NKF Banking, Finance & Regulatory Team

Switzerland's New Financial Market Architecture

Publication 18

NIEDERER KRAFT & FREY

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Zurich, August 2014

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In memory of our dear friend and partner Urs Pulver.

In the **NKF series** of publications an informal sequence of articles and essays is published that deal with issues related to the field of business activity of Niederer Kraft & Frey.

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Foreword

The Swiss finance industry is going through interesting times. In addition to the changing economic environment and political views on how to govern financial market activities, the regulatory framework is about to be amended in a fundamental and comprehensive way. No longer will regulation have a sector-focused approach. Rather, henceforth, the financial markets legal architecture will be based on different levels of regulation with the aim of applying the same rules to similar products and services across the industry.

Niederer Kraft & Frey Ltd (NKF) is not only one of the oldest business law firms in Switzerland, but it has also a very strong and recognised banking and finance practice. Partners of our firm are counseling clients on regulatory developments and act on expert commissions for new legislative proposals. Therefore, regulatory developments and proposals prepared by the Federal Administration are closely monitored by our practice groups.

The present publication is a joint effort of NKF's banking and finance partners (Dr. Sandro Abegglen, Dr. François M. Bianchi, Dr. Thomas A. Frick and Marco Häusermann) who have relied on the support from a number of members of the NKF Banking, Finance & Regulatory Team, namely Andrea Huber, Dr. Bertrand G. Schott, Luca Bianchi, Urs Hofer, Yannick Wettstein, Nico Hess and Niki Vischer. The publication does not intend to be a comprehensive discussion of the proposed new acts, but rather aims to provide an overview with a focus on what Swiss and foreign market participants need to be aware of in view of the currently discussed proposals.

The publication is based on the drafts and proposals published until 31 August 2014. As many of the proposals are still in an early stage, they might change significantly during the legislative process, so that developments will need to be monitored in the years to come.

Zurich, August 2014
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Abbreviations

AEI	Automatic exchange of information
AML	Anti-money laundering
AMLA	Federal Act of 10 October 1997 on Combating Money Laundering and Terrorist Financing in the Financial Sector
APA	Federal Act of 20 December 1968 on Administrative Procedure
Art.	Article
BA	Federal Act of 8 November 1934 on Banks and Savings Banks
BBl	Bundesblatt
BESA	Federal Act of 3 October 2008 on Book-Entry Securities
BIO-FINMA	Ordinance of 30 August 2012 of the Swiss Financial Market Supervisory Authority on the Insolvency of Banks and Securities Dealers
BIS	Bank for International Settlement
CCP	Central Counterparty
CDB 08	SBA Agreement on the Swiss Banks' Code of Conduct with Regard to the Exercise of Due Diligence
cf.	confer/compare
CHF	Swiss francs
CISA	Federal Act of 23 June 2006 on Collective Investment Schemes
CISO	Federal Ordinance of 22 November 2006 on Collective Investment Schemes
CISO-FINMA	Ordinance of the Swiss Financial Market Supervisory Authority of 21 December 2006 on Collective Investment Schemes
CRS	Standard for Automatic Exchange of Financial Account Information
CO	Federal Act of 30 March 1911 on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations)
CSD	Central Securities Depository

CSDR	EU Central Securities Depository Regulation
DEBA	Federal Act of 11 April 1889 on Debt Enforcement and Bankruptcy
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories
et seq.	*et sequens / et sequentes*
EU	European Union
EUR	Euros
FAQ	Frequently asked questions
FATCA	US Foreign Account Tax Compliance Act
FATF	Financial Action Task Force on Money Laundering
FBO-FINMA	Ordinance of the Swiss Financial Market Supervisory Authority of 1 January 2009 on Foreign Banks in Switzerland
FC	Financial counterparty
FDF	Swiss Federal Department of Finance
FFSO	Federal Financial Services Ordinance
FIDLEG	Federal Financial Services Act
FINIG	Federal Financial Institutions Act
FINMA	Swiss Financial Market Supervisory Authority
FINMAG	Federal Financial Market Supervision Act of 22 June 2007
FINRA	US Financial Industry Regulatory Authority
FINFRAG	Federal Financial Market Infrastructure Act
FMI	Financial market infrastructure
FMIO	Federal Financial Market Infrastructure Ordinance
FSB	Financial Stability Board
FX	Foreign Exchange
G-20	Group of Twenty
GLEIS	Global Legal Entity Identifier System
HNWI	High-net-worth individuals
ICA	Federal Act of 2 April 1908 on Insurance Contracts
IGA	Intergovernmental agreement
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISA	Federal Act of 17 December 2004 on the Supervision of Insurance Companies

ISDA	International Swaps and Derivatives Association
KIID	Key Investor Information Document
LEI	Legal entity identifier
LHID	Federal Act of 14 December 1990 on the Harmonisation of Direct Taxation at Cantonal and Communal Levels
LIFD	Federal Act of 14 December 1990 on the Federal Direct Tax
lit.	*litera / literae*
MiFID I	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments
MiFID II	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments
MiFIR	Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments
MTF	Multilateral Trading Facilities
N	note
NBA	Federal Act of 3 October 2003 on the Swiss National Bank
NFC	Non-financial counterparty
no.	number
ODRG	OTC Derivatives Regulators Group
OECD	Organisation for Economic Co-operation and Development
OTC	over-the-counter
OTF	Organised Trading Facilities
p. / pp.	page / pages
para.	paragraph
PEP	Politically exposed person
PFMI	Principles for Financial Market Infrastructures
ROC	Regulatory Oversight Committee
SAAM	Swiss Association of Asset Managers
SBA	Swiss Bankers Association
SCC	Swiss Criminal Code of 21 December 1937
SESTA	Federal Act of 24 March 1995 on Stock Exchanges and Securities Trading
SESTO	Federal Ordinance of 2 December 1996 on Stock Exchanges and Securities Trading
SFAMA	Swiss Funds & Asset Management Association

SFBC	Swiss Federal Banking Commission
SICAF	Investment company with fixed capital
SICAV	Investment company with variable capital
SIX	SIX Swiss Exchange
SNB	Swiss National Bank
SRO	Self-regulation organisation
TR	Transaction register
UK	United Kingdom
UPI	Unique product identifier
US	United States

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I. From Old to New: An Overview

(1) It is important to note that the term "old" refers to the Swiss financial market architecture as it stands today; thus, all acts referred to in Chapter I.A. below are still in full force and effect. As for the term "new" (Chapter I.B. below), we will refer to the regulatory architecture after the implementation of the three new financial market acts (FINFRAG, FINIG, FIDLEG) that are currently undergoing the public consultation process and are intended to enter into force over the next couple of years, with the earliest currently expected to be the FINFRAG in mid-2015.

A. The Existing Swiss Financial Market Architecture

(2) It is noteworthy that the regulation of the Swiss financial market started as early as 25 June 1885 with the adoption of a supervision act on private insurance companies that was repeatedly revised and restated and finally resulted in the current Insurance Supervision Act of 17 December 2004 (ISA). In addition to this (public law) regulation of private insurance companies, the Insurance Contract Act of 2 April 1908 (ICA) regulates and will continue to regulate the (private law) relationship between such insurance companies and their clients.

(3) However, the most fundamental Swiss financial market regulation dates back to the entry into force of the Swiss Federal Banking Act (BA) on 8 November 1934, which was the first significant attempt by Swiss legislators to capture the complexity and importance of financial markets. As with many financial market acts, the enactment of the BA was linked to and driven by a crisis, in this case the Great Depression. Along with the BA came the creation of the Swiss Federal Banking Commission (SFBC) as the former supervisory body of banking institutions.

(4) As in the sector of insurance and banking, subsequent sector-oriented acts were legislated when a need for regulation in a specific sector became evident. Thus, an act on investment funds was passed in 1966, which finally led to the current Collective Investment Schemes Act of

23 June 2006 (CISA). Similarly, by the adoption of the Stock Exchange Act (SESTA) on 24 March 1995, stock exchanges and securities dealers (other than those being or belonging to banks, whose respective activities were subject to the BA as so-called "indifferent business") – previously subject to cantonal regulation – finally became subject to federal regulation (which was already considered as early as 1895[1]).

(5) As a consequence, Swiss financial market regulation as it stands today is largely product- or sector-oriented. While some financial products, services and institutions – in particular in the areas of banking, insurance, funds, and securities dealing – are regulated by various separate acts and ordinances and were at least until 2009 subject to supervision by potentially different supervisory authorities, other financial products, services, and institutions – such as in the areas of asset management, advisory services, and structured products – remain entirely, or at least largely, unregulated. Such regime has not only raised issues with regard to financial conglomerates that offered products and services across different sectors, but has also lead to concerns with regard to the principle of "same business, same rules".

(6) The CISA, taken as an example, comprehensively regulates the following areas, however only in relation to collective investment schemes:

i. mandatory licensing requirements for certain key actors (*i.e.* the fund administrator) as well as the licensing conditions;
ii. product rules and requirements;
iii. transparency and documentation requirements;
iv. code of conduct duties at the point of sale; and
v. cross-border inbound offerings.

All of these areas are not well harmonised with the regulation of related topics in other financial market acts. For example, while the cross-border inbound offering of collective investment schemes is subject to Swiss regulation, the same is not the case (at least in absence of permanent physical presence in Switzerland) in connection with cross-border inbound offerings of banking and securities dealing services.

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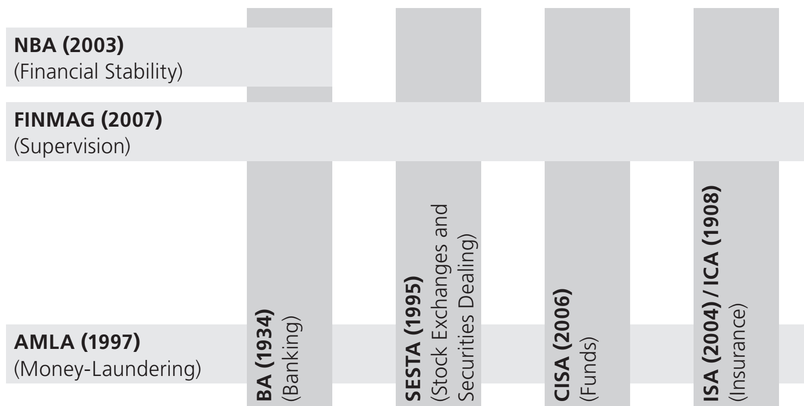
[1] On the long and winding road to Swiss federal stock exchange regulation, cf. the description in PETER NOBEL, Swiss Finance Law and International Standards, Berne 2002, pp. 597 *et seq.*

(7) Figuratively speaking, the existing architecture is based on a vertical pillar model. With the entire house being the Swiss financial market, the legislator has thus far deemed it sufficient to only build (*i.e.* regulate) certain pillars. Each pillar has been given its own shape and form. As such, plenty of empty spaces have remained in between those pillars.

(8) A notable exception to this conceptual model is the FINMAG whose adoption established the Swiss Financial Market Supervisory Authority (FINMA) – a single, integrated supervisory authority across different sectors, which carries out the functions of the former SFBC, the Private Insurance Supervision Authority and the Anti-Money Laundering Control Authority. Similarly, the Anti-Money Laundering Act of 10 October 1997 (AMLA) and the National Bank Act of 3 October 2003 (NBA) regulate and will continue to regulate issues of money-laundering and financial stability horizontally across different sectors.

(9) The following chart serves as illustration of the existing Swiss financial market architecture:



B. The New Swiss Financial Market Architecture

(10) After roughly 130 years of more or less unsystematic organic growth, it is undoubtedly time to consider a re-design of the Swiss financial market architecture. Sadly, the effective launch of such considerations is not entirely coincidental with the impact of the 2007 financial crisis, which in many respects marked a turning point in the formerly liberal Swiss

financial market regulation. While a new architecture *per se* would not necessarily require substantially new content (*i.e.* the pillars and beams to become bigger), the now envisaged reform project will certainly be accompanied by substantially new content in certain areas – particularly in view of harmonising Swiss regulations with existing and upcoming EU regulations, such as the Prospectus Directive[2], MiFID II and MiFIR, to ensure Swiss financial institutions' access to the European market by (hopefully) fulfilling the equivalency requirements under MiFID II. However, the fear remains that the new acts will provide for a supplementary Swiss finish in certain areas going even beyond what is required under EU financial market regulations. While the most notable changes will be discussed in the corresponding chapters, this overview will focus on the re-design of the architecture itself.

(11) In contrast to the existing pillar model, the new Swiss financial market architecture will, figuratively speaking again, work with both vertical pillars and horizontal beams. While certain vertical product- or sector-oriented regulations (such as the CISA) will remain in place, areas suitable for a harmonised regulation across different sectors will be carved out and incorporated into the new horizontal financial market acts. The future architecture will comprise different levels of regulation (product level, institution level, infrastructure level, point of sale level, supervision level, etc.), which will, for example, facilitate subjecting certain financial service providers, such as client advisors, to point of sale duties, while not introducing a licensing requirement at the institution level.

(12) The following four acts will constitute the core of this new horizontal regulation:

i. the existing Financial Market Supervision Act (FINMAG): supervision;
ii. the new Federal Financial Services Act (FIDLEG): products / point of sale;
iii. the new Financial Market Infrastructure Act (FINFRAG): infrastructure; and
iv. the new Financial Institutions Act (FINIG): institutions.

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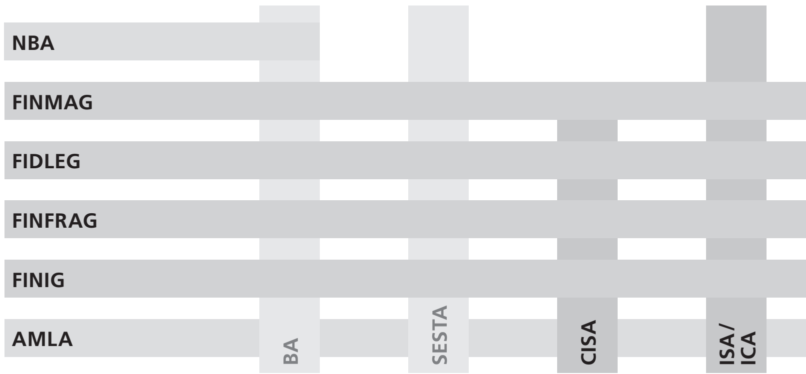
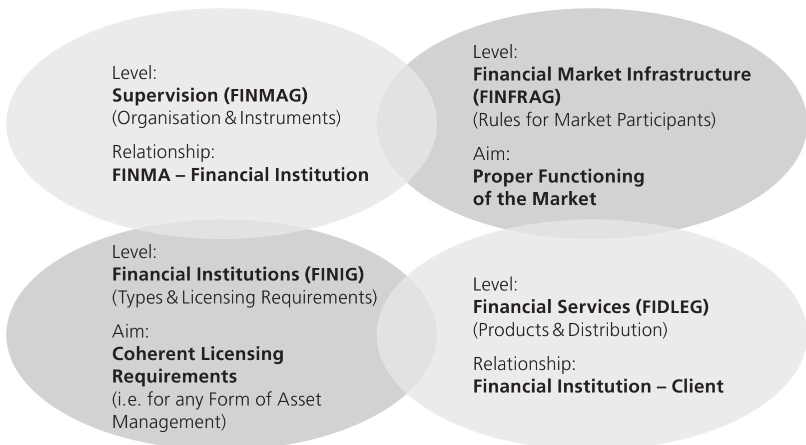
2 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

(13) The following chart illustrates the above described "pillar & beam" model:



(14) While for the time being the insurance sector will continue to be subject to its specific regulations and while the ISA and ICA will therefore remain in place (which, however, is rather a result of time constraints and internal processes than a stringent model-induced necessity), the insurance sector will nonetheless be affected by the new architecture, in particular by the FIDLEG. In contrast, other acts, such as the BA and the SESTA, will be completely integrated into the new horizontal acts (mainly into the FINIG and the FINFRAG).

(15) The following chart illustrates the aims of the above mentioned four horizontal acts as well as the areas of regulation and relationships governed by them:



(16) From a conceptual point of view (not yet accounting for content), the main advantage of the new architecture will certainly be that it will allow for greater coherence and adherence to the principle of "same business, same rules". A disadvantage, however, might be that market participants will be required to consult various acts to ensure compliance in their day-to-day operations. For example, a company exclusively active in the fund business (*e.g.* as an asset manager and distributor of funds), which under the current regime does not need to consult many acts other than the CISA and its implementing ordinances (note, however, that this comes along with a need to consult and be aware of the corresponding FINMA and the Swiss Funds & Asset Management Association (SFAMA) circulars, public notices, and FAQs as well), will now under the new regime have to consult the FINIG and its implementing ordinances (regarding the organisational requirements on institution level), the FIDLEG and its implementing ordinances (regarding marketing funds to potential investors), the FINMAG (when dealing with the supervisory bodies), and, finally, the CISA and its implementing ordinances (for sector-specific regulations).

II. Supervision – FINMAG

A. Overview

(17) The Federal Financial Market Supervision Act (FINMAG) entered into force on 1 January 2009 and is, therefore, not a new regulation. While the FINMAG will be partly amended through the introduction of the FINFRAG, FINIG and FIDLEG, its core will remain unaffected. Against this background, the publication at hand will not present the FINMAG in detail, but rather focus on the aforementioned three new financial market acts.

1. Overview on the Content of the Current FINMAG

(18) The FINMAG established FINMA, a single, integrated supervisory authority across different sectors which continues to carry out the functions of the former SFBC (banking supervision), the Private Insurance Supervision Authority (insurance supervision) as well as the Anti-Money Laundering Control Authority (anti-money laundering supervision of financial intermediaries). The creation of such integrated supervisory authority was in line with similar developments in other European countries.[3] However, certain Swiss supervisory authorities remain and will continue to remain outside and independent from FINMA, such as the Swiss Takeover Board (supervision of certain areas of the SESTA, *e.g.* public takeover offers), the Swiss National Bank (SNB) (which has a joint supervision mandate together with FINMA in areas of financial stability), and the Federal Gaming Board (supervision of casinos, etc.). Moreover, self-regulatory organisations (SROs), such as the Swiss Bankers Association (SBA) and SFAMA, continue and will continue to play a key role in Swiss financial market regulation. In particular, Art. 7 para. 3 FINMAG allows FINMA to publicly acknowledge a directive issued by an SRO as being a minimal standard and make compliance with such directive mandatory for all affected market participants regardless of whether they are members of the respective SRO. The same applies for external prudential audit firms, which are

[3] Cf. FEDERAL COUNCIL, Message on the FINMAG dated 1 February 2006, in: BBl 2006, pp. 2829 *et seq.,* pp. 2854 *et seq.*

responsible for the first level of prudential supervision in many areas and which will report relevant findings to FINMA (*i.e.* by way of yearly prudential audit reports or reports on special investigations).[4]

(19) The FINMAG governs (i) the competences and structure of FINMA (Arts. 1 *et seq.* FINMAG), including its organisation (Arts. 8–23 FINMAG), its enforcement tools (Arts. 24–37 FINMAG) and its cooperation with other Swiss and foreign authorities (Arts. 38–43 FINMAG), (ii) the criminal sanctions and the corresponding procedures in case of violations of certain key requirements under Swiss financial market regulation (Arts. 44–52 FINMAG), and, finally, (iii) the applicable administrative procedures and legal recourse system (Arts. 53 and 54 FINMAG). The content of the FINMAG can be classified as formal finance law in contrast to material finance law being set forth in the BA, SESTA, CISA, etc.[5]

2. Overview on the Upcoming Amendments of the FINMAG

a) Amendments of the FINMAG as part of the Introduction of the FIDLEG

(20) The consultation draft of the FIDLEG only provides for certain minor amendments to the FINMAG, *e.g.* a provision pursuant to which FINMA is the competent supervisory authority for ensuring compliance with the FIDLEG (the latter is, of course, also the case with regard to the FINFRAG and the FINIG).

4 Cf. for example the related IMF finding in IMF, Switzerland – Financial System Stability Assessment: Reports on Observance of Standards and Codes, April 2014, p. 51: *"FINMA has sufficient inspection and investigation powers vis-à-vis supervised entities and other persons, but has outsourced the exercise of these powers to a significant extent to audit firms and investigating agents. […] FINMA's own supervisory reviews are very limited."*

5 Cf. Patrick Hünerwadel / Marcel Tranchet, in: Basler Kommentar zum Finanzmarktaufsichtsgesetz, 2nd ed., Basel 2011, Art. 1, N 17 *et seq.*

b) *Amendments of the FINMAG as part of the Introduction of the FINIG*

(21) In contrast to the consultation draft of the FIDLEG, the consultation draft of the FINIG provides for a series of both minor and slightly more significant amendments to the FINMAG. The following are particularly noteworthy:

i. Financial services providers that are only subject to a registration requirement under the new acts (*i.e.* client advisors) will not be subject to continuous FINMA supervision; however, they will remain subject to enforcement tools and sanctions under the FINMAG.
ii. FINMA will be granted three new enforcement tools:
    1. it will be empowered to demand the provision of security in case of violations of financial regulations;
    2. in case of non-observance of a FINMA decree requiring the implementation of measures to restore the lawful state of affairs, FINMA will be entitled to take such measures itself at the defaulting party's cost and expense; and
    3. in addition to the already existing possibility to issue an occupational ban vis-à-vis managers of financial service providers, FINMA will be entitled to issue such a ban vis-à-vis certain lower level employees, such as securities dealers and client advisors.
iii. Finally, it remains undecided whether asset managers (which will become subject to supervision) will be supervised by FINMA directly or by a new semi-public supervisory authority, which, in turn, would be supervised and guided by FINMA. Essentially, the Swiss Federal Department of Finance (FDF) fears that the responsibility for the direct supervision of those newly supervised asset managers – given their potentially large number – could be too much of a burden to FINMA. The inspiration for a semi-public supervisory authority apparently came from the US, notably from the function held by the Financial Industry Regulatory Authority.[6] Hence, the consultation draft of the FINIG contains – in form of a variant – an entire new chapter on the role, organisation, duties, powers, and supervision of such new semi-public supervisory authority.

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6 Cf. on the whole, FEDERAL DEPARTMENT OF FINANCE, Explanatory Report to the Consultation Draft of the FIDLEG and the FINIG dated 25 June 2014 ("Explanatory Report FIDLEG/FINIG"), pp. 23 *et seq.*

c) Amendments of the FINMAG as part of the Introduction of the FINFRAG

(22) Finally, the consultation draft of the FINFRAG provides for a series of amendments to the FINMAG which, however, are rather unrelated to the new Swiss financial market architecture or the remaining content of the FINFRAG. These amendments concern the cooperation and exchange of information between FINMA and other Swiss and foreign supervisory, regulatory, governmental, and judiciary authorities and are the result of both lessons learnt during the 2007 financial crisis (namely, the inefficient cooperation among several competent authorities from different nations impeding the development of solutions to "too-big-to-fail" concerns) and the recent tax disputes between Switzerland and countries such as the US, Germany, France, etc. (specifically, the narrow and rather restrictive framework of the existing Swiss administrative assistance procedures resulting in either FINMA acting beyond the wording of the law or foreign authorities angered by the delay and limitations of information received).[7] The following elements of the respective provisions governing the exchange of information with foreign authorities are particularly noteworthy:

i. FINMA will be entitled to spontaneously – thus, without a formal request – exchange information with foreign authorities (not being limited to supervisory authorities); provided that such information exchange serves the purpose of enforcing financial market regulations and that the foreign authority is bound by official or professional secrecy. While this corresponds to current FINMA practice to a large extent, it will relieve certain limitations on such spontaneous exchanges imposed by Swiss case law.
ii. Regarding the administrative assistance procedure provisions (which will be concentrated in the FINMAG instead of being spread across different regulations), the most notable change is the option granted to FINMA not to conduct a so-called "client procedure" or at least not prior to the actual exchange of information. Such "client procedure" is normally applied if the information to be exchanged concerns or may affect a client – a client being defined as any person or institution that is not itself subject to supervision (*i.e.* an account holder, but, at least under current law, arguably also an external

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7 Cf. FEDERAL DEPARTMENT OF FINANCE, Explanatory Report to the Consultation Draft of the FINFRAG dated 29 November 2013 ("Explanatory Report FINFRAG"), p. 108.

asset manager). The affected client would normally have to be informed about FINMA's decision prior to the actual exchange of information and would have the right to appeal such decision within 10 days to the Federal Administrative Court. In addition, recent Swiss court rulings have granted such clients a right to inspection with regard to the original request of the foreign authority. Thus, the current "client procedure" not only potentially delays the exchange of information for months, but also potentially delivers the client the necessary information to take concealment measures within the additional time bought (*i.e*. destroying evidence or transferring assets).[8] These inadvertent consequences were not only a nuisance in view of FINMA, but have also been criticised by the International Monetary Fund (IMF).[9] Against this background, the FDF now suggests that FINMA have the option not to inform the client prior to the actual exchange of information if and to the extent that such information may impede or frustrate the effective accomplishment of the foreign authority's mission and generally not to grant a right of inspection with regard to the correspondence of the foreign authority. An appeal filed by a client retroactively may at the extreme lead to a court ruling confirming the illegality of FINMA's action. Thus, the proposed amendments massively limit clients' rights to be heard, which have been the basis for the aforementioned court rulings that did not follow the very same arguments – then made by FINMA – as now brought forward by the FDF in the explanatory report dated 29 November 2013 to the consultation draft of the FINFRAG (Explanatory Report FINFRAG).[10]

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8 Cf. Explanatory Report FINFRAG (FN 7), pp. 111 *et seq.*

9 Cf. Financial System Stability Assessment (FN 4), p. 52: *"The requirement to preserve client confidentiality consumes FINMA time and resources."* Cf. also the corresponding recommendation on p. 63: *"The authorities should pursue the abolition of the strict client confidentiality requirements and the requirement to inform the client of foreign authorities' requests for information."*

10 Cf. for example the arguments made by FINMA and the respective counter-arguments by the court in the ruling of the Federal Administrative Court of 22 March 2012, B-6062/2011, c. 5. Like the FDF does now in its explanatory report (FN 7), the FINMA then used the argument of the clear violation of the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information when granting a right of inspection. The Federal Administrative Court, however, deemed it highly unlikely that such would truly be the case.

B. Key Differences to EU Regulations

(23) The FINMAG provides the basis for a modern supervisory authority (FINMA) endowed with similar competences, enforcement tools, and responsibilities as compared to other EU supervisory authorities that are constituted as a single, integrated supervisory body. That being said there are some notable differences. For example, the Swiss supervisory model is different from the twin-peaks approach applied in the UK where supervisory and regulatory responsibilities are shared between the Financial Conduct Authority and the Prudential Regulation Authority. Finally, in contrast to certain EU supervisory authorities, FINMA does not have the power to impose pecuniary administrative fines, such as those imposed in the Adoboli case where the former UK Financial Service Authority, while not FINMA, fined UBS.

C. What Swiss and Foreign Market Participants Need to be Aware of

(24) All Swiss and foreign market participants, as well as their clients, need to be aware of the increased cross-border exchange of information among authorities as a consequence of the abolishment of certain limitations in the current Swiss administrative assistance procedure in the area of financial market regulation. This approach is consistent with the same increase in exchange of information in the areas of anti-money laundering or judicial assistance in criminal matters, most notably in relation to tax offenses.

(25) Swiss asset managers should consider the advantages and disadvantages of being subject to supervision by a semi-public supervisory authority separate from FINMA and, if deemed necessary, try to influence the ongoing legislative process in this respect and/or participate in the creation and setup of such authority.

III. Infrastructure – FINFRAG

A. Overview

1. The New Regime for Financial Market Infrastructures: Consolidated – Revised – Internationally Aligned

(26) The FDF's consultation draft for a Financial Market Infrastructure Act (FINFRAG) dated 29 November 2013 provides for a consolidated and comprehensive set of rules for the supervision of financial market infrastructures (FMIs). It will replace the current fragmented regime for FMIs consisting of provisions that can be found in a variety of different acts (*e.g.* BA, SESTA, NBA) and ordinances.

(27) The core reason for the new FINFRAG is to align the Swiss regime with international standards, in particular with the EU regulations such as MiFID II, MiFIR, EMIR and CSDR, in order to preserve Switzerland's global competitiveness.

(28) The FINFRAG will apply to the following categories of FMIs:

i. Trading Venues (Stock Exchanges, Multilateral Trading Facilities (MTFs) and Organised Trading Facilities (OTFs));
ii. Central Counterparties (CCPs);
iii. Central Securities Depositories (CSDs);
iv. Trade Repositories; and
v. Payment Systems.

a) Which Swiss-based FMIs Need to be Licensed by FINMA?

(29) The following ***Swiss-based*** FMIs will need to obtain a license from FINMA:

i. *Trading Venues* (*i.e.* Stock Exchanges, MTFs and OTFs). However, OTFs that do not provide for multilateral trading will not need to be licensed unless the "protective purpose" (*Schutzzweck*) of the FINFRAG so requires; the Federal Council shall determine the relevant criteria in an implementing ordinance (the "Financial Market Infrastructure Ordinance" (FMIO)).
ii. For *CCPs and CSDs*, currently supervised under a bank license, the FINFRAG will introduce *tailor-made* licenses. A license will be need-

ed irrespective of whether or not the relevant *institution* is deemed systemically important.

iii. *Trade Repositories* (however, as of today, there are no Trade Repositories domiciled in Switzerland).

iv. *Payment Systems* will have to obtain a license only if the "protective purpose" of the FINFRAG so requires. Since the purpose of the FINFRAG is described very broadly[11], the scope of the licensing requirement will remain vague until the Federal Council has issued the FMIO. Some indication can be found in the Explanatory Report FINFRAG[12], which explains that the licensing requirement will likely apply to systemically important Payment Systems (except for those operated by or on behalf of the SNB). However, there is no statement to the effect that *non*-systemically important Payment Systems would not be subject to licensing, nor is there any clarification as to the licensing requirements.

(30) An institution that meets all pertaining requirements as set forth in the FINFRAG/FMIO will be *entitled* to receive the relevant license.

(31) ***Supervisory authorities:*** The regime will remain unchanged, *i.e*. FINMA is the competent authority for the ongoing supervision of FMIs and, in case of systemically important FMIs, also the SNB.

b) What are the Recognition Requirements for Foreign Trading Venues, CCPs and Trade Repositories?

(32) Any foreign Trading Venue, CCP and Trade Repository will need to be recognised by FINMA in order to be allowed to grant access/provide services to Swiss participants. The proposed recognition requirements are as follows:

i. The foreign Trading Venue is subject to an "appropriate" regulation and supervision in its home state. The term "appropriate" indicates that the foreign regulation and supervision need not to be equivalent to the Swiss regime, but may be less strict.

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11 Cf. Art. 1 para. 2 FINFRAG: "Its [the FINFRAG's] purpose is to ensure the functioning of the securities and derivatives markets, the stability of the financial system, transparency, protection of the financial market participants and equal treatment of investors."

12 Cf. FN 7.

ii. The relevant foreign supervisory authority (i) has no objections, (ii) undertakes to notify FINMA in case it discovers breaches of law or other irregular practices by Swiss regulated participants, (iii) with respect to Trading Venues and CCPs only, grants administrative assistance to FINMA / with respect to Trade Repositories only, confirms that certain restrictions relating to the transfer of data will be complied with and that Swiss authorities are granted access to the data collected by the foreign Trade Repository.

(33) *Mutuality reservation:* FINMA may, even if the above criteria are met, refuse recognition if the foreign state (i) refuses access to its markets or (ii) discriminates Swiss Trading Venues, CCPs or Trade Repositories (as the case may be) compared to the national institutions.

(34) The proposed licensing and recognition requirements may be summarised as follows:

FMIs / **Lic. / Rec.**	**Trading Venues**	**CCPs**	**CSDs**	**Trade Repositories**	**Payment Systems**
License required?	yes (except certain OTFs)[a]	yes	yes	yes	no, *but…*[b]
Recognition of foreign FMIs required?	yes	yes	no[c]	yes	no
Systemically important FMIs are subject to special regulation/supervision.					

[a] OTFs providing only for bilateral trading need no license, unless the "protective purpose" of the FINFRAG so requires (criteria to be published by the Federal Council in the FMIO).

[b] License only needed if the "protective purpose" of the FINFRAG so requires (criteria to be determined by the Federal Council in the FMIO).

[c] Note: link arrangements *(Verbindungen)* between CSDs (see n. (47)) need FINMA approval.

a) *What are the Recognition Requirements for Foreign Trading Participants?*

(35) ***Foreign trading participants*** *(remote-member license):* The licensing requirements for foreign participants, which currently only apply to securities dealers seeking membership on a Swiss Stock Exchange, will be extended to *any participants of any Trading Venues*. In contrast to the cur-

rent regulation, foreign trading participants with a branch in Switzerland will also be able to obtain a remote-member license. The licensing regime proposed by the FINFRAG is slightly stricter than the current one – the proposed requirements are as follows:

i. the participant (i) is subject to an "appropriate" supervision, (ii) is subject to "equivalent" conduct rules, recording and disclosure duties and (iii) ensures that any such activities are separated from activities of its Swiss licensed entities (if any); and
ii. the foreign supervisory authority (i) has no objection and (ii) provides administrative assistance to FINMA.

Further, FINMA may refuse to grant a license in case the foreign state does not grant reciprocal rights.

d) *What are the General Requirements/Duties?*

(36) The FINFRAG, as proposed, provides for a variety of general requirements and duties FMIs will be subject to, including the following:

i. FMIs will be required to maintain an *adequate organisation* and meet the "fit-and-proper-test".
ii. They will need sufficient *regulatory capital and liquidity*, both on a stand-alone and on a consolidated basis; the Federal Council will determine the minimum requirements.
iii. A legal entity will be allowed to operate only one FMI at a time, except for CSDs, which may run both a securities settlement system and a central securities depository. Ancillary business activities may trigger both license/approval and capital/liquidity requirements.
iv. The outsourcing of substantial tasks, such as the risk management, will require prior approval by FINMA.
v. The FINFRAG further provides for duties relating to the business continuity (strategy, technical systems).
vi. FMIs will be required to provide non-discriminatory and open access to their services and will be subject to documentation and disclosure duties.

e) *What Additional Rules Apply to Systemically Important FMIs?*

(37) The current regime applicable to systemically important FMIs will be transferred into the FINFRAG, and the authority to establish the details

will remain with the SNB. The scope of information FMIs will be required to provide to the SNB will be extended.

(38) ***Stabilisation and wind-down planning:*** The FINFRAG, as proposed, provides for a duty of systemically important FMIs to prepare a stabilisation plan (*Stabilisierungsplan*) that describes the measures to be taken in case of a crisis for ensuring a continuation of system-relevant business processes. FINMA will, on the basis of the stabilisation plan, prepare a wind-down plan (*Abwicklungsplan*) describing how an ordered restructuring or liquidation may be carried out.

f) Trading Venues (Stock Exchanges, MTFs, OTFs)

(39) ***Stock Exchanges*** are defined as *facilities for the multilateral trading of securities on which securities are listed and which aim to provide a simultaneous exchange of offers among several market participants as well as the conclusion of contracts pursuant to non-discretionary rules*. The definition in the proposed FINFRAG is very similar to the current one.

(40) ***MTFs*** *serve the same purpose as Stock Exchanges, but the securities traded thereon may not be listed* ("listing" is defined in the proposed FINFRAG as the admission of securities to trading on a Swiss Stock Exchange in a standardised procedure in which the exchange assesses compliance of both the issuer and the securities with the requirements as determined by the exchange).

(41) ***OTFs*** comprise facilities providing for a simultaneous exchange of offers and conclusion of contracts, but do not qualify as Stock Exchanges or MTFs, e.g. internal multilateral trading facilities of banks. While an OTF may provide both multilateral and bilateral trading, only the former will be subject to licensing/supervision. An OTF, unlike Stock Exchanges and MTFs, will be permitted to trade on its platform securities for its own account (*Eigengeschäfte*).

Feature / Tr. Venue	Trading	Exchange of offers	Rules	Listing	Trading for own account
Stock Exchange	multilateral (bilateral possible)	simultane-ously	non-discretionary	yes	no
MTF	multilateral only	simultane-ously	non-discretionary	no	no
OTF	multilateral/ bilateral	simultane-ously	non-discretionary/ discretionary	no	yes

(42) ***Duties of Trading Venues and trading participants:*** Among various other duties, the FINFRAG will require Trading Venues to provide *pre-trading and post-trading transparency*. The current duty of stock exchange participants to *record* transactions and *report* them to the trading platform will be extended to any Trading Venue.

g) Central Counterparties (CCPs)

(43) As counterparty risks are not eliminated by interposing a CCP, but rather concentrated, and the failure of a CCP is deemed to pose a greater risk for the stability of the financial system than a system of bilateral trading, the *FINFRAG will subject CCPs to a comprehensive regulatory regime*. The main requirements CCPs will have to meet under the FINFRAG are as follows:

i. *Obtaining collateral and determination of a "default waterfall":* In order to mitigate credit and liquidity risks, CCPs will be required to obtain adequate collateral from the participants, in particular in the form of initial margin, additional margin and participation in a default fund. The CCP will need to determine the "waterfall" of collateral proceeds and other financial resources in case of a defaulting participant (pursuant to the requirements as set forth in the FINFRAG).
ii. *Limited means of payment:* The regulation currently applicable to systemically important FMIs will be extended to CCPs (irrespective of whether or not the CCP is systematically important). Accordingly, the CCP and its participants will be required to settle payments by transferring sight deposits at a central bank or, if not possible or practicable, use a means of payment with minor credit and liquidity risks.

iii. *Maintaining of liquidity buffer:* The liquidity buffer, as further described in the FINFRAG, will need to consist of cash or liquid financial instruments bearing only minor market or credit risks.
iv. *Adopting measures to mitigate risks arising from defaulting participants* and s*egregation of accounts* (as set out in the FINFRAG).

(44) *Interoperability arrangements* between CCPs will be subject to approval by FINMA. In order to avoid restraints of competition, the FINFRAG, as proposed, requires a CCP to accept the request of another CCP to enter into an interoperability arrangement, except if it would jeopardise a secure and efficient clearing.

h) Central Securities Depositories (CSDs)

(45) A CSD is a facility *that operates a central securities depository and/or a securities settlement system*. The latter is described as a facility that is based on common rules and procedures and that serves the purpose of clearing and settling transactions involving financial instruments, in particular securities.

(46) A CSD will be required, among other duties, to cover risks relating to the granting of credit (in particular by obtaining collateral), to maintain sufficient liquidity, to adopt measures mitigating a participant default and to segregate accounts.

(47) The FINFRAG, as proposed, describes link arrangements (*Verbindungen*) between CSDs as *agreements relating to (i) the execution of payment and transfer orders or (ii) the direct or indirect participation of a CSD in another CSD*. Such link arrangements will be subject to approval by FINMA.

i) Trade Repositories

(48) Similar to the description in EMIR, Trade Repositories under the proposed FINFRAG are described as *institutions that centrally collect, manage and deposit data relating to derivatives transactions*.

(49) Trade Repositories will be required to regularly disclose relevant transaction data. As of today, there are no Trade Repositories domiciled in Switzerland.

j) *Payment Systems*

(50) The FINFRAG, as proposed, addresses *wholesale* Payment Systems and describes them as *facilities that are set up on the basis of common rules and procedures and serve the purpose of clearing and settlement of monetary obligations deriving from financial market transactions between financial intermediaries*.

(51) The FINFRAG, as proposed, does not provide any specific duties relating to Payment Systems, but authorises the Federal Council to do so if and to the extent necessary to implement generally accepted international standards. The SNB's competence to determine specific requirements for systemically important Payment Systems remains reserved.

2. New Regulation on Derivatives Trading

(52) The recent financial crisis revealed that the lack of transparency in the markets for derivatives traded over-the-counter (OTC) has the potential to threaten the stability of the entire financial system. Since then, international efforts have been set in motion, in particular by the Group of Twenty (G-20) and the Financial Stability Board (FSB), to improve transparency and stability in the OTC derivatives market.

(53) In order to safeguard the competitiveness of the Swiss financial centre, strengthen financial stability, maintain the ability of Swiss market participants to access foreign markets and enable Swiss participants to take advantage of certain exemptions granted under foreign regulations (in particular under EMIR and the US-Dodd-Frank Act), it is necessary for Switzerland to implement equivalent standards on derivatives trading as fully as possible in parallel with other financial centres.

a) *Definition of Derivatives and Derivatives Transactions*

(54) OTC-derivatives were the trigger for the new regulations. OTC-derivatives are (i) traded bilaterally between market participants (*i.e.* not over a Trading Venue), (ii) rarely standardised (and hence generally more complex), (iii) often not cleared over a CCP and (iv) usually lesser collateralised. It is important to note that the FINFRAG, as proposed, also partially subjects non-OTC derivatives (*i.e.* derivatives that are traded over a Trading Venue) to its regulations.

(55) The FINFRAG, as proposed, defines derivatives as *financial contracts, the value of which depends on one or multiple underlying assets* (*Basiswerte*) and which do not qualify as a spot transaction (*Kassageschäft*).

(56) The FINFRAG, as proposed, clarifies that repo and securities lending transactions do not qualify as derivatives transactions and delegates to FINMA the authority to specify in the FMIO the derivatives that are subject to a clearing obligation (*Abrechnungspflicht*) or trading obligation (*Plattformhandelspflicht*). The scope of application for reporting duties and risk mitigation obligations will remain subject to interpretation. Submissions in connection with the FINFRAG consultation requested that a clear exemption for FX derivatives transactions be included given that for such transactions the settlement risk, rather than the counterparty risk, is an issue and settlement is mainly effected through CLS Bank International. Given that this aspect is treated differently in the current US and EU regulations, it remains to be seen what the Swiss approach will be.

b) Participants Subject to the New Rules

(57) In general, the derivatives trading rules will be applicable only to transactions between parties domiciled in Switzerland whereby the registered office as described in the articles or the company contract will be decisive or, alternatively, the place of actual administration. Foreign branches of Swiss participants will be treated as a Swiss domiciled participant while Swiss branches of foreign participants (unless specifically subjected to the FINFRAG by the Federal Council due to a lack of corresponding regulation abroad) will generally not be subject to the FINFRAG.

(58) ***Financial counterparties (FCs)*** are defined as counterparties professionally involved in financial markets such as banks, securities dealers, (re-)insurance companies, parent companies of a financial or insurance group or conglomerate, fund management companies, SICAVs, limited partnerships for collective investment schemes, SICAFs, asset managers of collective investment schemes, pension funds (*Vorsorgeeinrichtungen*) and investment foundations (*Anlagestiftungen*).

(59) ***Non-Financial counterparties (NFCs)*** are all legal entities that do not qualify as an FC which, for example, includes asset managers of non-collective investment schemes and investment advisors (other than under EMIR).

(60) The FINFRAG, as proposed, introduces two sub-categories, *i.e*. **small NFCs** and **small FCs.**

(61) ***Small NFCs*** are NFCs that have an average gross position (*Durchschnittsbruttoposition*) in all relevant categories of OTC derivatives below a certain threshold for a period of 30 consecutive days. Both, the categories of derivatives (*e.g.* credit derivatives, equity derivatives, interest rate derivatives, foreign exchange derivatives, etc.) and the thresholds for such categories will be set by the Federal Council in the FMIO. Positions for the reduction of risks (hedging) directly relating to the NFC's business or the liquidity or financial management of the NFC or its group are disregarded for the calculation of the average gross positions.

(62) Under EMIR, the EU has set the thresholds at EUR 1 billion for OTC credit derivative contracts and OTC equity derivative contracts and at EUR 3 billion for OTC interest rate derivative contracts, OTC foreign exchange derivative contracts and OTC commodity derivative contracts as well as other OTC derivative contracts. Similar thresholds may be expected to be applicable under the Swiss regulations.

(63) ***Small FCs*** are FCs that (i) enter into OTC derivatives transactions solely to hedge risks arising from mortgage transactions (*Hypothekargeschäften*) directly entered into with clients (FINMA, however, will be given the authority to further restrict the criteria in an ordinance) and (ii) have an average gross position (*Durchschnittsbruttoposition*) of such OTC-derivatives for the past 30 days period below the threshold yet to be set by the Federal Council in the FMIO. According to the Explanatory Report FINFRAG, a single derivatives transaction (even if minor) not in line with the exemptions would result in the exemptions for small FCs not being available at all – a rather strict approach in order to have any meaning in practice, which hopefully will be reconsidered for the final version of the FINFRAG.

(64) A change of status from a FC/NFC to a small FC/NFC will become effective after a four month waiting period. The classification of a counterparty is its own obligation and counterparties may – absent clear indications to the contrary – rely on confirmations of a counterparty with regard to its status.

(65) In case a small NFC/FC exceeds the thresholds for 30 consecutive days, then it will lose its status as a small NFC/FC.

(66) ***The following participants will not be subject to the new rules (except for the reporting duty):*** multilateral development banks (*e.g.* the World Bank and the European Investment Bank) and organisations owned by the Swiss Federation, cantons or municipalities for which they provide a guarantee or similar collateral (to the extent they do not qualify as a FC) as well as social insurance carriers and compensation offices (*Ausgleichskassen*).

(67) The Swiss Federation, cantons, municipalities, the SNB and the Bank for International Settlement (BIS) ***will not be subject to the new rules*** on derivatives trading.

(68) The following chart indicates the duties allocated under the proposed FINFRAG to the various regulated market participants:[13]

Participants / Obligations	Financial Counterparty (FC)	Small Financial Counterparty (small FC)	Non-Financial Counterparty (NFC)	Small Non-Financial Counterparty (small NFC)
Clearing	yes	no	yes	no
Reporting	yes	yes	yes	yes
Risk mitigation – operational risk	yes	yes	yes	yes
Risk mitigation – valuation	yes	no	yes	no
Risk mitigation – collateral	yes	yes	yes	no
Platform trading	yes	no	yes	no

c) Extraterritorial Effect of New Rules

(69) Like the corresponding US and EU regulations, the proposed FINFRAG has certain elements with an extraterritorial effect. For example, the clearing or platform trading obligations will also apply in case of a transaction between a Swiss and a foreign participant if the foreign participant would be subject to the clearing and platform obligation if it were domiciled in Switzerland ("what if-test").

[13] Explanatory Report FINFRAG (FN 7), p. 134.

d) What are the Key Obligations under the Proposed New Rules?

(70) With the proposed new rules, the risks associated to derivatives trading will be mitigated – the main risk being that counterparties cannot fulfil their obligations. The proposed FINFRAG implements four areas of regulation:

i. a clearing obligation;
ii. a reporting obligation;
iii. risk mitigation measures for uncleared derivatives transactions; and
iv. a platform trading obligation.

Clearing Obligation

(71) The primary risk mitigating measure will be the obligation that derivatives transactions must be cleared through a FINMA approved or recognised CCP. FINMA may allow clearing through a foreign non-recognised CCP in certain cases. If a CCP has only one or very few Swiss related transactions, the recognition process may be disproportionate for such CCP.

(72) The types of derivatives subject to the clearing obligation will be determined by FINMA in the FMIO, but will nevertheless be based on the basic principles set out in the FINFRAG (*i.e.* legal and operational standardisation, liquidity, trading volumes, availability of information on pricing mechanisms).

(73) Transactions involving small FCs/NFCs or participants that are generally exempt from the new rules (*e.g.* the Swiss Federation, cantons, municipalities, SNB, BIS, multilateral development banks, social insurance carriers are exempt from the clearing obligation) are not subject to the clearing obligation. Furthermore, transactions between parties that are (i) fully consolidated group members, (ii) subject to appropriate centralised risk evaluation, measurement and control procedures and (iii) not entered into to circumvent the clearing obligations, are also exempt from the clearing obligation.

(74) Clearing in connection with derivatives is a process whereby the positions of the counterparties are established through the calculation of the net positions by netting and the posting of collateral (margins) to secure the net obligations. A CCP is an organisation which enters in between the two counterparties, on the one side as buyer and on the other side as seller. A CCP must be able to model and measure the risks of a derivatives transaction and to control them, this is feasible only with stand-

ardised derivatives. For such purpose, only standardised derivatives are suitable for a clearing obligation while non-standardised derivatives will continue to be bilaterally cleared. Since a significant portion of derivatives transactions do not meet the criteria for a standardisation, such transactions will continue to be cleared bilaterally.

(75) The proposed requirements for becoming a direct member of a CCP (a clearing member) are high. Therefore, smaller FCs and most of the NFCs will clear their transactions indirectly through a clearing member (indirect participation).

(76) Currently, there is only one CCP domiciled in Switzerland, the SIX x-clear AG. However, SIX x-clear AG is not primarily involved in the clearing of derivatives transactions. Such market is dominated by foreign CCPs such as LCH.Clearnet Ltd or the Eurex Clearing AG, which are classified as systemically important by the SNB.[14]

(77) For cross-border transactions, the clearing obligation will also apply in case the foreign counterparty would be subject to a clearing obligation if domiciled in Switzerland ("what if-test").

(78) Clearing can also be effected pursuant to the rules of another jurisdiction if FINMA has recognised these foreign rules as equivalent in order to harmonise the various regulations. The EU and US regulations have similar concepts in place (*i.e.* "equivalence" and "substituted compliance").

Risk Mitigation Measures for Uncleared Derivatives Transactions

(79) Derivatives transactions not cleared through a FINMA approved or recognised CCP will be subject to risk mitigating obligations consisting of (i) the posting of adequate collateral to mitigate the counterparty risk, (ii) the daily valuation of the derivative at market prices and (iii) the obligation to organise operations to reduce operational risks.

(80) Transactions with counterparties generally exempt from the derivative trading rules (*e.g.* the Swiss Federation, cantons, municipalities, SNB, BIS, multilateral development banks, social insurance carriers) will also not be subject to the risk mitigating measures because they are deemed not to create risks that need to be specifically mitigated.

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14 Swiss National Bank, Annual Report 2013, p. 84.

(81) Except for small NFCs, the counterparties to non-cleared derivatives transactions will be required to exchange adequate collateral (margins) and such collateral must be segregated from other assets in order to allow for a swift and uncomplicated realisation of the collateral prior to the official liquidation of the counterparty. The proposed FINFRAG does not clarify what "adequate" collateral is. If certain criteria are met, group internal transactions will be exempt from the obligation to post collateral. Although foreign counterparties cannot be directly obliged to post collateral to a Swiss counterparty, it is the Swiss counterparty that will need to ensure that it receives adequate collateral, otherwise it is not allowed to conclude the transaction.

(82) Operational risk mitigating measures are, for example, the *timely confirmation of terms and conditions* of the derivatives transaction or the implementation of appropriate procedures for the *reconciliation of portfolios* as well as the timely *detection and settlement of potential disagreements* between the parties. According to the Explanatory Report FINFRAG, it is acknowledged that certain of these obligations already apply to FCs based on other regulations; however, a "best practice" must be developed for NFCs, in particular small NFCs.

(83) Derivatives transactions must further be *valued* daily on the basis of actual prices. If market conditions do not permit a valuation at market, a valuation based on appropriate models recognised in practice will be permitted. Beside the generally exempt counterparties, small FCs and small NFCs will also be exempted from the daily valuation obligation.

Reporting Obligation

(84) The key information of all derivatives transactions (without exemptions for small FCs/NFCs or group transactions) will need to be reported by the counterparties and the CCP to a FINMA approved or recognised transaction register (TR). The parties will need to avoid multiple reporting. The reporting obligation can be delegated.

(85) Counterparties and CCPs will need to ensure that the details of any derivatives transaction they have concluded and any modification or termination of the transaction are reported to a TR. The details will need to be reported no later than the working day following the conclusion, modification or termination of the transaction.

(86) The Federal Council will determine the format of the reporting. Given the aim to achieve better transparency, efficiency, integrity and the recognition of risks by implementing the reporting obligation, it is absolutely essential that the data delivered to the TRs globally can be shared, assembled and evaluated effectively and efficiently. This requires that the involved parties to the transaction and the type of the transaction are clearly identifiable and that the format is globally agreed upon and used by all TRs.

(87) The Regulatory Oversight Committee (ROC), a stand-alone committee established following the recommendations of the FSB and subsequent endorsement by the G-20, oversees the Global Legal Entity Identifier System (GLEIS) pursuant to which a standardised identification system is being globally implemented by means of the so-called legal entity identifier (LEI), a 20-digit, alpha-numeric code that connects to key reference information and enables the clear and unique identification of companies participating in global financial markets.

(88) As part of the ongoing effort to improve the OTC derivatives infrastructure, the International Swaps and Derivatives Association (ISDA) has also developed a plan to define a standardised taxonomy (classification) for OTC derivatives and develop unique product identifiers (UPIs) with the aim of supporting regulatory mandates to increase transparency through public and regulatory reporting.

(89) The reporting of information about derivatives transactions by Swiss parties to foreign TRs raises data confidentiality and professional secrecy issues. The FINFRAG, as proposed, states that the reporting of such data is also generally permitted to foreign TRs so that no permission pursuant to Art. 271 of the Swiss Criminal Code (SCC) (regarding unlawful activities on behalf of a foreign state) will be necessary in each case. However, a consent/waiver must be obtained if the data delivered abroad contains personal data.

Platform Trading Obligation

(90) Standardised derivatives will need to be traded over a FINMA approved or recognised platform in order to enhance pre- and post-trade transparency. Transactions with or among small FCs/NFCs and, if certain criteria are met, group internal transactions will be exempt from such obligation. FINMA will determine the scope of derivatives subject to such

obligation and take into account international standards, both of which will ensure some flexibility with regard to timing and allow for the adaptation to international standards. The platform trading obligation is not intended to become effective until such obligation has been imposed internationally (in particular in the EU).

e) Who Monitors Compliance with the Rules and what are the Sanctions?

(91) Compliance with the derivative trading rules will be examined by the auditor of the respective counterparty and, in case of regulated financial institutions, in accordance with the applicable financial laws.

(92) Violations of the rules on derivatives trading can be sanctioned by a penalty of up to CHF 500,000 (in case of an intentional breach) or up to CHF 150,000 (in case of a negligent breach).

f) Transitional Periods

(93) All derivatives transactions concluded *on or after the FINFRAG becomes effective* will be subject to the rules of the FINFRAG (*i.e.* no transitional periods for implementing operational and reporting procedures). The Federal Council will have to determine the scope of the application of the clearing, reporting and risk mitigating measure obligations under the FINFRAG to derivatives transactions that have been entered into *prior to the entering into force of the FINFRAG*.

3. Securing Measures / Restructuring / Bankruptcy / Netting Rules

(94) With regard to *non-regulated Swiss holding companies of financial groups or conglomerates or other Swiss material companies within such groups/ conglomerates that fulfil significant tasks in relation to regulated services*: According to the FINFRAG, as proposed, Art. 2 BA will be supplemented in order to make clear that FINMA is the competent authority for measures in case of insolvency (*Massnahmen bei Insolvenzgefahr*) or the bankruptcy liquidation procedures (*Bankenkonkurs*) of such non-regulated companies as well.

(95) The FINFRAG, as proposed, further states that the special insolvency regime that has been introduced for banks and securities dealers over the past years (*i.e.* Arts. 25–37 and 37*e*–37*g* BA) will apply *mutatis mutandis*

to FMIs to the extent that the FINFRAG does not contain provisions to the contrary. Some of these special provisions and features (*e.g.* securing measures, segregation of assets into good and bad bank, bail-in of debt) for banks and securities dealers are currently further specified in the FINMA Ordinance on the Insolvency of Banks (BIO-FINMA) which, however, is not referred to or incorporated into the proposed FINFRAG.

(96) For instance, Art. 27 BA (which, according to the proposed FINFRAG, will be replaced by Art. 80 FINFRAG) is supplemented by provisions in the BIO-FINMA (Arts. 53–55). These existing provisions, in their totality, are important in order to ensure a clear and well-founded legal basis for FMIs as, for example, required by Principle 1 of the Principles for Financial Market Infrastructures (PFMI). It is important that the pertinent regulations of the BIO-FINMA continue to apply and remain in force, and the proposed FINFRAG should therefore be clarified in this respect.

(97) The FINFRAG, as proposed, also contains a provision stating that any netting arrangements or arrangements permitting a private enforcement of collateral in the form of cash, liquid securities or other financial instruments will not be affected by any insolvency measures (*Insolvenzmassnahmen*) imposed. There is a risk that existing Swiss legislation and regulations that provide the legal framework relied upon by FMIs with respect to finality, close-out and netting provisions will be inadvertently over ridden or adversely impacted by the new FINFRAG rules. It should therefore be clarified that upon the insolvency of a participant, the FINFRAG will have priority over any conflicting insolvency provisions and will remain unaffected by any insolvency measures.

(98) Contrary to the current Swiss banking laws, the term "Insolvenzmassnahmen" is not specified in the proposed FINFRAG, which may cause uncertainty.

(99) Article 83 of the proposed FINFRAG states that set-off/netting arrangements will prevail over Art. 211 para. 2bis of the Debt Enforcement and Bankruptcy Act (DEBA). However, it should be clarified in the final version of FINFRAG that this provision should not be interpreted in any way as to compromise or call into question the scope of protection provided under Art. 80 para. 4 FINFRAG (which, like Art. 83 FINFRAG, deals with set-off/netting arrangements, but is not limited to giving priority to certain types of agreements with CCPs over Art. 211 para. 2bis DEBA only).

(100) The proposed FINFRAG also introduces a statutory transfer mechanism whereby collateral, claims and obligations of a bankrupt clearing member of a CCP held on behalf of an indirect participant shall be automatically transferred to the indirect participant or another clearing member designated by the indirect participant upon the bankruptcy of the clearing member.

(101) The proposed FINFRAG is not clear as to when and to what extent "*actiones paulianae*" (avoidance actions) also apply to actions taken by FMIs.

4. Further Provisions

(102) *Securities Dealers:* Except for the category of the securities dealers trading for the account of their customers (*Kundenhändler*), the different types of securities dealers (*i.e.* own account dealers, issuing houses, derivative houses and market makers) under the SESTA will be transferred from the SESTA into the FINFRAG and the individual license categories will be consolidated.

(103) The current regime relating to the *disclosure of shareholdings*, *public takeovers* as well as *insider trading* and *market manipulation* will be transferred into the FINFRAG.

(104) Among various other amendments of federal laws, the FINFRAG will also introduce new rules on *administrative assistance (Amtshilfe)*.

B. Key Differences to EU Regulations

1. Financial Market Infrastructures

(105) While in the EU there is a trend to limit self-regulation of trading venues, the proposed FINFRAG adheres to the concept of self-regulation. This different approach results in a number of deviations from the MiFID II/ MiFIR regulation. For example, under the proposed FINFRAG the compliance of trading requirements regarding securities is determined by the Trading Venue, whereas in the EU the relevant supervisory authority is the relevant competent authority.

(106) Under MiFID II, the operator of an OTF is not allowed to trade on its platform for its own account, whereas there is no such prohibition in the proposed FINFRAG.

(107) As opposed to the CSDR, the proposed FINFRAG does not require the immobilisation or dematerialisation of securities. A Swiss CSD, however, will be required to enable participants to hold their securities in form of book-entry securities within the meaning of the Swiss Book-Entry Securities Act (BESA).

(108) Unlike the CSDR which requires CSDs to implement a period of two days for the settlement of transactions in securities, the proposed FINFRAG provides that the CSD itself determines the settlement period for its system (however, the proposed FINFRAG requires CSDs to take into consideration international custom and the needs of their clients).

(109) Unlike the CSDR, the proposed FINFRAG also regulates link arrangements between CSDs in the context of which a CSD has an account with a depository that does not qualify as a CSD.

(110) The proposed regulation relating to the transfer of data between a Swiss Trade Repository and foreign authorities is more restrictive than under EMIR.

2. Derivatives Trading

(111) In order to ensure access of Swiss participants to the EU market and in order for Swiss participants being eligible for EU/US exemptions, the proposed FINFRAG has been drafted with a particular focus on ensuring compliance with the EU/US regulations. However, there are deviations.

(112) Under EMIR, the clearing and platform trading obligation also applies (i) to contracts between non-EU entities having a "direct, substantial and foreseeable effect" within the EU or (ii) where necessary to prevent evasion of EMIR. The proposed FINFRAG does not contain analogous provisions.

(113) The FINFRAG, as proposed, establishes the concept of "small FCs". While this concept is not included under EMIR, it is reflected under the Dodd-Frank Act in the US. In addition, under the proposed FINFRAG, asset man-

agers that do not manage collective investment schemes and investment advisors will qualify as NFCs, whereas under EMIR they qualify as FCs.

(114) While under the proposed FINFRAG derivatives traded over an exchange are also subject to the clearing obligation, the same is not the case under EMIR (given that most of these transactions are generally cleared centrally).

(115) The group exemption for the clearing obligation under the proposed FINFRAG will also apply in cross-border situations, whereas under EMIR the exemption is available only in case the relevant jurisdiction of the other group member has an equivalent derivatives regulation and the competent EU regulator has approved the exemption. In Switzerland, compliance with such exemptions will not be controlled by the regulator, but by the auditor of the Swiss participant.

(116) The Swiss reporting will not require the disclosure of the beneficial owner, whereas this is required under EMIR.

(117) Discrepancies also exist between the US (Dodd-Frank Act) and the EU (EMIR) regulations and the US and the EU are currently engaging in a dialogue to overcome these discrepancies. International harmonisation efforts (involving Switzerland) are also under way and were, *inter alia*, published by the OTC Derivatives Regulators Group (ODRG) in the form of a "Report on Agreed Understandings to Resolving Cross-Border Conflicts, Inconsistencies, Gaps and Duplicative Requirements" in September 2013.

C. What Swiss and Foreign Market Participants Need to be Aware of

1. Financial Market Infrastructures

(118) Under the current regime, Swiss trading venues are divided into "stock exchanges" and the rather vague category of "facilities similar to stock exchanges" (*i.e.* exchange-like facilities). Institutions qualifying as exchange-like facilities are only required to obtain a license if FINMA so determines. The FINFRAG, in accordance with the EU regulation, introduces a new concept consisting of three categories (Stock Exchanges,

MTFs and OTFs), replacing the catch-all category of exchange-like facilities by MTFs and OTFs. Swiss trading venues, especially exchange-like facilities, therefore, should closely examine the scope of the proposed new licensing requirements.

(119) The FINFRAG, as proposed, provides for tailor-made licenses for CCPs, CSDs and Trading Repositories for which new requirements apply.

(120) The FINFRAG, as proposed, does not regulate high-frequency trading or financial benchmarks, which has been criticised in the consultation process.

(121) The FMI regulation is a moving target since the FINFRAG, as proposed, delegates important areas of FMI regulation to the Federal Council. Thus, the regulatory concept will remain very flexible and facilitate constant alignment with international developments.

2. Derivatives Trading

(122) Both financial and non-financial counterparties will be subject to the new rules.

(123) The new rules will have an extraterritorial effect by also applying to foreign counterparties. In addition, Swiss counterparties will need to ensure that foreign counterparties meet certain criteria.

(124) The trading in derivatives will become more expensive and complicated.

(125) Compliance with the derivatives trading obligations will require (significant) administrative and operational adjustments and their implementation will take time.

(126) Together with the Swiss regulations, corresponding EU and US regulations must be analysed given their extraterritorial effect and applicability in Switzerland.

IV. Institutions – FINIG

(127) The Financial Institutions Act (FINIG) is one of the proposed new pieces of legislation that has emerged as a result of the authorities' endeavours towards achieving cross-sectoral regulation. It is currently in draft form and subject to change as a result of the Federal Council's consultation procedure, to be followed by Parliamentary review. The Federal Council launched the consultation on the Act on 27 June 2014, which will run until 17 October 2014[15].

(128) The effects of the proposed new law are controversial among representatives of the financial industry, economists and lawyers. While a general need for enhancement of investor protection is acknowledged, the methods suitable for its achievement are widely disputed. The large scope of criticism surrounding the draft FINIG at the very least indicates that it may not pass through the Federal Council consultation period and Parliamentary review without substantial alterations being made.

A. Overview

1. Aim and Scope of the New Proposed Law

(129) The draft legislation introduces a differentiated supervisory and regulatory regime for Financial Institutions (as defined below) providing asset management services to third parties. It is envisaged to become a framework law that will govern the licensing requirements and further organisational conditions for Financial Institutions. The aim of the FINIG is to (i) enhance the protection of investors and clients of Financial Institutions, (ii) increase the functionality of the financial market, and (iii) increase the stability of the financial system (Art. 1 para. 2 FINIG). The new proposed regulation further looks to improving market conditions, reducing conflicts of interest and increasing the attractiveness of the Swiss market for

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15 Federal Council Announcement of the consultation launch on the Federal Financial Services Act and Financial Institutions Act ("Launch Announcement"), 27 June 2014, available on <https://www.news.admin.ch/message/index.html?lang=en&msg-id=53561>, last seen on 29 July 2014.

asset management. The proposed FINIG shall provide for harmonised, cross-sectoral regulation in order to "create a *level playing field* for the supervised institutions"[16]. The following aspects relevant to Financial Institutions are intended to be regulated under the FINIG:

i. organisation of institutions;
ii. licensing requirements;
iii. supervision of institutions;
iv. foreign financial institutions;
v. tax compliance due diligence;
vi. insolvency measures; and
vii. criminal provisions.

(130) Under current law, not all Financial Institutions are regulated or subjected to prudential supervision. As a result of the most recent revision of the CISA, the mandatory licensing obligation was already expanded to asset managers of foreign collective investment schemes. Under the FINIG it is now envisaged for all asset managers to be placed under licensing obligations and prudential supervision (Arts. 4 and 82 FINIG). The expansion of the scope directly affects "independent" asset managers, who are currently only subjected to provisions of the AMLA, and asset managers of occupational pension schemes.

2. Financial Institutions

(131) The new FINIG will apply to the following financial services providers (collectively, the Financial Institutions), irrespective of their legal form:

i. *Asset managers*;
ii. *Qualified asset managers* (asset managers of collective investment schemes and asset managers of Swiss occupational benefits schemes);
iii. *Fund management companies*;
iv. *Securities houses* (currently classified as security traders); and
v. *Banks.*

(132) The new act shall not apply – among others – to persons who exclusively manage assets of persons to whom they have economic or family links or exclusively manage assets in the framework of employee participation plans (Art. 2 para. 2 lit. a FINIG). In particular, the exemption

16 Explanatory Report FIDLEG/FINIG (FN 6), p. 21.

also comprises the activities of (i) a family member for the *family office* of his family and (ii) persons who, without being related to the family, are employed to manage a single *family office* which solely manages its own financial assets and is controlled by a family member.

3. Adaption of Current Laws

(133) The individual Financial Institutions are typically defined according to their general business operations. Provisions concerning Financial Institutions already subject to prudential supervision under current law will basically remain unchanged and will be incorporated into the FINIG. However, the relevant provisions will be revised in order to remedy existing deficiencies due to the age of the provisions.

(134) This adaption will require the review of the existing regulations concerning asset managers of collective investment schemes (to be reclassified as qualified asset managers), fund management companies, securities dealers (to be reclassified as securities houses) and banks, currently regulated under the CISA, the SESTA and the BA, as applicable.

(135) The proposed transfer of regulations regarding fund management companies to the FINIG has been justified on the basis that such institutions practice a qualified form of asset management. Despite the proposed transfer of certain regulations into the FINIG, the product specific regulations of the CISA will continue to govern contractual and corporate structured collective investment schemes.

(136) The majority of the SESTA will be transferred into the FINIG, in particular the provisions concerning securities dealers. The term "securities dealer" used under the SESTA will be replaced by the term "securities house".

(137) Many of the general licensing requirements and duties provided for in the FINIG are also set out in the BA, and numerous BA provisions also apply to securities houses. Therefore, transferring the BA into the FINIG should lead to a simplification and harmonisation of regulation.

(138) The SESTA and BA are intended to be repealed entirely once provisions contained therein are adopted by the FINIG (Art. 124 FINIG in connection with Section I of the Appendix to the FINIG).

B. Selected Features of the New Proposed Law

1. Harmonised Supervision of All Institutions

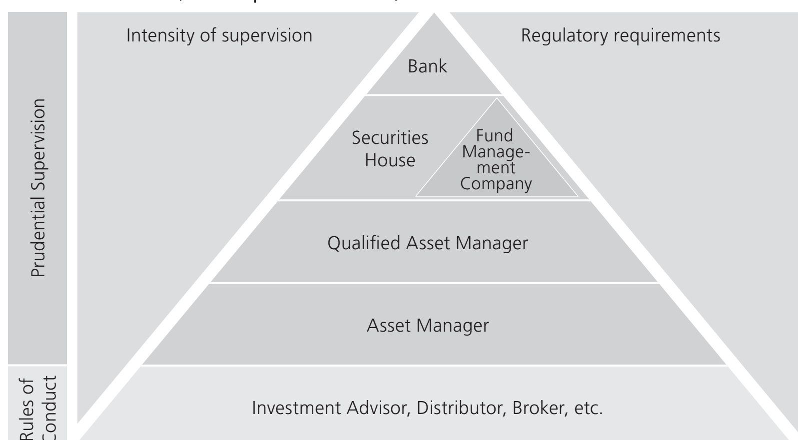
(139) According to current law, not all Financial Institutions (as defined by the FINIG) are supervised by FINMA. In particular, independent asset managers, except asset managers of collective investment schemes, may operate without license from or registration with the authorities[17]. This means that their operations are not subject to prudential supervision by FINMA and rules of conduct can neither be imposed nor controlled. An integrated supervisory regime is the core aspect to be established by the FINIG, which will subject all Financial Institutions providing asset management services for third parties to comparable regulation and supervision.

2. Licensing Provisions

(140) Financial Institutions falling within the scope of the FINIG will require a license from FINMA and may not be registered in the commercial register until such license has been granted (Art. 4 paras. 1 and 2 FINIG). Financial Institutions already in possession of a license at the time the FINIG enters into force will not require a new license; however, they must comply with the requirements of the new legislation within one year after its entry into force (Art. 125 para. 1 FINIG). The FINIG further provides for a licensing cascade regime (with a similar pattern as set out in Art. 12 para. 3 of the CISA and Art. 8 of the Collective Investment Schemes Ordinance (CISO), *i.e.* the higher license types will also encompass lesser license types so that institutions will not necessarily need multiple licenses). A license to operate as a bank will also include authorisation to operate as a securities house, qualified asset manager and asset manager (Art. 5 para. 1 FINIG). Hence, a license to operate as a securities house or fund management company will include authorisation to operate as a qualified asset manager and asset manager (Art. 5 para. 2 FINIG). A license to operate as a qualified asset manager, thus, also encompasses the ability to operate as a (non-qualified) asset manager (Art. 5 para. 3 FINIG). Finally, a license to operate as a Financial Institution includes the

17 However, such independent asset managers are subject to licensing under the AMLA or must become a member of a recognised anti-money laundering SRO. FINMA's supervision of independent asset managers is limited solely to ensuring compliance with the due diligence requirements set out in the AMLA.

authorisation to operate as a representative of foreign collective investment schemes (Art. 5 para. 4 FINIG).



(Source: FDF Regulatory Impact Assessment, free translation)[18]

(141) The FINIG will provide the conditions for the granting of licenses (Art. 6 FINIG). In general, Financial Institutions will be required to meet the licensing conditions and requirements throughout the duration of their business operations. Licensing requirements that can – for practical reasons – only be fulfilled upon performance of the business activity must at least be achievable by the Financial Institution.

3. Assurance of Proper Business Conduct

(142) In order to ensure client protection and business professionalism, a particular business conduct will be expected and explicitly required by the proposed law from all Financial Institutions (including the asset managers). A distinct set of obligations applicable to all Financial Institutions is envisaged in the draft act. The content of the assurance for proper business conduct requirements in the new act will consist of the requirements currently set out in the BA, SESTA and CISA. This corresponds to the licensing practice of FINMA. The professional qualifications required depend upon the individual person's function and responsibility. Furthermore,

[18] Federal Department of Finance, Regulatory Impact Assessment *(Regulierungsfolgenabschätzung zum Finanzdienstleistungsgesetz FIDLEG und zum Finanzinstitutsgesetz FINIG),* status 26 June 2014, p. 12.

the provisions of the FINIG will ensure that the assurance of proper business conduct cannot be endangered by the influence of qualified shareholders. The assurance of proper business conduct requirements will also explicitly apply to qualified asset managers and banks, each in their function as Financial Institutions.

4. Asset Managers

(143) In contrast to a financial advisor, an asset manager has the power to manage the investment of client assets independently. The central characteristic of an asset manager is the professional exercise of the activity in the name and for the account of the investor. Asset managers will be able to choose amongst legal forms that are suitable for the exercise of their asset management business. Hence, individuals may also act as asset managers. However, they will always have to be registered in the commercial register. Like all other Financial Institutions, asset managers must possess sufficient financial resources. Asset managers who buy or sell securities for clients over their own account or deposit will fall within the scope of provisions regarding securities houses and, thus, require a corresponding license (Art. 38 lit. a FINIG).

(144) The draft act provides for two options for the future supervision of (independent) asset managers. Either (i) direct supervision by FINMA or (ii) supervision by a quasi-governmental supervisory authority (Art. 82 FINIG), based on the US model of the Financial Industry Regulatory Authority (FINRA)[19]. Such supervisory authority shall have the authority to issue circulars and will have access to most supervisory instruments provided by the proposed FINMAG. The new supervisory authority will further take on the supervisory tasks provided for by the AMLA and FIDLEG.

(145) While some, such as the SBA, have applauded the new supervision of independent asset managers[20], others have rejected it. Applying the same supervisory methods for major banks to small- and medium-sized enter-

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19 Explanatory Report FIDLEG/FINIG (FN 6), p. 142.

20 Daniela Flückiger on behalf of the SBA, Aufgebrachte Anlageverwalter, in: TagesAnzeiger online, 27 June 2014, available on <http://www.tagesanzeiger.ch/wirtschaft/unternehmen-und-konjunktur/Aufgebrachte-Anlageverwalter/story/12076589>, last seen on 29 July 2014.

prises has, in particular, been heavily criticised as being inappropriate by the Swiss Association of Asset Managers (SAAM)[21], mainly due to the financial burden it will place on small asset managers. It is estimated that initial license costs may lie between CHF 70,000 and CHF 128,000 depending on the business size, with additional costs between CHF 19,000 and CHF 56,000 recurring annually[22]. Such costs may financially cripple smaller institutions to the extent that they will no longer be able to continue operating their business.

5. Qualified Asset Managers

(146) Asset managers of collective investment schemes and asset managers of assets of Swiss occupational benefits schemes will be reclassified as "qualified asset managers" (Art. 21 para. 1 FINIG). They will be supervised by FINMA and will need to comply with stricter requirements than those of asset managers of private individual assets. The more stringent requirements placed on asset managers of assets of Swiss occupational benefits schemes can be justified on the basis that they manage savings that secure the retirement provisions for the respective investors[23]. Compliance with occupational benefits regulations will continue to be monitored by the respective supervisory authorities.

6. Foreign Financial Institutions

(147) Provisions in the proposed new act concerning foreign securities houses and banks correspond to the relevant existing provisions in the BA (Arts. 3bis, 3^{quater} and 3ter BA). These provisions in the BA are already applicable to securities dealers under current law (Arts. 37 SESTA and 56 of the Stock Exchange Ordinance (SESTO)).

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21 Swiss Association of Asset Managers, FIDLEG/FINIG: Ein Monstrum! Eröffnung der Vernehmlassung für das Finanzdienstleistungs- und Finanzinstitutsgesetz ("SAAM Media release"), Zurich 27 June 2014, available on <www.vsv-asg.ch/uploads/file/news/2014/20140627_-fidleg-de.pdf>, last seen on 29 July 2014.

22 Zürcher Hochschule für Angewandte Wissenschaften (School of Management and Law), Analysis of FINIG Regulatory Costs *(Regulierungskostenanalyse zum Finanzinstitutsgesetz (FINIG)),* status 6 May 2014, p. 47.

23 Explanatory Report FIDLEG/FINIG (FN 6), p. 22.

(148) The FINIG, as proposed, harmonises the licensing obligation for branches of foreign qualified asset managers, securities houses and banks, which were previously set out in the CISO, the SESTO and the FINMA Foreign Banks Ordinance (FBO-FINMA), as applicable. A foreign Financial Institution will need to obtain a license if it employs persons who operate on a continuous and commercial basis on the institution's behalf in Switzerland (Art. 73 para. 1 FINIG).

(149) With regard to the license requirements, the FINIG, as proposed, will basically incorporate the respective regulations concerning branches in the banking, securities, and collective investments area (Art. 74 FINIG). FINMA may make the granting of the license for a foreign Financial Institution to open a branch in Switzerland subject to reciprocity from the state in which the foreign Financial Institution or qualified shareholders have their domicile (Art. 75 FINIG). Furthermore, the supervisory authority will be permitted to condition the creation of a branch of a foreign (independent) asset manager or a foreign qualified asset manager in Switzerland upon the lodging of adequate security, if such measure is warranted for the protection of investors or clients (Art. 77 FINIG).

(150) Similar provisions for branches will apply to representative offices of foreign Financial Institutions under the proposed FINIG. Foreign (independent) asset managers, qualified asset managers, securities houses and banks will need to secure a license from FINMA if they employ people in Switzerland who operate a representative office for such Foreign Institution on a continuous and professional basis in Switzerland (Art. 79 para. 1 FINIG). Foreign fund management companies, however, will not be permitted to create a representative office in Switzerland (Art. 79 para. 3 FINIG).

7. Tax Compliance

(151) There has been a clear increase in the focus on tax compliance in the financial markets in relation to tax evasion in recent years. The proposed FINIG revisits some of the initially proposed changes of the AMLA (*i.e.* extended due diligence recommendations on combating money laundering and terrorist financing) that were submitted for consultation by

the Federal Council in February 2013[24] and which were then rejected after the Parliamentary debate later that year. The respective provisions faced criticism in 2013 and will undoubtedly be challenged in the current Federal Council consultation and the following Parliamentary debate.

(152) The primary obligation will consist of determining whether there is an increased risk that the financial assets which the Financial Institution is planning to accept are undeclared or will not be declared to the relevant tax authorities (Art. 11 para. 1 FINIG). However, this obligation will only apply if the client's country of origin has not signed an agreement with Switzerland on the automatic exchange of information (AEI) in tax matters according to international standards (Art. 11 para. 3 FINIG). In circumstances where a Financial Institution must presume that the relevant financial assets are – in violation of tax obligations – undeclared, such institution will be expected to undertake the following actions (Art. 11 para. 4 FINIG):

i. refuse acceptance of the assets and a new business relationship; and
ii. in case of existing clients, terminate the business relationship, if:
    1. the existing clients cannot prove that the assets already in possession of the Financial Institution have been suitably taxed; and
    2. the rectification of the tax situation will not pose any unreasonable inconveniences for them.

8. Insolvency Provisions

(153) The regulation of insolvency under the proposed FINIG will mirror the respective provisions of the BA. However, the provisions will not only apply to banks, but also to fund management companies and securities houses. While this does not constitute a change to current law in relation to banks or securities houses, it does for fund management companies. Under current law, fund management companies are subject to the special regulatory provisions of the CISA concerning liquidation proceedings (Art. 137 *et seq.* CISA). Under the proposed FINIG, safeguards and, in individual cases, restructuring proceedings to fund management

[24] Federal Council Announcement on the launch of consultations on combating money laundering and on enhance due diligence requirements in the area of taxation, 27 February 2013, available on <https://www.news.admin.ch/message/index.html?lang=en&msg-id=47934>, last seen on 29 July 2014.

companies will also be applicable. Insolvency measures do not apply to asset managers and qualified asset managers since both act in the name and for the account of third parties and, thus, are not able to dispose of third party assets.

9. Criminal Provisions

(154) The proposed FINIG provision relating to professional confidentiality (Art. 19 FINIG) corresponds to current Arts. 47 BA, 43 SESTA and 148 para. 1 lit. k, para. 2 and para. 3 CISA. Persons shall be penalised by imprisonment of up to 3 years or a fine, if they (a) reveal a secret entrusted to them in their capacity as organ, employee, agent or liquidator, or that they became aware of in this capacity, or (b) tried to induce another to breach professional confidentiality obligations, or (c) reveal a secret, or use it for themselves or others, that was entrusted to them in violation of (a) (Art. 119 para. 1 FINIG). Persons shall be penalised by imprisonment of up to 5 years or a fine if they create a financial advantage for themselves or another through an act set out in (a) or (b) above (Art. 119 para. 2 FINIG). The negligent committing of an offence under the proposed FINIG shall be penalised with a fine of up to 180 daily penalty units (Art. 119 para. 3 FINIG).

10. Transitional Provisions

(155) Financial Institutions newly subjected to the legislation will need to report to the supervisory authority within six months of the FINIG's entry into force (Art. 125 para. 2 FINIG). Within two years of entry into force, such Financial Institutions must meet the regulatory requirements and request a license to operate (Art. 125 para. 2 FINIG). However, they may continue their operations until a decision regarding the license is made. Qualified asset managers, fund management companies, securities houses and banks that are already in possession of a license for the relevant activity upon the legislation's entry into force will not be required to apply for a new license, but must comply with the new law within a year of its entry into force (Art. 125 para. 1 FINIG).

(156) Independent asset managers who have performed their operations for at least 15 years will benefit from a *grandfathering clause*. They will not need to apply for a license, so long as they solely maintain their current

client relationships and do not take on any new clients (Art. 125 para. 3 FINIG). This exemption acknowledges the business experience of long term asset managers who already enjoy the trust of their clients and, thus, should not be required to apply for a license just in order to continue their business activities until retirement[25].

(157) FINMA will have the power to extend such deadlines (Art. 125 para. 4 FINIG).

C. Key Differences to EU Regulations

(158) A major difference between the proposed FINIG and current EU regulations relates to their structure. The proposed FINIG produces a harmonised and comprehensive regulation structure, whereas in EU jurisdictions strong fragmentation of the relevant legal sources still remains. Furthermore, financial institutions in the EU are not subject to a single supervisory body or a group of specific bodies, as envisaged in the proposed FINIG. They are instead supervised by European supervisory bodies according to their functions, such as the European Banking Authority for banks, and by the competent authorities in the home member state of the institution.

(159) According to national laws of EU member states, financial institutions are generally subjected to prudential supervision and licensing requirements in a manner similar to that foreseen by the proposed FINIG. However, apart from the proposed registration duties for client advisors under the FIDLEG, pure advisory services are not subject to an obligation to obtain a FINMA license.

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25 Explanatory Report FIDLEG/FINIG (FN 6), p. 147.

D. What Swiss and Foreign Market Participants Need to be Aware of

(160) Due to the envisaged scope of the FINIG, the majority of Financial Institutions will be subject to the proposed regulation. In order to comply with the new law within the time frame provided it is important for Financial Institutions to be aware of their obligations thereunder in advance.

1. Swiss Market Participants

i. All persons and Financial Institutions investing or managing third party assets on a professional basis will need to be in possession of a license from FINMA and comply with the assurance for proper business conduct requirements.
ii. Existing asset managers will benefit from a grandfathering clause and will not be subjected to prudential supervision if they have been exercising their activities for at least 15 years and limit themselves to continuing existing client relationships.
iii. Asset managers of collective investment schemes and asset managers of Swiss occupational benefits schemes will be newly classified as “qualified asset managers” and subject to stricter requirements.
iv. Extended due diligence requirements when accepting financial assets may be applicable.
v. Fund management companies will be subject to stricter insolvency regulations.
vi. Transitory provisions and deadlines will need to be observed.

2. Foreign Market Participants

i. As before, continuous physical presence of foreign Financial Institutions in Switzerland will lead to a requirement to establish a branch or representative office in Switzerland.
ii. Foreign Financial Institutions will need to comply with the same rules of conduct as Swiss Financial Institutions.

V. Services and Products – FIDLEG

A. Overview

1. General Provisions (Arts. 1–5 FIDLEG): Purposes and Definitions

(161) The purpose of the new Financial Services Act (FIDLEG) is client protection and the creation of a sufficiently level playing field in terms of regulatory conditions for the rendering of financial services (Art. 1 para. 1 FIDLEG). Key content of the new proposed law is the determination of requirements for the loyal, diligent, and transparent provision of financial services and of rules on the enforcement of civil claims of clients of financial services providers (Art. 1 para. 2 FIDLEG). In addition, the proposed FIDLEG regulates the organisation and approval of the client adviser register, the inspecting authority for prospectuses, and the ombudsman's office (Art. 1 para. 3 lit. a–c FIDLEG). Its proposed scope comprises the regulation of financial services providers, client advisers, distributors, and producers of financial instruments (Art. 2 lit. a–c FIDLEG)[26]. The FIDLEG, as currently drafted, defines, *inter alia*, the following important basic terms:

i. *Financial instruments* pursuant to Art. 3 lit. b nos. 1–7 FIDLEG are shares, non-voting equity securities, participation certificates, securities that can be converted (*e.g.* convertible bonds) or exercised (*e.g.* options) into shares, debt securities, shares or units of collective investment schemes, structured products (in particular, but not limited to, capital protected notes, maximum return products, and certificates[27]). Furthermore, derivatives are also considered financial

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26 Cf. Luca Bianchi, Proposed Regulatory Framework for Financial Products in Switzerland, in: CapLaw 1/2014, pp. 18 *et seq.*

27 In our view financial instruments include, but are not limited to, all structured products that are set out in the Swiss Derivative Map of the Swiss Structured Products Association, available on <http://www.svsp-verband.ch/home/swissderivativemap.aspx?lang=en>, last seen on 29 July 2014.

instruments according to Art. 2 lit. b FINFRAG[28] as well as deposits with redemption value or interest that depends on risk or market prices.

The offering of insurance products, in principle, will not be subject to the FIDLEG. However, the following exceptions will apply:

- insurance brokers will need to comply with the rules of the ISA and some of the provisions in the ISA will be brought in line with the FIDLEG;
- life insurance contracts that can be repurchased will be deemed to be financial instruments and their distribution, therefore, will be regulated directly by the FIDLEG (Art. 3 lit. b no. 6 FIDLEG)[29].

ii. *Financial services* are the following activities provided for clients: purchase and sale of financial instruments, acceptance and transmission of orders regarding financial instruments, asset management, providing of personal recommendations in respect of financial instruments (*i.e.* investment advisory), custody of financial instruments for the account of clients, carrying of accounts (!), and granting of loans in connection with transactions in financial instruments (Art. 3 lit. d nos. 1–7 FIDLEG).

iii. *Financial services providers* are all persons that provide financial services on a professional basis in Switzerland or for clients in Switzerland (Art. 3 lit. e FIDLEG).

iv. *Client advisers* are natural persons that provide financial services in the name of a financial services provider or in their own name (Art. 3 lit. f FIDLEG). In particular, the sales force of a bank, investment advisers, relationship managers, and natural persons that are *acting* as external distributors of financial instruments, could qualify as client advisers in terms of Art. 3 lit. f FIDLEG. Employees of financial ser-

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28 In the past, from a strictly legal perspective, some products (*e.g.* plain vanilla warrants) were not to be qualified as structured products in terms of Art. 5 para. 1 CISA and, therefore, not subject to the legal obligation to publish a simplified prospectus. Under the FIDLEG, as proposed, a KIID will have to be published also for these products (if an offer to private investors is intended), because all products set out in the Swiss Derivative Map qualify at least as derivatives according to Art. 3 lit. b no. 5 FIDLEG in connection with Art. 2 lit. b FINFRAG.

29 From an economic perspective, these insurance products show characteristics that are similar to other financial instruments due to their investment component.

vices providers that do not have contact to clients or have only a subordinated support function will not qualify as client advisers.

v. A *public offer* is defined as a communication to the general public which comprises sufficient information on the terms and conditions and the security in order to execute a purchase or *subscription* of the security (Art. 3 lit. h FIDLEG).

(162) The proposed FIDLEG will introduce a sophisticated concept of client segmentation. The basis for the differentiated investor protection are the following definitions:

i. *Clients* are persons, for which a financial services provider renders financial services (Art. 4 para. 1 FIDLEG). They are categorised as private clients, professional clients, and institutional clients;

ii. *Private clients* are clients that do not qualify as professional clients (Art. 4 para. 1 FIDLEG);

iii. *Professional clients* are: (i) regulated financial intermediaries, (ii) regulated insurance companies, (iii) foreign clients that are under equivalent prudential supervision as the persons in (i) and (ii), (iv) central banks, (v) public bodies with professional treasury operations, (vi) retirement benefits institutions with professional treasury operations, and (vii) enterprises with professional treasury operations (Art. 4 para. 3 lit. a–g FIDLEG). The Federal Council can declare that further client categories qualify as professional clients (Art. 4 para. 5 FIDLEG);

iv. The term *institutional clients* comprises professional clients according to Art. 4 para. 3 lit. a–d FIDLEG and *supranational and national* public bodies with professional treasury operations (Art. 4 para. 4 FIDLEG).

(163) Pursuant to the draft FIDLEG, high-net-worth individuals (HNWI) will be able to declare in writing that they wish to be deemed professional investors (*opting-out*; Art. 5 para. 1 FIDLEG). The Federal Council may make such persons' freedom to opt-out dependent on certain conditions, in particular, expertise qualifications (Art. 5 para. 1 FIDLEG). Institutional clients should be able to demand to be considered as professional investors (Art. 5 para. 3 FIDLEG). Further, professional and even institutional clients may declare in writing to be treated as private clients

(*opting-in*[30]; Art. 5 para. 2 FIDLEG). Financial services providers will have to inform their clients on the possibility of opting-in if they do not qualify as private clients automatically.

2. Requirements for Providing of Financial Services (Arts. 6–36 FIDLEG)

a) Code of Conduct

General Principle

(164) The FIDLEG defines the conduct duties of financial services providers vis-à-vis their clients (Art. 6 para. 1 FIDLEG). As a general principle, financial services providers will be obliged to act in the best interest of their clients and apply the required knowhow, due diligence and care (Art. 6 para. 2 FIDLEG and Art. 398 para. 2 of the Swiss Code of Obligations (CO)). The core aspects of these provisions are the information and enquiry duties described below. In addition, further provisions as set out in other financial market laws may be applicable (Art. 6 para. 3 FIDLEG).

Specific Duties

Information Duties

(165) Financial services providers will be subject to an information duty vis-à-vis their clients, in particular, regarding the following: (i) their name, address, regulatory status, and area of practice, (ii) the offered financial services, (iii) their economic ties to third parties that are connected with the offered financial services, (iv) the offered financial instruments, (v) the type of custody of the financial instruments, (vi) the risks connected with the financial services, financial instruments, and custody, (vii) the costs connected with the offered financial services, the purchase,

30 In connection with the CISA an opting-out describes the decision of a high-net-worth individual to switch out of his qualified investor status and into a non-qualified investor status (and, thereby, to benefit from more investor protection) (cf. Sandro Abegglen, Die unabhängigen Vermögensverwalter vor grossen Veränderungen – Elemente der KAG-Teilrevision, in: Peter R. Isler / Romeo Cerruti, EIZ-Vermögensverwaltung V, Zurich 2012, p. 86). *Vice versa,* under the terminology proposed by the FIDLEG an opting-out means that an investor waives his private investor status (and loses investor protection), and elects to be treated as professional investor. This inconsistency of the terminology of the FIDLEG and the CISA is likely to cause confusion.

sale and holding of the offered financial instruments, and (viii) the possibility to initiate a mediation proceeding before an ombudsman.

(166) With respect to advisory services and asset management, it is forseen that financial services providers will need to inform their clients on whether (i) their services are provided as independent or not, (ii) a continuous evaluation of the suitability of the financial instruments will be provided or not, and (iii) a market analysis will be provided in connection with the financial services or not (Art. 7 para. 2 lit. a–c FIDLEG). This information may be provided to the clients in standardised form (Art. 7 para. 3 FIDLEG). Advertisings must be marked as such (Art. 7 para. 4 FIDLEG). Financial services providers may only flag a specific service as "independent", if they (i) consider a sufficient number of financial instruments offered on the market, and (ii) do not accept benefits from third parties in connection with such service, or accept benefits, but forward them to their clients (Art. 9 para. 1 lit. a and b FIDLEG). Only financial services providers that fulfil these conditions in respect of all services which they provide will be permitted to identify themselves as an independent institution (as opposed to only a specific service) (Art. 9 para. 2 FIDLEG).

Assessment of Suitability and Appropriateness

(167) Financial services providers that render investment advisory or asset management services will be obliged to perform a suitability check, *i.e.* inquire about the financial situation and investment objectives, and also expertise, and experience of the clients regarding the offered financial instruments or financial services, prior to making a recommendation with respect thereto (Art. 10 FIDLEG). If the information obtained by the financial services provider is not sufficient for a suitability check, he will not be permitted to provide advisory or asset management services and will need to inform the clients accordingly (Art. 13 para. 2 lit. a FIDLEG). An advisor or asset manager will only be able to recommend financial instruments or execute transactions, respectively, if the recommendation or transaction, as applicable, is suitable for the client.

(168) A financial services provider that delivers financial services other than advisory or asset management services will need to perform an appropriateness check, *i.e.* assess the expertise and experience of his clients with respect to the offered financial instruments or financial services

and evaluate whether they are appropriate or not (Art. 11 FIDLEG). In case the gathered information is not sufficient to perform an appropriateness check, the financial services provider will need to warn the client about the fact that an assessment as to whether the financial instruments or the financial services are appropriate for the client is not possible (Art. 13 para. 2 lit. b FIDLEG).

(169) Professional clients may be deemed to possess the required expertise and experience (Art. 12 para. 1 FIDLEG). Further, per se professional clients may be considered able to bear the risk of financial services at all times, unless contrary indications exist (Art. 12 para. 2 FIDLEG). Finally, vis-à-vis institutional clients neither suitability nor appropriateness checks are required (Art. 20 FIDLEG).

(170) With respect to (a) *execution and transfer of client orders* and (b) the *administration of an account or deposits*, the financial services provider will not be obliged to perform a suitability or appropriateness check if these services have been requested at the initiative of the client (Art. 14 para. 1 lit. a and b FIDLEG). However, the financial services provider will be required to inform the client that these checks will not be made before executing the services (Art. 14 para. 2 FIDLEG).

Documentation and Reporting Duties (Arts. 15–16 FIDLEG)

(171) Pursuant to the draft legislation, financial services providers will be obliged to document the following in writing: (i) the services that have been agreed with clients and the information that has been given to them, (ii) the informing or the warning of the clients according to Arts. 13 or 14 FIDLEG, and (iii) the services that have been provided to the clients (Art. 15 para. 1 lit. a–c FIDLEG). Moreover, with respect to asset management and investment advisory services, financial services providers will be required to record the client's needs and the reasons for a recommendation that leads to the purchase or sale of a financial instrument (Art. 15 para. 2 FIDLEG).

(172) In addition, financial services providers will be obliged to deliver a copy of the documentation required by Art. 15 FIDLEG to their clients (Art. 16 para. 1 FIDLEG). They must notify their clients about the provided services, and, in particular, (i) give account on the executed orders, (ii) the composition, valuation and development of the portfolio, and (iii) the costs linked to the services (Art. 16 para. 2 lit. a–c FIDLEG). The Federal

Council will regulate the time and minimum content of such information (Art. 16 para. 3 FIDLEG).

Best Execution Principles / Securities Lending (Arts. 17–19 FIDLEG)

(173) Financial services providers will be obliged to comply with the principles of *bona fide* and equal treatment while processing client orders (Art. 17 para. 1 FIDLEG). The Federal Council will specify these principles, in particular, with respect to procedures and systems to settle client orders (Art. 17 para. 2 FIDLEG). Financial services providers will be bound to the duty of best execution in respect of financial, temporal, and qualitative aspects (Art. 18 para. 1 FIDLEG). In particular, not only the price of the financial instrument but also the costs linked to the execution of the order and the benefits according to Art. 26 para. 3 FIDLEG must be taken into consideration (Art. 18 para. 2 FIDLEG). The implementation of internal guidelines regarding the execution of client orders will be mandatory (Art. 18 para. 3 FIDLEG).

(174) It is intended that the following rules will apply with respect to the use of financial instruments of clients: Financial services providers may only borrow financial instruments from client holdings as counterparty or lend them to third parties if the clients have agreed to these transactions in a separate agreement, which must not be part of the general terms and conditions of the financial services provider (Art. 19 para. 1 FIDLEG). The approval of the clients is only valid if the clients (i) have been informed on the risks linked to these transactions, (ii) have a compensation claim on the due proceeds of the securities that have been lent, and (iii) receive a compensation for the securities lending (Art. 19 para. 2 lit. a–c FIDLEG). If a client is not a professional client the approval must be provided in writing (Art. 19 para. 3 FIDLEG). Uncovered securities lending transactions with financial instruments of private clients will be prohibited (Art. 19 para. 4 FIDLEG).

Lower Requirements regarding Institutional Clients (Art. 20 FIDLEG)

(175) With respect to transactions with institutional clients Arts. 6, 7, 8 para. 1, 9 and 16 para. 2, 17, 18 and 19 FIDLEG will be applicable (Art. 20 FIDLEG). The other rules of the code of conduct will not be mandatory (Art. 20 FIDLEG). For institutional clients no Key Investor Information Document (KIID; *Basisinformationsblatt*) will need to be provided. Furthermore, the

obligations to perform suitability or appropriateness checks, as well as some of the regulatory documentation and accountability duties will not be compulsory vis-à-vis institutional clients (in particular, those set out in Art. 15 and Art. 16 para. 1 and 3 FIDLEG). Of course, accountability duties deriving from the civil law may still be applicable (cf. Art. 400 para. 1 CO).

b) *Organisation / Conflicts of Interest (Arts. 21–27)*

(176) Financial services providers will be obliged to ensure the fulfilment of their duties according to the proposed FIDLEG with internal guidelines and an adequate organisation (Art. 21 FIDLEG). They will need to ensure that their employees possess the skills that are required for their tasks (Art. 22 para. 1 FIDLEG) and that only registered client advisers are acting as client advisers (Art. 22 para. 2 FIDLEG). Actual or potential conflicts of interests will need to be avoided. Employee transactions should be monitored and inappropriate behaviour excluded (Art. 27 para. 1 FIDLEG). In particular, appropriate and suitable measures will need to be implemented in an internal guideline (Art. 27 para. 2 FIDLEG).

(177) Financial services providers will be obliged to take appropriate measures to avoid conflicts of interest or respective disadvantages of clients (Art. 25 para. 1 FIDLEG). If a disadvantage for clients cannot be excluded it must be disclosed to the respective client (Art. 25 para. 2 FIDLEG).

(178) Financial services providers will only be permitted to accept benefits in connection with the performance of financial services, if (a) clients have explicitly waived their claims on receiving such benefits, or (b) the benefits are forwarded to the clients completely (Art. 26 para. 1 lit. a and b FIDLEG). A waiver by the clients will only be valid if the type and amount of the benefits are disclosed before the financial services have been provided. If the amount of the benefit cannot be determined in advance, the financial services provider will need to inform its clients on the calculation parameters *and* the range of the benefits (Art. 26 para. 2 FIDLEG). Benefits in terms of Art. 26 para. 1 FIDLEG will consist of payments, such as commissions, rebates, distribution remunerations, retrocessions and similar payments, including other financial advantages (*e.g.* soft dollars) that are made to the financial services providers (Art. 26 para. 3 FIDLEG). These proposed provisions are stricter than the current case law of the

Swiss Federal Court concerning retrocessions[31] in particular because the proposed provisions would seem to be applicable to all financial services and not only to services that fall subject to Art. 400 para. 1 CO is applicable.

c) *Client Advisers (Arts. 28–33 FIDLEG)*

(179) According to the draft legislation, client advisers will need to possess sufficient knowledge on the code of conduct set out in the FIDLEG and have the expertise that is required for their activities (Art. 28 FIDLEG). Only registered client advisers will be permitted to work as client advisers (Art. 29 FIDLEG). Conditions for the registration are that the client advisers (i) have obtained professional liability insurance or equivalent collateral has been provided, and (ii) are connected to an ombudsman's institution according to Art. 75 FIDLEG (Art. 30 para. 1 lit. a and b FIDLEG). In addition, client advisers will have to provide evidence that they (i) do not have a criminal record regarding violations of Arts. 119–121 FIDLEG (*i.e.* violations of the rules for prospectuses or KIIDs, illegal offering of financial instruments, or violations of the code of conduct of the FIDLEG) or 137–172ter SCC (offences against property), and (ii) have not become subject to a professional ban as contemplated by Art. 30 para. 2 lit. a and b FIDLEG (*i.e.* regulatory ban of activity or prohibition to exercise his profession). The proceeding before the registration office will be governed by the Administrative Procedure Act of 20 December 1968 (APA) (Art. 33 FIDLEG).

d) *Cross-border Activities into Switzerland (Arts. 34–36 FIDLEG)*

(180) It is foreseen that foreign financial services providers performing a cross-border activity which requires a license in Switzerland will need to be registered in the client adviser registry (which will be conducted by a FINMA approved registration office), unless they have obtained an ap-

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[31] Cf. decisions of the Swiss Federal Court 4A_127/2012 of 30 October 2012, c. 5.6, and 4A_266/2010 of 29 August 2011, c. 2.6 *et seq.*; Sandro Abegglen, Retrozession ist nicht gleich Retrozession, in: SZW 79 (2007), pp. 122 *et seq.*; Sandro Abegglen, Der Verzicht auf Ablieferung von Retrozessionen – Einordnung und Anforderungen, in: recht 2007, pp. 190 *et seq.*; Luca Bianchi / François Bianchi, RdF-Länderreport Schweiz: Aktuelle Entwicklungen im Aufsichts-, Zivil-, Bilanz und Steuerrecht für den Kapitalmarkt, in: RdF 2014/1, p. 73.

propriate license (Art. 34 paras. 1 and 2 FIDLEG). A cross-border activity is defined as any activity of a financial services provider with a domicile outside of Switzerland that renders a financial service to a client in Switzerland. The financial services may be provided with or without permanent physical presence of employees in Switzerland. It is quite remarkable to note that, in principle, there exists no general duty to establish a Swiss branch under the proposed FIDLEG. However, in case of an ongoing physical presence the FINIG will require the establishment of a branch or representative office in Switzerland[32]. In addition, under the CISO, if the distribution of structured products to non-qualified investors is intended and the products are not listed with SIX Swiss Exchange (SIX), a Swiss branch (with the regulatory status that is required for the relevant business activities) is mandatory for the issuer or the guarantor[33]. Presumably, this rule will be transferred to the Federal Financial Services Ordinance (FFSO).

(181) Prerequisites for the registration of cross-border activities that will be regulated by the FIDLEG are (i) a license from (a) the supervisory authority in the home country or in the place of the head office of the service provider or (b) an equivalent prudential supervision, (ii) professional liability insurance, (iii) a written commitment to FINMA to provide complete information on the Swiss business activities and the business relationships maintained in Switzerland, and (iv) an agreement on the collaboration and the exchange of information between FINMA and the relevant foreign supervisory authority (Art. 35 lit. a-d FIDLEG).

(182) The register for foreign financial services providers that wish to render cross-border financial services into Switzerland will be administrated by FINMA who may be served by foreign providers (Art. 36 para. 1 FIDLEG). Swiss clients shall receive the same protection they benefit from when facing Swiss financial services providers. Therefore, the code of conduct according to Arts. 6 *et seq.* FIDLEG, will also apply to cross-border activities of foreign financial services providers (Art. 6 para. 1 FIDLEG).

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32 Art. 73 *et seq.* FINIG.

33 Cf. François Bianchi / Luca Bianchi / Yannick Wettstein *et al.*, Debt Capital Markets 2014, in: David Lopez / Adam E Fleisher / Daseul Kim, Getting the Deal Through – Debt Capital Markets in 19 Jurisdictions Worldwide (2014), p. 100; Bianchi / Bianchi (FN 31), p. 70.

3. Offering of Financial Instruments (Arts. 36–71 FIDLEG)

a) *Prospectus (Arts. 37–57 FIDLEG)*

Prospectus Duty (Art. 37 FIDLEG)

(183) It is foreseen that whoever offers financial instruments for sale or subscription in a public offering into, in or from Switzerland or requests admission of financial instruments on a regulated market according to Art. 25 FINFRAG will be required to publish a prospectus beforehand (Art. 37 para. 1 FIDLEG)[34]. The prospectus duty will also apply to the resale of financial instruments in case of firm underwritings (Art. 37 para. 2 FIDLEG). The prospectus duty will be subject to certain exceptions as described below (*safe harbour rules*), in which cases there will be no obligation to publish a prospectus. Further exceptions will be set forth by the Federal Council (cf. Art. 48 FIDLEG).

Exceptions regarding the Type of the Offering (Art. 38 Para. 1 lit. a–e FIDLEG)

(184) According to the proposed new rules, there will be no duty to publish a prospectus in case of offers that satisfy any of the following:

i. address only professional clients (lit. a);
ii. address less than 150 investors that qualify as private clients (lit. b);
iii. address only investors that purchase financial instruments in the amount of at least CHF 100,000 (lit. c);
iv. have a minimum denomination of CHF 100,000 (lit. d); or
v. have a total volume of not more than CHF 100,000 in a period of time of 12 months (lit. e).

Exceptions regarding the Type of the Financial Instrument (Art. 39 lit. a–j FIDLEG)

(185) Furthermore, there will be no duty to publish a prospectus in case of offerings regarding any of the following:

i. shares which are issued outside of a capital increase in exchange for existing shares of the same kind (lit. a);
ii. financial instruments that are offered for exchange due to a takeover if written information exist that has a content which is equivalent to an issuance prospectus (lit. b);

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34 Regulated markets may only admit financial instruments that fulfil the prospectus requirements for public offers (Art. 40 FIDLEG).

iii. financial instruments that are offered or allocated due to a merger, split, conversion, or transfer of assets if written information exists that have a content which is equivalent to an issuance prospectus (lit. c);
iv. shares that are redeemed to the holders of shares of the same kind if written information on the amount and the type of the shares as well as the reasons and details of the offer exist (lit. d);
v. financial instruments that are offered or allocated to members of the board or the management or employees if written information on the amount and the type of the shares as well as the reasons and details of the offer exist (lit. e);
vi. shares on capital of central banks (lit. f);
vii. securities that are issued by establishments with ideal purpose (lit. g);
viii. certificates of deposits (*Kassenobligationen*) (lit. h);
ix. money market instruments (lit. i); and
x. derivatives that are not offered by way of an issuance (lit. j).

Content (Art. 42 FIDLEG)

(186) The content of the prospectus will be regulated in Art. 42 FIDLEG. The prospectus will need to comprise the information which is relevant for the decision of the investor (Art. 42 para. 1 FIDLEG), such as information on:

i. the issuer/guarantor (if applicable) (*i.e.* (a) the board of directors, management, auditor, and other bodies, (b) the last annual report, (c) the business situation, and (d) the material perspectives, risks, and litigation);
ii. the securities, in particular, the terms and conditions, risk factors, and final terms (where applicable); and
iii. the offer, in particular, the type of placement and the estimated net revenue of the issuance.

(187) The prospectus will need to be provided either in German, French, Italian, or English (Art. 42 para. 2 FIDLEG). Information may be incorporated to the prospectus by way of reference to the extent specified by the Federal Council (Art. 43 paras. 1 and 2 FIDLEG). Furthermore, the prospectus will have to contain a summary of the essential information set out in comprehensible form (Art. 42 para. 3 FIDLEG). The summary will need to be made in a uniform format that allows for a comparison with summaries of similar financial instruments (Art. 44 para. 1 FIDLEG). With respect to debt securities, the prospectus may be in the form of an issuance pro-

gramme, whereas the final terms of a specific product under the base prospectus may be issued in separate final terms (Art. 46 para. 1 FIDLEG).

Approval Proceeding (Art. 53 FIDLEG)

(188) A major change is being proposed with respect to the approval of prospectuses. Under the proposed FIDLEG, any prospectus for a *public* offering (and not only a stock exchange listing prospectus like under the previous regime[35]) will need to be examined and approved by an authority with respect to completeness, coherence, and comprehensibility (Art. 52 para. 1 FIDLEG in connection with Art. 53 para. 1 FIDLEG). An approval of the prospectus only after the issuance of the respective financial instruments could be implemented for certain debt securities by the Federal Council (Art. 52 para. 2 FIDLEG). Furthermore, the responsible body may approve a prospectus that is published under foreign law for a public offer (or approval for trading on a regulated market) into, in, and from Switzerland, if (i) it is drafted according to international standards, and (ii) the applicable information duties are equivalent to those of the FIDLEG (Art. 55 lit. a and b FIDLEG). It will still be possible to submit missing information by way of a Swiss wrapper[36]. Furthermore, Swiss selling restrictions and a Swiss tax wording will have to be implemented[37]. The prospectus will be valid for public offers or trading on a regulated market for a period of 12 months after its approval (Art. 56 FIDLEG). It will be possible to register supplements to the prospectus with the competent authority (Art. 57 para. 1 FIDLEG).

b) Special Provisions for the Offering of Collective Investment Schemes (Arts. 49–51 FIDLEG)

(189) The management companies of open investment funds, respectively, SICAV, according to the CISA will be obliged to publish a fund contract in the form of a prospectus (Art. 49 para. 1 FIDLEG). The prospectus will

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35 Cf. Philippe Weber / Markus Kronauer / Andrea Huber, Die Börsenzulassung in der Schweiz in ihrem rechtlichen und steuerlichen Umfeld, in: Mathias Habersack / Peter O. Mülbert / Michael Schlitt, Unternehmensfinanzierung am Kapitalmarkt, 3rd ed., Cologne 2013, p. 1512.

36 Cf. Bianchi / Bianchi / Wettstein et. al (FN 33), p. 97.

37 Cf. Bianchi / Bianchi / Wettstein et. al (FN 33), pp. 97 *et seq.*; Philippe Weber, The Offering of Foreign Securities in Switzerland, in: Thomas Reutter / Thomas Werlen, EIZ-Kapitalmarkttransaktionen III, Zurich 2008, pp. 11 *et seq.*

need to either include the fund regulations or make reference to the place where they can be obtained (Art. 49 para. 2 FIDLEG). The Federal Council will specify the content of the prospectus (Art. 49 para. 3 FIDLEG). The prospectus and its updates will need to be filed with FINMA immediately (Art. 49 para. 4 FIDLEG). The same rules will apply to the SICAF by analogy (Art. 50 para. 3 FIDLEG).

(190) Furthermore, the Swiss Limited Partnership (*Kommanditgesellschaft für kollektive Kapitalanlagen*) as defined in Art. 98 CISA will need to publish a prospectus (Art. 50 para. 1 FIDLEG). It will need to contain the following information that is included in the partnership agreement according to Art. 102 para. 1 CISA (Art. 50 para. 2 FIDLEG):

i. investments;
ii. investment strategy;
iii. investment restrictions;
iv. risk diversification;
v. risks linked to the investment; and
vi. investment techniques.

(191) Due to the FINMA approval requirement as set out in the CISA, prospectuses of collective investment schemes will not be subject to the approval by the evaluation body according to Art. 53 para. 1 FIDLEG (Art. 52 para. 3 FIDLEG).

c) Key Investor Information Document (Arts. 58–63 FIDLEG)

(192) It is foreseen that in order to offer a financial instrument to private clients, a standardised Key Investor Information Document (KIID; *Basisinformationsblatt*) will have to be published. If the offer is made by way of an issuance of a financial instrument in the primary market (i) an indicative version of the KIID will need to be provided before subscription and (ii) the KIID will need to be published (Art. 58 para. 2 lit. a and b FIDLEG). An exception from the duty to provide a KIID will apply to shares and securities similar to shares that grant membership rights (Art. 59 FIDLEG). KIIDs will need to include the following information:

i. the name of the financial instrument and the identity of the issuer;
ii. the type and characteristics of the financial instruments;
iii. the risk- and return profile of the financial instrument, in particular, the probability of a capital loss;
iv. the costs of the financial instrument;

v. the minimal holding period and the liquidity profile of the financial instrument; and
vi. information on the licenses and approvals that are connected with the financial instruments.

(193) The KIID will need to be a separate document that is clearly distinguishable from marketing material and easy to understand for a private investor (Art. 62 paras. 1 and 2 FIDLEG). The producer of the financial instrument will need to regularly update the information included in the KIID and update the document where required (Art. 62 para. 3 FIDLEG). The Federal Council will regulate the details on the following topics: (i) content, (ii) volume, language, and design of the KIID, as well as (iii) the modalities of providing it to private clients (Art. 63 lit. a–c FIDLEG).

d) *Common Provisions (Arts. 64–67 FIDLEG)*

(194) The financial instruments provider will need to (i) deposit the approved prospectus/KIIDs with the evaluation body and (ii) publish them as soon as possible (and at the latest before the beginning of the public offer (Art. 64 para. 1 lit. a and b FIDLEG)). The publication requirement can be satisfied either through (i) publishing the prospectus in a newspaper or the Swiss Official Gazette of Commerce, (ii) making hard copies of the prospectus available free of charge at the domicile of the issuer or the lead managers, (iii) publishing the prospectus electronically on the website of the issuer, the regulated market, or the lead manager, or (iv) publishing the prospectus in electronic form on the website of the evaluation body (Art. 64 para. 3 lit. a–d FIDLEG in connection with Art. 66 FIDLEG). However, even if the prospectus is published electronically, additional hardcopies will need to be made available free of charge (Art. 64 para. 4 FIDLEG).

e) *Advertisings (Art. 68 FIDLEG)*

(195) Advertisings in terms of Art. 68 FIDLEG will comprise any activities that have the purpose to sell a financial instrument, irrespective of their type or form[38]. Advertisings will need to be clearly recognisable and labelled as such (Art. 68 para. 2 in connection with Art. 7 para. 4 FIDLEG). If a prospectus or a KIID is published for a financial instrument such must be

[38] Cf. FINMA Circular 2013/9 "Distribution of Collective Investment Schemes", p. 3.

stated in advertisings (Art. 68 para. 1 FIDLEG). Advertisings and any other information on financial instruments will need to be consistent with the prospectus and the KIID.

f) *Liability (Art. 69 FIDLEG)*

(196) A new cross-sector legal foundation for prospectus liability is proposed by Art. 69 FIDLEG. Specifically, where information that is inaccurate, misleading or in breach of regulatory requirements is provided or disseminated in prospectuses, KIIDs, advertisings, or similar statements relating to the issue of financial instruments, any person involved may be liable to the acquirers of the financial instruments for the resulting losses (Art. 69 FIDLEG). The main proposed conditions for a prospectus liability are the following: (i) active legitimation, (ii) passive legitimation, (iii) damage, (iv) violation of a duty of care/information, (v) causation, and (vi) fault[39]. Any damage that has been caused by inaccurate, misleading or insufficient (*e.g.* not in line with the legal minimum requirements) information in a prospectus, KIID, or similar notifications (potentially including advertisings) must be compensated. The Swiss Federal Court currently requires an overwhelming likelihood of the causation between the violation of a duty and the damage. Any natural or legal person that was involved in the production of these documents will be liable to the purchaser of a financial instrument, unless he can prove that he is not at fault (*due diligence defence*). The liability will not be limited to the prospectus itself, but will include documents included by reference according to Art. 43 FIDLEG.

g) *Special Provisions for the Offering of Structured Products (Art. 70 FIDLEG)*

(197) Under the proposed new legislation, structured products may only be offered to private clients (without an asset management agreement) into, in or from Switzerland, if they are issued, guaranteed or secured in an equivalent manner by a Swiss bank, securities dealer or insurance company or a pertinent foreign institution subject to equivalent standards of supervision (Art. 70 para. 1 lit. a–d FIDLEG). The existing rule in the CISO

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39 Cf. Benedikt Maurenbrecher / Stefan Waller, Prospekthaftung und strukturierte Produkte, in: Thomas Reutter / Thomas Werlen, EIZ-Kapitalmarkttransaktionen IV, Zurich 2009, p. 67 *et seq.*

will most likely be integrated in the FFSO, thereby, requiring that the foreign issuer or the guarantor have a regulated Swiss branch[40]. A Swiss branch of a foreign institution in the context of the issuance of structured products can be a representative office, a branch office, a subsidiary, a sister company or a group company (provided that it comes under consolidated supervision at the group level and has the regulatory status that is necessary to render its activities)[41].

4. Enforcement of Civil Claims (Arts. 72–116 FIDLEG)

(198) Clients will have a right to request the delivery of a copy of their client file and any other documents relating to their client relationship that was produced by the financial services provider under their business relationship free of charge (Art. 72 para. 1 FIDLEG). The burden of proof for the fulfilment of information and disclosure duties is proposed to be shifted to the financial services provider (Art. 74 para. 1 FIDLEG). Further, if the financial services provider has not fulfilled his legal information and disclosure duties, it will be presumed that the client would not have executed the concerned trade. Combined with the just mentioned reversal of the burden of proof according to Art. 74 para. 1 FIDLEG, this regime, *de facto*, may provide for a *put option* for clients if the provider cannot prove fulfillment of its information duties. In addition, a claiming client will benefit from the proposed institution of an ombudsman's office, either an arbitration court or a litigation costs fund (which will be sponsored by financial services providers and will bear an appropriate part of the litigation costs of the clients), as well as class actions (Art. 75 *et seq.* FIDLEG).

5. Supervision and Exchange of Information (Arts. 117–119 FIDLEG)

(199) FINMA will monitor and enforce compliance with the requirements for the provision of financial services and the offering of financial instru-

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40 Cf. Art. 4 para. 1 lit. b CISO.

41 Cf. BIANCHI / BIANCHI / WETTSTEIN *et al.* (FN 33), p. 100; FINMA FAQ-Structured Products of 23 December 2010 *(currently being revised)*, p. 2, available on <https://www.finma.ch/e/faq/beaufsichtigte/pages/faq-strukturierte-produkte.aspx>, last visited on 29 July 2014.

ments among the supervised financial services providers (Art. 117 para. 1 FIDLEG).

(200) FINMA, the supervisory organisation, the client adviser registry, the prospectus approval body, the ombudsman, and its supervisory authority will be entitled to exchange information (Art. 118 FIDLEG).

6. Criminal Provisions (Arts. 119–121 FIDLEG)

(201) Intentional violations of the provisions regarding prospectuses and KIIDs may be sanctioned with imprisonment of up to three years or a fine (Art. 119 para. 1 lit. a and b FIDLEG). Such violations will comprise (i) wrong or missing facts and information in the prospectus or KIID, and (ii) violations of the prospectus duty (including proper drafting and the actual creation of the prospectus/KIID). Negligent violations will be sanctioned with a fine.

(202) Furthermore, the illegal offering of financial instruments[42] (*i.e.* a distribution to private clients without a KIID) will be sanctioned with a fine of up to CHF 500,000 (or CHF 150,000 in case of negligence) (Art. 120 paras. 1 and 2 FIDLEG). In addition, non-compliance with the code of conduct of the FIDLEG may result in a fine of CHF 50,000 for intentional breaches (and CHF 15,000 for negligence).

7. Final Provisions (Arts. 122–125 FIDLEG)

(203) In principle, the FIDLEG will become effective immediately after its entering into force. However, for financial instruments that have been offered to private clients prior to the FIDLEG's entry into force, a transitional period of two years will apply by the end of which a KIID must be published (Art. 124 FIDLEG).

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[42] It is quite surprising to see that the wording of the FIDLEG mentions only structured products. We believe that this is an error. Consequently, in our view, Art. 120 para. 1 lit. b FIDLEG is applicable to offerings of all financial instruments to private investors that occur in violation of the duty to provide a KIID according to Art. 58 para. 1 FIDLEG.

B. Key Differences to EU Regulations

(204) MiFID entered into force in November 2007 and contains rules on markets and financial instruments. A core element of MiFID is a regulatory code of conduct for investment firms, including rules on appropriateness of financial services and financial instruments and the evaluation of the suitability by asset managers and advisers. The new alignment of the European financial markets regulation after the financial crisis has led to a revision of MiFID, which resulted in MiFID II. MiFID II enhances the legal prerequisites for asset management and advisory services. It also specifies the minimal duties in case of execution only transactions. In addition, it restrains the possibilities to accept distribution fees, retrocessions, and similar benefits from third parties. Finally, it contains restrictions regarding the use of the label of an "independent" asset manager. Besides, the duties of the producers of financial instruments are largely harmonised in Europe. The European Prospectus Directive regulates that securities may only be offered publicly or admitted to a regulated market if a respective prospectus has been previously published.

(205) MiFID II differs from the FIDLEG amongst others in the following key points:

i. it does not regulate natural persons that act as financial services providers in one legal act, respective rules exist only in the various EU-member states;
ii. prospectuses are approved by the national supervisory authorities and not by a separate approval body;
iii. it requires pure investment advisers to obtain a regulatory approval, whereas the proposed FINIG and FIDLEG require only compliance with the code of conduct;
iv. it restricts execution only orders of retail clients to non-complex financial instruments, whereas the proposed FIDLEG allows private clients execution only orders for any financial instruments, regardless of their qualification as complex or non-complex;
v. it requires an *ex ante* prospectus approval, whereas the proposed FIDLEG provides the possibility of an *ex post* approval for some financial instruments (*e.g.* bonds);

vi. it allows member states to introduce the requirement to establish a branch (for third-country cross-border providers), whereas the proposed FIDLEG, in principle, does not;
vii. in contrast to the proposed FIDLEG, it does not provide for a fund for litigation costs; and
viii. it does not subject all types of financial services but only asset management and investment advisory to the regime on inducements.

(206) In particular, strong opposition can be expected where the proposed FIDLEG rules exceed the MiFID II standards and in particular on the regime for enforcement of civil claims which proves to be very client/plaintiff-friendly. Furthermore, it remains to be seen to what extent Swiss politicians will support the government's intention to achieve full equivalency and whether the goal of full equivalency will mean equivalent in principle or on a rule-by-rule basis.

C. What Swiss and Foreign Market Participants Need to be Aware of

1. Swiss Market Participants

(207) *Services*: Swiss financial services providers will have to consider the following key points:

i. all types of asset managers (including external asset managers[43]) will become subject to prudential supervision;
ii. the code of conduct will be applicable even for investment advisers;
iii. the distribution license for distributors of collective investment schemes will be abolished and replaced by the registration duty for individual client advisers;
iv. implementation of the suitability and appropriateness rules;
v. client segmentation;
vi. strategy in connection with new rules on inducements;

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43 Sandro Abegglen/Andrea Huber, A Changing Landscape – A Guide to Regulatory Developments in the Distribution of Retail Investment Products, in: Herbert Smith Freehills, November 2012, p. 38.

vii. decisions whether providers shall be dependent or independent, and whether dependent or independent financial services shall be provided;
viii. preparation of appropriate client information; and
ix. compliance with the Swiss regulatory code of conduct.

(208) *Products*: Swiss financial instruments providers should be aware of the following issues:

i. new rules concerning the prospectus for financial instruments;
ii. preparation of KIID templates;
iii. preparation of marketing material templates; and
iv. implementation of IT solutions regarding the efficient production of product documentation and marketing material.

2. Foreign Market Participants

(209) *Services*: Foreign financial services providers will have to consider the following key points:

i. registration duties for foreign financial services providers;
ii. compatibility of EU regulations with Swiss regulations; and
iii. key points for Swiss financial services providers (see above).

(210) *Products*: Foreign financial instruments providers should be aware of the following issues:

i. new rules regarding the prospectus for financial instruments that are offered in Switzerland;
ii. preparation of KIID templates for Switzerland;
iii. preparation of appropriate client information; and
iv. key points for Swiss financial instruments providers (see above).

VI. Further Relevant Acts

A. Federal Act to Implement the 2012 Revised Recommendations of the Financial Action Task Force (FATF)

(211) Switzerland has implemented far-reaching regulations and measures to combat money laundering and terrorist financing. The implemented regulations and measures include preventive measures under administrative law, repressive measures under criminal law and law enforcement, international cooperation measures and soft law regulations, such as the SBA Agreement on the Swiss Banks' Code of Conduct with Regard to the Exercise of Due Diligence (CDB 08), likely to be published in an amended version in mid-2015[44], and anti-money laundering regulations established by the various SROs.

(212) Switzerland has been a member of the Financial Action Task Force on Money Laundering (FATF) since its creation in 1989. As a consequence of the FATF revised recommendations of February 2012, Switzerland is in the process of adapting its own AML regulation. On 13 December 2013, the Federal Council adopted the dispatch on the new Federal Act for Implementing the Revised FATF recommendations for the attention of the Swiss Parliament. Along with the modification of several federal acts such as the CO, the SCC and the CISA, the newly proposed regulation, *inter alia*, suggests the inclusion of several key topics within the AMLA discussed in greater detail below.

1. New Predicate Offence for Cases of Tax Offences

(213) The Federal Council initially proposed to introduce a new criminal offence for tax fraud in the Federal Act on Direct Federal Taxation (LIFD)

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44 The CDB 08 revision shall cover the following aspects: (i) transition from present regulations to ban of active support for capital flight and tax evasion to planned self-regulation "code of conduct on rejection of undeclared assets", (ii) regulations for identification of shareholders in legal entities and commercial partnerships, (iii) introduction of a number of standard forms, among others, concerning identification of shareholders, information on life insurance with separate account/deposit management (insurance wrapper) and declarations for foundations and trusts.

and the Federal Act on the Harmonisation of Direct Taxation at Cantonal and Communal Levels (LHID). Firstly, the criteria for the criminal offense of tax fraud was proposed to include any fraudulent behaviour and secondly, serious tax frauds (*i.e.* where taxable assets of CHF 600,000 or more had been concealed from the tax authorities) would qualify as a punishable felony and serve as a predicate offence to money laundering, as opposed to the current regime, under which only felonies (*i.e.*, offences punishable by more than three years of imprisonment) constitute predicate offences to money laundering in Switzerland.

(214) As a result of the consultation procedure, the Federal Council decided to delete its initial proposal to introduce a new criminal offence in the tax law. It has rather proposed in a separate bill that Art. 305bis of the SCC be amended so that not only felonies, but also tax frauds pursuant to Art. 186 LIFD or Art. 59 LHID would constitute predicate offences to money laundering, as long as the amount of tax evaded exceeded CHF 200,000 per tax period.

2. Inclusion of Domestic PEPs and International Organisations' PEPs

(215) Pursuant to the 2012 FATF Recommendations, for due diligence purposes there should be an obligation to identify domestic PEPs, foreign PEPs, and persons exercising or having exercised an important function at or on behalf of international organisations' PEPs.

(216) Pursuant to proposed Art. 2*a* AMLA, a formal definition of national PEPs shall be included. All financial intermediaries should equally apply the PEPs regulations in terms of risk assessment. Relatives of PEPs are in a similar way concerned by such rules.

3. Improved Transparency of Legal Entities with Bearer Shares

(217) Based on the FATF Recommendations 2012, countries should implement measures to identify the beneficial owners of legal entities and enhance the transparency of unlisted companies with bearer shares. The Federal Council proposed that companies having issued bearer shares choose between (i) the disclosure to the company of the shareholders' identity and the identity of the beneficial owners of the shares if the shareholder has a stake of 25% or more in share capital or the voting rights at the

time of acquisition of the shares (in addition, the company shall keep record), (ii) the disclosure of the shareholders' identity to the financial intermediary which will keep such record (*i.e.* the company decides to delegate this duty to an authorised third party), (iii) a simplified conversion of the bearer shares into registered shares or (iv) issuance of bearer shares in the form of uncertificated securities credited to a securities account by a custodian.

4. Implementation of Stricter Rules on the Identification of Beneficial Owners

(218) The FATF identified some unresolved deficiencies under Swiss law during its last review. Among these deficiencies is the identification of beneficial owners. Therefore, Art. 4 AMLA shall be amended by formally including an obligation to identify the beneficial owners of all unlisted companies as well as to progressively introduce due diligence obligations concerning the identification of the beneficial owners of all legal entities for operating companies only.

5. Mandatory Involvement of Financial Intermediary for Cash Payments in excess of CHF 100,000 for Movable or Immovable Property

(219) A new rule in the AMLA shall be introduced requiring all payments in excess of CHF 100,000 for property purchases or sales of movable property to be arranged through a financial intermediary subject to the AMLA. In its last review, the FATF identified deficiencies in the Swiss anti-money laundering provisions concerning professions outside the financial sector. Therefore, a new category of persons shall be introduced in Arts. 2*b* and 2*c* AMLA to whom the anti-money laundering regulations will apply.

6. Timeline

(220) The draft bill was discussed by the Council of State on 12 March 2014. Discussion and potential amendment by the National Council is still pending, but will likely occur during the course of 2014. The entry into force of the bill is currently expected for January 2016. It should be noted, however, that Switzerland announced in February 2014 that it intends to accelerate its shift towards the AEI as a consequence of the draft Standard

for Automatic Exchange of Financial Account Information (CRS) issued by the OECD on 13 February 2014 and acknowledged by the EU member states in a revised directive on 24 March 2014. This new standard aims at adapting the structure of the FATCA IGA (intergovernmental agreement) with the final goal of a worldwide tax transparency system. The Federal Council plans to unilaterally apply the new AEI standard of the OECD to all double taxation treaties not yet adapted to it and accordingly instructed the FDF to prepare a corresponding draft.

(221) In light of the FATCA IGA regulation and the newly introduced OECD standards for an AEI, it remains to be seen whether and to what extent the proposed revised AMLA provisions will be affected by such new international standards.

B. Further Amendment to the Anti-Money Laundering Act (Extension of Due Diligence Obligations with respect to Taxation)

(222) Banks and other financial intermediaries will have to comply with enhanced due diligence requirements when accepting assets in order to prevent the inflow of untaxed assets. Based on the Federal Council's resolution dated 27 November 2013, the new requirements are to be discussed in coordination with the conclusion of possible agreements on the automatic exchange of information between Switzerland and its main partner countries.

(223) The extended due diligence requirements are the result of the Federal Council's financial market strategy and serve to ensure a tax-compliant financial centre. They are to supplement the existing due diligence requirements to prevent money laundering.

(224) The Federal Council anticipates that an internationally recognised standard for the AEI will exist in the foreseeable future, which would enable Switzerland to conclude the agreements necessary for implementation with important partner states. Enhanced due diligence requirements should apply additionally for those states with which no such agreement exists. This procedure will make it possible to coordinate these requirements with the implementation of an AEI.

(225) The Federal Council has instructed the FDF to submit a proposal on the structure of the extended due diligence requirements when agreements on an AEI in accordance with the international standard can be concluded with the main partner states or if it has been established that no AEI agreement can be concluded in the foreseeable future.

(226) With its main partner states such as the members of the OECD, the G-20 and the EU, Switzerland should be in a position to conclude the relevant agreements for implementation of the AEI within two to four years.

C. Changing Landscape in the Swiss Insurance Industry

(227) The proposed FIDLEG is intended to apply to any financial products. In response to the hearing report of the FDF in February 2013, the Swiss Insurance Association subsequently objected against applicability of the proposed FIDLEG to insurance products.

(228) In December 2012 and March 2013, the chambers of the Swiss Parliament decided not to deliberate on a bill proposed by the Federal Council on an overall reform of the ICA, which, *inter alia*, aimed at the improvement of the policyholders' legal position. The parliament mandated the Federal Council to elaborate on a bill for a partial reform of the ICA. Thus, the proposal for an overall reform which had been in preparation for a decade was surrendered (the expert commission was already established in 2003).

(229) The main concern is that the insurance industry will be regulated by two different legal regimes, the specific regime applicable to insurances only and the general provisions applicable to financial institutions and service providers, which may lead to conflicting results and to legal uncertainty.

(229) Based on the final report of the European Insurance and Occupational Pensions Authority (EIOPA) issued in October 2011 regarding the equivalence assessment of the Swiss supervisory system in connection with Arts. 172, 227 and 260 of the Solvency II Directive, it is currently expected that that European Commission will recognise the Swiss Solvency Test to be equivalent to Solvency II regarding reinsurance, group capital as well as group supervision. EIOPA's analysis will be revisited once the

Solvency II's delegated acts are adopted. Since the date of application of the Solvency II Directive has been postponed to 1 January 2016, it is unclear when the European Commission will take its decision on Solvency II equivalency.

D. Total Revision of FINMA Collective Investment Schemes Ordinance (CISO-FINMA)

(231) The FINMA consultation on the FINMA Collective Investment Schemes Ordinance (CISO-FINMA) in which pending issues of the revision of the CISA as per 1 March 2013 will be clarified and finally settled ended on 19 May 2014. It is currently expected that the revised CISO-FINMA will enter into force on 1 January 2015[45].

(232) This revision aims to enhance investor protection, maintain market access in light of the standards that have been changed at the national and international level and oblige license holders to ensure that appropriate and efficient risk management is in place. In particular, the revision includes the following rules:

i. The rules on the delegation of fund manager's duties to third parties will be governed by the revised CISO-FINMA in detail. The current practice will be maintained, but amended in certain aspects to allow for a more flexible delegation considering the corporate and fund law legislation. These rules will also apply to asset managers of collective investment schemes and representatives of foreign collective investment schemes. The new rules on the delegation in the CISO-FINMA will replace the FINMA Circular 2008/37 "Delegation by fund management companies / SICAVs".
ii. The risk assessment models for derivatives will have to be made based on calculating the market value of the derivatives' underlying base value (equivalent underlying assets).
iii. To minimise the risks involved in managing securities, rules on the requirements for the management and custody of securities will be introduced that comprise all OTC derivative investment techniques

45 Transition period until 1 January 2016, in some cases until 1 January 2017.

and business transactions. Particularly, securities must be highly liquid, have trading day values and be issued by a creditworthy issuer who is independent of the counterparty.

iv. The revised rules explicitly provide for the possibility to set up master-feeder structures.

v. Custodian banks will have to introduce internal guidelines on controlling fund management companies and SICAVs.

vi. The revised CISO-FINMA also sets out the details on the calculation of the *de minimis* threshold under which asset managers – which only market collective investment schemes to qualified investors – will not fall within the scope of the CISA.

vii. The new rules set out in the CO for companies on accounting, valuation, accountability and publication requirements will be reflected in the CISO-FINMA for collective investment schemes accordingly.

VII. Timeline and Key Issues to Observe

(233) Under the currently envisaged timelines, the various new acts may move at different speeds and become effective at different times. Currently, a consultation (*Vernehmlassung*) is in progress with interested parties in the finance industry based on drafts of the various acts. It is expected that the Message (*Botschaft*) of the Federal Council to Parliament commenting the proposed wording of the act for Parliamentary debate will be issued in the third quarter of 2014 for the FINFRAG, in the fourth quarter for the FIDLEG and in the first quarter of 2015 for the FINIG. It is further expected that the earliest date the acts could become effective is the third or fourth quarter of 2015 for the FINFRAG and the first quarter of 2017 for the FINIG and the FIDLEG (with certain parts of the FIDLEG coming into force even later). The changes to the FINMAG will become effective together with the relevant acts they are proposed together with.

(234) Therefore, market participants will be well advised to closely observe the developments and the debates around the new acts in 2014 and 2015. Key issues to be aware of include, in particular, the following:

i. Increased cross border exchange of information between Swiss and foreign authorities relating to market participants;
ii. New licensing requirements for trading venues, central counterparties, central securities depositories and payment systems;
iii. New rules applicable to derivatives trading;
iv. Introduction of general licensing obligations for all institutions investing or managing third party assets on a professional basis;
v. (Already today:) Strict requirements applicable to asset managers of collective investments schemes and of Swiss occupational benefit schemes;
vi. New rules applicable to cross-border business, in particular, that foreign financial institutions must comply with the same rules of conduct as Swiss financial institutions and must register in Switzerland;

vii. Abolition of the license for distributors of collective investment schemes, but introduction of a registration duty for all individual client advisors;
viii. Implementation of the suitability and appropriateness rules, obligation to perform client segmentation and providing of appropriate client information for asset management, advisory and to a limited extent execution only business;
ix. New rules on inducements (retrocessions);
x. Distinction between dependent and independent client advisor and applicability of specific rules to each of them; and
xi. Introduction of KIID templates for financial instruments.

(235) In summary, any participant in the Swiss market, regardless of whether it is a Swiss or a foreign entity, needs to review its current business model and evaluate whether and to what extent it needs to be adapted to comply with the comprehensive changes made to the Swiss regulatory architecture.

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NKF Banking, Finance & Regulatory Team

Switzerland's New Financial Market Architecture

Publication 18 – Update 10 September 2014

NIEDERER KRAFT & FREY

FINFRAG – LATEST DEVELOPMENTS
Publication of Message to Parliament with Revised Draft-FINFRAG on 3 September 2014

The following highlights key differences between the latest draft of the FINFRAG published on 3 September 2014 and the preliminary draft on which NKF Publication 18 of 31 August 2014 was based.

A. Financial Market Infrastructures

(1) ***Organised Trading Facilities (OTFs):*** OTFs no longer qualify as Financial Market Infrastructures (**FMIs**) or as a trading venue (*Handelsplatz*). OTFs are now defined as facilities: (i) providing for a multilateral trading in securities (*Effekten*) and other financial instruments by way of exchanging offers and concluding contracts pursuant to discretionary rules, (ii) providing for a multilateral trading in financial instruments that are not securities (*e.g.* OTC-derivatives) by way of exchanging offers and concluding contracts pursuant to non-discretionary rules, or (iii) providing for a bilateral trading in securities (*Effekten*) and other financial instruments by way of exchanging offers.

(2) OTFs are not considered to be independent financial market infrastructures. The operator of an OTF must either be licensed as a bank, securities dealer, stock exchange or multilateral trading facility or be recognised by FINMA as a foreign stock exchange or multilateral trading facility. The operator of an OTF must comply with certain specific obligations regarding organisation (avoidance of conflicts of interest, safeguarding of a controlled trading) and regarding post-trading transparency.

(3) ***Dark Pools/High-Frequency Trading:*** The transparency requirements for multilateral and organised trading facilities shall address the problem of dark pools, *i.e.* trading venues with less or no transparency. The organisational obligations further establish the basis for regulating/restricting high-frequency trading.

(4) ***Trading Venues (Stock Exchanges and Multilateral Trading Facilities (MTFs)) – pre-trading transparency:*** The pre-trading transparency requirements only relate to shares (*Aktien*) and "other securities"; the latter will be determined by the Federal Council.

(5) ***Recognition of foreign Trading Venues and foreign Trade Repositories:*** If FINMA has determined that the foreign institutions are subject to an appropriate regulation and supervision in their home state (which, according to the Message (*Botschaft*), should be the case for EU-based institutions), they are no longer re-

quired to obtain specific recognition from FINMA but rather are deemed to be recognised.

(6) ***Central Counterparties (CCPs) and Central Securities Depositories (CSDs) – regulatory capital and risk diversification:*** In addition to the requirements as set forth in the preliminary draft, CCPs and CSDs, as proposed in the current draft, will also be required to maintain sufficient regulatory capital (both on a stand-alone and a consolidated basis) and to provide for an appropriate risk diversification.

(7) ***CCPs and CSDs – segregation duty of participants:*** The segregation duty not only applies to CCPs/CSDs but also to their participants; the latter will be required to segregate own assets and liabilities from assets and liabilities of indirect participants.

B. Derivatives Trading

(8) ***Definition of Derivatives:*** The draft clarifies that beside repos and securities lending transactions also structured products do not qualify as derivatives. The Federal Council can further exempt certain categories if this is necessary for the implementation of recognised international standards.

(9) ***Definition of Small Financial Counterparties:*** The qualification as a small financial counterparty is no longer dependent on the volume of derivatives used for the purpose of hedging real estate mortgage risks but depends on the significance of its derivative trading volumes generally.

(10) ***Compliance with Obligations under Foreign Law:*** It is being clarified that the derivative trading obligations can also be deemed complied with in case (i) they are in compliance with foreign law and such foreign law is recognised by FINMA as equivalent and (ii) if for effecting the business a foreign financial market infrastructure has been involved that is recognised by FINMA.

(11) ***Clearing Obligation:*** Derivatives that are not cleared by any licensed or recognised central counterparty and FX swaps and forwards, so long as they are settled payment versus payment (*Zug um Zug*), are not subject to clearing obligations.

(12) ***Reporting Obligation:*** The obligation to avoid multiple reporting has been deleted and new rules specify which party involved in a derivatives transaction is obliged to ensure that the transaction is reported to a transaction register.

(13) ***Risk Mitigating Measures:*** These obligations also do not apply to FX swaps and forwards as well as to derivatives transactions that are voluntarily cleared through a licensed or recognised central counterparty. Agreements for the private realisation of security granted in connection with derivatives transactions remain valid

also in case of debt enforcement proceedings or in case of insolvency measures being initiated against the security provider if the value of such security can be objectively determined.

(14) ***Platform Trading Obligation:*** Derivatives that are not accepted for trading on any trading venue or organised trading facility as well as FX swaps and forwards, so long as they are settled payment versus payment (*Zug um Zug*), cannot be subjected to the trading platform obligation.

C. Securing Measures/Restructuring/Bankruptcy/ Netting Rules

(15) The relevant section of the pre-draft has been substantially overhauled and most provisions were deleted. Instead, Art. 27 of the Banking Act is being replaced by a new article. Thereafter, protective measures, restructuring proceedings and bankruptcy liquidation proceedings shall not affect pre-agreed agreements regarding (i) the netting of claims (including the agreed method to calculate the value), (ii) the private realisation of security in form of securities or other financial instruments that have a value which can be objectively determined, and (iii) the transfer of claims and obligations as well as security in form of securities or other financial instruments that have a value which can be objectively determined.

(16) However, these agreements are also subject to FINMA authority to suspend the termination of contracts or to suspend the exercise of rights under the above mentioned netting, security and transfer agreements for a maximum period of two business days. Such suspension is excluded or lapses if the termination or exercise of rights is not related to the measures taken, relates to a behavior of the insolvent bank or to the carrier assuming the contracts in full or in part. If following the suspension the licensing requirements and the other statutory requirements are (again) fulfilled, the contracts shall continue to exist and the above mentioned rights shall no longer be exercisable.

(17) According to the new draft, the rules on protective measures, restructuring proceedings and bankruptcy liquidation proceedings apply also to FMIs unless the FINFRAG contains deviating provisions. Similar rules are implemented with respect to the insolvency of a participant of a central counterparty.

D. Information Exchange

(18) A new article in the FINMAG (Art. 42c) shall enable supervised insititutions to deliver non-client related information to foreign supervisory authorities without previously requiring a permission by the Federal Council under Art. 271 of the Swiss Criminal Code (on activities for foreign public authorities).