

Asset Management Breakfast The Future of Asset Management in Switzerland

2013

Grand Hotel Kempinski, Geneva

Audit.Tax.Consulting.Corporate Finance.



Agenda

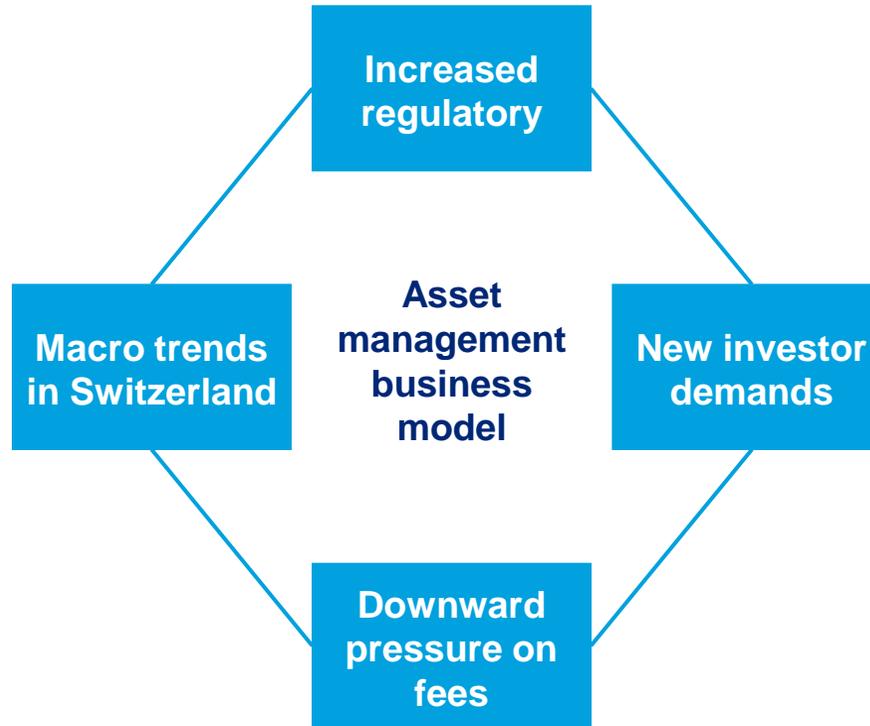
Topic	Speaker	Timing
Introduction	Andreas Timpert	8.30 am
Regulatory Update	Marc Raggenbass	8.40 am
Investor Survey – Results	Stefanie Eliasson	9.15 am
Successful Business Models	Andreas Timpert	9.30 am
Q&A	Andreas Timpert, Marc Raggenbass	9.45 am

Introduction

Market challenges

Compliance with new regulations results in increased capital requirements and subsequently in a higher cost base

Long-term ambition to strengthen Switzerland as a global asset management hub.
Impact of shift in tax transparency and market push of global players



Investors expect a greater link to performance in fee structure and a focus on value for money

Revenue pressure from investors and competition combined with cost pressure from regulatory demands

Regulatory Update

Reforming OTC derivative markets

Global response: same aims but differences in approach

“All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements.” (G-20 Leaders, September 2009)

US

The US is the most advanced in legislating and implementing OTC reforms under the **Dodd Frank Act Title VII**. Reporting requirements have been applicable since 31 December 2012; clearing requirements will be phased in from Q1 2013.

The extra-territoriality implications are still unknown but will have a large impact on foreign banks. For example, as a registered swap dealer a foreign bank's global business may be in scope of the CFTC rules.

EU

The European Market Infrastructure Regulation (EMIR) will provide the framework for mandatory clearing, reporting and bilateral margining for OTC derivatives. The requirements will need to be implemented throughout 2013/15.

Mandatory trading requirements (EU equivalent to US swap execution facility (SEF)) are on a much slower timescale. These will be implemented through changes to the Markets in Financial Instruments Directive (MiFID) in Q4 2015.

Asia

Asia is making some progress towards implementation, although at a slower pace than the US and EU. Reform in Japan is most advanced, with Hong Kong and Singapore at earlier stages of the legislative process. Differences are emerging. Unlike the US and the EU approaches, all three jurisdictions have stated a preference towards using local infrastructure, such as domestic CCPs.

Switzerland

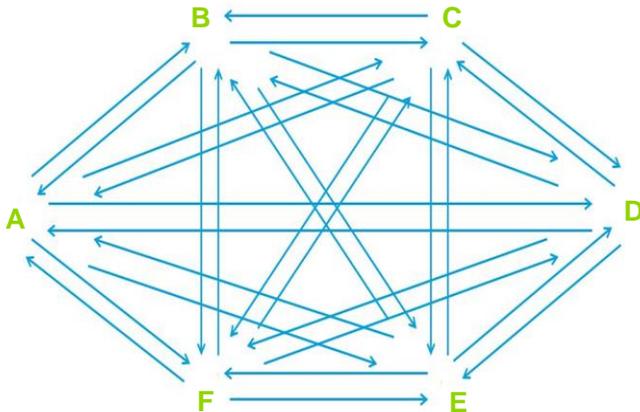
Switzerland already requires dealers to report information on derivatives. This legislation does not cover the entire scope of the G20 commitments and Switzerland is planning to publish legislation on OTC derivative reform for consultation in Q2 2013.

Addressing interconnectedness in OTC derivative markets

Mandatory clearing is a key regulatory response

Problem

In the **bilateral model** each market participant has a legal relationship with, and separate (gross) exposure to each of the other participants, creating a tangled web of exposures



Weaknesses exhibited during the crisis

Counterparty credit risk

Possible systemic implications that a default or fear of a default can have due to the interconnected web of market participants

Lack of transparency

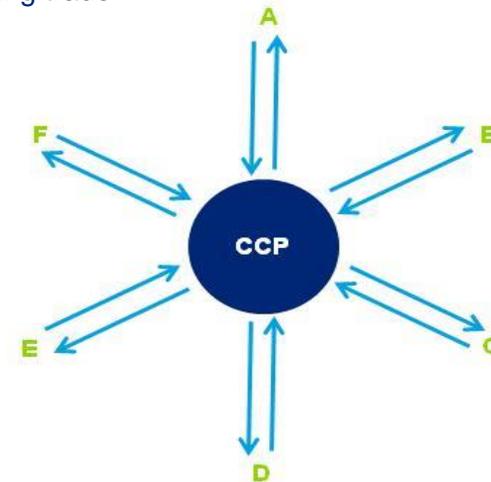
Regulators did not have sufficient oversight of global positions to detect the accumulation of pockets of risk within the financial system

Weak risk management

especially for bespoke transactions, led to realised losses in times of market stress

Solution

In the **CCP model**, each market participant has a legal relationship with and (gross) exposure to the CCP only, regardless of the identity of their counterparty in the underlying trade



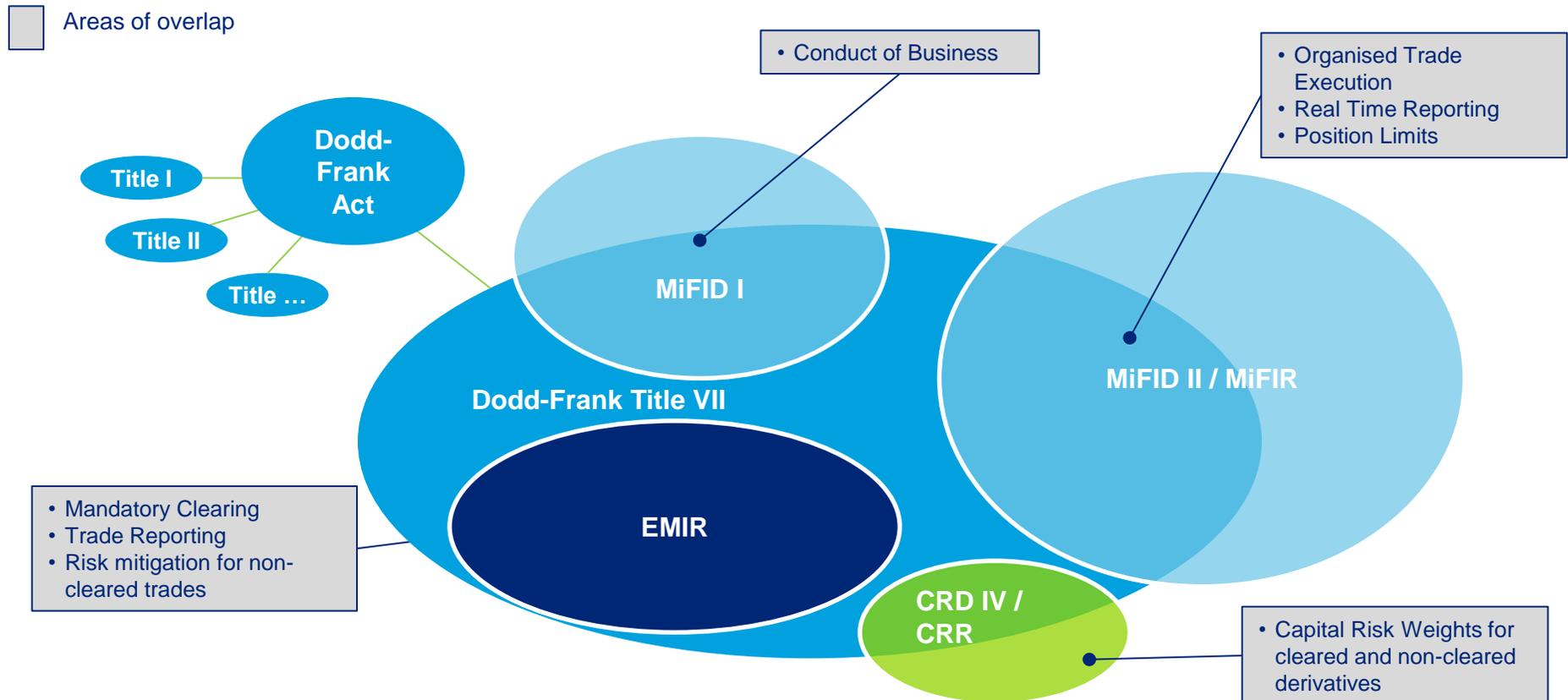
Regulatory response

- All standardised derivatives should be centrally cleared
- Non centrally cleared derivatives should be bilaterally collateralised and subject to higher capital requirements
- All OTC derivatives should be reported to a trade repository
- All standardised and sufficiently liquid OTC derivatives should be traded on an exchange or electronic trading platform

OTC derivative market reform in the US and EU

How Dodd-Frank Title VII translates into EU regulation

US and European regulation to reform to OTC derivative markets is similar in overall intent. In the EU, EMIR provides the framework for implementing the bulk of the G-20 commitments and will be complemented by changes in MiFID II and in the Capital Requirements Directive (CRD IV). Dodd-Frank Title VII covers all three of these initiatives. Whilst the overall framework is similar there are some differences in the detail of the requirements.



European Market Infrastructure Regulation (EMIR)

Overview

- EMIR introduces sweeping requirements aimed at reducing counterparty risk, improving transparency and mitigating systemic risk. The requirements will, in some shape or form, affect all participants in OTC derivative markets
- The scope is far reaching and covers the five main asset classes: interest rate, credit, foreign exchange (FX), commodity and equity derivatives
- Some relief from the clearing and margining requirements has been granted to non-financial firms, pension funds and intra-group transactions, although strict conditions apply
- All financial counterparties that transact in OTC derivatives will be affected in some shape or form

The four main pillars of EMIR

All standardised OTC derivatives will be cleared through central counterparties (CCPs)

Harmonised framework for the provision of clearing services within Europe

Non-cleared derivatives will be subject to strengthened risk management requirements, including the need to collateralise positions

All OTC and exchange traded derivatives will be reported to trade repositories (TRs)

The legislative process to date has been long but the end is in sight and compliance dates are looming. Whilst the detail on the shape and form that margins for non-cleared trades will take is still unclear, firms now have sufficient clarity on the rest of the requirements to be actively stepping up their implementation plans, leveraging efforts with other regulatory change programmes where possible

Swiss financial markets infrastructure regulation

The Swiss Federal Government decided in August 2012 to improve the regulation regarding OTC derivatives trading and financial market infrastructure. It will present a draft consultation paper by June 2013.

Current status

- Use of standardised derivative products is increasing in Switzerland.
- Legislative / regulatory steps for central clearing of standardised derivative products are in process.
- Legislative / regulatory steps requiring that all or any subset of standardised derivatives to be traded on a exchange or electronic trading platform are in process (however, see Art. 5 para. 2 Stock Exchange Act).
- Legislative / regulatory steps requiring reporting to trade repositories are in process (however, see Art. 15 para. 2 Stock Exchange Act for securities dealers).

Financial counterparties

- To safeguard the competitiveness of the Swiss financial market place, and to improve financial stability, Switzerland should implement the G20 requirements and the FSB recommendations.
- In ensure competitiveness of Swiss financial institutions and market access to the EU, Swiss regulations should be equivalent to the EU requirements.
- Swiss financial counterparties should be able to clear transactions through Swiss CCP and fulfil their reporting obligations through Swiss trade repositories.

Non-financial counterparties

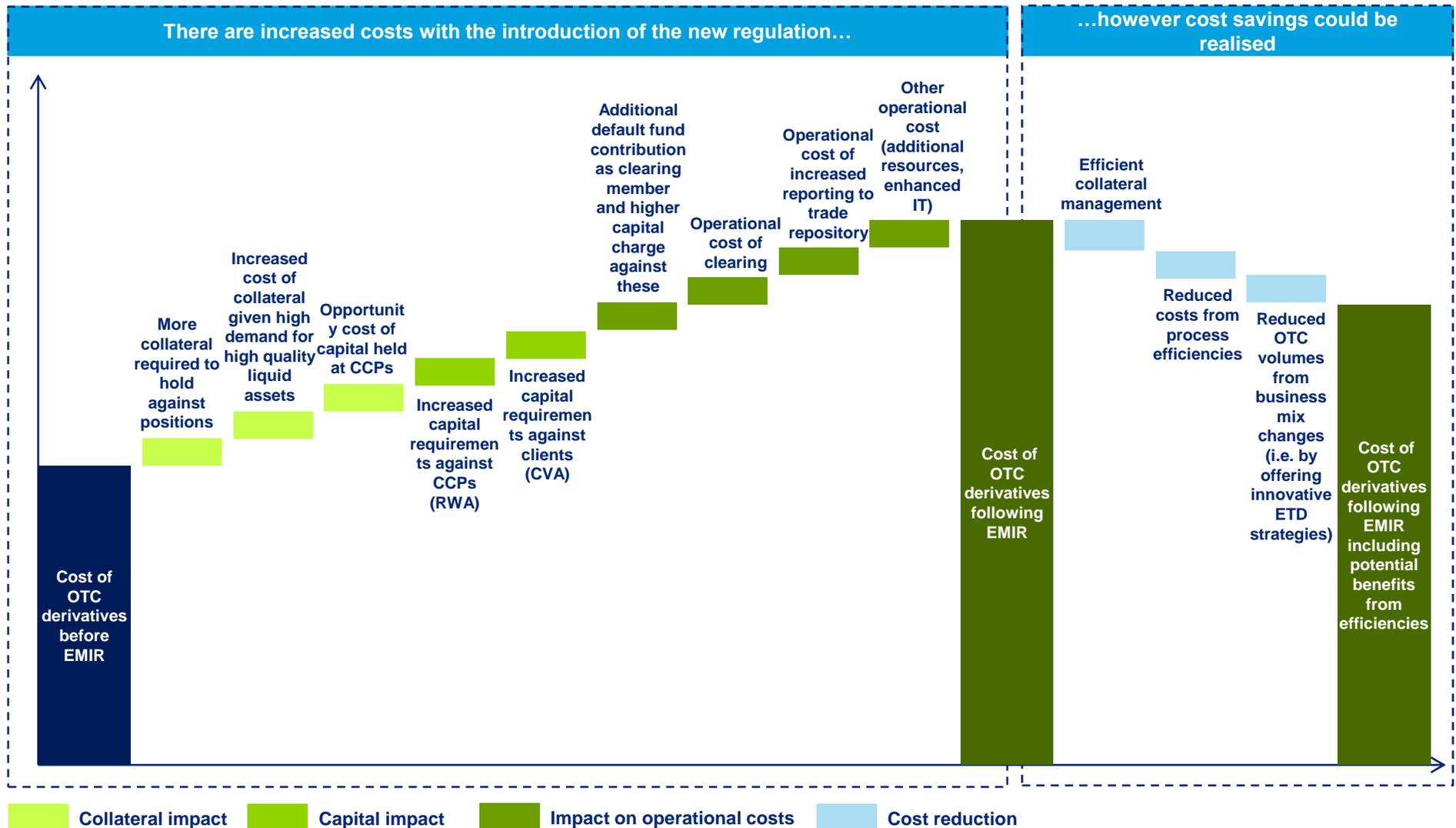
- According to several business associations and economic organisations, the impact the new regulations might have on non-financial counterparties will remain remote.
- Due to the high clearing thresholds, only the biggest Swiss companies (probably less than 10) may fall under the clearing obligations.

EMIR: Hot Topics

Greater clarity from the regulation highlights a number of challenges

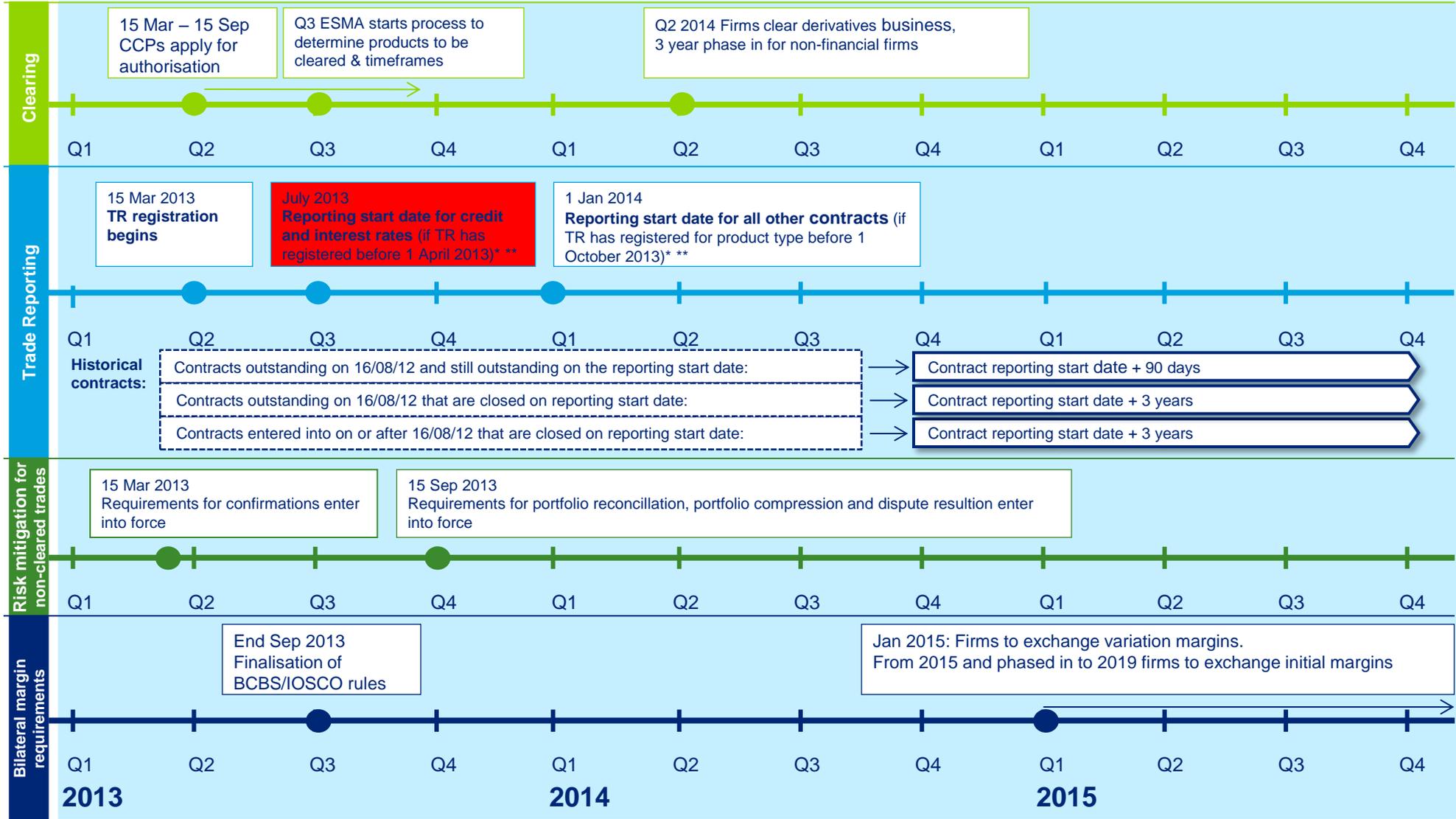
Segregation	<ul style="list-style-type: none">▪ Firms providing client clearing will need to make significant operational changes to support the offering of individually segregated accounts both for clients and indirect clients
Trade Reporting	<ul style="list-style-type: none">▪ The reporting requirements introduce significant challenges for firms and in some aspects are more onerous than those envisaged under Dodd-Frank. Differences include the timing for reporting, the scope of assets covered and the data captured. In many instances the EU requirements are more burdensome
Confirmations	<ul style="list-style-type: none">▪ The confirmation requirements are seen as particularly challenging from an operational perspective and currently the subject of much industry debate
Intra-group Transactions	<ul style="list-style-type: none">▪ Firms who back-to-back trades across different regulatory regimes will face operational challenges. Exemptions are linked to the issue of third country equivalence and subject to uncertainty. Intra-group transactions are subject to reporting and operational risk requirements regardless of whether exemptions apply elsewhere
Collateral Management	<ul style="list-style-type: none">▪ There will be a significant increase in the demand for high quality and highly liquid collateral. Collateral demands at the transaction level coupled with stringent limits on its reuse will lead firms to consider collateral optimisation strategies
Client On-boarding	<ul style="list-style-type: none">• The introduction of bilateral margining with lead firms to review existing credit support annexes and amend as appropriate. In addition firms transacting with non-financial counterparties will need to consider how this will be monitored and what this means in practical terms
Extra-Territoriality	<ul style="list-style-type: none">▪ How EMIR interacts with Dodd-Frank and other regimes is the big unanswered question. The risk is that the same transaction will be subject to duplicative and costly requirements

EMIR: Significant financial impacts & operational challenges



EMIR: Timeline

Implementation throughout 2013/2014/2015

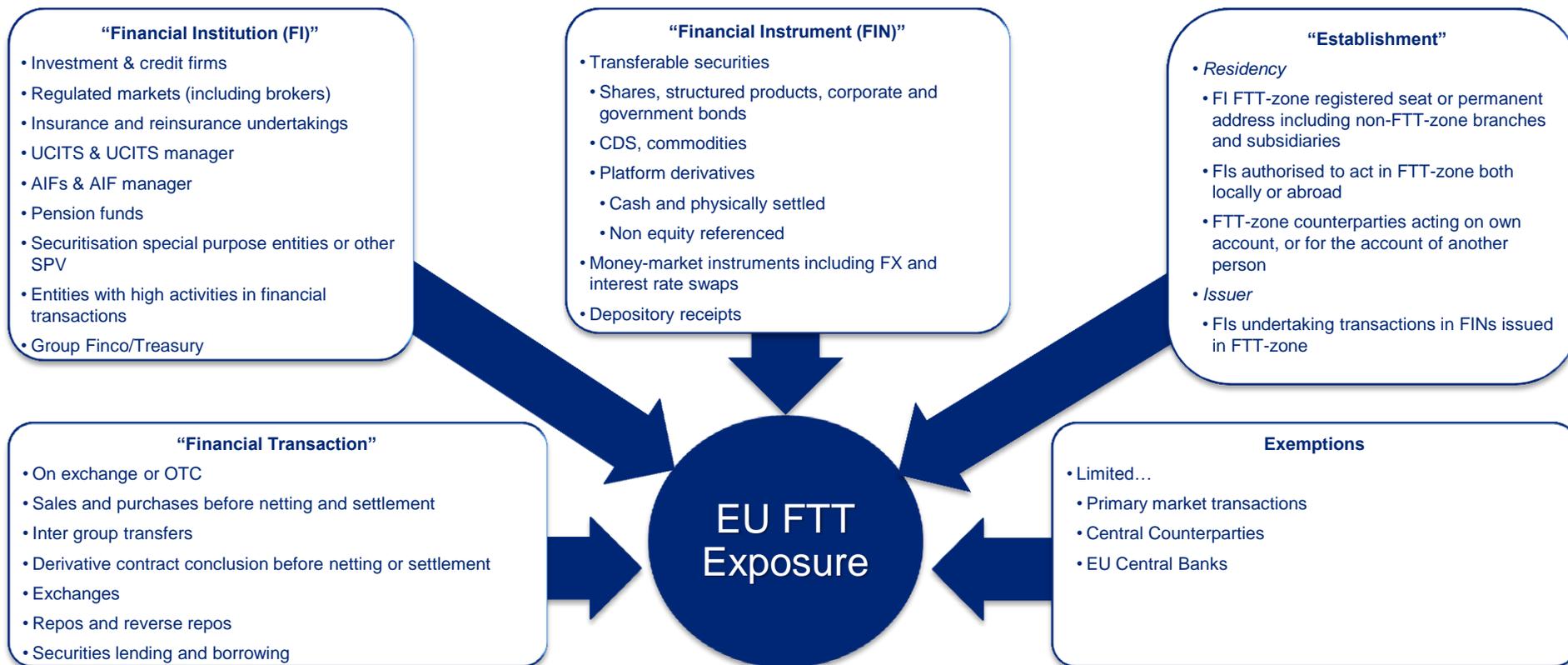


*Where a TR registers after 1 April 2013 (credit and interest rates) or 1 October 2013 (other contracts) firms must start reporting within 90 days of the date of registration. If there is no TR registered by 1 July 2015 reports must be sent to ESMA **Information on collateral must be reported 180 days later

The EU FTT

Overview and scope

The FTT proposal was published on 14 February 2013 and the intended implementation date is January 2014. Only 11 Member States (MS)* are participating - under “enhanced cooperation”**. The tax covers “financial transactions” carried out by “financial institutions” on “financial instruments” “established” in the FTT-zone. The minimum proposed tax rate is 0.01% for derivative products and 0.1% for other financial instruments. Under current proposals, it will be for participating MS to decide how tax revenues should be used; they could flow directly into the EU budget, reducing contributions of participating MS



* France, Germany, Belgium, Austria, Slovenia, Portugal, Greece, Slovakia, Italy, Spain and Estonia

** When a group of at least nine MS decide to move ahead with an initiative, once it proves impossible to reach unanimous agreement on it within a reasonable time frame

Regulatory update

Asset Management specific impacts

EMIR

The OTC derivatives market is facing considerable changes not only in Europe but across the world, as new regulations are introduced to tackle the fallout from the financial crisis.

- The cost of compliance with EMIR is likely to impact investment performance
- Effective collateral management will be critical to fund performance
- Managers may need to consider the impact of EMIR on their business model as well as on their operations and procedures
- Managers may need to establish connections with the most appropriate CCP for their business in terms of margining levels and fees

Financial Transaction Tax

The introduction of an EU-wide financial transactions tax is likely to have a significant impact on fund industry performance and attractiveness, where fund's domicile will clearly become a key differentiator.

- The base of the tax is extremely broad, covering transactions carried out by Financial Institutions on the vast majority of Financial Instruments once the existence of an economic link to the FTT zone has been established
- The domicile of the investment funds will potentially become one of the key drivers to be carefully considered by the fund promoters
- Fund promoters and asset managers must follow the developments in relation to the EU FTT closely, as the current proposal is likely to impact the performance and attractiveness of their fund products

Regulatory update

Markets in Financial Instruments Directive (Swiss Impact)

Switzerland and the Markets in Financial Instruments Directive (MiFID)

MiFID II is not only about compliance but it is about strategy as well. For **asset managers** and **investment advisors**, the new EU regulation will have a major strategic impact; it will as well bring new market opportunities and competitive advantages.

- For the last few years, several new legal and regulatory requirements have been implemented in the EU and its member states (MIFID I, AIFMD, UCITS, EMIR) and additional rules are in the legislative pipeline (MiFID II, PRIPS).
- Swiss Financial Institutions are not within the scope of EU regulations. However, they are indirectly impacted in so far as they provide cross-border services to clients living in an EU member state (Lugano Convention, Rome I Ordinance, Local Requirements). The coordination of EU law with Swiss requirements becomes more and more difficult.
- Client protection for retail clients has been massively increased with the EU. The Swiss parliament has and is going to implement adequate client protection rules as well. FINMA is of the opinion that further improvements are necessary (FINMA position paper).
- To have access to the EU market, Swiss standards must be compatible with EU requirements: System of equivalence: (regulatory arbitrage is becoming a serious reputational risk factor for Switzerland).
- Missing client protection may lead to additional legal, compliance and reputational risks for financial institutions. On the other hand, further rules mean additional costs and in some cases competitive disadvantages.

Regulatory update

Markets in Financial Instruments Directive (MiFID II)

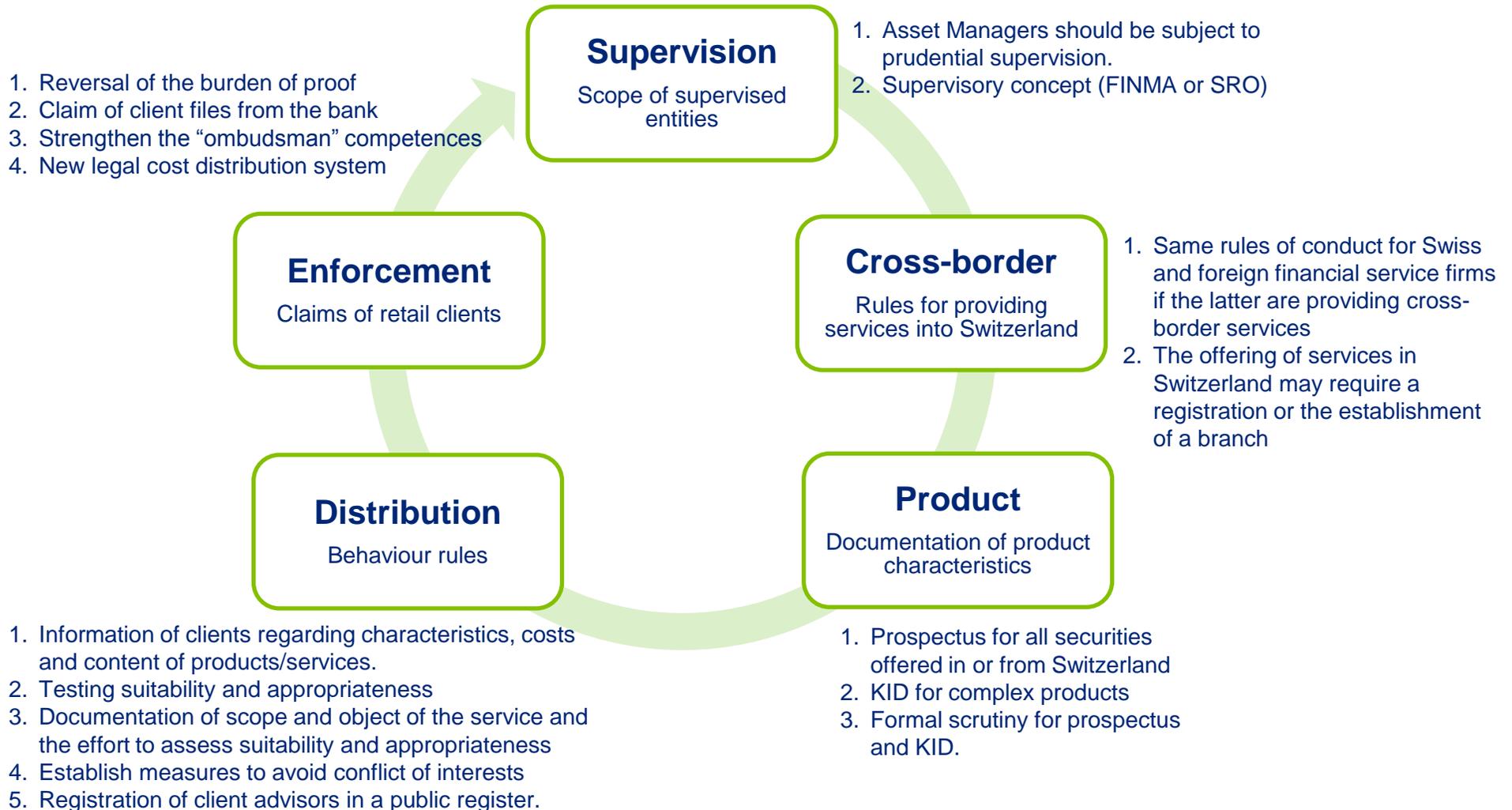
Current state of play:

- 26 October 2012: EU Parliament voted on its amendments to the EU Commission's proposal. It did however not vote on the EU MiFID II draft but referred it to its Committee on Economic and Monetary Affairs.
 - Investor protection and conflict of interest: Whoever designs a financial product to be sold to retail and/or professional clients must ensure that these products are suitable to a defined category of clients
 - Incentives: Firms selling investment products should not provide incentives which may result in an employee breaking conflict of interest rules.
 - Third-country firms – rule of equivalence: The new regime should provide for a comparable level of protection to individuals in the EU receiving financial services from a third-country firm.
 - Inducements: Stricter disclosure requirements but no ban of inducements.
- Draft MiFID II proposal passed to EU counsel: EU Counsel has not yet reached general approval:
 - 15 April 2013: Latest EU Council compromise proposal.
 - A larger group of EU Member States favor the Presidency compromise which imposes stricter disclosure requirements on firms receiving inducements. A smaller group of Member States remain committed to introducing a general ban on inducements.
 - Several Member States have strong reservations regarding the Commission proposal introducing a third country regime. They are of the opinion that the introduction of a third country regime is unnecessary and disproportionate and would prefer to keep national rules by deleting the equivalence decision for the provision of services by third country firms and the possibility for third country firms to passport into other Member States.
- Triparty discussions in the second half of 2013.
- MiFID II in force not before the end of 2015.

Regulatory update

The Swiss reaction – Financial Service Act (FFSA)

Key thrusts of potential regulation: 18 February 2013



Regulatory update

Cross-border financial services

Currently (under MiFID I), the regime applied to third country firms is at the discretion of national regulators, which means that the impact on firms will vary by country depending on the current arrangements implemented.

The EU commission plans the following according the draft MiFID II:

- Introduction of a **harmonised approach** across Europe to the treatment of third country firms.
- This includes the requirement that any third country firms actively providing financial services to **retail clients or opting up professional clients (vs. per se) need to establish a branch.**
- Third countries firms will only be able to use this route if their home country supervision has been deemed **equivalent to MIFID II.**
- ESMA will carry out the equivalence assessment and will maintain a **central list of the relevant countries.**
- The branch would need to comply with **specific requirements**, such as conduct of business and conflicts of interest rules.
- Third country firms could continue to provide services to **eligible counterparties**, provided they are supervised in their own countries and are registered with ESMA.

Regulatory update

Suitability and appropriateness

Services	Suitability test	Appropriateness test
Investment advisor	Required	Not applicable
Portfolio manager	Required	Not applicable
Others (e.g. "Execution Only" for complex products)	Not applicable	Required
"Execution only" for not complex products	Not applicable	Not applicable
<ul style="list-style-type: none"> No credit/ loans through service provider 	New	 <ul style="list-style-type: none"> Shares of enterprises, if listed at a regulated, MTF or equivalent market (exceptions: non UCITS shares and into derivatives embedded shares). Bonds and guaranteed depth securities, if listed at a regulated, MTF or equivalent market (exceptions: titles which are embedded into derivatives or structures which are difficult to understand by clients). Money market instruments (exceptions: titles which are embedded into derivatives or structures which are difficult to understand by clients). Shares and holdings of UCITS shares (exception: structured UCITS, i.e., UCITS which target to generate algorithm based returns on predefined terms, which are linked to the performance, price or any other characteristic of the underlying security, indices or reference portfolio, or UCITS with similar characteristics (article 36 of EU directive for investment funds).
<ul style="list-style-type: none"> No complex products 	New	
<ul style="list-style-type: none"> Services initiated by client 	As before	
<ul style="list-style-type: none"> Client is informed about missing suitability and appropriateness test 	As before	
<ul style="list-style-type: none"> No conflict of interest 	As before	

Regulatory update

Cross-border services / dos and don'ts

Action	Dos	Don'ts
Credit services	<ul style="list-style-type: none"> Continuation of a business relationship Initiative started by client 	Focused, repetitive offering of credit services
Client visits	<ul style="list-style-type: none"> Deepen existing business relationship Socializing 	Targeting potential new clients
Mails, phone calls, faxes etc.	<ul style="list-style-type: none"> Periodic client information services based on existing relationship Client is asking for information 	<ul style="list-style-type: none"> Direct mailing without previous relationship Cold calls Mass mailings
Marketing	<ul style="list-style-type: none"> General information about the financial institution No host country specific information 	<ul style="list-style-type: none"> Information about specific products and services Information including country specific details
Services by financial intermediary	<ul style="list-style-type: none"> Contact by financial intermediary is based on random occasions 	<ul style="list-style-type: none"> Financial intermediary is a part of the financial institution's distribution channel

Regulatory update

Cross-border services / dos and don'ts

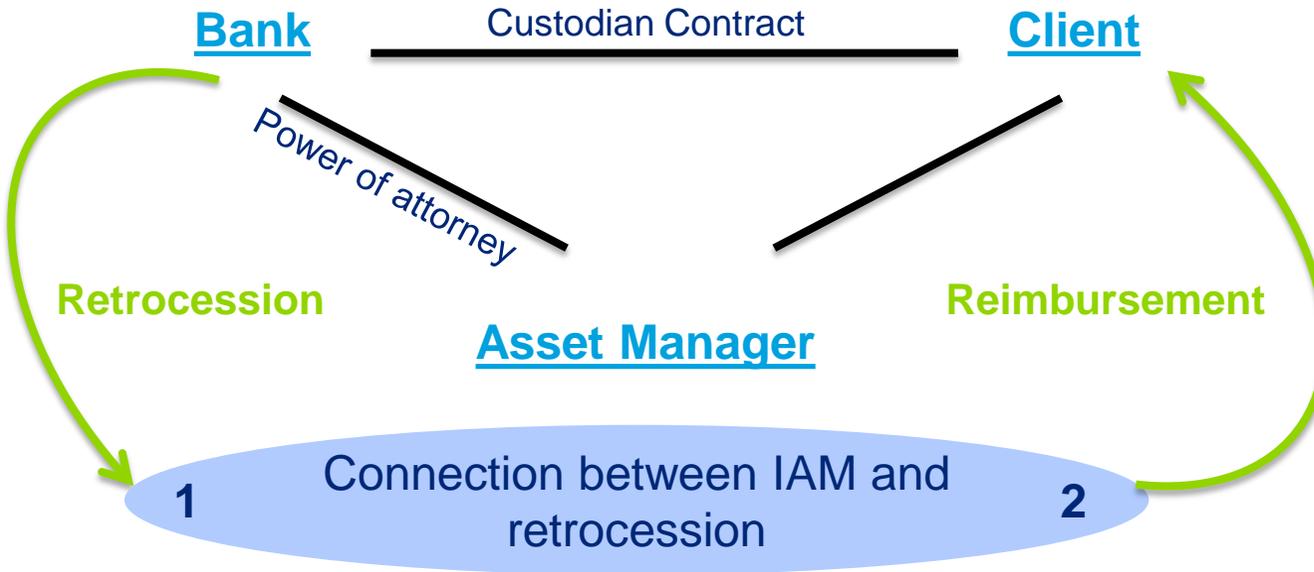
Action	Dos	Don'ts
Internet	<ul style="list-style-type: none">▪ Information is limited to general information▪ To include email address▪ To allow access to general webpage	<ul style="list-style-type: none">▪ Country specific domain name▪ Location plan starting including home country map▪ References of clients with residence / legal seat abroad▪ Using foreign currency▪ Information in local language▪ Providing tax advise

Regulatory update

Retrocessions

Triangle relationship Bank / Client / Asset Manager

BGE 137 III 393
BGE 132 III 460



Discretionary AM Contract

- Duties
 - Duty of loyalty
 - Duty of diligence
 - Duty of disclosure
 - Duty of reimbursement
- Legal Basis
 - Art. 392 Swiss Code of Obligations
 - Art. 11 SESTA

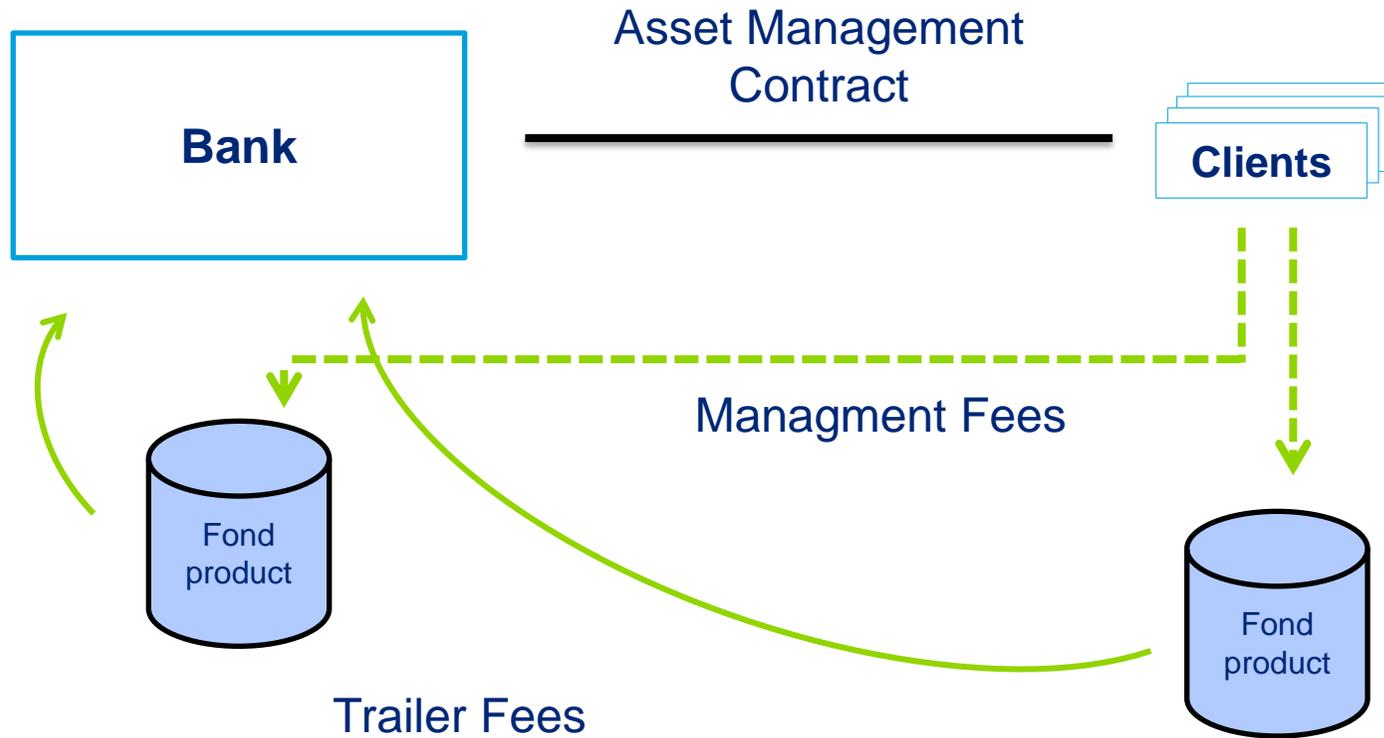
Retrocessions are payments from the custodian bank to the asset manager, which the bank received from its customers in the form of commissions (1). The purpose of such payments is to reimburse the asset manager for certain administrative actions under the contract between the custodian bank and the asset manager (2).

Regulatory update

Retrocessions

Management Fees / Trailer Fees

BGE 4A_127/2012
30 October 2012



Investor Survey – Results

Survey approach and key statistics

Identified themes

1 Complexity of products

2 Product pushing

3 Trust-gap

4 Investor behaviour

Research

Formal Retail Survey

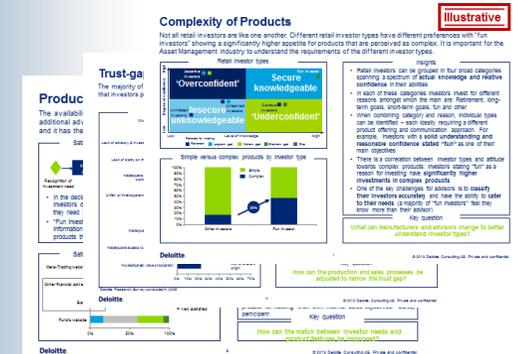
- Online survey, distributed October, 10th until October, 29th 2012
- 390 respondents to the survey, all residents of Switzerland
- 62% male, 38% female
- Nationalities: 51% CH, 13% D, 8% GB, 28% other

In-depth Interviews

- Follow-up in depth interviews
- Approximately 10% of sample covered
- Picked by random sampling
- 45 minutes each
- Semi-structured interview

Survey results

Illustrative



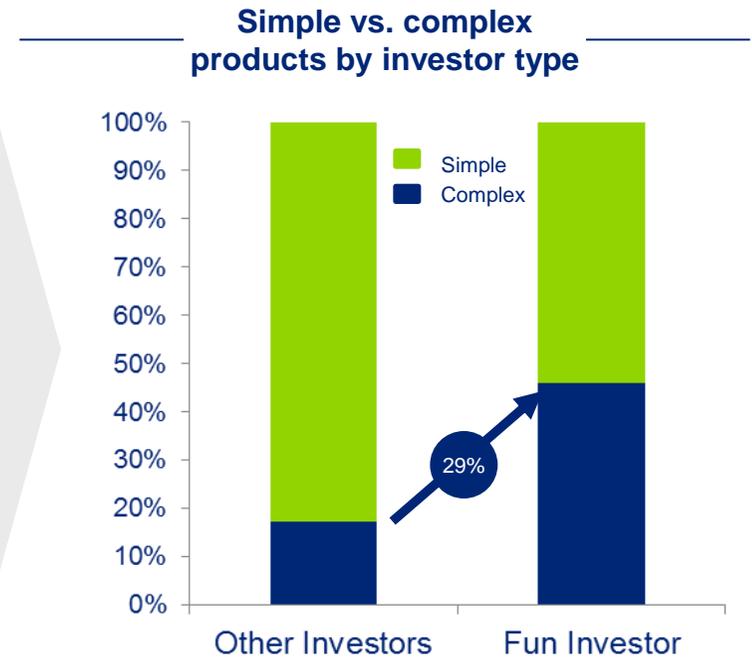
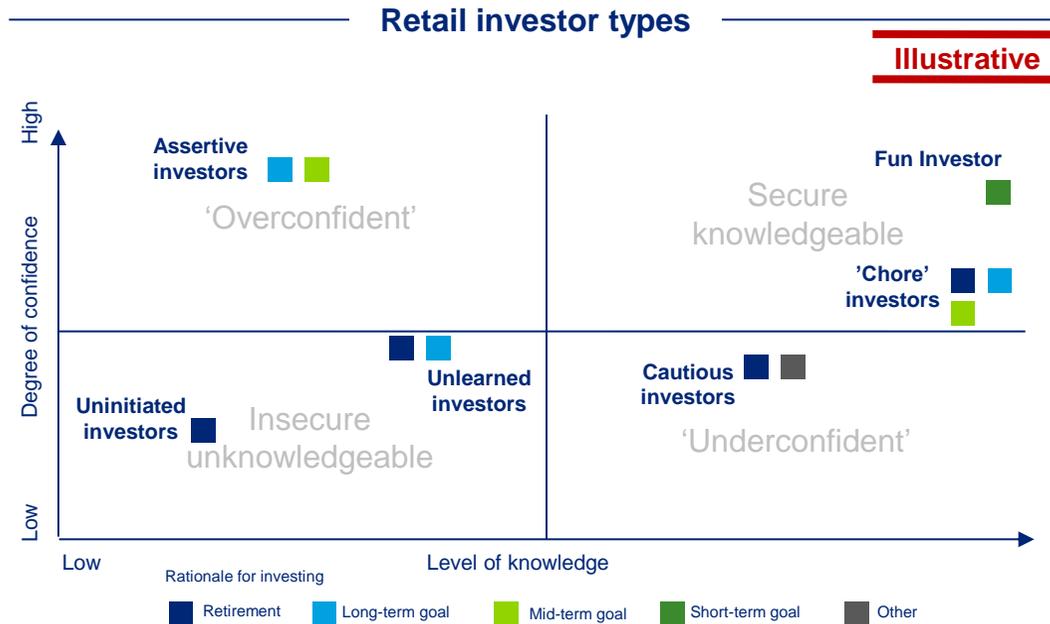
Complexity of products



- Retail investors want simple products and define them **as transparent, predictable, comparable and traceable**
- Investors perceive current products as **"disconnected"** from their needs, wanting more **"control"** and a **"better understanding"** of their investment
- The perceived complexity of products is not mitigated by supporting sales material, such that **only 7% of investors feel confident in using Factsheets, KIDs, or understand the meaning of TERs and PTRs**
- Excluding participants with a background in financial services, **0% of investors feel confident in using supporting sales material**

How can product information be better aligned with investor needs?

Complexity of products



- Different retail **investor types have different preferences** with “fun investors” showing a significantly higher appetite for products that are perceived as complex
- It is important for the Asset Management industry to **understand the requirements** of the different investor types

What can manufacturers and advisors change to better understand investor types?

Product pushing

Advisor vs. manufacturers perception

Advisors

Perceived as being wrongly incentivised
Pushing products with biggest gain for themselves
Incompetent and lacking required abilities¹

Manufacturers

No distinct identity in the eyes of investors
Produce needlessly complex products
Do not know the needs of investors

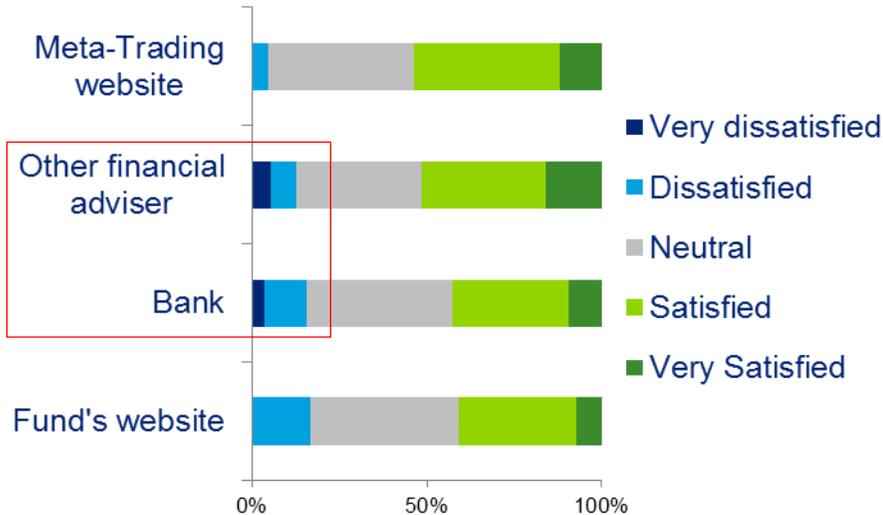
- Participants of the structured interviews **questioned the competence** of their advisors. However, the ability to explain products is highly valued by investors (55%)
- Below 10% of participants stated to have followed the investment advice of their advisor with regard to products
- Investors cannot see the benefit of **continuously paying fees** after their initial purchase unlike stocks/bonds
- **91 %** of the investors **believe financial advisors are pushing products**

How can the match between investor needs and product features be improved?

¹ Required abilities such as product knowledge, market knowledge, technical knowledge and empathy

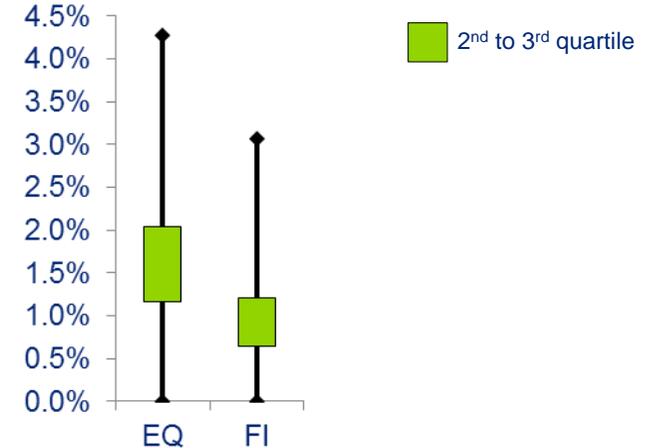
Product pushing

Satisfaction level of information sources



Fund price range

Difference between min. and max. TER of funds in the Swiss market place (Jan. 2013, SFA)



- The recent press coverage on retrocessions has raised awareness on financial flows in the industry¹
- Investors are **dissatisfied with banks and other financial advisers as information sources**, they are unwilling to pay for a service that they are not satisfied with
- Currently the majority believes that advisory **fees are not justified** and where survey participants understand the data they consider fund **TERs too high**

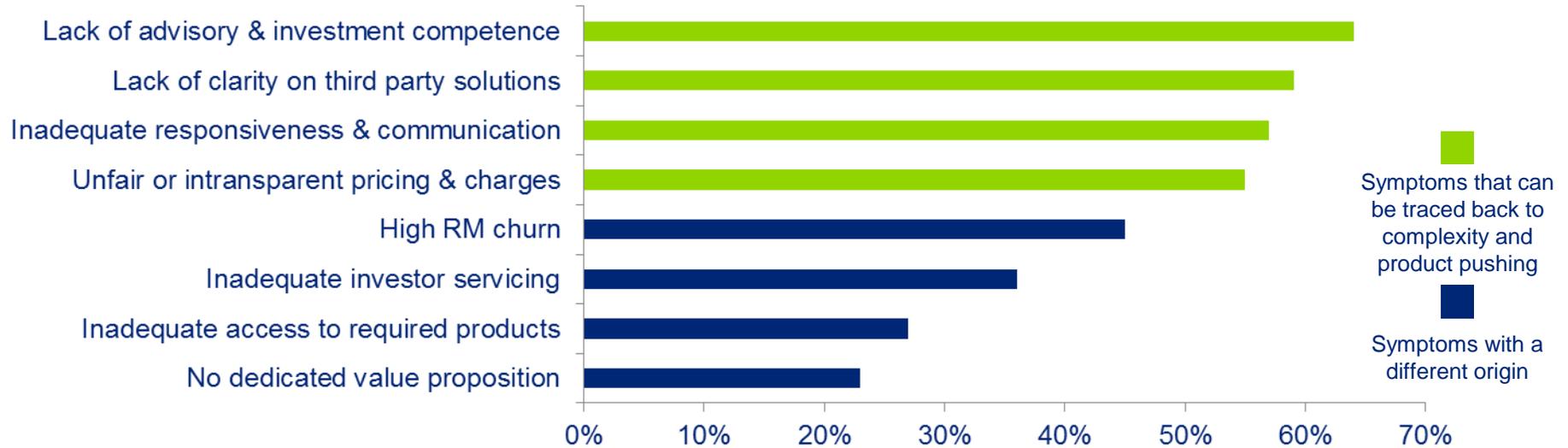
"I switched two times my banks due to incompetent and obnoxious RMs which lacked the basic knowledge to advise me and tried to push products on me that were clearly not beneficial to me." Survey participant

How can the required change in fee flows be used to improve investor perception with regards to product pushing?

¹While the online survey was completed before the ruling on retrocessions by the Swiss Supreme Court, the structured interviews took place in December/January

Trust-gap

Satisfaction level of information sources

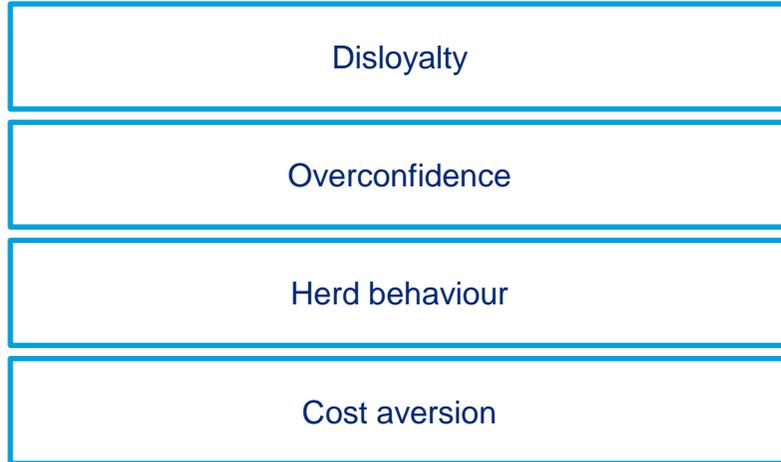


- The relationship between advisors and investors is significantly disturbed
- **70% indicated a trust deficit** with only 9% stating that they actively seek advice on products and follow it
- **Investors feel misunderstood:** too many products available in the market which are not addressing their specific needs, nor are existing ones **properly communicated** to them
- In depth interviews showed that investors trust their advisors when it comes to executing their orders

How can the production and sales processes be adjusted to narrow the trust gap?

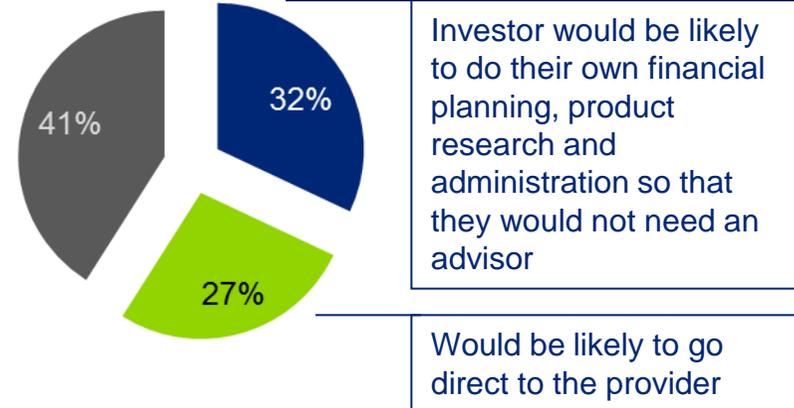
Investor behavior

Investor reactions resulting from trust-gap



Advisory fee¹

What consequences would you draw if a fee for advisory was charged?

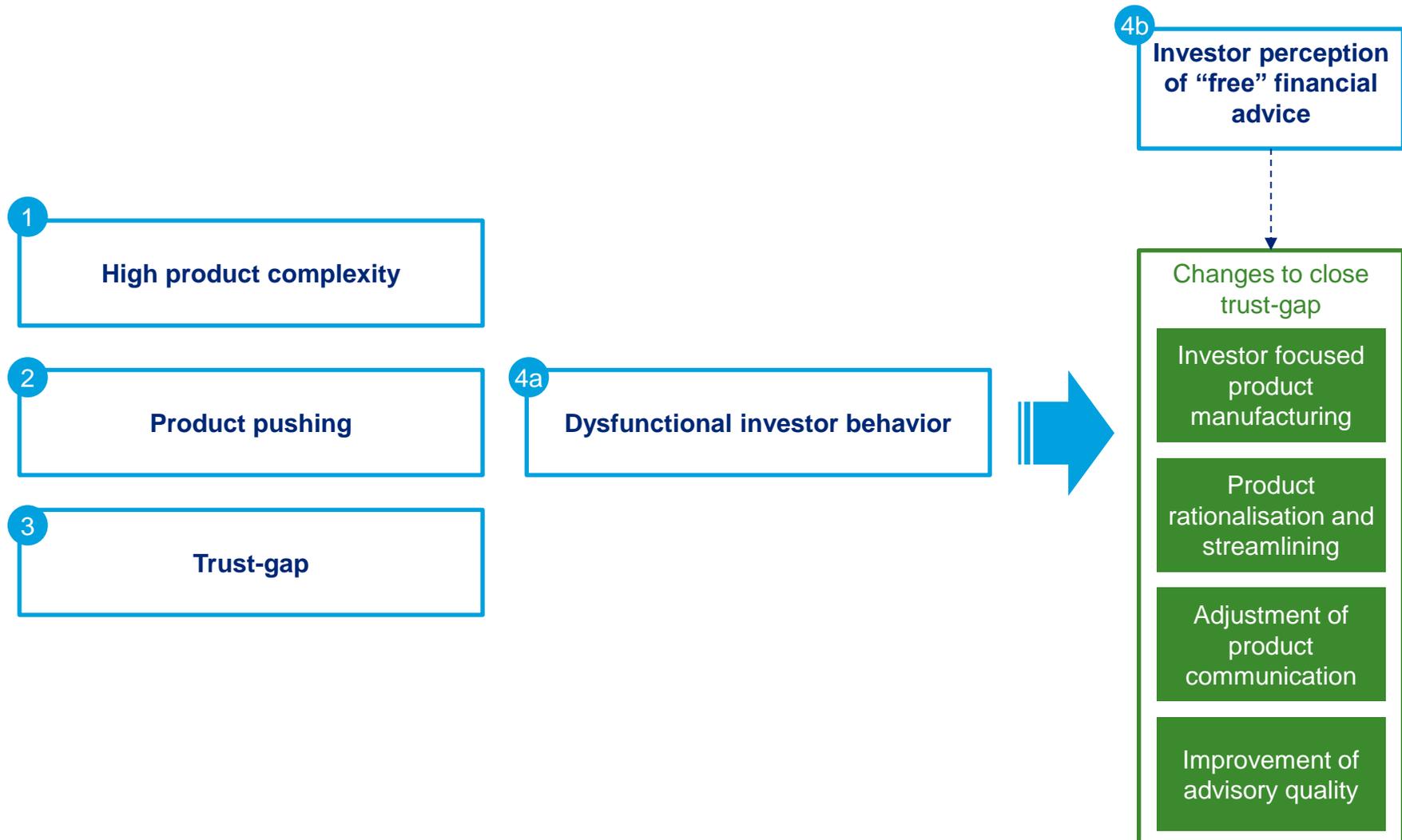


- Investors find themselves trapped between mistrust and lack of knowledge and suffer from the industry's inability to communicate effectively
- While a **significant number agrees that products are overly complex** and financial information is difficult to read, an equally **large number would rate themselves as very knowledgeable**
- Investors are used to **receiving unpaid advice** without showing the same level of willingness to use banks or other advisors for execution
- In a recent UK survey 87% of investors who bought a product through a bank advisor in the last three years assumed the process was free of charge¹
- Comparing and switching providers has never been easier

Can manufacturers and distributors reverse the trust-gap while introducing a new fee model?

¹Deloitte Research, based on UK population, 2012

Pain points



Successful Business Models

Successful business models embrace the challenges outlined focusing on investor needs while keeping costs under control

- Determine how to match expectations of institutional investors with products & services
- Align processes and communication with retail investor needs



- Make investor requirements a key input to product development
- Consider impact of regulatory changes on product design & development

- Avoid tactical approaches for regulatory change
- Re-think value chain to manage costs effectively

Investor Experience

Understand and focus on investor requirements



Investor type	Changing requirements	Responses
Institutional Investors	<ul style="list-style-type: none">▪ Increase desire for customized, on-demand reporting▪ Pressure on fees, in particular performance fees▪ Search for alternative Alpha	<ul style="list-style-type: none">▪ Leverage technology to lower cost of customization▪ Adjust fee models – service fees rather than “all-in” management fees▪ Broaden product offering and/or align with “low-risk Alpha”
Retail investors	<ul style="list-style-type: none">▪ Desire for “simple products”▪ Low cost products▪ Alignment of product offerings with investor needs	<ul style="list-style-type: none">▪ Understand retail investor types▪ Embrace drive for fee transparency and need to offer low cost funds▪ Adjust product development

Product Leadership

New end-to-end product development process

A successful end-to-end product development process' prime focus is to offer a product portfolio which at all times targets investor needs. The process is therefore highly interactive and continuous

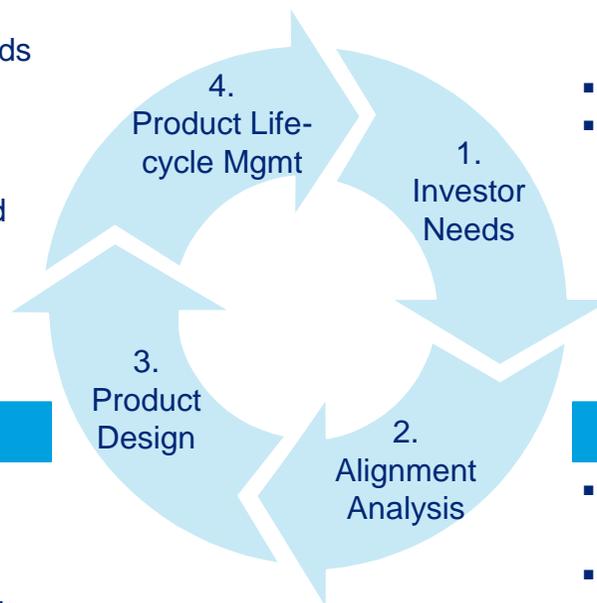


4. Product life-cycle management

- **Life-cycle framework:** Establishing understanding, processes and KPI's to monitor a product continuously with regards to typical metrics, but also the fit with investor needs and competitive developments
- **Life-cycle communication:** Defining and executing targeted communication in line with changing positioning of individual products including monitoring of impact

3. Product design

- **Product Benefit:** Design process clearly articulating essential benefit that new product will bring to investors
- **Product pricing:** Modular fee structure kit to mix and match particular product with fee earning potential



1. Investor needs identification

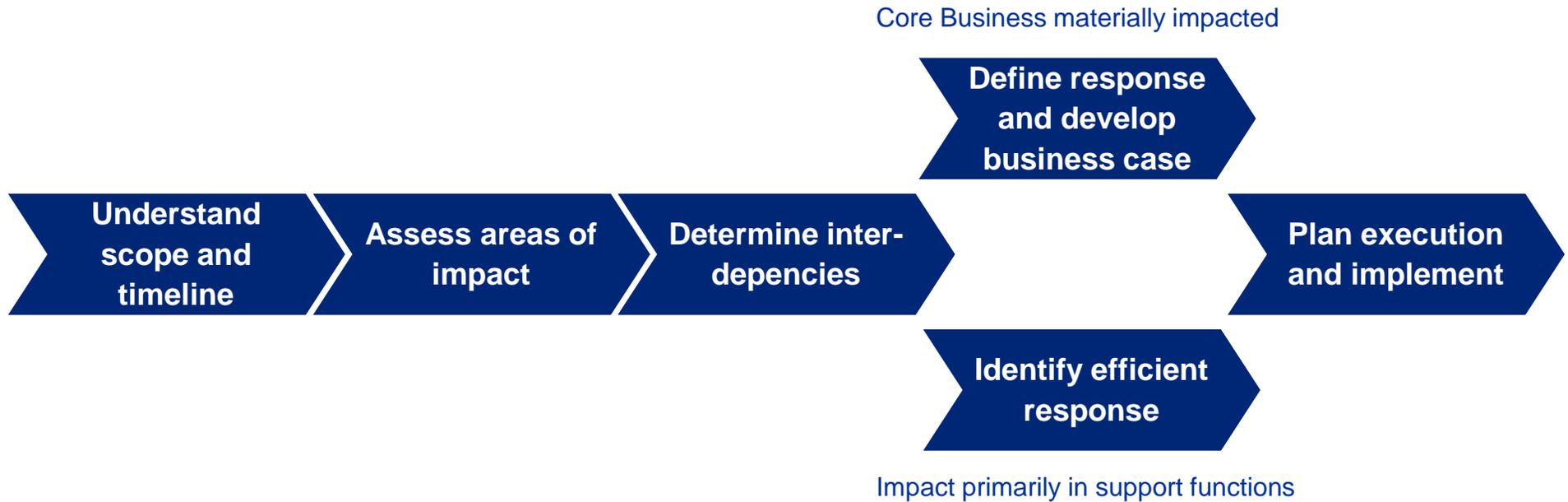
- **Direct:** Tapping directly into investor preferences via survey and questionnaires, or website tracking
- **Indirect:** Using feedback from advisors
- **Comparative:** Leveraging market data and competitor analyses

2. Alignment analysis

- **Investor identification:** Investor types to be defined
- **Investor mapping:** Current portfolio mapped against identified investor types
- **Alignment:** Appropriate actions to be taken to adapt the portfolio and align individual products

Operational Excellence

Deliver regulatory change in a cost effective manner



Successful Asset Managers in 2020:

- ... have embraced regulatory change and lead through transparency and suitability in all aspects of their business
- ... adjusted their operating model to be profitable in spite of lower management fees
- ... offer products and services in line with investor needs, leverage different channels and employ clear communication strategies



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