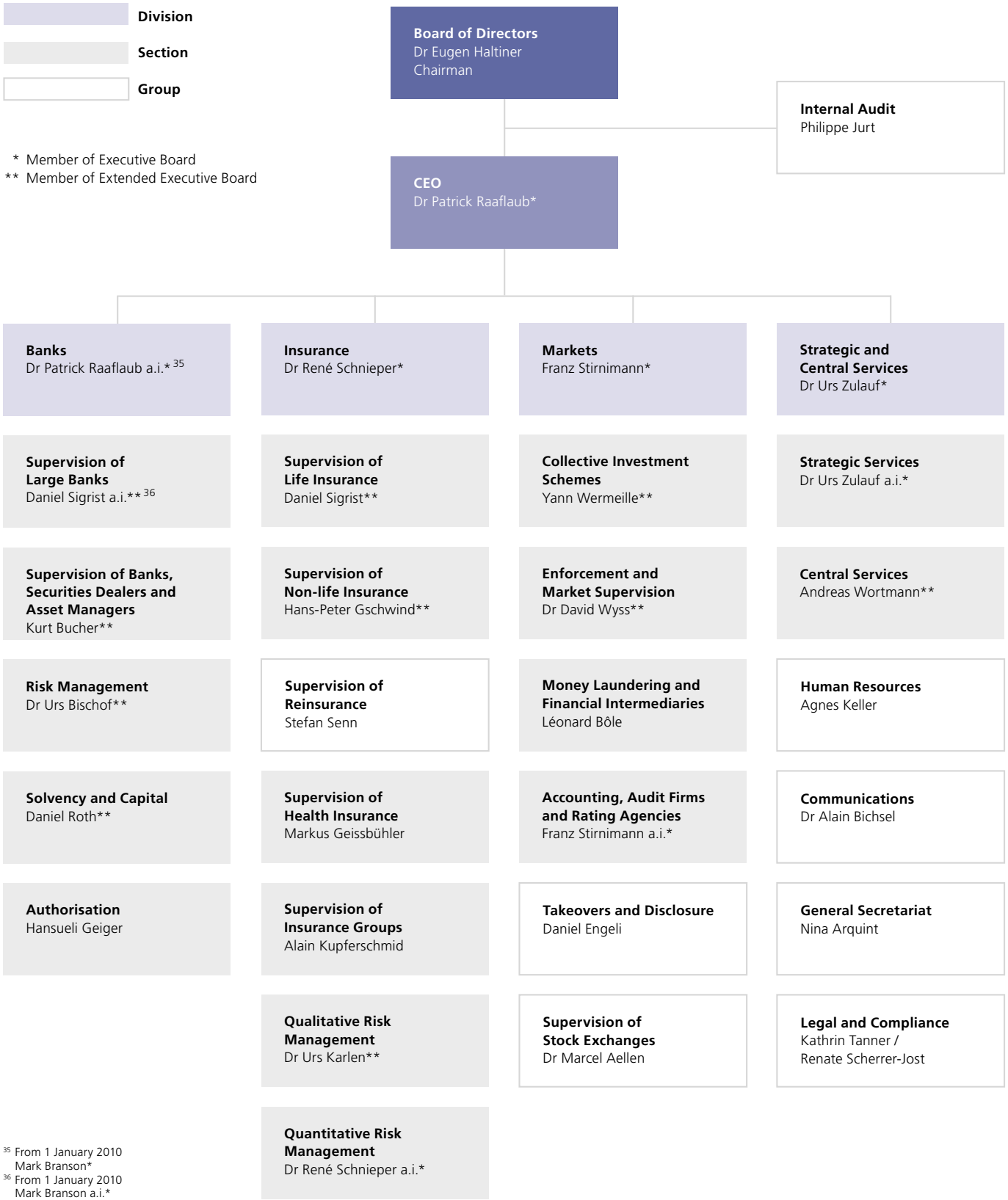
plus on a case-by-case basis the Executive Board member responsible for a supervised institution, where this institution is the subject of proceedings.

The Enforcement Committee passes enforcement rulings, except where this is the preserve of the Board of Directors for matters of substantial importance. Decisions on takeover matters are also excluded. In order to assure the efficient incorporation of specialist knowledge, the Enforcement Committee may bring in other people as appropriate, particularly specialist members of the Board of Directors in disclosure matters.

[34] Mark Branson became Head of Banks Division on 1 January 2010.

ORGANISATION CHART

(status on 31 December 2009)



[35] From 1 January 2010
Mark Branson*
[36] From 1 January 2010
Mark Branson a.i.*

FINMA'S CORE VALUES

The following core values govern FINMA's conduct both internally and when dealing with external partners.

Independence: FINMA prizes its independence, integrity and reputation. It is autonomous in its positioning, which is guided solely by factual, objective considerations. It fosters dialogue with the industry, particularly with supervised institutions, without allowing itself to be compromised by this proximity. It adopts positions based on facts and promotes these consistently but proportionately.

Competence: FINMA performs its statutory tasks competently and responsibly, through its knowledgeable, committed and confident employees.

International networking: FINMA cultivates an international network of relationships, reflecting the global scope of the financial sector. It cooperates with foreign supervisory authorities in its supervisory activities and participates actively in the work of international organisations, seeking outcomes that take due account of the interests of the supervised institutions and of Switzerland as a financial centre.

Internal transparency: FINMA sets high standards for its employees and fosters their professional development. It links remuneration to performance and focused advancement to the specific skills and knowledge needed. Objective, measurable criteria are used to assess performance.

External transparency: FINMA follows a transparent, consistent information policy, creating credibility and predictability both internally and externally.

Integrity: FINMA demonstrates professionalism and fairness, which breed trust.

Efficiency: FINMA shows initiative and its activities are driven by objectives and results. It uses resources efficiently and takes into account the economic consequences of its actions.

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