NewsLetter

Information by the Law Firm of Lutz Rechtsanwälte

New Audit Supervision Act: Control over the Controllers

by Thomas Reimann

The new Audit Supervision Act (Revisionsaufsichtsgesetz or RAG for short) came into force on 1 September 2007. From 2008 on, the entire auditing sector including the activities of auditors and auditing companies, will thus be under the supervision of the newly created Audit Supervision Authority (Revisionsaufsichtsbehörde, RAB), which will have considerable influence on the whole auditing sector through its authority for licensing and supervision. An overview.

The globalisation of the economy does not end when it reaches the borders of Switzerland. The massively strengthened corporate governance regime introduced by the Sarbanas Oxley Act in light of the Enron/Worldcom scandals have caused Swiss legislators to create an independent supervision authority for the auditing area, which is recognised also by the USA, for fear that internationally operating Swiss auditing companies will sooner or later be excluded from the US market. Putting the Audit Supervision Act into force together with the creation of the Audit Supervision Authority will eliminate this fear from international relations. Also, the Audit Supervision Act and the Audit Supervision Authority will have considerable influence on the domestic legal practise.

Auditing services with state authorisation only

Whoever wishes to carry out the numerous statutory examination and auditing activities from 1 January 2008 on, will require a state authorisation from the Audit Supervision Authority. In order to cope with the expected rush of an estimated 15,000 requests for authorisation, there is a pragmatic regulation in effect until 31 December 2007. Requests for authorisation which are filed prior to the end of 2007 will be provisionally granted subject to further investigation during the following two years. Those who make the application for permission after 31 December 2007 will not receive any provisional authority and must factor in that their application cannot be reviewed and granted prior to the end of 2008.

Entry into the central register

The Audit Supervision Authority keeps a centralised public register that can be accessed via the Internet, in which all persons and auditing companies authorised to carry out examinations and provide auditing services after 1 January 2008 are registered. An entry in this register shows the level of authority grant-

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ed and thus defines the scope of auditing services the respective auditor is allowed to provide.

Who will be permitted to audit what for whom in the future?

The new audit regime for Swiss companies provides for differentiated audits depending on the size and not the legal structure of the audited company, as was previously the case. The respective changes in corporate law will come into force on 1 January 2008 (see also NewsLetter 02-2007).

Accordingly, the Audit Supervision Act also differentiates between different auditing services, whose provision from 1 January 2008 on will be subject to the authorisation granted by the Audit Supervision Authority:

• The authorisation level of Auditor permits the person or auditing company to provide auditing services within the scope of a so-called Limited Audit (also referred to as review) according to Article 727a and Article 727c Code of Obligations ("CO");

• With the Expert Auditor level of authorisation, all auditing services within the scope of the so-called Regular Audit specification according to Article 727 CO can be carried out as long as the company being audited is not a publicly owned company within the meaning of Article 727 para. 1 CO;

• The examination of publicly owned companies as mentioned in Article 727 para. 1 CO is permitted when granted the authorisation level of State Supervised Auditing Company. This authorisation is the most encompassing and far reaching and therefore entails state supervision.

Impact of the Audit Supervision Act on the auditing sector

The newly introduced authorisation system will lead to an increase in quality in the provision of auditing services. The different authorisation scales will, however, lead to a medium-term decrease in profits for the smaller auditing firms and individual persons operating in the auditing sector. What will affect the decrease the most will be how many firms that have the right pursuant to Article 727a CO to refuse a limited audit (so-called opting-out) will actually exercise this right in the future.

Necessary action for businesses

Audits up until the end of the 2007 business year are carried out in accordance with the old laws and may be carried out by persons without authorisation from the Audit Supervision Authority. For standalone, i.e. non-recurring examination procedures (e.g. examination of capital increase reports, capital decreases, liquidation proceedings, mergers and others) the situation is different, however. These examinations may only be carried out by those persons with authorisation from the Audit Supervision Authority as of 1 January 2008.

For all companies founded prior to 1 January 2008, the audit provisions in the articles of incorporation must be examined and brought in line with the new audit framework. All of these companies may avail themselves of a changeover period of two years. All new companies set up after 1 January 2008 must comply with the new auditing provisions at the outset. ■

by Dr. Peter Lutz

Accession to the Hague Trust Convention: Revaluation of Switzerland's Attraction for Trusts

The Hague Trust Convention came into force in Switzerland on 1 July 2007. It ensures that the legal status of trusts is recognised in Switzerland. The uncertainties present up until now were dealt with and useful foundations for the growing trust business in Switzerland were created.

Institution of the trust

Trusts are particularly common in states with Anglo-Saxon legal tradition. The term describes a legal relationship in which certain assets are transferred on a fiduciary basis to one or more trustees, who manage these assets and use them for a purpose determined in advance by the settlor (the person giving the assets in trust). The trust assets form a legally independent special fund. Often, a protector is named alongside the trustee who has further powers and duties, in particular supervisory duties, in relation to the trust. The protector is not the owner of the trust assets. The ownership rights are divided into the legal ownership of the trustee and the equitable ownership of the beneficiary – a strange concept from a continental lawyer's perspective. This means that although the trustee is the owner of the funds under civil law aspects, he must always strictly act in the interest of the beneficiary.

The purpose of a trust can be general (purpose trust) or for the benefit of the beneficiary (private trust). In the trust charter, the settlor often provides for exact instructions on how the trust assets should be managed and used. According to the different types of benefits, trusts can be separated further into fixed interest trusts, in which the benefits are determined beforehand, or discretionary trusts, in which the trustee has great discretion in regard to the management and the benefits provided to the beneficiaries. Should the trustee infringe the conditions of the trust charter or the legally imposed duties, a breach of trust for which the Trustee stands liable results.

Situation in Switzerland

There are many assets that belong to trusts or are managed in the name of trusts in Switzerland. Although the idea of the trust was already widely recognised under the old Swiss law, the legal situation that existed was encumbered with some uncertainties.

Effects of the ratification in Switzerland

Switzerland ratified the Hague Trust Convention on 1 July 2007. At the same time, the corresponding amendments to the Private International Law Act (PILA) and the Swiss Debt Enforcement and Bankruptcy Act (DEBA) came into force. The PILA was amended to include regulations on the jurisdiction of Swiss courts and recognition of foreign decisions. The DEBA newly sets out that in cases of bankruptcy of the trustee the trust assets – net of any claims the trustee itself may have – are segregated from the bankrupt estate and thus not available to the bankrupt trustee's creditors. Also, the provisions regulating the enforcement procedure against the trust assets have been amended.

The above overview can be expanded with reference to a number of selected provisions in the convention:

- The convention applies only to trusts evidenced in writing (Article 3).
- The trust is governed by the law chosen by the settlor (Article 6 para. 1).
- The trustee may sue and be sued in its capacity as trustee, and he or she may appear or act in this capacity before a notary or any person acting in an official capacity (Article 11 para. 2).
- The trust assets shall not form part of the trustee's estate upon his or her bankruptcy; the trust assets shall not form part of the matrimonial property of the trustee or his or her spouse nor part of the trustee's estate upon its death; the trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with his or her own property or has alienated trust assets (Article 11 para. 3).

Conclusion

The ratification of the Hague Trust Convention provides legal certainty for the growing trust industry in Switzerland. It is advisable to seek competent advice when setting up and managing a trust, however, as private law as well as international and taxation law must carefully be considered. ■

FINMAG – A New Focus in the Swiss Financial Market Supervision

by Dr. Sabine Kilgus

In the summer of 2007, the Swiss Federal Parliament enacted the Swiss Federal Act regarding Financial Market Supervision (FINMAG), which is intended to entirely reorganize the financial market supervision. The new legislation will come into force as of 1 January 2009.

The FINMAG does not replace previous laws. The banking, stock market, capital investment, mortgage bond, anti-money laundering, and insurance supervision acts and their respective implementation provisions (ordinances as well as further regulations) will remain in force. The FINMAG is rather a new, additional statute and will govern the overall objectives of the supervision, the organization of the supervisory authority, and the sanctions available to it. This is a new and, for the first time in Switzerland, common law binding for all financial intermediaries.

Objectives of the Regulation

Article 5 FINMAG specifies the supervision objectives as follows:

"As required by the respective financial market statutes, the objective of the financial market supervision is to protect the creditors, the investors, and the insured, as well as to ensure the efficiency and effectiveness of the financial markets. It contributes therewith to the strengthening of the reputation and competitiveness of the financial market Switzerland."

The protection of creditors and investors are traditional regulatory purposes of any financial market regulation. What is new in Article 5 FINMAG is the explicit mentioning of the protection of the financial system and the reputation of the financial market. The latter is an essential element for the international standing of the Swiss financial market. Also for the first time a supervisory statute now states that the competitiveness of the financial market Switzerland must be saveguarded.

These fundamental premises are spelled out in specific terms in the instruction to the new supervisory authority, the FINMA, in its capacity to promulgate regulation in Article 7 para. 2 FINMAG:

"It [meaning the FINMA] promulgates regulation only to the extent necessary to achieve its supervisory objectives. It especially considers:

a. the costs arising for those supervised by regulation;

b. the impact of regulation in the market, for the innovation capability and the international competitiveness of the financial market Switzerland;

c. the different business activities and risk exposures of those supervised; and

d. the international minimum standards."

In paragraphs 3 and 4, Article 7 then advocates implementation of self-regulation by the market participants and of transparency.

By being included into the FINMAG, these cornerstones regarding the objective and the means of regulation in the financial markets will become a guideline for all executory decisions under the FINMAG as well as for any further regulation projects concerning the financial markets.

Organization

The FINMA (Financial Market Supervisory Authority) will be the supervisory authority for all financial intermediaries. The presently separate regulating authorities for banks, insurance companies, vehicles of collective investments and "other" financial intermediaries will be "merged" or integrated under the FINMA "holding structure" and operated as departments under that umbrella. However, the FINMA is not going to be a Federal agency but – modeled after the British FSA (Financial Services Authority) – will become an independent legal entity set up outside the federal administration in the legal form of an incorporated public-law corporation. Just as the Eidgenössische Bankenkommission (Federal Banking Commission; EBK) today, this new entity will only be accountable to Parliament.

The FINMA is to be governed by a board of directors elected by the Swiss Federal Council. The daily business, however, is placed in the hands of an executive management. The FINMA is designed to be financed by the regulatory

fees paid by the financial intermediaries and not through the federal budget – something already the case for the three supervisory agencies today. This should enhance the autonomy and flexibility of the FINMA, both with respect to the Federal Government as well as vis-à-vis the market participants.

Reform of sanctions

Compared to the present provisions, the range of sanctions in the new FINMAG will be broader; the sanctions can be more severe but also more differentiated. In any case, they have a more clearly defined legal basis and are equally applicable to all supervised entities. Considering the present situation, the new statute will have a positive impact on the foreseeability and the sustainability of regulation and lead to equal treatment of all market players.

In particular, the FINMA will be entitled to explicitly impose the following measures:

• to confiscate profits that stem from transactions which have been declared illegal or that violate proper business standards;

• to disclose the sanctions imposed and the names (persons and intermediaries) of those involved; and

• to prohibit individuals at fault to work in the top management or to serve on the board of a financial intermediary.

In addition, there are the more technical provisions on the authority of FINMA to publicize the initiation of an investigation, to restore a situation to its proper state, and to issue a declaratory decree. Last but not least, the employment of an independent investigator and the revocation of the business license of a financial intermediary remain sanctions also under the new law.

Outlook

It remains to be seen whether and to what extent the FINMAG will effectively lead to a clarification of previously unclear goals and aims of financial market supervision as is expected today. Whether combining all previous supervisory agencies under the roof of a holding structure is going to result in the desired increase in efficiency is largely an open question. The clarification of the sanctions that are given to the supervisory authority will be a clear advantage of the new law. It then cannot longer be the case that controversial but important decisions are taken without explicit statutory basis. ■

"Can we, just for a moment, Your Honor, ignore the facts?"

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