Banking in the crosshairs: Investigations by financial regulators and competition authorities in the banking industry – Libor, Forex, what next?

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Benjamin Dürig

FRORIEP
Bellerivestrasse 201,
8034 Zurich, Switzerland
+41 386 60 00
bduerig@froriep.ch

Benjamin Dürig, FRORIEP, Zurich, Switzerland

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Certain episodes of benchmark manipulation (Libor, Forex, etc) have generated global doubt and concern with regards to the integrity of many benchmarks, undermining the integrity of the system and legal and commercial certainty, and resulting in major losses for investors.

1. **Have the authorities from your jurisdiction proposed or adopted any measures to ensure the necessary integrity of the market and of its benchmarks, guaranteeing that they are not distorted by any conflict of interest, that they reflect economic reality and that they are used correctly? (i.e.: measures to better protect investors, reinforce confidence, address unregulated areas, and/or ensure that supervisors are granted adequate powers to fulfil their tasks)**

The short answer is no.

In the aftermath of the Libor and Forex "scandals" in 2012 and 2014 respectively, the Swiss Financial Market Supervisory Authority (FINMA) sanctioned the involved banks and initiated proceedings against some of their employees (see 6 below).

Also, in connection with both these Libor and Forex manipulations, the Swiss Competition Commission (COMCO) initiated investigations against several banks (see 4 below).

Finally, criminal proceedings against several individuals who were involved in these benchmark manipulations were initiated, all of which are still pending (see 6 below).

However, no new "general" measures to ensure the integrity of the market and its benchmarks were proposed by the authorities. It appears that the existing laws and powers of the supervisors, and in particular the display of these powers in connection with the Libor and Forex manipulation cases, are deemed adequate to ensure the integrity of the market and its benchmarks.

This was made clear by FINMA already in 2013 in connection with the revision of its Circular 2008/38 on "Market conduct rules" (now Circular 2013/08), which was revised due to a revision of the Federal Act on Stock Exchanges and Securities Trading (SESTA). The revised Circular now explicitly states that, for the "purpose of assessing the assurance of proper business conduct on the part of the supervised institutions […], the provisions on insider information and market manipulation […] apply not only in respect of securities admitted to trading on Swiss exchanges, but also *mutatis mutandis* in respect of […] trading on markets other than the securities market (e.g. commodity, foreign exchange and interest rate markets), particularly in connection with benchmarks". However, in both its explanatory and consultation reports on the new Circular, FINMA points out that the cited passage of the new Circular has nothing to do with the revised SESTA but is merely a "formulation" of its long-standing practice. In this context, FINMA explicitly refers to its handling of

the Libor case, in which the manipulation of foreign benchmarks was deemed a violation of the proper business conduct requirement (see 5 – 7 below).

Under current law, the foreign exchange market is not specifically regulated in Switzerland. In comparison to trading on stock exchanges, which is regulated by the SESTA, there are hardly any legal or regulatory norms that need to be complied with. This will not change due to the Forex manipulations. The upcoming changes in Swiss financial market law (in particular the Financial Market Infrastructure Act, FMIA, which will probably become effective end of 2015 / beginning of 2016) will create uniform regulation of financial market infrastructures and derivatives trading in line with market developments and international requirements (a case of "voluntary alignment" to EMIR and Dodd Frank, see 10 below). They will not, however, have an impact on "plain" foreign exchange trading.

Finally, it is noteworthy that the relevant penal provisions in Swiss law dealing with market abuse are aimed at securities trading only but are not designed to protect the integrity of benchmarks (see 6 below).

2. Which authority monitors financial bodies in your jurisdiction?

The Swiss Financial Market Supervisory Authority (FINMA).

When it comes to anti-trust aspects, the Swiss Competition Commission (COMCO) is competent to investigate in the financial sector.

3. [For EU and EFTA member states] has your country completed the transposition of Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments (also known as «MiFID II»)? If not, when will transposition be completed?

N/A.

Switzerland is implementing large parts of MiFID II on an autonomous level in the form of "voluntary alignment" (see 10 below) in order to ensure that Swiss financial service providers keep their access to the European financial markets and that Swiss supervisory law is deemed "equivalent" to European law. For this purpose, the afore-mentioned FMIA (see 1 above) and other new financial market laws are being implemented at the same pace as MiFID II and the respective regulations (MiFIR, EMIR etc.).

4. Have the authorities in your jurisdiction conducted any inquiry on leading banks or institutions in relation anti-trust practices with regards to essential financial information and/or the clearing system?

Yes.

The Swiss Competition Commission (COMCO) has been investigating the two biggest (and systemically relevant) banking groups in Switzerland, UBS AG and Credit Suisse Group AG, along with six more banks with regard to the manipulation of foreign exchange rates since March 2014. The investigation is still pending.

The authorities are examining whether the banks colluded to fix foreign exchange rates, e.g. by exchanging confidential information, co-ordinating with others in the market to execute transactions at an agreed price, and attempting to influence the WM/Reuters rates.

Further, in connection with the Libor manipulations, COMCO has been investigating potential unlawful agreements among banks since February 2012 – investigation still pending. The investigation is directed against UBS AG and Credit Suisse Group AG, as well as against more than ten foreign financial institutes and other companies.

5. Which new requirements have been established in order to reinforce governance and oversight and introducing measures sanctioning those responsible for LIBOR and other index manipulation?

Libor

In connection with Libor, UBS AG had voluntarily taken a number of measures aimed at preventing such misconduct in the future. Specifically, UBS AG's procedures for Libor submissions were fundamentally revised, corresponding procedures for Euribor submissions were implemented, an overarching Benchmark Submissions Policy was put into place and various measures such as trainings, oversight and compliance review were adopted.

In connection with the findings of its internal investigations, UBS AG dismissed numerous employees. Other employees had at the time already left the bank, were reprimanded, temporarily suspended and/or had their salary reduced. That measure included managers and staff.

In the order, FINMA admonished UBS AG for severe violation of the organisational as well as the proper business conduct requirements under Swiss financial market laws. Additionally, FINMA imposed various supervisory measures aimed at further strengthening UBS AG's interest reference rate submission processes.

Finally, FINMA ordered UBS AG to disgorge estimated profits resulting from Libor manipulations amounting to CHF 59 million to the Swiss Confederation.

Forex

In connection with Forex, FINMA has demanded UBS AG to:

- strengthen the compliance function as an independent control function;
- limit the utilization of certain communication media and monitoring their utilization ("chats");
- prohibit certain employee transactions ("jamming", "front running", "partial fills", etc.);
- mandate internal audit with various audits particularly with regard to compensation schemes and establishing a report on the findings;
- strengthen the whistleblowing process.

Furthermore, FINMA imposed extensive additional measures to promptly remediate the organizational shortcomings revealed during the proceedings:

- For the entire global foreign exchange and precious metals business, the maximum annual variable compensation was limited to 200 per cent of the basic salary for a period of two years. For other individuals at the investment bank in Switzerland who receive a total remuneration of more than CHF 1 million, a similar rule was imposed (with exceptions possible, if granted at board level);
- UBS AG was obliged to automate at least 95 per cent of its global foreign exchange and precious metals trading, as well as to install effective controls for the remaining voice trading;
- UBS AG has to implement measures that prevent conflicts of interest between client and proprietary trading (in particular separation at an organizational and staff level).

In order to ensure the complete implementation of those measures, FINMA has mandated a third-party investigator.

Finally, FINMA ordered UBS AG to disgorge estimated profits resulting from Forex manipulations amounting to a total of CHF 134 million to the benefit of the Swiss Confederation (which is the highest amount ever confiscated by FINMA).

In order to establish the knowledge and conduct of the individuals involved in the case, FINMA also initiated proceedings against eleven of the bank's former and current employees (which may result in a prohibition from practising a profession in the financial sector, see 6 below).

6. **Has any similar scandal-malpractice affected your jurisdiction? Have penalties been imposed? and/or administrative or criminal sanctions? If not, which sanctions are foreseen in your jurisdiction for this type of misconducts?**

No similar scandal-malpractice has affected Switzerland.

As the relevant penal provisions in Swiss law dealing with market abuse are aimed at securities trading only, they are not applicable with regard to manipulating benchmarks. Although it is possible to construe benchmark manipulations as embezzlement, fraud or, in the case of front running, breach of the banking secret according to the Swiss Penal Code and the Banking Act respectively, to our knowledge there is only one criminal investigation pending with regard to Libor manipulations against a former UBS trader (as a matter of fact, it seems that the investigation has not even been formally opened after more than one year). On the other hand, the Office of the Attorney General of Switzerland has initiated criminal investigations against several individuals involved in the Forex "scandal" in late 2014. These investigations are pending. In case of a condemnation, the defendants would be subject to imprisonment of up to three years or monetary penalties (which depend on the income of the defendant).

The legal basis for FINMA to intervene in the Libor and Forex manipulation cases were the requirements for proper business conduct and adequate organisation which apply on any bank (see 7 below). In this context, the possible sanctions range from orders to restore compliance, over the issuance of a declaratory ruling (which may be published - "naming and shaming") and prohibition from practising a profession in the financial sector for individuals to the confiscation of profits that result from the violation of the supervisory provisions at hand. As *ultima ratio*, FINMA can revoke the licence of a supervised person or entity and, as the case may be, liquidate it. However, FINMA does not have the competence to impose penalties.

It remains to be seen how COMCO will qualify the conduct of the involved banks with regard to Libor and Forex (see 4 above) as COMCO may hand down administrative penalties in the amount of 10 per cent of the turnover achieved in Switzerland in the last three years by the company in question.

7. **How are the potential conflicts of interest affecting banks or other financial institutions addressed in your jurisdiction? Which requirements are adopted to ensure that benchmarks reflect economic reality and that they are used correctly?**

Conflicts of interest are addressed in civil law insofar as a client relation with a service provider in the financial sector is qualified as a mandate which means that the agent has to avoid any conflict of interest due to its obligation of loyalty towards the client. In this context the Federal Supreme Court has ruled in 2012 that all

retrocessions, kickbacks and other third party compensations paid to asset managers have to be handed over to the client unless the client has expressly and knowingly renounced such payments. However, when it comes to benchmark manipulation, there is not necessarily a direct contractual relation between the bank manipulating the benchmark and the investor losing money. Also, it would be quite difficult for an individual to prove its loss due to the manipulation.

Conflicts of interest are further addressed in supervisory law. Since the manipulation of the Libor benchmark and other market manipulation cases, FINMA has made it clear that market manipulation will not be tolerated regardless of whether a regulated or unregulated market is concerned, based on the following grounds:

According to Swiss law, a bank needs to have an organization adequate to its business activities and to permanently fulfil the requirements for proper business conduct. Manipulative market abuse such as insider trading and unilateral exploitation of information to the client's or other market participants' disadvantage or other repeated conduct that breaches the bank's duty to act in the clients' interests is irreconcilable with the requirements for proper business conduct and thus subject to sanctions by FINMA (see 6 above for possible sanctions). This applies in particular for inappropriately influencing closing rates and benchmarks.

A bank needs to be capable of capturing, monitoring and limiting operational and legal risks arising from its business activities. In order to do so, the bank is obliged to have an adequate and effective control system. Professional standards for business conduct must be implemented by internal regulations and adhered to. Banks and their employees have to conduct themselves in a manner that does not compromise the institution, i.e. they should not damage their own reputation, the trust clients have in them or the reputation of the Swiss financial market place. Failing to comply with these obligations is subject to sanctions by FINMA.

8. Are any measures foreseen in your jurisdiction for the protection of "whistleblowers"?

Under Swiss labor law, there is no particular protection of whistleblowers. Whistleblowing employees risk to lose their employment. Even if the termination of their employment agreement is deemed abusive, they will not be re-employed but are only entitled to damages equivalent to up to six months of salary.

Currently, the Federal Parliament is discussing a law with regard to whistleblowing but it does not seem that this is going to massively improve the protection of whistleblowing employees.

However, a lot of large companies, and in particular the bigger banks in Switzerland have their own whistleblowing policies and/or operate whistleblowing hotlines that allow employees to report inappropriate conduct without having to fear repressions.

Considering that FINMA has ordered UBS AG to strengthen the whistleblowing process as a consequence of the Forex manipulation case (see 5 above), the protection of whistleblowers may even be considered as part of an adequate organization of a financial institution under supervisory law.

9. Is there any measure in place in your jurisdiction to guarantee suitable and appropriate evaluation of benchmarks?

There are provisions in various fields of law that may prevent benchmark manipulation, ranging from civil and criminal law to supervisory and competition law (see 6 and 7 above). However, these provisions are not tailor made for benchmark protection but apply on a case by case basis only.

10. Which requirements and/or transparency rules –if any- are undertaken in your jurisdiction in order to prevent distortions of competition resulting from divergences between other national laws and/or to provide more legal certainty for market participants? (i.e. to prevent or limit regulatory complexity and potential regulatory arbitrage)

In Switzerland, which does not participate in the EU, but which is surrounded by EU-member states, the lawmaker has long since learned to closely watch foreign regulatory and legal developments and to adapt its own legislation accordingly in order to grant Swiss companies access to those foreign markets. This practice has been called "voluntary alignment", even if it is not always voluntary.

Transparency is guaranteed as interested circles are consulted by the administration during the lawmaking process, which does not mean that their input is always implemented in the draft law which is then submitted to the parliament and, as the case may be, the people.

Obviously, as the Swiss way is reactive and the directly democratic lawmaking process in Switzerland often takes longer than in other countries, there can be periods of divergences between national and foreign law which are not beneficial to Swiss market participants.

More so, sometimes the Swiss people, by referendum or initiative, voluntarily implement rules that are incompatible with foreign law. This was recently the case when the people adopted the "mass immigration" initiative which aims at restricting the amount of foreigners coming to work in Switzerland and therefore conflicts with the free movement of people treaty between Switzerland and the EU. Negative economic effects are likely to result from such decisions but they have to be accepted and implemented by the Federal Council and the Parliament.