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Switzerland: Financial Sector Assessment Program—Factual Update—IOSCO Objectives and Principles of Securities Regulation

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SWITZERLAND

FACTUAL UPDATE:

IOSCO Objectives and Principles of Securities Regulation

MAY 2007

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MONETARY AND CAPITAL MARKETS DEPARTMENT

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I. INTRODUCTION

1. **This note presents a factual update of regulatory developments in the area of securities regulation and supervision since the completion of the 2001 FSAP**.[1] As a factual update, the note does not entail a reassessment of compliance with IOSCO Principles, but a descriptive report of key developments in the area of securities regulations, with a special reference to the main recommendations made by the 2001 FSAP mission. The material is based heavily from background documents prepared by the Swiss authorities.

2. **Overall, there has been substantial progress in implementing FSAP recommendations in various areas of securities regulation**. In part, changes have been motivated by the need to adapt securities regulations in Switzerland to international developments, with the aim of supporting the position of the Swiss financial centre. The project to unify financial supervision under the Federal Authority for Market Oversight (FINMA), currently under Congress consideration, is expected to strengthen the budgetary independence, staffing, and enforcement powers of the supervisor. As traditional in Switzerland, the front-line supervision of securities intermediaries continues relying extensively on the external auditors, but significant steps have been taken to strengthen the regulations and oversight of the external audit function, with further initiatives on the pipeline. Regulations on cross-border exchange of confidential client information for supervisory purposes were eased—albeit their effectiveness awaits a court ruling. The authorities are also reviewing rules on unfair trading practices with the aim of correcting existing weaknesses and improving the alignment of Swiss regulations on market abuse with other major financial centers. On the other hand, less progress has been attained in the area of sanctioning powers, particularly over the unregulated institutions, and the mission saw room to further strengthen the political independence of the FINMA.

3. **In 2004, Switzerland became a signatory of the IOSCO Multilateral Memorandum of Understanding (MOU) after undergoing a thorough review process**. The Swiss Federal Banking Commission (SFBC) has expressed commitment to seek authority to become a full signatory of the IOSCO Multilateral MOU.

II. INSTITUTIONAL SETTING AND MARKET PARTICIPANTS

4. **Securities intermediaries in Switzerland comprise primarily securities dealers and investment funds**.[2] Total assets of investment funds reached US$674 billion

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[1] Prepared by Francisco Vazquez (Monetary and Capital Markets Department).

[2] The category of securities dealers includes not only market makers and client dealers (who trade securities in their own name for the account of clients), but also issuing houses, derivative houses, and own account dealers.

(172 percent of GDP) in the third quarter of 2006. About one-half of the assets are invested in foreign funds, which are in most cases established by Swiss financial institutions in Luxembourg, and their products offered in Switzerland to residents and nonresidents. Both the securities and the fund businesses are dominated by the large banks (UBS and Credit Suisse).

5. **As in other developed jurisdictions, certain types of securities intermediaries are not subject to licensing requirements or prudential supervision**. Independent asset managers and investment advisors who do not manage funds in their name on behalf of clients are not required to be licensed. Also, securities intermediaries trading on their own account and with a gross turnover below ChF5 billion per year are not required to be licensed, nor are those providing services to qualified investors only.[3] According to industry figures, in 2005 the non-regulated sectors included approximately 2,600 independent asset managers, 120 companies dedicated to private equity, and more that 150 hedge funds and funds of hedge funds (FoHF). Some of these intermediaries, however, have been incorporated within the scope of prudential supervision as a result of the new Collective Investment Schemes Act (CISA), which entered into force in 2007.

6. **Switzerland is the second largest market of funds of hedge funds (FoHF) worldwide, after the US**. The hedge fund industry encompasses a group of licensed and regulated funds, most of them structured as FoHF, plus a segment of unregulated off-shore funds offered by Swiss financial companies. The number of registered hedge funds increased from 39 in 2001 to 256 in 2006 (including 123 Swiss funds and 133 foreign funds). Assets invested in the registered hedge funds have been increasing accordingly, reaching US$9.4 billion in 2006 (compared with US$330 billion invested in all regulated Swiss funds). The size of assets in off-shore hedge funds is not well known, as the funds invested are not statistically documented or reported in a standard form. However, industry estimates indicate that there are more than 150 unregulated hedge funds and FoHF offered by Swiss financial companies, with an invested asset volume of about US$200 billion, against an estimated US$1,105 billion worldwide.

7. **The unregulated hedge funds cannot be offered directly to the broad public in Switzerland—their distribution is restricted to qualified investors only**. On the other hand, the regulated hedge funds and FoHF may be sold directly to the public. The specific structure of the licensed FoHF however, allows for investments in off-shore hedge funds,

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[3] Qualified investors include: (i) financial intermediaries and insurance companies subject to prudential supervision, (ii) institutions with professional treasury operations, (iii) high net-worth individuals, and (iv) investors who have concluded a written discretionary management agreement with a supervised financial intermediary or an asset manager, provided that the later falls under the scope of anti-money laundering supervision, and follows a code of conduct that is accepted as minimal standard by the SFBC.

which are then distributed to the broad public. Non-traditional investments are also offered for public distribution through other structures, such as Swiss-based companies listed in the SWX Swiss Exchange, closed-end-funds, and hedge fund-linked structured products (provided they are not closely tied to a single hedge fund). For the regulated hedge funds, the regulatory framework focuses on investor protection, mainly through transparency and control of the professional qualifications of fund managers and representatives (Box 1).

8. **In 2006, the SWX Swiss Exchange ranked tenth worldwide by market capitalization, while its subsidiary Eurex ranked third worldwide in terms of derivative transactions**. The Swiss Market Index (SMI) increased by a significant 31 percent in 2005, and an additional 20 percent in 2006, despite a sharp drop of 13 percent around May-June 2006. Market capitalization of the SWX Swiss Exchange was US$1.0 trillion at end-2006 (equivalent to 2.5 times GDP), and trading volumes increased by 48 percent in 2006 (the third largest increase worldwide) to US$1.6 trillion. The SWX Swiss Exchange has a strategic positioning in Europe, with subsidiaries operating in the UK, and Germany. It maintains full ownership over virt-x, the pan-European securities exchange for blue-chip stocks based in London. All the stocks included in the Swiss blue-chip index are listed in the SWX Swiss Exchange, but fully traded in virt-x, thus combining Switzerland's regulatory framework for issuers with the trading oversight of the UK FSA. The SWX Swiss Exchange, together with Deustche Börse AG, have joint ownership of Zurich-based Eurex, which was the 3rd exchange worldwide in terms of stock option contracts traded in 2006. Further, in 2005 the SWX Swiss Exchange acquired the Bremen Stock Exchange in Germany, and launched a new trading platform in Germany in January 2007 to support expansion in the rapidly-growing market for securitized derivatives.

9. **The supervision and regulation of the securities market are entrusted to the SFBC**. The responsibilities of the SFBC include, among others, licensing and supervising securities dealers and stock exchanges, and regulating the disclosure of shareholdings in listed companies and takeover bids.

10. **The front-line supervision of securities dealers, however, relies extensively on authorized private external auditors**. The SFBC does not regularly perform on-site inspections of securities dealers. Instead, the direct supervision of both securities dealers and the SWX Swiss Exchange has relied traditionally on the external audit function. External auditors are required to examine compliance with the obligations arising from the Stock Exchange Act, the implementing ordinance, and other relevant rules and regulations. The enforcement of regulations is also supported by the SWX Swiss Exchange operating as a self-regulatory organization (SRO). The SWX Swiss Exchange is responsible for admitting participants to trading, enforcing listing rules, supervising price formation, executing and settling transactions, and ensuring market transparency.

Box 1. Regulation of Hedge Funds in Switzerland

Since the mid-1990s, mutual funds have been allowed to register FoHF in Switzerland as a special investment category, making them available to private individuals with no investor qualifications. In addition, FoHF also operate under the legal form of investment companies under the regulation of the SWX Swiss Exchange, and are traded as equities freely accessible to small investors.

The regulatory and supervisory framework of hedge funds and FoHF in Switzerland focuses on investor protection, emphasizing the professional quality of fund management companies. In general, the licensing procedures for hedge funds and FoHF are stricter than those that apply to traditional funds. They entail interviews with fund representatives and a qualitative assessment of fund managers, risk management systems, reporting lines and internal risk controls, as well as an analysis of other parties involved in the investment scheme, including custodian bank, external managers and advisers, prime brokers, and administrators. Albeit not formally specified in the regulations, registered hedge funds are also subject to a stricter supervisory regime. External auditors are required to have professional expertise in the area of alternative investments, and special audits must be conducted by the external auditors on a quarterly basis in the first two years after inception, focusing on the particular structure and risk-return characteristics of individual funds.

The protection of hedge fund investors is also pursued through transparency. Hedge fund prospectuses are required to include a special warning clause that has to be approved by the SFBC, and detailed information on the fund investment policy, characteristics, and special risks. Target funds are always shown in the annual and semi-annual reports of FoHFs, and investors have to be given the possibility of exercising their right of redemption at least four times per year. Statutory restrictions on the operations of hedge funds are minimal and mainly oriented to safeguarding the special structure of the FoFHs. For example, FoHF are not allowed to carry out short sales, nor to invest in another FoHF, and they cannot invest more than 30 percent of their assets in target funds managed by the same manager or management company. Further, funds are not allowed to have a leverage of more than six at any time (this was a previous SFBC practice which been now formally incorporated in the regulations).

III. Recommendations of the 2001 FSAP and Factual Update

11. **The 2001 FSAP found Swiss securities regulations largely in compliance with the IOSCO Objectives and Principles of Securities Regulation**. There were some areas,

however, where implementation was deemed to be incomplete, and the mission made a series of recommendations to ensure full implementation. The description below provides a brief reference to these recommendations, and follows-up on key regulatory developments, organized by topical groups of principles.

Principles 1–5: The Attributes of the Regulator

12. **The 2001 FSAP mission recommended broadening the jurisdiction of the SFBC to include all types of securities transactions and intermediaries, strengthening its operational and budgetary independence, and increasing its regulatory powers**. In particular, the mission noted that the jurisdiction of the SFBC could be broadened to include the regulation of primary markets and all asset managers. The mission also advocated for effective separation between the SFBC and the government, by specifying in the law the grounds for removal of the members of the SFBC Board and granting the SFBC full budgetary independence. The mission recommended a more active involvement of the SFBC in on-site supervision and the oversight of external auditors, and increasing the staffing and resources allocated to supervisory tasks, in line with the size and importance of the supervised securities firms and the banking industry.

13. **On the jurisdiction of the SFBC over primary markets, the SFBC already authorizes and supervises issuing houses**. Issuing houses are subject to the authorization and supervision of the SFBC, which is also empowered to take the necessary measures to restore proper conditions and remove any irregularities on licensing requirements (e.g., fit and proper business activity) or other legal provisions.

14. **In case of public offerings for the subsequent admission to listing, the primary market is also governed by self-regulation**. Prospectus have to be drafted according to listing rules that take into account internationally recognized standards. Listing rules are enacted by the SWX Swiss Exchange (the SRO) and approved by the SFBC. The SWX Swiss Exchange can refuse admission to listing or can impose conditions that need to be met by the issuer before the securities can be traded. Sanctions can be imposed for violations, including reprimands, financial fines, suspension from trading, and delisting. In addition, the Swiss Bankers Association has enacted allocation directives for the primary market which are binding for all banks and securities dealers due to the requirement of self-regulation as minimal standard.

15. **The jurisdiction of the SFBC over securities intermediaries has been broadened under the new legislation on collective investments, albeit some segments remain outside the scope of regulation**. The CISA, which entered into force in January 2007, imposed a licensing requirement on the managers of Swiss collective capital investments. Besides, in 2005, the SFBC decided to offer independent Swiss asset managers of foreign eurocompatible investment funds the opportunity to obtain a license as securities dealers and

place themselves under the SFBC supervision.[4] As in most jurisdictions, some segments of the securities industry—which are deemed by the authorities as not relevant from the perspectives of financial stability and investor protection—remain outside of the scope of securities regulation (see paragraph 5).

16. **The jurisdiction of the FINMA will encompass the supervision of banking, insurance, and securities markets**. The draft FINMA Act, which is currently under Congress consideration, is envisaged as an umbrella statute placed above the other, specialized financial markets statutes. As a result, banks will have to meet the requirements of the Banking Act, securities dealers the requirements of the Federal Act on Stock Exchanges and Securities Trading (SESTA), insurances the requirements of the Act on the Supervision of Insurances, collective investment schemes the requirements of the CISA.

17. **The mission encouraged the authorities to undergo a thorough review of the objectives of FINMA, to eliminate potentially conflicting goals**. The mission was of the view that provisions in the draft FINMA Act intended to balance the public benefits of regulation with its costs could give excessive weight to the later, creating tension with the financial stability objective and limiting the capacity of the FINMA to conduct effective supervision. The mission was of the view that existing guidelines and current SFBC practices provide sufficient grounds to properly take into account the costs of proposed regulations and feedback from the regulated institutions.

18. **The budgetary independence of the supervisor is expected to be strengthened under the FINMA, but operational independence seems to fall short of the recommendations made by the 2001 FSAP**. Legally, the FINMA would operate as a public institution with a statute similar to the statute of the SNB, creating the ground to increase its budgetary and operational independence. The budget of the FINMA will be covered by fees charged to the supervised institutions, and independent from the Federal Budget (albeit still subject to the approval of the Federal Council) which is expected to strengthen FINMA's budgetary independence. Also, under the current project, the staff of the FINMA will be employed according to private law statutes, which are more flexible than public statutes and are expected to help introduce a more efficient management of the staff. The managerial structure of FINMA will have a board of directors, a management board and an auditing unit. Members of the board may be removed from office by the Federal Council, and the grounds

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[4] This initiative was also in response to EU legislation on investment funds, which stipulates that, from February 2007 at the latest, management of the assets of eurocompatible investment funds may only be transferred to companies which are subject to licensing requirements and adequate supervision in their country of origin.

for removal are still not clearly specified in the regulations, which raises some caveats on the operational independence of FINMA from the Government.

19. **The SFBC enacted a new code of conduct for its members and staff, and has been making progress on staffing**. The code of conduct seeks to reinforce the professional standards of the SFBC personnel, including confidentiality. It comprises a whole range of principles and rules regarding incompatibilities with other professional activities and the behavior to be adopted in the case of conflicts of interest, which are binding to all SFBC employees. The staffing of the SFBC has been increased to 167 persons (from 115 in 2001), and the authorities are expecting to hire further staff before and after the launching of FINMA.

Principles 6–7: The Role and Oversight of Self-regulatory Organizations (SROs)

20. **Switzerland was found to be fully compliant with IOSCO Principles 6 and 7, but the 2001 FSAP made some recommendations to further strengthen the role of SROs**. In particular, the 2001 FSAP advocated for a more proactive and direct involvement of the SFBC in supervising the SWX Swiss Exchange in the areas of market surveillance and listing. Particular emphasis was placed on the protection of end-users and investors as well as on the supervision of possible market abuse practices. The mission also advocated for an explicit oversight of the regulatory functions performed by professional associations such as the Swiss Bankers Association, and the Swiss Funds Association.

21. **Since 2002, the SFBC adopted a more proactive approach toward the SROs aimed at strengthening the transparency and effectiveness of their function**. Self-regulation has a long-standing tradition in Swiss financial markets and is well developed by international standards. The Swiss authorities rely heavily on SROs to support market oversight, reduce the workload of the SFBC, and ensure proximity to market participants. To reinforce this feature, the SFBC has taken steps to formalize and institutionalize its contacts and interaction with the SROs. A continuous process of supervision has been reportedly established regarding the execution of the self-regulatory obligations of the SWX Swiss Exchange.

22. **A set of rules and codes of conduct for self-regulation were enacted by the SFBC in 2004 and adopted as a binding minimal standard for the supervised institutions**. Further, the draft FINMA Act contains a specific provision on self-regulation. In parallel, an issue paper was prepared and distributed to the SROs in 2005 to motivate joint discussions on the integration of self-regulation and state regulation, the importance of transparency and credibility in self-regulation, and the need for supervisory involvement in the development of the regulatory standards adopted by the SROs. In area of securities, current regulations require stock exchanges to have in place an organizational structure appropriate to their

activities, and to submit their regulations and subsequent amendments to the SFBC for approval.

Principles 8–10: The Enforcement of Securities Regulations

23. **The 2001 FSAP recommended increasing the involvement of the SFBC in direct supervision, strengthening its enforcement powers, and developing a quality assurance program for the external auditors**. The mission noted the heavy reliance of the SFBC on the external auditors for frontline supervision, and recommended a more direct involvement of the SFBC in the examination process, and a closer follow-up of external audit reports. The mission advocated for the strengthening of the external audit function, including through the implementation of quality controls, and reinforcing the independence of external auditors from the supervised companies. The mission also recommended granting the SFBC formal surveillance powers over the external auditors, and increasing the range of available sanctions over audit companies and the supervised institutions.

24. **The direct on-site supervision on the SFBC remains mainly limited to the two large banks, but the SFBC reportedly joins the external audits in banks and securities dealers on a regular basis**. The authorities consider that the practice of joining the on-site work of external auditors serves the purpose of direct supervision and provides a quality check of the external auditor. Since 2004, the SFBC has been enabled to appoint an investigator with ample powers to conduct on-site examination and check the extent of financial difficulties in banks and securities dealers, as well as compliance with existing regulations.

25. **In 2002, a new unit was established in the SFBC entrusted with the monitoring of audit companies—also in response to events that revealed deficiencies in the audit function**. The unit verifies that audit companies meet the requirements for accreditation and comply with supervisory and audit rules. It also manages a quality review of audit companies, which includes organization structure, independence, personnel qualifications and experience, processing systems and audit expenditures and fees. Quality reviews are performed through inspections and random checks on audit activities, including on-site. A number of serious deficiencies were uncovered by these quality reviews, triggering immediate corrective action.

26. **The SFBC has been implementing an extensive reform of audit regulations, with three circulars governing the audit function entering into force in 2006**. The reform was intended to formalize the risk-oriented auditing approach already established in practice, improve the transparency of the work and remit of external auditors, facilitate a meaningful and timely reporting, and increase the independence and monitoring of auditing companies. The first circular establishes the procedures for annual audits of banks and securities dealers, both on a solo and a consolidated basis. It divides the object and implementation of the audits

in two areas: (i) an accounting audit, which parallels the typical remit of auditors in other jurisdictions, and (ii) a supervisory audit, which reflects the role of auditors in on-site supervision that characterizes the Swiss regulatory system. To improve transparency and communication between the auditors and the supervisor, the circular requires auditors to disclose their risk assessment of the supervised institution and their proposed auditing strategy to the SFBC. The second circular deals with the form and content of audit reports, and also reflects the separation between accounting audit and supervisory audit. Increased flexibility in setting reporting periods also permits timelier reporting. The third circular contains provisions for recognizing, appointing, and changing audit companies and lead auditors, enhancing their independence, and monitor their activities. The results of the quality reviews of audit companies, however, have uncovered the need for further revisions to the regulatory framework. The authorities plan to address these in the context of the project for establishing a general Federal Audit Supervisory Authority planned for 2007.

27. **Less progress has been attained in the area of SFBC sanctioning powers, particularly over the unregulated institutions**. The SFBC has no sanctioning powers over unregulated institutions. While the later are still subject to the provisions of the criminal code, these are too narrowly defined and difficult to sanction, making enforcement less effective. To overcome this limitation, the SFBC should be given the power to impose administrative sanctions on all financial intermediaries, regardless of whether they are registered or not. The definitions in the criminal code could also be expanded to accommodate cases of insider trading and market abuse.[5] Moreover, regular cases could be dealt directly by the SFBC via administrative sanctions, leaving only the serious cases to the criminal authorities.

28. **A draft circular on market abuse prepared by the SFBC in 2004 was opposed by the consulted parties and is currently subject to revision**. A joint working group on market supervision, headed by the SFBC, has been commissioned with the task of preparing a revised circular, comparing supervisory practices in competing financial centers, and phrasing a mandate for an expert group entrusted with a comprehensive reform of the criminal code to regulate insider trading and price manipulation.

Principles 11–13: Cooperation with Foreign Supervisors

29. **The 2001 FSAP noted that the exchange of confidential information with domestic and foreign regulators was subject to restrictions associated with the legal framework**. The FSAP noted that, at the domestic level, the legislation did not provide for full freedom to exchange confidential client information between all the supervisors

[5] A working group led by the SFBC is currently analyzing these issues (see under Principles 25–30).

concerned (including those responsible for insurance and pensions). The mission also noted that, at the international level, the Swiss law did not allow for adequate cooperation with foreign regulators.

30. **The SFBC has already signed a significant number of Memoranda of Understanding (MoU) with foreign regulators, providing the basis for a wide exchange of information**. Beginning in 1997, the SFBC had signed MoUs or exchange letters with a number of key foreign regulators. This process has continued after the completion the 2001 FSAP, notably including the China Securities Regulatory Commission (2003) and the UK FSA (2004). On the basis of these agreements, a wide range of information has been exchanged with foreign regulators.

31. **A law amendment easing restrictions on the sharing of confidential information with foreign supervisors for regulatory purposes was passed in 2005**. The law amendment, which entered into force in 2006, authorized the SFBC to transmit non-public information on the supervised institutions or their clients to foreign supervisors, for the enforcement of regulations on stock exchanges, securities trading or securities traders. The information was also authorized to be retransmitted to other authorities, courts or bodies for the same purpose without the specific approval of the SFBC, and authorized to be released in the publications of public proceedings, if required by foreign country regulations. However, the sharing of information on clients of Swiss financial intermediaries with foreign supervisors continues subject to prior client notification and consent, and could be challenged by the customer by means of administrative court appeal within a ten-day period. In all cases that have been appealed to date, (eight decisions involving request of assistance from six foreign authorities), the Federal Supreme Court has confirmed the decision to the SFBC.

32. **Switzerland was admitted into Annex B of the IOSCO Multilateral Agreement already in 2004**. The SFBC completed the application and screening processes required to become a member of IOSCO, and has expressed commitment to seek authority to become a full signatory of the IOSCO MoU. The SWX Swiss Exchange is an associate member of the IOSCO.

Principles 14–16: Issuer Disclosure

33. **The 2001 FSAP found room to improve protection of minority shareholders and the comparability of financial information disclosed by issuers**. The mission noted that the primary market was not under the jurisdiction of the SFBC, and that the powers of the SWX Swiss Exchange over the primary market were limited to public offers for the subsequent admission to listing in the exchange. Accordingly, the mission recommended expanding the jurisdiction of the SFBC to cover public offers in the primary market, and granting the SFBC the power to verify the accuracy and completeness of the information disclosed to investors, and the power to delay or stop an offer if investor protection is

jeopardized. The mission also recommended strengthening accounting and auditing regulations to ensure the comparability of financial information disclosed to investors, and to introduce proper supervision and sanctioning of auditors and listed companies.

34. **New regulations aimed at improving transparency of listed companies entered into force in 2007**. The new rules require listed companies to disclose in their financial statements all the allowances of the current and former members of the board and directors and of the management as well as of their relatives and other close persons. They also have to disclose the remunerations of the members of the board of directors individually as well as the highest remuneration paid to a member of the management. Possible loans accorded to managers have to be disclosed too. Moreover, the shareholdings of the members of the board of directors and the management as well as their relatives and other close persons have to be disclosed.

35. **Also, new regulations on the admission and supervision of auditors for all types of companies were enacted in 2005**. The Federal Accounting and Auditing Act, expected to enter into force in 2007, introduces regulations and principles for the admission and supervision of auditors which apply to all types of companies—independently of their legal form or their statute as listed. At the same time, Swiss accounting and auditing rules will be harmonized in accordance with EU directives. These rules will apply to all types of companies, albeit the specific requirements will be adapted to the economic situation of individual companies.

36. **The regulations also require the constitution of a new independent authority for the supervision of auditors and auditing companies**. The new authority will be entrusted with the regulation and supervision of auditors and auditing companies, and is expected to be empowered to impose sanctions and take adequate measures to restore proper conditions, if necessary. It will also be in charge of administrative and criminal assistance in relation to international affairs.

Principles 17–20: Collective Investment Schemes

37. **The 2001 FSAP mission found the regulatory framework of collective investment schemes compliant with IOSCO Principles, but advocated for a more direct involvement of the SFBC in front-line supervision**. The mission noted that regulations on collective investment schemes were in line with the EU Directive Undertakings for Collective Investments in Transferable Securities (UCITS). The mission recognized that fund management companies were properly separated from their custodian banks, but highlighted that, in most cases, the custodian bank and the fund management company belonged to the same financial group. The mission noted that the front-line supervision of fund management companies relied mainly on the external auditors and advocated for a more direct involvement of the SFBC in direct supervision of fund management companies.

38. **The 2001 FSAP mission was of the view that the licensing requirements for fund management companies were largely appropriate**. The requirements included, inter alia, provisions concerning investment policy (including warnings on special risks in the case of licensed hedge funds and other investment vehicles with non-traditional risk profiles), calculation of issue and redemption prices, distribution of profits; managers' compensation, and fees and expenses. The mission also praised the sound fit and proper criteria applied by the SFBC to fund managers, particularly in the case of hedge funds and other funds with special risks, and noted that persons in charge of selling funds to the public were required to be authorized and that foreign funds were required to appoint a representative in Switzerland.

39. **A new law governing collective investment schemes entered into force in 2007**. As mentioned above, the CISA broadened the scope of SFBC regulation for some segments of independent asset managers (see paragraph 15). It also added a new category to accommodate investments in private equity, and is open only to qualified investors. As under previous regulations, the licensed collective investment schemes fall under the supervision of the SFBC, with the exception of listed investment companies, which are directly under the supervision of the SWX Swiss Exchange. Unlicensed collective investment schemes are not subject to supervision and cannot be sold directly to the public.

40. **In parallel, the SFBC amended regulations on investment schemes to make the Swiss investment fund legislation fully consistent with the EU Directive on UCITS**. The Ordinance on Collective Investment Schemes (CISO) entered into force in February 2007, replacing the Investment Fund Ordinance (IFO). The new regulations accommodate the wider use of derivatives for securities funds, setting up an overall exposure of 200 percent of the net fund assets, fully in line with EU UCITS III Directive. Rules on financial statements were extended to the new collective investment schemes, and adapted to the increased information needs. Provisions on accounting have been made more focused and simplified. The new regulations also set the main features of audits and audit reports. The details will be governed by two circulars that are in the pipeline following the risk-oriented approach established in the banking Circulars "Audit" and "Audit Reports", and the subdivision between financial and regulatory audit (see above).

Principles 21–24: Market Intermediaries

41. **The 2001 FSAP mission advocated for extending prudential regulation to all market intermediaries, and saw room to improve customer protection**. The mission noted that some securities dealers were outside the scope of prudential regulation (i.e., those providing services to qualified investors only, or those trading on their own account with a gross turnover below SWF5 billion per year), and advocated for prudential oversight over all

market intermediaries.[6] The mission also recommended that the Swiss conduct of business rules could be supplemented by SFBC instructions to ensure a higher degree of customer protection, particularly in the area of customer suitability tests and the disclosure of potential conflict of interests.

42. **The authorities were of the view that the case for wide-ranging regulation of market intermediaries is not well grounded**. According to the authorities, the case for prudential supervision only results from securities dealers that could potentially affect financial stability, or those that engage in business activities with clients in need of protection. The authorities were of the view that securities dealers trading on their own account, or those providing services only to qualified investors do not call for a need of consumer protection or supervision. Therefore, the first recommendation was not implemented. The authorities also noted that the EU MiFID Directive contained comparable exceptions concerning securities dealers trading on their own account as well as with regard to qualified investors.

43. **Regarding investor protection, the authorities noted that current legislation provides sufficient grounds to prevent conflict of interests**. The authorities noted that the SESTA provides sufficient grounds to ensure transparency and to address potential conflicts of interest before the transaction is conducted. Furthermore, the authorities noted that this is also reinforced by the Code of Conduct for Securities Dealers of the SBA, which is binding for all banks and securities dealers by virtue of the SFBC-Circular 04/2 Self-Regulation as Minimal Standard.

Principles 25-30: The Secondary Market

44. **The 2001 FSAP mission found Switzerland fully compliant with IOSCO Principles 25–30, but saw room to improve the supervisory role of the FSBC over the secondary market**. In particular, the mission reiterated previous remarks on reliance on external auditors for supervision, albeit recognizing that the SFBC was in the capacity to exercise direct supervisory functions whenever deemed necessary. The mission also noted that limitations on the ability of the SFBC to exchange confidential client information with foreign regulators could affect the proper supervision in other markets.

45. **A working group headed by the SFBC is revising current regulations on market manipulation and other unfair trading practices**. The group started work in early 2006, and has been entrusted with the task of comparing Swiss regulations on market abuse with regulations of other financial centers and assessing possible adjustments to the Swiss regime.

[6] The mission recognized, however, that the authorities were opposed to this view, on the grounds that these dealers did not constitute a threat to financial stability and did not raise any investor protection concerns.

More generally, the group will also consider a new formulation and extension of the scope of these rules to strengthen Swiss regulations.