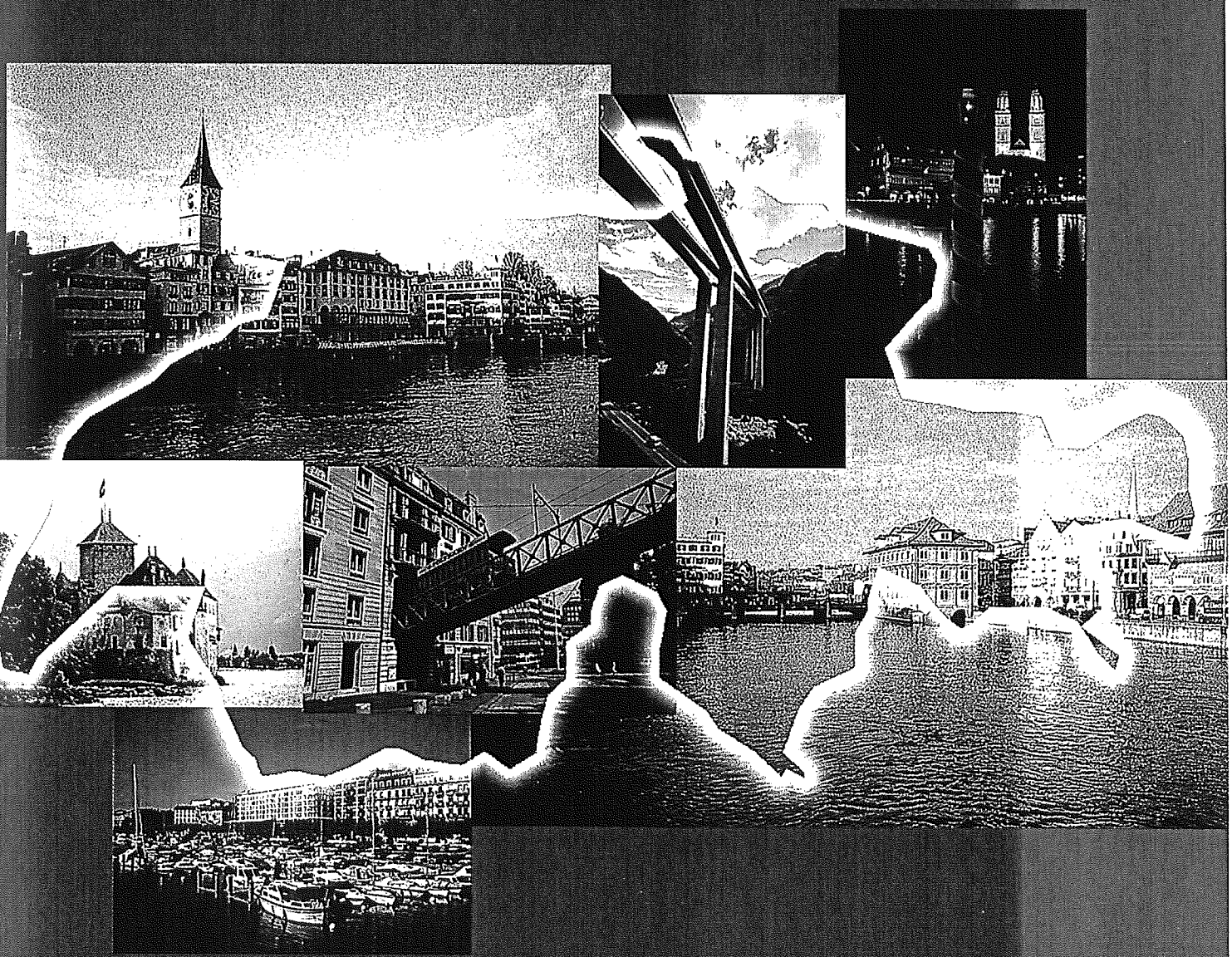
Switzerland

A legal Guide



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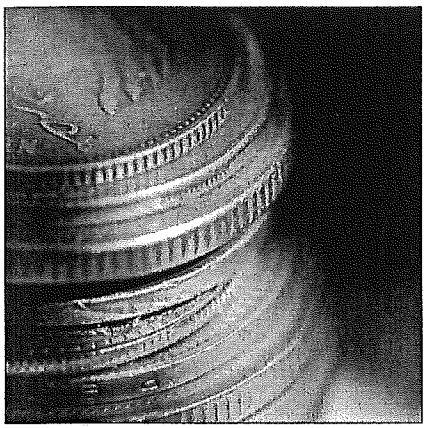
INTERNATIONAL FINANCIAL LAW REVIEW

Banking and finance



By Peter Honegger, Peter Isler and Urs Pulver of Niederer Kraft & Frey

The increasingly global activities of banks and financial intermediaries have substantially influenced many aspects of Swiss legislation and legal practice. The most affected areas include cross-border mergers and acquisitions of Swiss banks and broker-dealers, consolidated supervision, on-site inspections of foreign banks, outsourcing of electronic data processing, enhanced prevention of money laundering in the field of financial intermediaries, dormant accounts and internet banking.

ACQUISITIONS

General information

In 1999 concentration in the banking and financial sector continued. Of particular interest in this respect are the acquisitions in the field of asset management. Since mid-1998 the following were the most important transactions, most of which were effected by auction sales:

Date	Target	Purchaser	AuM
December 1999	ATAG Asset Management	Basellandschaftliche Kantonalbank	CHF8 billion
November 1999	STG Asset Management	Swiss Life	CHF6 billion
September 1999	Global Asset Management	UBS	CHF14 billion
February 1999	Banca del Gottardo	Swiss Life	CHF31 billion
December 1998	Guyerzeller	HSBC	CHF13 billion
July 1998	Banca della Svizzera Italiana	Generali	CHF31 billion

Although most of the purchase prices of the target firms in the above transactions have not been published, one can assume them to be somewhere between 6-8% of the assets under management (AuM) of private clients and 3-4% of the AuM of institutional investors, respectively.

Supplementary licence; notification duties

The acquisition of a Swiss bank or securities trader (ie broker-dealers, traders, issuing houses, derivative firms and market makers) by foreigners is subject to a supplementary licence from the Swiss Federal Banking Commission (FBC). The supplementary licence is a condition precedent to the completion of the acquisition. Although there is no express legal requirement to notify the FBC of the proposed acquisition or apply for the supplementary licence prior to the signing of the acquisition agreement, the regulator is often informally informed of the project at an early stage. The requirement of a supplementary licence applies irrespective of whether, prior to the acquisition, the relevant bank or securities trader was already foreign controlled. A new supplementary licence is also needed in the event that non-Swiss shareholders who directly or indirectly hold at least 10% of the share capital or the voting rights or otherwise significantly may influence the business activities (a Qualified Participation) transfer their shareholdings to another foreign or foreign controlled person. The FBC grants the supplementary licence subject to the following requirements:

- the purchaser's (ie the ultimate shareholder's) country of residence ensures reciprocity. This requirement does not apply if the purchaser's country of residence has ratified the 1994 General Agreement on Trade in Services (GATS);
- the company name of the foreign controlled Swiss bank or securities trader must not indicate or suggest that it is Swiss controlled. This is the reason why for instance Banca della Swizzera Italiana had to change its name into BSI when it was acquired by Generali Asset Management; and
- the most important prerequisite applies if the bank or securities trader is acquired by a financial conglomerate. In this case, the FBC requests evidence that the group is subject to an appropriate consolidated supervision (within the meaning of the Basle Minimum Standards) by foreign supervisory authorities and a letter from such regulator confirming that the business activity in Switzerland is approved.

The supplementary licence will be granted to and, therefore, must be applied for by the regulated target. In addition, each of the relevant bank or securities traders and the acquirer must notify the FBC prior to acquiring or selling directly or indirectly a Qualified Participation or whenever a Qualified Participation is increased or decreased so that the thresholds of 20%, 33% or 50% of the capital or voting rights are reached or passed. Furthermore, under the company law, publicly listed target companies must list in the attachment to the balance sheet those shareholders and their participation who hold more than 5% of all voting rights. Acquirers of publicly listed equity securities are obliged to report such acquisitions to the target company and the Swiss exchange at which the shares are listed if they thereby attain, fall below or exceed the thresholds of 5%, 10%, 20%, 33 1/3%, 50% or 66 2/3% of the voting rights. Finally, the Swiss law provisions on public take-over offers apply to Swiss companies whose equity securities are, in whole or in part, listed on a stock exchange in Switzerland.

Merger control

The acquisition must be notified under the Swiss merger control laws if both of the following thresholds are surpassed:

- the enterprises involved in the transaction have worldwide turnover of at least CHF2 billion ($1.2 billion) combined or combined turnover in Switzerland of at least CHF500 million; and
- at least two of the enterprises involved in the transaction have turnover in Switzerland totalling at least CHF100 million.

For banks, the relevant thresholds are calculated on the balance sheet total, instead of turnover, divided by a factor of 10. The Swiss Federal Competition Commission is the regulator responsible for merger control. However, the FBC may replace the Competition Commission in the case of mergers or acquisitions of banks if the FBC deems it appropriate for reasons of protection of the bank customers. To our knowledge, the FBC has never made use of this power so far. In September 1998 the Competition Commission issued a notification checklist which specifies the information that must be provided, however it is not a legally binding form. The Competition Commission is willing to issue a comfort letter if, in the given case, the relevant thresholds are not met.

ON-SITE INSPECTION OF FOREIGN BANKS

In June 1996 the Basle Committee on Banking Supervision adopted the Stockholm Recommendations to facilitate cross-border risk supervision following the collapse of both the Bank of Commerce and Credit and Barings Brothers as a direct result of fraudulent behaviour outside the banks' home countries of operation. Switzerland has recently implemented these recommendations, with the result that as of October 1999 foreign authorities are permitted to carry out on-site inspections of the offices of foreign banks located in Switzerland. The new provisions with regard to on-site inspections supersede the Swiss Penal Code that generally prohibits the gathering of evidence by foreign authorities on Swiss territory for use in foreign administrative and court proceedings. Previously, the Swiss Federal Finance

Department was in charge of authorizing foreign authorities to conduct on-site inspections in Switzerland on a case-by-case basis. Quite often, plant inspections have been authorized to enable registration of Swiss products with foreign food and drug agencies, however, on-site inspections of foreign banks were seldom permitted. The new rules, which are established in the Banking Law and in the Stock Exchange Act, require FBC authorization for inspections of Swiss branches and subsidiaries of foreign banks, financial intermediaries and stock exchanges. Such authorization is granted by the FBC if the foreign authority conducting the inspection is:

- the home country supervisor;
- subject to official or professional secrecy; and
- using the information collected for consolidated supervision only.

The last requirement means that permission will only be granted if the supervision of the organization, key personnel, risk management and reporting vis-à-vis the authorities is the actual objective of the inspection. Customer-related data, however, must not be the subject matter of on-site inspections. If a foreign authority requires access to customer-related information (eg for the assessment of risk concentration or in the case of overwhelming evidence of fraudulent behaviour on the part of management), it must file a request for mutual assistance. The FBC will then collect the necessary data and, after issuing an order (subject to formal appeal to the Swiss Federal Tribunal), will subsequently forward the data to the foreign authority. Such secrecy protection, which is unique compared to international standards, is, however, limited to asset management customers. Data concerning commercial loan customers may be examined directly by the foreign authority conducting the on-site inspection. However, the bank may request that the foreign authority be permitted to conduct the examination only in conjunction with the FBC or an auditor recognized by the FBC. All evidence gathered in Switzerland according to these procedures may only be used by the authority conducting the on-site inspection. Any forwarding of such information to other authorities is subject to the prior consent of the FBC.

OUTSOURCING

Until recently, cross-border outsourcing by banks was subject to the FBC's approval. In 1991 the FBC issued an order with respect to the implications of Swiss banking secrecy concerning the outsourcing of Electronic Data Processing (EDP): a branch of a foreign bank seeking to transfer its EDP abroad was requested to ask its customers for their prior formal consent. According to the FBC's ruling, the customer's prior consent to the outsourcing contained in the general business conditions was only sufficient to the extent such waiver was clearly indicated (in the general business conditions) and signed by the customer. The Data Protection Act in 1993 established thereafter a lower standard: according to this Act, prospective cross-border data transfer must simply be made known either to the customer or, alternatively, to the Swiss Federal Data Protection Officer. In the field of banking, however, both the formal approval of the FBC and the explicit banking secrecy waiver of the customer were still required for cross-border outsourcing.

Since November 1999 outsourcing has been expressly dealt with in the FBC's Outsourcing Guidelines. Most importantly, outsourcing is no longer subject to the FBC approval provided the conditions of the Outsourcing Guidelines and of the Data Protection Act are met. Pursuant to the guidelines, banks (and broker-dealers) may outsource services relating to the control and supervision of market, credit, debtor, administration, liquidity, image, operation and legal risks, in particular the outsourcing of information technology, administration or controlling. However, banks (and broker-dealers) are not permitted to outsource the organizational and supervisory functions of the board of directors or important management duties. Additionally, outsourcing is subject, among other things, to the following conditions:

- the bank must enter into a written agreement with the service provider which clearly states the subject matter of the outsourcing;
- the bank has a duty to carefully select, instruct and supervise the service provider;
- the outsourcing agreement must clearly address a back-up system in case the service provider fails to perform its contractual duties and also address adequate technical and organizational measures ensuring that customer-related data is not made available to third parties and is adequately protected from theft, infringement, copying, fire and other risks;
- the service provider must explicitly agree to the duties of professional secrecy, including banking secrecy or broker-dealer secrecy;
- the customer must be informed of the outsourcing, even an outsourcing within the same group; and
- the bank's auditor must examine and confirm the bank's compliance with the Outsourcing Guidelines and the outsourcing agreement.

MONEY LAUNDERING

Various money laundering affairs, such as those involving Banca Ambrosiano, the Pizza Connection and the Lebanon Connection, have increased international pressure on the Swiss banking and financial community, even though Switzerland introduced the so-called know-your-customer rules as early as 1977. The Financial Action Task Force on Money Laundering (FATF) criticised the fact that the Swiss-know-your-customer ➡

rules applied solely to banks, and not to para-banks, ie financial intermediaries. The Federal Money Laundering Statute extends to all financial intermediaries, including banks, securities traders, portfolio managers, managers of investment funds, insurance companies offering life insurance or shares in investment funds, business lawyers and fiduciary agents, who by profession accept custody of assets of others or help to invest or transfer assets. The Statute requires that, as from April 1 2000, financial intermediaries other than banks, securities traders, fund managers and insurance companies, join a recognized Self-Regulating Organization (SRO) or obtain a licence from the Money Laundering Control Authority. Such financial intermediaries not affiliated with a SRO and without a licence will be punished by a fine of up to CHF200,000 and may be barred from professional activity.

Moreover, financial intermediaries have a duty to appoint compliance officers to ensure compliance with the Federal Money Laundering Statute and, furthermore, to instruct and educate their employees on the prevention of money laundering. In addition, they must issue Anti Money Laundering Directives for their personnel regarding:

- the duty to verify the identity of a customer;
- the duty to ascertain the identity of the ultimate beneficial owner;
- appropriate action in the event of unusual or suspicious transactions; and
- the duty to inform the Money Laundering Reporting Office of Switzerland (MROS) and the duty to block the assets in question in the event of a well-founded suspicion that the assets involved are the proceeds of a serious crime or are under the control of a criminal organization.

Any failure to comply with the obligation to inform MROS is punishable by a fine of up to CHF200,000. Between April 1998 and March 1999 MROS received 160 well-founded reports of suspected money laundering involving assets totalling over CHF330 million. The majority of the reports were handed over to public prosecutors in Zurich, Geneva and Ticino, Switzerland's most important banking and financial centres.

DORMANT ACCOUNTS

In December 1999 the Independent Committee of Eminent Persons, better known as the Volcker Committee, published its Report on Dormant Accounts of Victims of Nazi Persecution in Swiss banks. The Committee mandated 650 accountants to scrutinize the archives of 254 banks with respect to the funds of victims of Nazi persecution. These accountants found 4.1 million accounts and came to the conclusion that 53,886 of them had a probable or possible relationship to victims of Nazis persecution. With the Committee's encouragement, the FBC ordered the Swiss banks to report all foreign and Swiss accounts opened prior to May 9 1945 that had been dormant since that time. In July and October of 1997, the Swiss banks published the names of these 5,570 foreign accounts in the world press and on the Internet. Additionally, the names of 10,758 account holders of Swiss and of unknown domicile were published in Switzerland. The banks also reported an additional 63,738 domestic or unknown domicile accounts of CHF100 or less that were not published. An important part of the effort to ensure justice for claimants to dormant foreign accounts is attributed to the Claims Resolution Tribunal. As of November 15 1999 a total of 1,281 claims have been resolved, resulting in awards having a book value of more than CHF23 million, reflecting about one-third of the CHF72 million book value of the accounts published in July and October 1997. The amounts paid by Swiss banks under the auspices of the Claims Resolution Tribunal may be deducted from the Global Settlement Agreement under which UBS and Credit Suisse Group have agreed to pay $1.25 billion to the victims of Nazi persecution. Prior to its dissolution on February 23 2000, the Volcker Committee encouraged the FBC to publish a third list some time in the year 2000. This third list is supposed to include some 3,000 account holders whose names appeared during the auditors' investigation process. The list might also include the names of some 23,000 account holders of closed accounts, for which, due to the passage of time, only the names of the account holders are available. No decision has so far been taken by the FBC in this respect.

The Swiss Bankers Association has issued new Guidelines on the Handling of Dormant Accounts, which will become effective on July 1 2000. These Guidelines emphasise the importance of the prevention of dormant accounts and seek to avoid any publication of account holders in the future. Pursuant to the Guidelines, the banks are obliged to report all dormant accounts to the SEGA Share Register (SAG), by December 31 2000 at the latest or, if the account becomes dormant thereafter, not later than one year after the customer-relationship becomes dormant.

INTERNET BANKING

In 1999 various banks introduced home trading stations for private clients by accepting orders via the internet and then automatically forwarding them to the Swiss Exchange (SWX). In the period between May 1999 and October 1999 some 10% of all orders placed with the SWX were placed over the internet.

The practice of internet brokerage has raised various legal issues. In particular, a bank's duty to verify the identity of a customer is clearly much more complex

when an account is being opened over the internet. According to the Federal Money Laundering Statute and the 1998 Agreement on the Swiss Banks' Code of Conduct With Regard to the Exercise of Due Diligence, the following rules apply to a bank's duty to verify customer identity: upon establishing a banking relationship with a private individual, the bank should request the presentation of an official identification document (passport, ID) and should copy, date, sign and place in the new account file all pages containing information pertinent to the client's identity. Such verification procedures are clearly applicable only when personal negotiations occur between the bank and its customer. If the business relationship is entered into by way of the internet, the customer obviously will not personally visit the bank and present an official identification document. Banks may, however, choose to apply regulations pertaining to business relations entered into through correspondence in which case the customer is requested to fill in the bank's account opening documentation online, to then download and sign the account opening documentation and send it to the bank. If the documentation is properly filled in, the bank will provide the customer with a security code, thereby verifying the customer's domicile indicated in the account opening documentation.

Also of concern to online brokers is the legal validity and enforceability of the customer's acceptance of the risks of online trading such as failure of performance, error, omission, interruption, defect, delay in operation or transmission, computer virus, or line system failure. Banks have developed sophisticated disclaimers dealing with no offer, no reliance, no warranty, limitation of liability and waiver of banking secrecy. Such disclaimers should be included in the account opening documentation and be signed by the customer, if possible. Alternatively, the disclaimer should have a so called access link, whereby the user will be granted access to information only after consenting to the disclaimer by clicking the "I agree to terms" button, thereby making an explicit declaration of intention. No court decisions dealing with the legal validity of internet disclaimers have been taken as of the present time.

NIEDERER KRAFT & FREY
RECHTSANWÄLTE

BAHNHOFSTRASSE 13
CH-8001 ZURICH

Telephone: +41 1 217 1000
Fax: +41 1 217 1400
E-mail: nkf@nkf.ch
WWW: www.nkf.ch

Languages:
Dutch, English, French, German, Italian and Spanish

Number of lawyers: 51

Contacts:
Dr. Peter R. Isler
Dr. Peter C. Honegger
Dr. Urs Pulver

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