



## Self-regulation in the financial sector - the Swiss experience

Dr. Urs Zulauf  
Head Legal Department of the Swiss Federal Banking Commission

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### Summary

Self-regulation and industry standards play a significant role in Swiss financial market regulation both in terms of volume and substance. A flexible but sustainable government framework addressing the interface between statutory regulation and industry standards helps to increase their effect. The Swiss Federal Banking Commission is committed to maintain and further develop its productive working relationships with self-regulatory bodies in the future. Beyond any differences in details the Swiss Federal Banking Commission shares with these organisations the common goal of achieving flexible but high standards in the regulation of the Swiss financial market in the interest of both market participants and investors.

### Zusammenfassung

Selbstregulierung ist ein wichtiger Teil der Schweizer Finanzmarktregulierung, sowohl umfangmässig als auch inhaltlich. Ein flexibler aber nachhaltiger staatlicher Rahmen für die Berührungspunkte zwischen staatlicher Regulierung und Selbstregulierung kann ihre Wirksamkeit fördern. Die Eidg. Bankenkommission ist bestrebt, auch künftig ihre produktiven Beziehungen zu den Selbstregulierungsorganisationen im Finanzmarkt aufrechtzuerhalten und zu vertiefen. Jenseits allfälliger Differenzen in Detailfragen teilt sie mit diesen Organisationen den Willen, im Interesse der Marktteilnehmer und der Anleger flexible aber hohe Standards in der Schweizer Finanzmarktregulierung zu erreichen.

### Résumé

L'autorégulation tient une place importante dans la réglementation des marchés financiers en Suisse, tant au niveau de son étendue que de son contenu. Un cadre étatique flexible mais solide assurant l'interface entre la réglementation étatique et l'autorégulation permet d'augmenter son efficacité. La Commission fédérale des banques s'engage également à l'avenir à maintenir et renforcer les relations fructueuses qu'elle entretient avec les organismes d'autorégulation dans le secteur financier. Au-delà d'éventuelles divergences de détail, celle-ci partage avec ces organismes la volonté commune d'atteindre des standards flexibles mais élevés dans la réglementation des marchés financiers, cela dans l'intérêt des participants et des investisseurs.



## ***SPEAKING NOTES***<sup>1</sup>

Dear Ladies and Gentlemen, esteemed Colleagues

During the next 10 minutes I would like to give you an overview of the **role** self-regulation plays in the Swiss financial sector, describe the partly conflicting trends on the international level and summarise the Swiss Federal Banking Commission's **position** on self-regulation. I will present different **categories** of self-regulations accompanied by prominent **samples**. Before I conclude I will address the challenges that self-regulation is facing and provide means to mitigate potential weaknesses. When we use the term "*self-regulation*" in Switzerland it can include both the *setting* as well as the *enforcement* of standards by self-regulatory organizations. In our understanding "self-regulation" also includes the idea of industry standards and guidance.

### **I. Role of self-regulation**

Self-regulation looks back on a long tradition on the Swiss financial market and is acknowledged as a valuable alternative to state regulation. The sheer volume of self-regulatory texts is impressive. As per June 2007 self-regulation counted approximately 190 acts of self-regulation on 1'280 pages, while state regulation - which includes laws, ordinances, circulars and the like - amounts to round about 127 regulations on 1'200 pages; hence about the same size. From a Swiss perspective, 2'500 pages of regulation covering all sectors of financial markets and all layers of statutory and self-regulation look terrifying. However, it may change the perspective to learn from the UK FSA that this authority intends to considerably reduce the more than 8000 pages of its actual rule-book.

### **II. Conflicting trends on the international scene**

Internationally two conflicting trends can be observed regarding self regulation:

- Since a couple of years, one can observe countries turning away from the concept of self-regulation. To a large extent this development was provoked by the financial scandals of the last decade that led to a number of legislative initiatives including the Sarbanes-Oxley Act of 2002 to name the most prominent example. Further, in November 2005 the Securities Exchange Commission (SEC) released a concept study wherein it considered totally abandoning the concept of self-regulation. Similar tendencies can be noticed in several EU member states as well as in the EU itself, which is aligning its legislation towards one single financial market.
- However, besides these developments there are also signs pointing in the opposite direction acknowledging the advantages and the added value that self-regulation generates in specific areas or situations. For instance, the Financial Times of Feb-

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<sup>1</sup> The following text comprises the full version of the speech on the subject matter; the presentation held on the occasion of the Swiss – City of London Financial Roundtable was shortened in certain parts.



ruary 21, 2005, rated the burden of regulation as the biggest risk facing world's banks.

The Swiss Federal Banking Commission has taken these trends as an occasion to evaluate its stance on self-regulation. The outcome of its assessment is summarized in the report „Self-regulation in the Swiss Financial Sector“ that is published today. The report can be downloaded from our website and is available in German and French including an English summary.

### III. SFBC Position with regard to self-regulation

In its report, the Swiss Federal Banking Commission concludes that self-regulation is a cornerstone of Switzerland's financial market architecture and that it will continue to rely on self-regulation, where it produces the best results. Beyond that, the Swiss Federal Banking Commission seeks to strengthen the significance and effectiveness of self-regulatory norms by providing a suitable statutory framework. Specifically, the recognition of self-regulations by the Swiss Federal Banking Commission and the observation of certain regulatory principles make for a favourable framework. The UK FSA, if our understanding is correct, has chosen a similar approach with respect to Industry Guidance that can gain recognition by the regulator and thus complement state regulation that is moving more and more towards principles based regulation.<sup>2</sup> Back to the concept of self-regulation as such, it is not just acknowledged by our regulatory agency, it further receives a legal basis in the Act on Financial Market Supervision – briefly the “FINMA Act”. The FINMA Act was adopted by Swiss Parliament by the end of June this year and will become effective on the 1st of Jan 2009. This Act is the foundation for the integration of the banking, securities and assurance regulators as well as the AML Control Authority into one integrated supervisor. It explicitly refers to self-regulation as a concept to be supported by the new authority and stipulates the competence of the authority to recognise self-regulations as a minimal standard and enforce them - a concept that is already practiced today.

### IV. Categories and samples of self-regulations in the Swiss financial market

Now, let me dive into the different forms that self-regulation takes in the financial sector of Switzerland and add a few samples. Basically, there are three different categories:

- **Autonomous or voluntary self-regulation** derives from the autonomy of private subjects and economic freedom without government agencies becoming involved. It must solely respect the general boundaries of Swiss and applicable international law. Common examples of this category are the codes of conduct elaborated by professional associations like the Association of Swiss Asset Managers or the Association of Swiss Financial Analysts.
- **Self-regulation recognised by the regulator as a minimum standard:** Under this category, the Swiss Federal Banking Commission has to date recognised a total of 21 self-regulations as minimal standards. The procedure for recognition as a mini-

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<sup>2</sup> FSA confirmation of Industry Guidance, Discussion Paper published in Nov. 2006.



mal standard can be initiated by the industry representatives themselves or at the suggestion of the Swiss Federal Banking Commission. Recognition is given only if the relevant issues have been addressed properly and the self-regulation complies with applicable law and official regulations. As a consequence of the recognition, a self-regulation is no longer applicable to the members of the respective self-regulator only but becomes applicable to the whole sector as the minimum to be respected. Once a self-regulation is recognised, compliance is audited by authorised audit firms and violations are sanctioned by the Swiss Federal Banking Commission. The recognition confers a stronger normative effect to self-regulations, however, they do not attain a statutory character through that process. In recognising a body of rules the Swiss Federal Banking Commission implicitly renounces, for the time being, regulations in that specific area. One well-known example of this category is the Agreement on the Swiss banks' code of conduct with regard to customer due diligence. This agreement was first released in 1977 by the Swiss Bankers Association. It stipulates rules on customer due diligence by banks. Violations of the Due Diligence Agreement are sanctioned by a Supervisory Board established by the Swiss Bankers Association. In the same time, a violation can fail the statutory test of proper business conduct, which is one of the requirements for maintaining a banking license in Switzerland. -- Further examples concern the funds industry: The Swiss Funds Association has issued a code of conduct as well as various guidelines, all of which are recognised as a minimum standard and apply to the entire funds industry in the country.

- **Compulsory self-regulation that is based on a mandate by the legislator:** In this category you will find acts of self-regulation that are based on a statutory mandate by the legislator to self-regulators. These mandates are often combined with a prescription of objectives and principles to be achieved as well as the competence of the regulator to recognise the resulting self-regulation or amendments thereof. As a consequence of the statutory mandate, the Swiss Federal Banking Commission basically refrains from regulating in that area. This framework confers a level of legislative legitimation on self-regulations. This third category hosts some of the core self-regulations of the Swiss financial market. One set is based on the Federal Act on Stock Exchanges and Securities Trading ("SESTA"). SESTA grants exclusive competences of self-regulation and enforcement to Swiss stock exchanges. Accordingly, Swiss exchanges enjoy a certain scope of discretion when setting and enforcing rules. In the same time, however, they are – unlike other self-regulators - subject to supervision by the Swiss Federal Banking Commission. Under the SESTA stock exchanges shall, amongst other things, ensure an organizational structure appropriate to their activities and organize the market with a view to achieve efficiency and transparency. In 1996 the SWX Swiss Exchange has, with a view to implementing the objectives and principles prescribed by the SESTA, issued the Listing Rules. These outline the conditions for listing and maintaining a listing as well as the suspension of trading and the termination or cancellation of a listing. The SWX Swiss Exchange does a good job in the supervision and enforcement of its regulations and has won recognition nationally and internationally. Another field of application of compulsory self-regulation is anti money laundering. For the para-banking sector, the **Federal Act on Anti Money Laundering** ("AML Act") stipulates the creation of self-regulatory organisations, who themselves are under supervision by the statutory AML Control Authority. The self-regulatory organisations are private organisa-



tions vested with a right to exercise a surveillance function over their members. Financial intermediaries, who are not already subject to supervision under a special law (like for example banks under the Banking Act) can choose to be supervised directly by the official AML Control Authority, or, they can choose to join a self-regulatory organisations. A slightly different concept applies to institutions that are subject to prudential supervision e.g. by the Swiss Federal Banking Commission. Here the statutory regulator substantiates the standards of diligence and compliance unless one of the self-regulators takes over and fulfills this regulatory task. -- This rather complex system that Switzerland chose in order to combat anti money laundering was deemed appropriate and equal to official regulation by the Financial Action Task Force (FATF) on the occasion of the third country evaluation in November 2005.

## V. Challenges

Overall, the Swiss Federal Banking Commission's experiences are positive and there is no reason to deviate from this path in the future. Having said that, one has to accept that self-regulation may have weaknesses that need to be considered when deciding on the appropriate regulatory instrument. For instance, one issue is self-regulators' and their members' susceptibility to conflicts of interest, as a consequence of which important stakeholders like investors might miss out and not be included by the regulating party. Further, self-regulators sometimes encounter difficulties in enforcing regulations when members have not subjected themselves to their regime. There are, in the eyes of the Swiss Federal Banking Commission, remedies to mitigate the disadvantages or weaknesses of self-regulation. Specifically, the recognition of self-regulations as a minimum standard or the recognition based on a statutory mandate to self-regulate provide a *framework* that increases legitimacy, effectiveness and credibility of self-regulations such that they are perceived as equal to official regulation. To obtain recognition of their self-regulations the Swiss Federal Banking Commission invites self-regulators to consider the same regulatory principles as government agencies do when they establish regulations. This includes reflections on costs and benefits, prior consultation of persons or institutions concerned, co-ordination and an open pro-active dialogue with the regulators and other government authorities as well as accessible regulations just to name a few. The consideration of these regulatory principles will further the recognition of self-regulations in Switzerland and abroad and create an added value.

## VI. Conclusion

Let me conclude: Self-regulation plays a significant role in Swiss financial market regulation both in terms of volume and substance. A flexible but sustainable government framework addressing the interface between official and self-regulation helps to strengthen their effect. The Swiss Federal Banking Commission is committed to maintain and further develop its productive working relationships with self-regulatory bodies in the future. Beyond any differences in details the Swiss Federal Banking Commission shares with these organisations the common goal of achieving flexible but high standards in the regulation of the Swiss financial market in the interest of both market participants and investors.