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Key themes

1. Reform of financial market regulation

Current plans to change the law regarding crucial areas of financial market regulation will directly affect the work of the Swiss Federal Banking Commission. However, the various plans are at different stages in their progression, making it hard to coordinate them, although such coordination is not entirely necessary. All regulatory plans require changes to the law, which have to be passed by parliament. In addition, a number of new regulations and changes to regulations exist in the form of ordinances and circulars (see II/1.2 and 2, III/1.2-1.4 and IV/1.1 and 1.2). All in all, it is very difficult to gain an overview of what is happening in terms of regulation at the moment.

Integrated regulatory authority and regulation of asset managers

In December 2001, the Swiss Federal Council entrusted a new commission of experts, headed by Professor Ulrich Zimmerli, with the legislative implementation of the recommendations made by the "Financial Market Regulation" expert commission under Professor Jean-Baptiste Zufferey in November 2000 (see Annual Report 2000, p. 96ff – NB German only). The new commission is scheduled to deliver its report at the end of 2002. The most important of the Zufferey commission's recommendations from the FBC's point of view concerns the creation of a new regulatory authority. This authority would not only take over the current duties of the FBC and the Federal Office of Private Insurance, it would also regulate independent asset managers, who are currently only monitored with regard to the Money Laundering Act. A crucial consideration for the FBC is whether the regulatory duties in question will be transferred to a single authority or to more than one. Whichever is the case, the main internationally recognized requirements for regulatory authorities will have to be met (see Annual Report 2000, p. 97ff).

- The regulatory authority's independence must be ensured at all times. This means operational independence from the government and from parliament. The scope of the new body's authority, its objectives and the tools at its disposal must be clearly specified in the applicable law. However, its decision-making process must not be restricted by any political authorities. Such restrictions would result in the regulator serving short-term political interests. This requirement must be borne in mind when the conditions governing the regulator's accountability to the democratically elected constitutional bodies and the voting process are formulated.
- The regulator must have sufficient resources at its disposal, which would ideally be achieved through an appropriate level of both administrative and financial independence. The authority's employees and bodies must be subject to very high professional standards at all levels, meaning – among other things – that specialists with the requisite qualifications must be offered competitive salaries.

- The regulator must have sufficient authority to demand information from all market participants. Furthermore, it must have credible means of intervention at its disposal, those necessitating legal remedies, although not to such an extent that urgent decisions are delayed or blocked.
- All options for the monitoring of independent asset managers must be assessed without prejudice, including the possibility of integrating elements of self-regulation.
- The new expert commission is also to look into whether the new authority might additionally be able to take over the duties of the Swiss Commission for Casinos as stipulated in the Gambling Act, as well as those of the Money Laundering Control Authority as stipulated in the Money Laundering Act. However, the wider the variety of duties assigned to a regulatory authority, the more difficult it is for the authority to carry out those duties in an efficient and organized manner. This creates the risk of the authority becoming overstretched and ultimately being unable to carry out any of its duties satisfactorily. In any case, there are plenty of convincing arguments in favour of placing the new authority in charge of only the core areas of financial market regulation.

Regulation of financial conglomerates

The FBC thinks that merging the banking and insurance regulators is a less urgent matter than creating appropriate legislation to cover the separate regulation of banking, securities trading and insurance groups on the one hand and financial conglomerates on the other (see Annual Report 2000, p. 98). The Commission has thus lobbied intensively for the creation of such legislation in the context of the ongoing complete revision of the Insurance Regulation Act (see VI). Proposals are to be submitted to parliament before the end of 2002. Even the eventual creation of a fully integrated regulatory authority would not invalidate these proposals, except insofar as they contain stipulations regarding cooperation between the regulators. Implementation of the proposals, together with the policy of cooperation on individual cases between the Federal Office of Private Insurance and the FBC (see VI), an international first, would give Switzerland a regulatory framework which sets new standards in the global arena.

Regulation of payment and securities clearing systems

Also in 2002, the Federal Council intends to submit a bill to parliament to completely revise the National Bank Act. One aspect of this revision which is of particular relevance to the financial market is the inclusion of regulatory duties with regard to payment and securities clearing systems (see II/1.1.2). The preliminary drafts issued at the end of 2001 propose sharing these duties between the Swiss National Bank and the FBC. The SNB would be responsible for monitoring systems. If it were to identify a risk to the overall financial system arising from a particular system, e.g. the Swiss Interbank Clearing payment system or the SIS SECOM securities clearing system operated by SegaIntersettle AG, it would be able to enforce minimum requirements. The FBC, meanwhile, would have the explicit authority (but no obligation) to enforce the Banking Act in rela-

tion to the system operator, treating the latter as a bank but applying special regulations for activities which diverge from those of a normal bank. SegaIntersettle AG already has a banking licence. This proposal is intended to bring monitoring of payment and settlement systems in Switzerland into line with the EU standard, which would in turn strengthen the competitive position of the Swiss system operators in the international marketplace.

Law on insolvency and restructuring at banks and investor protection

The importance of proposed changes to the legal provisions on insolvency and restructuring at banks and the protection of bank investors (see II/1.1.3 and Annual Report 2000, p. 37ff) must not be underestimated. The Federal Council intends to submit these changes to parliament at some point in 2002. This means that there is a good chance, after five successive failures in 1938, 1940, 1948, 1967 and 1981, of the clearly inadequate legal provisions on the restructuring and liquidation of banks finally being revised. The proposed changes would have the effect of streamlining the complex and overlapping procedures currently in place and significantly extending the scope of the FBC's duties and responsibilities. In particular, the Commission would have authority over the restructuring and liquidation of banks and securities trading companies. The additional provisions on protection for bank investors would also mean the Commission taking responsibility for overseeing and approving the banks' self-regulation activities.

Bank audit reform

The FBC's initiative to revise the basic framework for supervisory audits of banks and securities traders (see II/1 and Annual Report 2000, p. 46) should also result in extra duties for the Commission. This is especially true in connection with the proposals by the Nobel commission of experts concerning routine audits by other recognized audit bodies in conjunction with the FBC. Increased use of direct regulatory measures for other complex groups in addition to the two big banks and overall supervision of intensified quality assurance for audit tasks can also be expected to have a similar effect. However, a lot depends on the details of these new measures, although the International Monetary Fund's audit team has welcomed them in the context of its Financial Sector Assessment Program (see I/2). Work on the legislative implementation of the Nobel commission's recommendations is likely to take some time yet, with the current plans not allowing for anything to be submitted to parliament before 2004 at the earliest. Nevertheless, new audit rules will appear in the form of FBC ordinances and circulars before then.

Revision of the Investment Fund Act

The FBC asked the Federal Department of Finance at the end of 2001 to set up a commission of experts to draw up proposals for an extensive revision of the Investment Fund Act (see IV/1.1.1). This request was a direct result of changes to the EU's investment fund legislation, which were effectively decided on in 2001 and will significantly improve the range of opportunities available to the European fund industry. Changing the Investment Fund Act would allow the

Swiss industry to keep pace with these European changes. One especially important innovation concerns authorizing fund managers to manage the assets of pension funds and individual investors. In addition to this push for reforms on the back of the new European legislation, however, other key matters must be resolved, chief amongst them the introduction of fund-like investment companies with fixed or variable capital and the regulation of investment companies. It was still impossible to estimate a time frame for these reforms at the end of 2001. In this case, too, we cannot expect any drafts to be ready for submission to parliament until at least 2003 or 2004.

Penal provisions for insider trading and share-price manipulation

Efforts to review the penal provisions relating to the financial market in Articles 161 and 161bis of the Swiss Penal Code had also not progressed past the early stages as 2001 came to an end. At the request of the cantons, which are responsible for implementing penal measures, a working group headed by Hanspeter Uster of the cantonal government of Zug is looking at possible changes to the relevant substantive and procedural law (see IV/2.5.4). For instance, the scope of the penal provisions for insider trading, which is very narrow by international standards, may be extended. The current provisions are problematic, both in domestic use (see Charles Vögele case, IV/3.5.1) and – due to the requirement for double criminal liability – in the context of international judicial and administrative assistance (see I/6.2). The question is also raised as to whether the cantons should be responsible for penal measures. The ultimate point to address will be the possibility of supplementing the current penal provisions, or even replacing them outright, with administrative penalties to be enforced by the FBC, such as seizing profits or imposing fines on individuals or companies. The scope of and time frame for these deliberations was still difficult to assess at the end of 2001.

Administrative assistance and on-site checks

The idea of revising the provisions on administrative assistance in the Stock Exchange Act and the Banking Act had not led to a concrete initiative by the end of 2001, but the FBC views this as a definite possibility. The Commission will undertake intensive efforts to promote this idea in view of the Federal Supreme Court's recent ruling restricting the scope for administrative assistance in various crucial respects (see I/6.2). Independently of this ruling, a need to adapt the current provisions will also arise as a result of the changing international environment, which is causing Switzerland's stance on administrative assistance to come in for increasing criticism from various international bodies (see I/3, VII/1.2.3.2 and 1.2.4). The same applies to the restrictions under Swiss law on on-site checks of foreign-owned banks by foreign regulatory authorities (see VII/1.1.1.7).

2. IMF's Financial Sector Assessment Program

The International Monetary Fund (IMF) conducted a Financial Sector Assessment Program (FSAP) in Switzerland in 2001 (see Annual Report 2000, p. 32ff). Since compliance with standards and codes of conduct is an important aspect of the FSAP, the FBC played a key role in the Program. Switzerland was among the first international financial centres to express willingness to undergo an FSAP. This followed the May 2000 decision of the Financial Stability Forum (FSF) to classify Switzerland as an "offshore" financial centre. Switzerland saw the FSAP as an opportunity to prove that it meets all international minimum standards and that the "offshore" label was thus unfair. Other leading international financial centres have also confirmed their willingness to undergo FSAPs: Luxembourg in October 2001, Singapore in November 2001 and the UK in February 2002.

The FSAP, devised in the wake of the Asian crisis, is conducted by the IMF in conjunction with the World Bank. The aim is to carry out an assessment once every five years or so to complement the obligatory, annual Article IV Consultation, which deals primarily with economic issues, monetary policy and financial policy. The FSAP has three main components, together providing an account of the general state of a financial system and how resistant it is to crises:

- The financial system's general state of health is assessed using aggregate micro indicators of the solvency, indebtedness and liquidity of financial institutions as well as macro indicators such as balance of payments and volatility of exchange rates and interest rates.
- Standard questionnaires are used to assess compliance with international standards and codes of practice with regard to transparency in monetary and financial policies (IMF Code of Good Practices on Transparency in Monetary and Financial Policies), banking regulation (Basel Committee, Core Principles of Effective Banking Supervision), stock exchanges and markets (IOSCO Objectives and Principles of Securities Regulation), insurance (IAIS Insurance Core Principles) and payment systems (BIS Core Principles for Systemically Important Payment Systems).
- "Stress tests" and scenario-based analyses are used to determine the effects of external macro shocks on the solvency of the banking system.

IMF representatives made a pre-mission visit to Switzerland in June 2001. The main purpose of this visit was to establish the principal issues at stake in the planned assessments. The actual FSAP consultations took place at the end of October 2001. A 15-strong delegation, comprising 8 IMF representatives and 7 experts from foreign regulatory authorities and central banks, stayed in Switzerland for two weeks. As part of the assessments of banking and stock-exchange regulation, the delegates talked to numerous representatives of the FBC, banks, associations, auditors, SWX and virt-x. These talks were both open and constructive. The IMF delegates proved to be highly knowledgeable and professional. Their task was principally to elaborate on the extensive corpus of information on the regulation and monitoring of the financial sector gleaned from the authorities using IMF questionnaires. They focused on the indirect regulatory system, the position of the cantonal banks and the significance of their state guarantee, self-regulation, regulation of financial conglomerates and the after-

math of 11 September. The current plans for reforming financial-sector regulation were also touched upon. In view of their importance for the system as a whole, a lot of attention was paid to the two big banks. The IMF met with representatives of the Federal Reserve Bank of New York and Britain's Financial Services Authority prior to the consultations in order to gain an insight into the level of cooperation between regulators with regard to monitoring the big banks. At the end of their stay, the IMF delegates communicated their preliminary findings to the Swiss authorities. Regulation in Switzerland, they said, complied in the main with the financial sector's international standards and principles.

With the groundwork completed, the IMF began compiling a detailed report for discussion with the Swiss authorities during the annual Article IV Consultation, which was due to take place at the end of February 2002. These discussions will form the basis of the IMF's Financial System Stability Assessment (FSSA). The FSSA aims to simulate and evaluate the relationship between macroeconomic developments and the stability of the financial sector. It will also outline Switzerland's position with respect to leading international standards and principles in the financial sector. The FSSA is passed to the IMF's Executive Board as background information for the Country Report. It will be discussed by the Executive Board in May 2002. The FSSA for Switzerland is scheduled to be published at the same time as its Article IV Country Report.

3. Terror attacks

The attacks on the United States on 11 September 2001 had direct and indirect consequences for the Swiss financial sector, both instantly and in the months that followed.

Immediate consequences of the attacks: systemic problems

Swiss banking institutions which own operations in New York or cooperate with New York-based institutions encountered systemic problems immediately after the attacks. These problems were not due to the failure of internal systems, but were instead caused indirectly by system failures at partner institutions with premises in the immediate vicinity of the World Trade Center or by the disruption of telecommunications in the entire South Manhattan area. The fact that no serious damage was caused to Swiss banks can in part be attributed to the implementation of contingency plans developed for the Y2K problem (see Annual Report 1999, p. 56ff – German only). Furthermore, the banks managed to take the necessary measures to restore operations fully within a very short time. The injection of liquidity by the Federal Reserve Bank was especially instrumental in maintaining financial-market stability during the first few days after the attacks.

Search for links to terrorism in the global financial system

Mere days after the attacks took place, police and other criminal prosecution authorities embarked on an intensive, global search to identify those who masterminded and perpetrated them in order to prevent further atrocities. One of the avenues explored was the search for terrorist links in the global financial system. The FBC played a crucial role in this respect as go-between, ensuring contact between other authorities involved in the investigations and institutions un-

der its jurisdiction.

It was active on two main fronts: dealing with queries regarding suspicious stock-market transactions in the run-up to 11 September, and forwarded lists of people with suspected links to terrorism.

- The Commission began investigations at SWX Swiss Exchange and Eurex Zurich on 18 and 21 September 2001 in an attempt to identify terrorists through suspicious transactions prior to the attacks. A particular aim of these investigations was to ensure rapid and complete dissemination of the findings of internal inquiries at SWX and Eurex Zurich. At the same time, the Commission requested information on the Swiss participants of SWX (warrants), Eurex (standardized derivatives) and virt-x (SMI blue chips) trading in especially sensitive securities, notably those of airlines and insurance companies, between 3 and 11 September 2001. The Commission also received requests for administrative assistance in September 2001 from the US Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC), asking for additional information from SWX and Eurex Zurich.

  Following its initial analyses, the FBC contacted 9 banks to inquire about the identities of clients and beneficial owners as well as the exact circumstances surrounding certain transactions which had been deemed suspicious. Around 100 such transactions in specific securities (US securities and those of airlines and insurance companies), some of them for relatively small amounts, were identified in the period around 11 September. Following an in-depth analysis of the data collected, the Commission established that no dubious transactions had been executed on Switzerland's exchanges in connection with the attacks during the specified period.

  The Commission received additional requests for administrative assistance at this point from foreign stock-market regulators, namely the French Commission des Opérations de Bourse (COB) and the German Bundesaufsichtsamt für den Wertpapierhandel (BAWe). These regulators were asking for information on transactions with potential links to the attacks which had been executed by Swiss banks in foreign markets. It was still dealing with these requests at the end of the year.

- In its investigations subsequent to the terror attacks, the FBC collaborated closely with the US authorities and with other Swiss authorities dealing with 11 September. It joined a task force comprising representatives from the Office of the Attorney General of Switzerland, the Federal Office of Criminal Investigations, the Federal Office of Justice, the Federal Department of Foreign Affairs, the Money Laundering Reporting Office and the Money Laundering Control Authority.

  The Commission forwarded to all banks and securities trading companies the lists of individuals and organizations published by the US authorities following President George W. Bush's executive order of 24 September 2001. It also forwarded the consolidated list of names supplied by the Federal Reserve Bank of New York to the Bank for International Settlements (BIS). The Commission enclosed a note with the lists asking the banks and securities trading companies to look for direct contractual relationships with individuals suspected of having links to terrorism, as well as for assets with such individuals as their beneficial owner, and to report any findings to the Money Laundering

Reporting Office without delay. According to the Money Laundering Act, persons who have been reported to the Reporting Office may not be informed of this fact, and their assets may be blocked for a period not exceeding 5 working days. The Office of the Attorney General must decide within these 5 days whether the blocking of the assets is justified and will therefore be maintained.

At the FBC's request, the Office of the Attorney General set up a central support unit with the Federal Office of Criminal Investigations to provide additional information on an informal basis to banks and securities trading companies in cases of doubt. This support unit was able to contact all the relevant criminal prosecution authorities directly. Having this mechanism in place meant that participants in the Swiss financial market could take the necessary measures very quickly, proving that Switzerland is not a hiding place for terrorist funds and ensuring that all suspicious business relationships were be reported and submitted to the Office of the Attorney General for evaluation.

The FBC also kept the institutions under its jurisdiction duly informed of the measures taken by the State Secretariat for Economic Affairs (Seco) to implement UN sanctions against the Taliban. As part of these measures, financial institutions were obliged to block the assets of individuals or organizations in the list appended to the Federal Ordinance on Measures against the Taliban (SR 946.203) for an unlimited time pending possible changes to the list of names published by the UN. All instances where assets were blocked had to be reported to Seco, regardless of whether or not they had already been reported to the Money Laundering Reporting Office.

The Swiss legal system thus has all the necessary means for efficiently combating the funding of terrorism.

Postponement of issuance and redemption of investment funds

The 11 September attacks also affected the investment fund business. The New York Stock Exchange was closed for almost a week, during which time it was impossible to calculate the value of stocks listed there. Further to a request from the Swiss Funds Association, the FBC announced that it would allow the redemption of all investment fund units with an equity weighting of 10-20% and a listing on an exchange closed in the wake of 11 September to be postponed (Article 26 para. 1 point a of the Investment Fund Ordinance). The Swiss Funds Association informed its members of this decision. All the affected fund managers and foreign funds authorized for sale in Switzerland took advantage of the emergency ruling, the latter subject to the rules in force in their country of domicile.

The decision to postpone calculation of net asset value and redemption must, according to Article 26 para. 2 of the IFO, be reported immediately to the fund's official auditor, the regulatory authority and, in an appropriate manner, the investors. This obligation to report to the regulator also applied to the Swiss representatives of foreign funds in accordance with Article 3 para. 3 of the Investment Fund Act. The FBC's investigations concluded that the majority of fund managers and representatives of foreign funds had prepared contingency plans in order to meet their obligations towards investors quickly and in full. Investors

were informed of the exceptional circumstances through the usual media releases as well as by telephone, e-mail and notices on corporate Internet sites. However, the Commission also noted that some representatives of foreign funds failed to meet the requirement to inform the regulator, while others only did so after receiving a reminder. The companies in question were reminded of their responsibilities in the appropriate way.

Nada Management Organization SA (formerly Al Taqwa Management Organization SA)

Also in connection with the 11 September attacks, the US raised suspicions that Lugano-based Al Taqwa Management Organization SA (operating since March 2001 under the name Nada Management Organization SA) had links with terrorist groups. As far back as 2000, the FBC investigated Al Taqwa Management Organization SA on suspicion of unauthorized banking activity. The company had close ties to Bank Al Taqwa Ltd, which was based in Nassau in the Bahamas. Information received from the general public caused the Commission to suspect that Al Taqwa Management Organization SA was effectively operating as a branch of Bank Al Taqwa Ltd. It therefore sought the cooperation of the Bahamas banking regulator from the very beginning of its investigation. The Commission sent an observer to Al Taqwa Management Organization SA. Its investigations revealed that liquidating the Swiss company on the grounds of unauthorized banking activity could not be justified on the basis of the available evidence and the actions of the banking regulator in the Bahamas. It was found that the crux of the problem lay with Bank Al Taqwa Ltd. Following discussions with the Bahamian regulator, Bank Al Taqwa Ltd decided in early 2001 to cease trading as a bank and surrendered its banking licence. Since Al Taqwa Management Organization SA had already been forced to cease all its operations in Switzerland that could have been held to be associated with Bank Al Taqwa Ltd, it was then requested to change its name. The company complied with this instruction and changed its name to Nada Management Organization SA. However, the Commission's investigations at this stage were neither aimed at nor suitable for identifying possible connections with terrorist groups.

Consequences for international organizations

The FBC was involved in international discussions with a number of organizations regarding the consequences of 11 September. The Financial Action Task Force on Money Laundering (FATF), the International Organization of Securities Commissions (IOSCO) and the Basel Committee intensively addressed the issue of combating the funding of terrorism.

The FATF called a special plenary session in Washington at the request of the United States. The aim of this meeting was to assess the feasibility and efficacy of specific recommendations for clamping down on terrorist funding. The FATF members made the following commitments at the meeting:

- to take immediate steps to ratify and implement the relevant UN instruments, notably the International Convention for the Suppression of the Financing of Terrorism (9 December 1999)

- to criminalize the financing of terrorism, terrorist acts and terrorist organizations as well as money laundering in connection with terrorist activities
- to freeze and confiscate terrorist assets
- to report suspicious transactions linked to terrorism
- to provide the widest possible range of assistance to other countries' criminal prosecution and regulatory authorities
- to impose anti-money laundering requirements on alternative remittance systems (especially *hawala* banking), including making it compulsory to specify the sender's name and address on international transfers
- to strengthen customer identification measures in international and domestic wire transfers
- to ensure that entities, in particular non-profit organizations, cannot be misused to finance terrorism.

In order to secure the swift and effective implementation of these new standards, the FATF agreed on the following plan of action:

- By 31 December 2001, all FATF members will carry out a self-assessment against the recommendations. This will include a commitment to come into compliance with the recommendations.
- All countries around the world will be invited to carry out a self-assessment by June 2002, when a process will be initiated to identify jurisdictions which lack appropriate measures.
- Additional guidance will be developed for financial institutions on the techniques and mechanisms used in the financing of terrorism.
- FATF members will regularly publish the amount of suspected terrorist assets frozen in accordance with the appropriate United Nations Security Council Resolutions.

The problem of terrorist funding was also taken into consideration for the revision of the FATF's "40 Recommendations". For instance, the Task Force stepped up its efforts concerning "corporate vehicles", correspondent banks, identification of beneficial owners and regulation of non-bank financial institutions.

In the main, Swiss banking law already fulfils the FATF recommendations on combating terrorist funding.

4. Business relationships with politically exposed persons (PEPs)

The FBC invested a great deal of effort in 2001 in the fight against abuse of the Swiss financial sector by politically exposed persons.

In addition to proceeding against the banks involved in the Montesinos affair (see 4.1 below) and following the progress of the Abacha affair (see 4.2 below and Annual Report 2000, p. 22ff), it also played a part in national and international regulatory initiatives (see 4.3 below). At national level, the Commission set up a working group to revise its guidelines on the combating and prevention of money laundering (FBC Circular 98/1). The working group will also examine the issue of business relationships with persons who perform important public functions (see II/2).

4.1 Montesinos

The FBC concluded its investigation into former Peruvian secret service chief Vladimiro Lenin Montesinos Torres in 2001. It ruled that the Managing Director of a foreign bank active in Switzerland should resign at once.

In autumn 2000, the judicial authorities of the Canton of Zurich began a criminal investigation of Montesinos on suspicion of money laundering, in the course of which assets totalling approximately USD 114m were blocked in accounts at Swiss-based banks. Either Montesinos, his business partners or other persons in contact with him are the beneficial owners of these assets. Montesinos was former Peruvian President Alberto Fujimori's closest personal advisor for a number of years, and was perceived as the de facto head of the Peruvian secret service SIN.

The Commission checked whether 5 banks with Swiss domicile had fulfilled their due diligence and reporting obligations under the Banking Act and the Money Laundering Act when accepting and managing Montesinos assets (see Annual Report 2000, p. 22). It did not need to take any steps with respect to the other 4 banks involved in the investigation. However, the Commission ruled that the fifth bank had failed to fulfil its due diligence obligations, and therefore demanded that the Managing Director of that bank be removed from his post. This action was published, along with the name of the bank in question as a preventive measure.

The said bank was found to have been grossly negligent in accepting assets from politically exposed persons (PEPs). The Commission concluded that the bank had not exercised due diligence in its relationship with Montesinos and had neglected its obligation to determine the financial circumstances behind an unusual business relationship. Despite the considerable value of the assets, the bank did not make the effort to establish the background to the incoming funds. Furthermore, claims by the client's business partners to the effect that the money stemmed from trading in defence equipment should have prompted the bank to pay special attention to clearing this matter up. Even when establishing the client relationship, the bank relied entirely on information supplied by third parties. To top it all, the bank was not even aware that Montesinos was a PEP,

even though it would have been very easy to deduce that this was the case on the basis of publicly accessible information, and therefore entirely reasonable to expect the bank to do so.

Given his position in the bank's hierarchy, the Managing Director was held responsible for the serious shortcomings in its organization. The Commission also found him to have been responsible for personally approving the Montesinos relationship despite the fact that the correct account-opening procedure was not followed. This means that he also bore some of the responsibility for the bank's failure to acknowledge its client's PEP status. The Commission therefore ruled that the Managing Director was not able to guarantee irreproachable business conduct in the management of a bank in Switzerland. It asked the bank to dismiss the Managing Director. The bank accepted this ruling and took measures to remedy its organizational deficiencies. The Commission asked for a special audit to be carried out in 2002 to verify that appropriate measures have been implemented within the bank. This audit will not be carried out by the bank's usual audit company.

Due diligence in identifying clients with PEP status is a fundamental prerequisite for compliance with the FBC's rules on dealing with PEPs. Banks must not assume that clients will identify themselves as PEPs without being asked. They have to set up internal or external control systems to facilitate additional research on clients' backgrounds. Public information sources can be very helpful in this respect. Banks must exercise particular caution with regard to clients from countries where corruption is rife (see Annual Report 2000, p. 24). Only one of the banks investigated had made personal contact with Montesinos or undertaken additional research. The rest had relied entirely on information from third parties. This does not constitute due diligence where important private banking relationships are concerned. When a single bank is affected, terminating a relationship which is dubious, but does not yet meet the requirements for a reporting obligation, poses no problem at all. However, if we look at the financial system as a whole, the problem is not solved if the client's assets are simply transferred to another bank. This issue is being considered by those revising the guidelines on the combating and prevention of money laundering and the agreement on the Swiss banks' code of conduct with regard to the exercise of due diligence (see II/2).

The Commission found evidence, then, of a disorganized bank failing to exercise due diligence, but it is clear that in the Montesinos case, the mechanisms in place for combating money laundering had the effect desired by the legislators. The reporting obligation built into the Money Laundering Act was a decisive factor in shedding light on the Montesinos affair. The banks involved blocked the assets attributed to Montesinos and reported them to the Money Laundering Reporting Office. Thanks to action by the Swiss police and criminal prosecution bodies, the Peruvian authorities were made aware of the Montesinos assets which had been identified and blocked.

4.2 Special audits

In September 2000, the FBC published the findings of its investigation into business relationships between Swiss banks and the entourage of former Nigerian President Sani Abacha (see Annual Report 2000, p. 22ff). The Commission ordered special audits of three banks.

The aim of these audits was to analyse the extent to which the banks had implemented appropriate measures, to review existing business relationships and to assess the reliability of the banks' internal controls.

The audit reports are currently being evaluated.

4.3 International initiatives

Switzerland arranged a conference in Lausanne in November 2000 on business relationships with PEPs. Representatives of criminal prosecution authorities and banking regulators from the G7 states and Switzerland engaged in intensive discussions on the issue of PEPs and the lessons learned from the Abacha affair (see Annual Report 2000, p. 22ff). The conference had two particular aims. Firstly, it sought to compare the systems used in different countries. Secondly, it was intended to work towards more stringent recording of assets belonging to persons who perform important public functions, the idea being that it should not be possible to shift assets no longer tolerated by one national financial system to a neighbouring one.

Following the conference, the regulatory authorities of several G7 states and Switzerland decided to draw up recommendations on accepting assets from persons who perform important public functions. The "Supervisors' PEP working paper 2001", published in November, contained the following:

- a definition of persons who perform important public functions, in particular heads of state, members of government, high-ranking criminal prosecution and military officials and those closely associated with them
- a list of factors by which banks should be able to identify a PEP relationship, including large sums designated "commission" or paid in by a central bank
- a reminder that banks are obliged to exercise special care in relation to known PEP clients, in particular by consulting publicly accessible information sources
- a ruling that the decision to accept a person who performs an important public function as a client should be made at the directorial level
- a note that contractual relationships with persons who perform important public functions must be regularly checked by people in the higher levels of a bank's hierarchy.

This document is in no way binding, but it can be assumed that the signatory states will use it as a basis for appropriate regulations concerning persons who perform important public functions. The FBC will bear this in mind when revising its guidelines on money laundering (see II/2).

The principles outlined in the working paper were also included in the document signed off by the Basel Committee in 2001 on banks' due diligence obligations regarding the identification and monitoring of clients (see VII/1.1.1.7). Both documents will influence the work of the FATF (see VII/1.6). The Commission welcomes these international efforts and intends to promote them, given that this is an international problem.

5. Offshore branches of Swiss banks

The FBC was able in 2001 to refine its practice in terms of the regulation of the activities of banks incorporated under Swiss law in financial centres which have been criticized by the Basel Committee, the FATF and the Financial Stability Forum (FSF). Insofar as the Commission performs a consolidated regulatory role in the banks' country of origin, with its jurisdiction also covering foreign branches, it demands that both internal and external auditors be granted legally unrestricted access to foreign branches and subsidiaries for on-site checks. The Commission wants cross-border regulation to be possible not just from a legal point of view, but in reality as well. This would enable it, for example, to investigate whether banks incorporated under Swiss law are misusing their foreign subsidiaries to circumvent Switzerland's minimum standards on money laundering (see FBC Circular 98/1, Geldwäscherei [Money Laundering], point 6 – German/French only).

5.1 Approval practice for establishment and acquisition

In accordance with Article 3 para. 7 of the Banking Act and Article 6b of the Banking Ordinance, banks incorporated under Swiss law which intend to establish a subsidiary, branch, agency or representative office abroad must first provide the FBC with all the information necessary to evaluate the entity's activities. Article 6b of the Banking Ordinance states that this information must include a business plan, which must describe the nature of the planned business and its organizational structure. It must also include the entity's address in the foreign country and the names of administrators, operative managers, auditors and the regulatory authority of the country in question. This information allows the Commission to check group-level organization, compliance with group-level management principles and company-level risk provisions (see FBC Circular 96/3, Revisionsbericht [Audit report], point 33 – German/French only). In order to obtain a green light from the Commission, the bank must prove two things: that it has taken the financial and organizational measures necessary for its planned foreign activities, and that it can ensure monitoring and control of its new unit. The Commission has to be satisfied that it will be able to exercise suitable consolidated regulation in each case. As soon as these conditions are met, the Commission gives the bank confirmation of its approval and, in line with the minimum requirements of the Basel Committee, informs the relevant foreign regulator that it does not intend to oppose the consolidation of the new unit within the structure of a bank incorporated under Swiss law.

Using the new practice introduced in 2000 (see Annual Report 2000, p. 31), the Commission determined during 2001 that the prevailing legislation in a number of countries makes cross-border regulation according to international standards impossible. As a result, several banks incorporated under Swiss law were refused permission to extend their activities to the countries in question. Although some obstacles had been removed through legislative changes and intensive contact between the Commission and the foreign regulators, the Commission nevertheless conducted detailed assessments of certain jurisdictions. It also asked the banks for additional information in order to make sure that they were not intending to form or buy companies outside Switzerland under pressure from some of their clients with the aim of circumventing legal provisions and codes of conduct which apply in Switzerland, in particular those relating to due diligence and client identification (see FBC Circular 96/3, Revisionsbericht [Audit report], point 33). It must be recalled in this context that financial intermediaries are bound under point 6 of FBC Circular 98/1, Richtlinien zur Bekämpfung und Verhinderung der Geldwäscherei [Guidelines on the combating and prevention of money laundering] to inform the Commission when local regulations contradict the recommendations contained in that document. The Commission also provisionally banned a bank from forming a foreign subsidiary in 2001 on structural grounds. It ruled that the bank had failed to develop adequate organization and control structures at group level to cope with the rapid expansion of its offshore activities.

5.2 Focused audits by statutory auditors

In February 2001, the FBC ordered focused audits of 73 subsidiaries belonging to 37 banks which own subsidiaries in one or more countries or regions designated as offshore centres. The external auditor focuses in such cases on money laundering, client identification and application of the guidelines relating to politically exposed persons. Consolidated regulation of these offshore subsidiaries by the Commission can only be effective if the external auditors are given access to all the relevant information. It must also be possible to assess the reputation risks Swiss banking groups are exposed to through their offshore subsidiaries.

While Swiss auditors are free to delegate normal audit tasks to foreign staff, these focused audits must be carried out on-site by a Swiss auditor. This is the best way to ensure that offshore units also comply with the applicable Swiss rules. The audit report produced must comprise three main sections. The first section includes general information on the significance of the offshore unit, a description of its relationships with other group units, details of the normal audit tasks carried out on-site, an explanation of how the unit is monitored and an assessment of how its overall control mechanisms work. The second section includes detailed information on client identification procedures and group-level compliance with the rules regarding money laundering. In the final section, the Commission expects a report on the extent to which the Swiss auditors were granted access to client files and all other available information.

The focused audit reports were submitted to the Commission at the start of

2002. Analysis of these reports will, it is hoped, provide an overview of the current situation in the countries where the focused audits were carried out.

6. International administrative assistance

International cooperation gained importance throughout 2001, as evidenced by the resources employed and the amount of contact between countries. A great deal of information was exchanged in connection with the regulation of stock markets and securities trading, with a number of letters passing between the FBC and its foreign counterparts (see 6.1 and 6.2 below). Contact with foreign banking regulators was also stepped up. In-depth discussions took place with a view to agreeing on the terms of international cooperation, and agreements to this effect were concluded with the Danish and Dutch banking regulators. Talks are still underway with other countries, namely the US, France and Italy. Exchanging letters is becoming ever more important, since information needs to flow smoothly for consolidated supervision to be possible. Supervising internationally active finance groups requires that the authorities responsible be allowed to carry out their duties globally. Several foreign authorities have expressed a wish to conduct on-site checks of Swiss branches or subsidiaries of banks under their jurisdiction (see II/3.2.2). The Commission, on the other hand, does not usually conduct such checks of foreign branches or subsidiaries of Swiss institutions itself. It does, however, ask external auditors to conduct such checks as part of their thorough group-level audits (see 4.3 and 5 above).

6.1 Correspondence with foreign regulators

There are three basic prerequisites for sharing information with foreign stock-market regulators: the foreign authority must be bound by official or professional secrecy, it must use the information supplied exclusively for the purpose of regulating stock markets and security trading, and it must not forward the information to any third party before gaining the FBC's permission. Foreign regulators must provide the Commission with a general declaration to the effect that they are legally authorized and intend to respect Swiss law, or simply an ad-hoc declaration that they acknowledge the conditions for administrative assistance in a specific case (see Annual Report 2000, p. 129ff). The Commission can also provide a declaration of its own if the foreign regulator asks for one. In practice, this leads to correspondence between the Commission and its foreign counterparts. The following foreign regulators had given the Commission a general declaration by the end of 2001:

Australia	ASIC	Australian Securities & Investments Commission
Belgium	NASDAQ Europe	
	EURONEXT Brussels	
Denmark	Finanstilsynet	Danish supervisory authority
Germany	BAWe	Bundesaufsichtsamt für den Wertpapierhandel (federal office of securities trading regulation)
France	COB	Commission des Opérations de Bourse (stock exchange commission)
United Kingdom	DTI FSA (virt-x)	Department of Trade and Industry Financial Services Authority
Hong Kong	SFC	Securities and Futures Commission
Italy	CONSOB	Commissione Nazionale per le Società e la Borsa (national companies and stock exchange commission)
Netherlands	STE	Stichting Toezicht Effectenverkeer (securities trading regulator)
Portugal	CMVM	Comissão do Mercado de Valores Mobiliários (securities trading commission)
Sweden	Finansinspektionen	Swedish financial supervisory authority
Spain	CNMV	Comisión Nacional del Mercado de Valores (national securities trading commission)
US	CFTC	Commodity Futures and Trading Commission
	SEC	Securities and Exchange Commission

6.2 Administrative assistance practice in relation to stock markets

Requests from foreign regulatory authorities for administrative assistance once again caused the FBC's workload to increase significantly. The Commission's own rulings were supplemented by a large number of rulings from the Federal Supreme Court. FBC Bulletin 43 is devoted entirely to this subject.

Since the Stock Exchange Act came into force, the Commission has received requests relating to more than 650 financial institutions. No request could involve more than one bank, but each could relate to either several clients at the same bank or several clients at different banks. Some requests could be dealt with informally, and there were two main reasons for this: either it was not necessary to supply client information because transactions were initiated by an asset manager, or the clients in question gave their permission for the requested information to be passed on. The Commission has issued 115 rulings to date. About half of these were appealed against and brought before the Federal Supreme Court, which has issued 57 rulings of its own to date, 18 in 2001. The Federal Supreme Court ruled on various key issues in the period from 1998

to 2000, largely approving the FBC's practices (see Annual Reports 1998, p. 104ff, 1999, p. 26ff and 2000, p. 25ff). In 2001, it essentially confirmed its rulings and added a few more specific comments. Some of these rulings facilitate administrative assistance, others hamper it. Some even make it impossible.

Federal Supreme Court rulings which facilitate administrative assistance:

- The requirements for initial suspicion are relatively low. If a transaction was executed prior to the publication of confidential information, which caused the price and thus the value of the transaction to increase, this is sufficient grounds for suspicion (Federal Supreme Court rulings 125 II 65 and 126 II 409).
- The FBC must verify the existence of an initial suspicion. However, it is not required to investigate whether this initial suspicion proves to be well-founded on the basis of the information received, and whether any information requested relates to suspicious or ordinary transactions. It is the foreign authority's responsibility to decide whether a suspicion is justified, since the Commission does not have access to the information required to make this decision (Federal Supreme Court ruling 2A.162/2001 of 10 July 2001).
- Swiss law does not require a declaration which is binding under international law for compliance with Article 38 of the Stock Exchange Act. A "best efforts" declaration is sufficient, even if the foreign authority is under an obligation to pass evidence of criminal activity to the relevant criminal prosecution authorities (Federal Supreme Court ruling 2A.317/2000 of 10 May 2001).
- In the interests of procedural economy, it is permissible, insofar as the applicable conditions are met, to issue a single ruling which simultaneously orders a financial institution to supply the requested information, approves the hand-over of the said information to the foreign authority and also approves the forwarding thereof to a third party, for example a criminal prosecution authority (Federal Supreme Court rulings 125 II 450, 2A.262/2000 of 9 March 2001 and 2A.354/2000 of 5 April 2001).

Federal Supreme Court rulings which hamper administrative assistance

- Unlike administrative assistance, the forwarding of information to criminal prosecution authorities requires a justified additional suspicion (Federal Supreme Court rulings 2A.317/2000 of 10 May 2001 and 2A.162/2001 of 10 July 2001).
- The forwarding of information to criminal prosecution authorities can only be approved if double criminal liability has been verified (Federal Supreme Court ruling 125 II 450).
- The Federal Office of Justice can only approve the forwarding of information to criminal prosecution authorities if it rules that this action is justified. The Federal Office of Justice must communicate its decision on this matter to all involved parties (Federal Supreme Court rulings 125 II 450, 2A.269/2000 of 27 April 2001 and 2A.162/2001 of 10 July 2001).
- Entities and employees of a financial institution conducting transactions for their own account are regarded as clients. This means that the relevant administrative procedure applies (Federal Supreme Court ruling 2A.352/2000 of 9 March 2001).

- Even disclosing the name of an independent asset manager requires that the administrative procedure be applied, regardless of whether or not the client's name is disclosed (Federal Supreme Court ruling 2A.237/2001 of 3 September 2001).

Despite the difficulties arising from Swiss legal provisions and from the Federal Supreme Court's rulings, the Commission was able to grant administrative assistance in a relatively large number of cases. However, many issues remain unresolved. The Commission's administrative assistance for the US SEC and Italy's CONSOB was blocked towards the end of 2001 by Federal Supreme Court rulings. The court had imposed conditions relating to compliance with the special purpose principle and confidentiality. After the Commission re-established contact with the two authorities and received supplementary declarations, it issued new rulings in both cases, both of which were appealed against and brought before the Federal Supreme Court. The appeal in the CONSOB case was still pending at the end of 2001.

The Federal Supreme Court sanctioned the appeal in the SEC case on 20 December 2001. This decision, which the court said was justified by the public nature of individual proceedings the SEC might have pursued, made it impossible for the Commission to grant administrative assistance to the SEC. It is highly probable that this state of affairs will have an impact on the Commission's working relationships with other financial regulators in US and other countries, since these other regulators may pursue similar policies to the SEC. The situation is neither understood nor accepted by the international community, which means that the national legislation must be reviewed as soon as possible.