2007

Annual Report
Key themes

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

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When the reins controlling the markets begin to slip, the challenges for both players and supervisory authorities increase. Many markets are currently galloping off towards the extremes. Every sector is in the running, and those with the highest pedigree are leading the field. They are urged on by the prospect of prizes – and, perhaps occasionally, by the spurs. In the race for returns, investors are offered highly promising bets; yet they barely know the runners and riders. Readers can no doubt guess what happens next: the first horse stumbles, then a second, a rider falls from the saddle, then another follows.

The sudden increase in defaults by low-grade debtors in August 2007, as the US subprime mortgage turbulence took hold, was a phenomenon limited in both geographical scope and financial magnitude, yet it provided an unexpected and graphic example of how quickly the financial system can tilt out of balance, posing an acute danger to stability. Securitising loans and packaging them into complex products is a business model that major investment banks have been pushing for some years now. "Originate and distribute" transformed loans of every kind, and the risks that go with them, into tradable commodities. Laxity in the granting of loans and margins so low that they barely compensate the final investor for the inherent risk were the inevitable result. A lack of transparency meant that investors were purchasing risks they did not want to buy. Product innovations and the successful extension of trading activities led to a massive expansion of balance sheets. If demand collapses, the financial products that have been prepared for sale are left gathering dust in the banks' warehouses, with the result that valuation becomes difficult. Liquidity problems exacerbate the situation, as a loss of confidence causes interbank business to dry up.

All these phenomena were in evidence last year. The Swiss financial sector was affected too due to the exposure of its investment banking business, though the extent of this varied from institution to institution. Growing uncertainty necessitates rapid information and agreement on measures to be taken. It helps if those concerned are accustomed to working together. The close contacts at various levels that have been established between the banks and the Banking Commission, and with the Swiss National Bank and supervisory authorities abroad, proved their worth. An approach based on trust and respect for the responsibilities of the supervisory authorities is of especial value in times of difficulty.

The shock has not yet subsided, the implications of what has happened are still insufficiently understood, and the possibility of further losses on the positions concerned cannot be ruled out. Lessons still have to be learned. Yet some of the conclusions can already be outlined. The banks need to comprehensively review their risk management, the ways in which they plan and manage liquidity and capital, and the level of transparency they provide about these. The supervisory authorities must ask themselves just how far the regulatory framework and therefore the requirements hitherto imposed on banks and the way they are monitored are still appropriate. Increased expertise and manpower needs to be devoted to the supervision of globally active institutions, while a revision of the now outdated regulations is desirable. Targeted extensions of the regulatory framework may be appropriate; overhasty tightening of the reins is, however, not opportune. Whatever safety measures are necessary, we must ensure at all costs that races continue to take place in which all the horses – including those bred domestically – can go on taking their chance to win.

Eugen Haltiner
Chairman

1 Financial market turbulence

US mortgage market triggers broader turbulence

July 2007 saw severe turbulence in the US mortgage sector, as the subprime market began to crumble. The ensuing developments in the second half of the year provided a clear demonstration of the limits of a market for risks which the banks' models, based as they were on the false assumption of a permanently liquid market, had valued far too optimistically. Although not unexpected in itself, the correction in the US subprime mortgage market and in the financial instruments based on it (which had been securitised many times over) rapidly led to a collapse of confidence even among the most highly regarded financial institutions. The result was a global liquidity squeeze. In Switzerland, the main direct casualties among regulated financial intermediaries were the two big banks, which were exposed via their global investment banking operations. After initial major writedowns on illiquid lending positions in the third quarter, the banks affected were also obliged to re-examine their subprime positions in the fourth quarter and adjust their values substantially downwards.

Crossover effects

If the turbulence in the financial markets were to spill over into the real economy, leading to an economic slowdown or even a recession in the US, other areas of the banks' business, and other risk positions, would also be affected.

Influence of the fair value option

The upheaval in the markets has its impact on the banks at various levels. Questions of valuation in particular are influencing a large number of financial products, some of them highly complex. Trading positions are affected just as much as available-for-sale instruments. In the absence of readily observable market prices, especially, valuing these instruments correctly using the fair value option is a difficult task for the banks: accounting regulations and the associated transparency requirements can mean that one bank's published writedown practice directly influences that of other institutions. This interaction can lead to frequent and unpredictable adjustments in the value of such financial products and may even send those values spiralling downwards.

1.1 Effects on the two big Swiss banks

Big banks step up their reporting

The Banking Commission, working together with the Swiss National Bank, extended the range of information it requires from the two big banks. In a departure from the usual reporting frequency, it requested weekly (and in some cases daily) updates on key business figures and forecasts for the company as a whole or, in the case of the big banks, their particularly exposed investment banking arms. The aim was to enable the Banking Commission to make its own up-to-date assessment of developments and share this with the National Bank and foreign supervisory authorities.

Initial focus on provisions for liquidity

Between August and October 2007, the main focus was on supplying the banks with liquidity, with particular emphasis on institution-specific provision for additional stress scenarios. Cooperation with the two big banks, and between the National Bank and the Banking Commission, worked well throughout this phase.

UBS hit hard

When the banks published their third-quarter results, it became clear to the public at large that compared with its European peers, UBS in particular had a major exposure to the US mortgage business. The lack of reliable market prices for US subprime loans and the associated collateralised debt obligations (CDOs) made valuation difficult for a substantial portfolio of assets. Repeated value corrections were required, ultimately leading not just to exceptionally large fourth-quarter losses but even to a negative full-year result.

Focus on regulatory capital

Despite the losses, UBS did not at any time face a liquidity shortage, nor was there ever any risk of insolvency. Both the statutory capital requirements and the additional buffers demanded by the Banking Commission as a precautionary measure were complied with at all times. Indeed, the extra capital reserves contained in the buffers have proven to be a valuable safeguard, as they prevent problems in one business area from immediately spreading to others. They are also designed to prevent losses in foreign business leading to a credit squeeze in Switzerland: in other words, a situation in which loans to companies and individuals dry up. The Banking Commission followed and welcomed the measures taken by UBS to rapidly shore up its capital base. The fact that the Government of Singapore Investment Corporation (GIC) was ready to invest 11 billion Swiss francs in UBS equity can be viewed as a sign that this sovereign wealth fund has faith in UBS's long-term earnings power.

Credit Suisse more cautious in its US subprime business

Credit Suisse pursued a more cautious investment policy than UBS in the US subprime business, and as a result its write-downs were smaller. However, Credit Suisse has a larger exposure in leveraged finance, where it was also obliged to make certain value adjustments.

Limits of risk management

Recent events have shown that reality can be far removed from what happens in mathematical models, and that the latter can often lead to a false sense of security. Substantial risks can arise at the extremes of a probability distribution – in other words, in the area of exceptionally rare losses. Sudden changes in operating conditions can undoubtedly cause statistical models, which are based on sustained and uniform trends, to lose their ability to predict what will happen next. In addition, important information can be lost when aggregating risk indicators. Offsetting of positions and their hedges can disguise the underlying risk, for example when the hedges operate only subject to certain conditions or have different maturities. Taken together with weaknesses in the models, false incentive structures such as the internal invoicing of excessively cheap refinancing costs can lead to an accumulation of substantial risks. However outdated they may seem, there may well still be a case for nominal limits. Appropriate stress testing can also complement the model view and assist in analysing loss potential.

1.2 Initiatives at the international level

Cooperation between supervisory authorities

In the wake of the market turbulence, the Basel Committee on Banking Supervision, IOSCO and the Financial Stability Forum launched a range of initiatives. At the suggestion of the Federal Reserve Bank of New York, the authorities supervising globally active investment banks stepped up the already closer cooperation that they had begun back in September 2005 (Senior Supervisors Group), when the objective had been to reduce backlogs in the processing of OTC credit derivatives. Supervisory authorities from the US (FED, OCC, SEC), the UK (FSA), Germany (BaFin), France (CB) and Switzerland (Banking Commission) were involved. These steps to maximise openness and transparency between national supervisory authorities regarding the situation of and problems faced by specific financial institutions were both a confidence-building measure and a means of assessing more thoroughly the scope of the turbulence. Ultimately, cooperation and coordination between supervisory authorities was also in the interests of the financial intermediaries concerned, for whom uncoordinated measures by individual supervisory authorities would have represented an additional burden at a difficult time.

1.3 Other banks

Limited consequences for small and medium-sized banks

In August 2007, the Banking Commission surveyed around 40 small and medium-sized banks that were potentially vulnerable to the fallout from the subprime turbulence. It emerged that these institutions felt they had suffered little or no impact from the turbulence and that generally they had almost no exposure to it, or a limited and indirect exposure at most. The institutions surveyed nevertheless indicated that the overall negative trend of the financial markets in August 2007 had affected both their revenues and the performance of their clients' assets under management. Some banks also stated that they had increased their liquidity reserves or frozen credit facilities granted to foreign companies exposed to the subprime turbulence.

2 Market abuse

Administrative and criminal law standards

The Swiss regulation regarding avoidance of market abuse is based on both administrative law and criminal law. A part from a couple of criminal offences relating to financial market activity which can be found in the Swiss Criminal Code, the Swiss Stock Exchange Act provides for a series of obligations pertaining to market supervision.

2.1 Market supervision by the Swiss Federal Banking Commission

Supervisory practice based on the requirement for proper conduct

The Banking Commission's activities in the area of market supervision initially involve preliminary investigations. The Banking Commission can impose sanctions for market abuse only on the financial intermediaries that it supervises. It has developed its own practice based on the need to ensure proper conduct of business. The Banking Commission intends to summarise its practice in a circular entitled "Market Conduct Rules" which will detail the kinds of conduct that are viewed as permissible, and those that constitute market abuse. The requirements under administrative law clearly differ from those under criminal law and are stricter than the financial market offences provided by criminal law. Market participants – such as banks and securities dealers – that are subject to the Banking Commission's supervision must comply with stricter requirements.

General market supervision by foreign supervisory authorities

In other major financial centres, the supervisory authorities are not only responsible for market supervision in respect of the financial institutions they monitor, but also have a general responsibility for every market participant. Accordingly, they can investigate cases of market abuse involving every participant, applying the same rules and imposing the same sanctions on those breaching them. Many of these supervisory authorities have a more sophisticated set of measures at their disposal, sometimes involving administrative sanctions. No all-embracing market supervision of this type by the Banking Commission exists in Switzerland.

2.2 Financial market offences

Responsibility of the criminal prosecution authorities

Besides the market supervision carried out by the Banking Commission, the criminal prosecution authorities enforce the provisions on financial market offences contained in the Criminal Code. Yet financial market offences are narrowly defined in Swiss criminal law, and it is the Banking Commission's view that many actions which should be regarded as criminal, are excluded. By international standards too, Swiss regulations contain substantial gaps.

Insider trading

The Banking Commission regrets that the definition given to insider trading is limited to situations akin to issues and mergers; indeed, it has for many years been campaigning to have this limitation removed. The passing of the Federal Council's drafted amendment in December 2006 means that a conclusion to the relevant parliamentary consultation is now in sight. No decision has yet been taken on when it will come into force. However, the insider trading provision still has numerous other shortcomings: majority and minority shareholders of a company, for example, are not regarded as primary insiders. Furthermore said provision does not cover the use of price-relevant information acquired by chance or as a result of a criminal activity.

Price manipulation

As far as price manipulation is concerned, there are substantial limitations to the definition of "transaction crimes" (i.e. transactions committed by carrying out stock exchange transactions). Only price manipulation effected by means of fictitious transactions is subject to punishment, yet market prices can just as easily be manipulated by means of real transactions. Moreover, the criminal provision is limited to price manipulation. It takes no account of actions designed to influence the volume traded or the valuation of securities. Nor does the wording of this provision cover manipulation by simply entering orders into the trading system.

Need for revision on financial market offences

The prohibitions imposed by other major financial centres are more comprehensive and cover significantly more acts of market abuse. It is in the interest of the Swiss financial sector that its standards be brought more closely in line with those of its international counterparts and that effective measures be developed to combat market abuse. There is an identified need for an overhaul of the criminal provisions regarding financial market offences. The extension of the criminal provision on insider trading to cover areas other than issues and mergers is important and a first step in the right direction; but it closes only one loophole, albeit a major one.

2.3 Implementation of market supervision

Competences of the SFBC following the introduction of the Stock Exchange Act

Until the Stock Exchange Act introduced supervision of the markets by the Banking Commission, the criminal law on insider trading was more or less a dead letter. The definition of price manipulation as a criminal offence was not included in the criminal code until the concluding provisions of the Stock Exchange Act. The Banking Commission's involvement in market supervision and its cooperation with the criminal prosecution authorities have in recent years led to a number of successful convictions for insider trading. No one has yet been convicted of price manipulation.

Overlap with cantonal criminal law enforcement

Yet the implementation of the provisions regarding financial market offences remains unsatisfactory. Not only are the offences narrowly defined and the treatment of market participants unequal: the duplication of effort at the investigation stage is a further weakness. Coordination between the Banking Commission and the criminal prosecution authorities has gone some way towards reducing the amount of duplication, but the collaboration is purely informal and works better with some domestic authorities than with others. There is also a conflict between the requirement for the parties to cooperate in an administrative proceeding and the right not to incriminate oneself in a criminal proceeding. Moreover, the rules regarding the competence of administrative and prosecution authorities in criminal matters are unsatisfactory, as they sometimes place simultaneous competence upon cantonal criminal prosecution authorities that, in some cases, have little familiarity with financial market offences. A critical reassessment of the interfaces between the authorities involved is therefore required, and competences may have to be more clearly defined.

2.4 Market supervision working group

Analysis of market supervision

The market supervision working group that was set up by the Banking Commission in January 2006 in association with the Swiss Bankers Association and the SWX Swiss Exchange has examined the aforementioned issues of market supervision in detail. In particular, it has compared the legal framework and practice in Switzerland with those of other major financial centres. The Banking Commission endorses its findings and conclusions, as they are in line with the views which the Commission has held, and for which it has argued, for some time.

No general market supervision by the Banking Commission

Switzerland is not the only country in which supervision of the markets is based on both administrative and criminal law. In financial centres such as London and Frankfurt, however, there are clearer rules governing the interaction between the authorities involved and the competences under administrative and criminal law. The supervisory authorities have a broad-based competence in market supervision; they investigate market abuse in general, involving any participant, and in some cases may even initiate criminal proceedings. Comparable crimes are also more broadly defined than in the two financial market offences (insider trading and price manipulation) covered in Switzerland.

Loss of efficiency due to structural weaknesses

Shortcomings in the interaction between administrative and criminal law are impairing the overall efficiency of market supervision; yet this is vital to an unimpeachable and properly functioning financial centre, especially where its reputation is concerned. Given the weaknesses in the structure and design of market supervision in Switzerland, a thorough review is required. The Banking Commission therefore recommended the setting up of a commission of experts charged with examining in detail both the financial market offences and the interaction between administrative and criminal law, and offering proposals for improvements.

Commission of experts

Once the appropriate instructions had been issued by the Federal Council, in October 2007, the Department of Finance established a commission of experts to investigate in detail the regulation of financial market offences and market abuse. The commission will look at which authorities should be responsible for prosecuting financial market offences and market abuse, where the relevant rules should be incorporated into the system and the extent to which material improvements in the definitions of offences are required. Its initial task is to examine whether action is required and to submit prioritised suggestions on how to proceed. This information will then be used as a basis for deciding whether and to whom instructions for a draft of new legal provisions should be issued. The setting up of the commission is a first step; swift action must now be taken to set the next moves in train.

3 Disclosure of holdings

3.1 Supervision required

Competence of the Banking Commission

The Stock Exchange Act requires that shareholders report their holdings in companies listed in Switzerland, once these reach certain thresholds. This increases transparency for investors, market participants and issuers. The purpose is to make it impossible to acquire or dispose of important holdings covertly. To aid in its implementation, the legislature gave the Banking Commission the power to file criminal complaints with the Department of Finance in the event of breaches of the duty to report. Where investors have deliberately disregarded this duty, the Department of Finance can fine them up to twice the value of the undisclosed holding. The Banking Commission is obliged to investigate its suspicions before filing a complaint. It may, however, also issue a declaratory ruling, formally notifying the party concerned of their breach of the reporting requirement. It can also petition the relevant civil court judge to suspend the party's voting rights.

Major proceedings by the Banking Commission

A number of large-scale cases led to such investigations in 2007. On one hand the Banking Commission was contacted by issuers, while on the other, the first half of the year saw numerous media reports of takeover battles in which investors were alleged to have exploited loopholes in the system for disclosing holdings in order to build up a large stake in the target company unnoticed. As a result, the Commission initiated a number of investigations, some of them wide-ranging, into cases where large holdings had been acquired in various Swiss companies, notably with regard to Sulzer, Ascom, Implenia and OC Oerlikon. In the Sulzer case, the Banking Commission intervened simultaneously in three banks: evidence was gathered and the circumstances were investigated with the support of commissioned investigators. The effort involved in establishing the facts and processing the evidence obtained was huge, and work will therefore continue during the year 2008.

Loopholes in the rules on disclosure of holdings

The investigations clearly showed that the substantive law, the investigatory powers of the Banking Commission, and the tools available to enforce the duty to report and to sanction breaches are inadequate. The process of establishing the facts proved to be both complex and time-consuming. The Banking Commission would achieve its aims more rapidly if it could proceed directly against investors suspected of malpractice. It is also a matter of concern that the investigations are conducted primarily to establish the basis for suspicions with a view to filing a criminal complaint. The Department of Finance must then conduct administrative proceedings involving highly complex subject matter and, in some cases, repeat the evidence-gathering procedure. Its declaratory ruling merely allows the Banking Commission to censure the conduct of the investor who is at fault, without this necessarily having any consequences. Except in respect of institutions that it supervises, the Banking Commission has no power to impose sanctions under the rules pertaining to the disclosure of holdings. The competence to request suspension of voting rights was not given until the Stock Exchange Act was tightened in December 2007.

3.2 Tightening of the Stock Exchange Act

New thresholds

The aforementioned cases were taken up in Parliament, and the amendments to the Stock Exchange Act (SESTA) required by the federal law on financial market supervision (FINMAG) were used as an opportunity to propose an urgently needed tightening of the disclosure obligation under Art. 20 SESTA. Parliament also supplemented the reporting thresholds and reduced the lowest one to 3%. In so doing, it was guided by the rules applied by other major financial centres, and in particular the requirements of EU law. The legislature further resolved that all rights of issue and disposal should now be explicitly set out in the law, and specified that the exercise of rights to sell (puts) should be deemed equivalent to a sale.

Use of other financial instruments in takeover attempts

Parliament also saw the danger that those seeking to take over companies in the future would develop further strategies involving other financial instruments, in order to build up a large holding in their target without being detected. It therefore resolved to extend the reporting requirement to all transactions involving financial instruments that are carried out with a view to a public takeover offer. This move will address developments yet to come in the highly innovative financial market.

Exemptions for banks and securities dealers

Powers to delegate competence were also expanded, requiring the supervisory authority to exempt banks and securities dealers from reporting and disclosure obligations, in line with internationally accepted standards. This amendment is inspired by the EU transparency directive, which creates exemptions from the reporting requirement for regulated financial institutions with respect to activities such as trading positions, securities lending, market making and price maintenance, as well as intraday trading.

Improved transparency – extra work

The lower initial threshold and the application of the reporting requirement to additional financial instruments will increase transparency in disclosure and takeover law. However, it will also mean more work for banks and for shareholders who are subject to the reporting requirement. The organisational measures necessary to ensure that the reporting obligation is complied with correctly and in a timely manner will result in additional costs. The processing and monitoring workload of disclosure offices at the stock exchanges and of the Banking Commission – in its capacity as second instance under disclosure provisions – will increase.

Suspension of voting rights to sanction infringements

Finally, much attention was devoted to the parliamentary debate on the powers of civil court judges to suspend voting rights for breaches of the reporting obligations. Improvements in the implementation of disclosure provisions are to be welcomed. Until now, the only tool available in the applicable law has been a criminal complaint to the Department of Finance. The suspension of voting rights is a useful and effective measure. It remains to be seen, however, whether civil court judges will in practice be able to cope with the expected time pressure and the complexity of the matter.

3.3 Amendments to the Banking Commission's Stock Exchange Ordinance

Amendments to the Banking Commission's Stock Exchange Ordinance

Parliament viewed these changes to the law as a priority and stipulated that they should come into force rapidly, on 1 December 2007. The changes to the Stock Exchange Act necessitated immediate amendments to the Banking Commission's Stock Exchange Ordinance (SESTO-SFBC). The Banking Commission therefore worked with representatives from the financial sector to rapidly draw up the necessary implementing regulations, and sent them out for a brief hearing period. Revised or completely new rules were introduced to cover the treatment of conversion, acquisition (calls) and sale (puts) rights as well as other financial instruments, exemptions for banks and securities dealers, investment funds, the content of the notification report, publication and, finally, the transitional provisions. Revision of the provisions regarding securities lending and comparable transactions as well as details of the reporting obligation for financial instruments in connection with public tender offers were postponed to allow for in-depth analysis to be carried out.

Urgent tightening already completed on 1 July 2007

The Banking Commission had already tightened the rules on disclosure, with new provisions coming into force on 1 July 2007. The amendments had been taken in hand in mid-April 2007, as it became clear that there was a broad consensus in Parliament in favour of measures to increase transparency with regard to disclosure rules at the statutory level. The specific purpose of this first partial revision was to dispense with the reporting obligation in respect of conversion, acquisition (calls) and sale (puts) rights that do not provide for physical delivery (and which are termed "cash settlement" options), and to do away with the 5% exemption threshold for conversion, acquisition (calls) and sale (puts) rights.

3.4 Further proposals from the Banking Commission

Further implementation measures required

The Banking Commission emphasised during the parliamentary consultation on FINMAG that it was necessary to examine further tools for enforcing the disclosure obligations. The large-scale investigations regarding possible breaches of disclosure obligations during the purchase of additional holdings especially demonstrated the need for effective investigative tools. The use of commissioned investigators to search the involved banks enables relevant information to be gathered quickly. However, wider investigation powers and sanctions would allow more efficiency. The Banking Commission's proposals therefore aim to strengthen the powers of the new supervisory authority FINMA through the following measures:

- use of commissioned investigators to be extended to investors outside the supervised financial sector,
- suspension of voting rights not by a civil court judge but instead as a supervisory law measure by the supervisory authority,
- seizure of illegally obtained profits,
- a prohibition on buying securities of the issuer concerned or of companies traded or listed in Switzerland,
- and an obligation for wrongful acquirers to dispose of their holdings down to the level of the last correctly reported threshold.

Parliament took note of the Banking Commission's proposals, but has not yet had time to examine them in detail. Consistent enforcement of disclosure provisions can only be achieved if effective tools are available. The Banking Commission will therefore continue refining its proposals, with a view to their possible implementation. The work of the commission of experts set up by the Department of Finance to examine market supervision will provide an opportunity to do this.

4 Implementation of the collective investment schemes legislation

New, modern legislation

The new legislation (Collective Investment Schemes Act, CISA; Collective Investment Schemes Ordinance, CISO; SFBC Ordinance on Collective Investment Schemes, CISO-SFBC) came into force on 1 January 2007 (CISA and CISO) and 15 February 2007 (CISO-SFBC). These comprehensive, modern and flexible rules provide the basis for Switzerland remaining an attractive and competitive domicile for funds. The Banking Commission's annual report 2006 contains detailed information on this legislation. The numerous innovations introduced by the new collective investment schemes legislation have however not yet been used by the industry as widely as expected.

Authorisation of asset managers, SICAVs and LLPs

Asset managers of Swiss collective investment schemes that require an authorisation since 1 January 2007 had to register with the Banking Commission by the end of June 2007 and to submit a corresponding application by the end of the year. A total of ten requests were granted by the end of 2007. Under certain circumstances, managers of foreign collective investment schemes may also opt for voluntary supervision. Some chose to take this opportunity and eight requests were granted. This new option appears to meet a need within the sector, and it has clearly removed a competitive disadvantage for Switzerland as a fund domicile. Interest in authorisations for SICAVs and LLPs (Limited Liability Partnerships) also rose in the fourth quarter of the year as the relevant SFA (Swiss Funds Association) model documents became available. A number of SICAVs and LLPs under Swiss law were authorised by the end of the year.

Tax situation of LLPs

Unfortunately, although the tax situation for collective investments in Switzerland is essentially favourable, there is a difficulty for LLPs in that the issue of the taxation of what are termed "carried interests" of general partners and fund managers has not yet been completely resolved.

Operational implementation of the legislation

With regard to the new legislation and in order to deal quickly and efficiently with the approvals and authorisations, the Banking Commission implemented a range of personnel and organisational measures. Different departments – not only Authorisation/Investment Funds – are currently involved in the operational implementation of the collective investment schemes legislation. In addition, a fourth investment funds group was set up in spring 2007, and extra staff were recruited for this purpose. A summary procedure, which is described in the relevant guidelines, is being applied for the approval of UCITS III, as with UCITS I. As a result, the Banking Commission is now in a position to respond rapidly to applications from clients, leading to the reduction of processing times (especially for the approval of products). Compared to 2006, the number of pending cases was substantially reduced.

Circulars

The implementation of the collective investment schemes legislation in supervisory law imposed a considerable workload on the Banking Commission. As supervisory authority, the Banking Commission publishes its practice in the form of circulars. All the existing SFBC Circulars related to funds were revised and three new ones were prepared. The multi-stage procedure allows sector representatives to get involved at an early stage and thereby ensures that the circulars meet practical needs without neglecting investor protection.

Guidelines

The Banking Commission's guidelines set out the documentation and information required for the authorisation of institutions and approval of products that are governed by the Collective Investment Schemes Act, thereby simplifying the procedure for compiling applications. The existing guidelines have also been adapted to the new law, while the Banking Commission has prepared four completely new guidelines to take the extended scope of the law into account.

Self-regulation by the SFA

The new legislation also required amendments to the self-regulatory provisions of the SFA, including its code of conduct and the various guidelines and model documents such as the prospectus, simplified prospectus, fund contract and articles or incorporation. In some cases, there were considerable delays in the preparation of the model documents. This impeded the development of the Swiss funds market in 2007. The Banking Commission could not authorise the first SICAV under Swiss law until the end of September 2007. The publication of the model documents on time would have also benefited the existing 1,115 Swiss contractual investment funds at the end of 2006, as the fund management companies were obliged to submit adapted fund documents to the Banking Commission until the end of 2007 in order to comply with the new legislation.

Publications

The rules governing publications and their content concerning amendments to the fund contract or investment regulations are more liberal than those under the investment funds legislation. The accepted publication for investment funds now include the print media mentioned in the prospectus as well as publicly accessible electronic platforms recognised by the supervisory authority. There are no material requirements for the recognition of such platforms. The Banking Commission recognised three platforms by the end of 2007, all of which can publish prices. Two platforms are registered for legal publications. Amendments to these documents now need to be published only once, and a summary of the key changes is sufficient. The above mentioned measures will also lead to a substantial reduction of publication costs.

Assessment of the new legislation

It is still too early to assess whether the new legislation will stand the test, as few new trends have yet emerged. The funds' sector and the Banking Commission have been too busy with its implementation. As the implementation phase is now coming to an end, it can be expected that the sector will take the innovations into consideration. The Banking Commission offers a competitive interpretation of the collective investment schemes legislation while maintaining investor protection.

5 The FINMA project

Political approval

The federal law on financial market supervision (FINMAG) completed its passage through Parliament in June 2007. The law provides for the Banking Commission, the Federal Office of Private Insurance and the Money Laundering Reporting Office to be combined into a single authority. The deadline for calling a referendum elapsed on 11 October without one being launched, and there are therefore no further obstacles to the new financial markets supervisory authority FINMA beginning work on 1 January 2009.

Employment under public law

Parliament chose not to adopt the Federal Council's proposal that staff of the new authority should be employed under private law, choosing instead to make them subject to public law. The main reason given for this decision was that in an authority with sovereign responsibilities, employment should be governed by public law. FINMA will, however, have its own staff charter designed to give it the flexibility necessary to recruit and retain qualified and experienced specialists. The charter will require the approval of the Federal Council. Throughout the preparatory phase, the Banking Commission will be advocating its case for allowing FINMA – a strong, internationally recognised supervisory authority – the flexibility it needs in order to attract qualified staff.

Project status

Approval for the law marked the start of a new phase in the merger preparations, which the head of the Federal Department of Finance had instructed the authorities involved to begin making, back in March 2006. The project, headed by the Chairman of the Banking Commission, is condensing the results into findings for presentation to the FINMA board of directors to aid it in decision-making. The Federal Council has fixed the beginning of 2008 as the date for electing the board, which will have between seven and nine expert members who must be independent of the supervised community. The board will set out FINMA's strategic goals and is accountable to the Federal Council. Its task is to take decisions on business of fundamental importance, issue the ordinances delegated to FINMA, decide on circulars, monitor the executive board and oversee internal control. Its responsibilities will also include appointing the executive board, though the appointment of the CEO will be subject to approval by the Federal Council.

Partial entry into force of FINMAG

Parts of FINMAG are scheduled to enter into force in parallel with the election of the board of directors. As a result, FINMA will have its own legal personality even during the preparatory period. This will enable it to take the decisions necessary for it to commence its supervisory activities from January 2009. Until FINMAG comes into force in its entirety, however, full responsibility for supervision will remain with the three existing authorities.

Challenging transitional period

Preparations for FINMA are being carried out primarily by project teams made up of staff from the three authorities that are to be merged. As the existing authorities have to continue their supervisory activities while at the same time preparing for the merger, but without extra staff, the project represents a major challenge – and additional work – for all concerned.

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