

# NKF Client News

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## EU Equivalence Assessment of Swiss Stock Exchanges

### 1. Introduction

On 27 June 2019, the Swiss Federal Department of Finance ("FDF") announced that it was activating the measures adopted by the Swiss Federal Council on 30 November 2018 to protect the Swiss stock exchange infrastructure in anticipation of the expiration on 30 June 2019 of the stock market equivalence granted by the European Commission.

As a result of these protective measures, with effect from 1 July 2019 trading venues in the European Union ("EU") will be prohibited under Swiss law from offering or facilitating trading in equity securities (including shares) of companies with registered offices in Switzerland where such equity securities are listed on a Swiss stock exchange or are traded on a Swiss trading venue.

In essence, these protective measures are intended to remove potential legal barriers for EU investment firms to trading Swiss equity securities on Swiss stock exchanges and trading venues (where liquidity for Swiss equity securities is typically greatest) through the implementation of a recognition obligation for foreign trading venues that admit equity securities of certain Swiss companies to trading or facilitate such trading. Notably, the protective measures do not impact companies with registered offices in Switzerland that are listed and traded exclusively on exchanges outside of Switzerland.

### 2. Legal Background

On 3 January 2018, MiFID II / MiFIR<sup>1</sup> was implemented in the EU with the aim to increase market transparency and, thus, improve market stability and investor protection. MiFIR Article 23 introduced an obligation for EU investment firms to trade equity securities on (i) a trading venue in the EU or (ii) an equivalent third-country trading venue (the so-called "share trading obligation"). Importantly, this obligation covers all equity securities (i) admitted to trading on a regulated market or traded on a trading venue in the EU<sup>2</sup> and (ii) traded on such EU trading venues in a way that is not non-systematic, ad-hoc, irregular and infrequent. Thus, in order for EU trading participants to be able to directly access Swiss stock exchanges and trading venues for transactions involving applicable equity securities, Switzerland's stock exchanges and trading venues require equivalent third-country status under MiFIR, unless such trading is non-systematic, ad-hoc, irregular and infrequent.

In anticipation of the implementation of MiFID II / MiFIR on 3 January 2018, the EU Commission issued a decision on 21 December 2017 granting Switzerland's stock exchanges equivalence and concluded that all requirements to achieve this status had been met. However, the decision was limited to a period of one year (i.e., 31 December 2018), but was extended to 30 June 2019. As of today, the European Commission has not extended Switzerland's equivalent third-country status beyond this date.

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<sup>1</sup> EU Directive 2014/65/EU (MiFID II); EU Regulation No 600/2014 (MiFIR).

<sup>2</sup> This condition captures most of the equity securities listed on the SIX Swiss Exchange Ltd, the principal equity exchange in Switzerland, as such equity securities are often also admitted to trading on a regulated market or traded on a trading venue in the EU.

### 3. Historical Background

Since signing the first free trade agreement in 1972 and following the vote against joining the European Economic Area in a popular referendum in 1992, Switzerland and the EU have formalized their relations through an increasing number of bilateral agreements (currently 20 main agreements and over 100 ancillary agreements).

Over the past decade, the EU has pushed for an institutional framework agreement to comprehensively define Switzerland's ties with the EU. Amid slow progress in the negotiations, the EU Commission has hardened its position towards Switzerland. Indeed, while the issue of stock exchange equivalence is actually not related to the institutional framework agreement and the EU Commission has stated that Switzerland fulfills all requirements for being granted equivalence, in its decision on 21 December 2017 initially granting Switzerland's stock exchanges temporary equivalence, the EU Commission stated that when revisiting whether to extend its decision on equivalence, it would consider progress made between the EU and Switzerland on the negotiation of an agreement establishing a common institutional framework for existing and future agreements through which Switzerland participates in the single market of the EU.

Without equivalent third-country status, EU investment firms (subject to limited exemptions) are no longer permitted to trade applicable equity securities of Swiss companies on Swiss stock exchanges and trading venues.<sup>3</sup> This could not only negatively affect the trading volumes of Swiss companies on Swiss stock exchanges (where orders from EU investment firms account for a substantial portion of trading volumes), but also EU investment firms due to the loss of direct access to the liquidity pool of Swiss equity securities on Swiss stock exchanges to ensure the best possible trade price and best execution (notably, SIX Swiss Exchange is the fourth largest stock exchange in Europe).

### 4. The Swiss Federal Council Ordinance of 30 November 2018

To remove potential barriers to access by EU investment firms to Swiss stock exchanges and trading venues under the MiFIR share trading obligation and to safeguard the Swiss stock exchange infrastructure, the Swiss Federal Council enacted certain protective measures set out in the *Ordinance on the Recognition of Foreign Trading Venues for the Trading of Equity Securities of Companies with Registered Office in Switzerland* (the "Ordinance").

In essence the Ordinance introduces a recognition obligation applicable to foreign trading venues if they admit equity securities to trading or permit trading in equity securities (including shares) of companies with registered offices in Switzerland where such equity securities are listed on a Swiss stock exchange or are traded on a Swiss trading venue ("Swiss issuers"). According to the Ordinance, the Swiss Financial Market Supervisory Authority FINMA ("FINMA") will only grant recognition to such foreign trading venue if (i) it is subject to appropriate regulation and supervision and (ii) the jurisdiction, in which the foreign trading venue is registered, does not restrict its market participants from trading the equity securities of Swiss issuers on trading venues in Switzerland and thereby significantly adversely affects the trading in such equity securities at Swiss trading venues. If these conditions are not met, the foreign trading venue will not be granted recognition by FINMA; consequently, these venues will not be allowed under Swiss law to offer trading in the equity securities of Swiss issuers.

On 27 June 2019, the FDF published an updated list of such jurisdictions that have not met the necessary conditions under the Ordinance. Currently, this list comprises only the member states of the EU, the result of which means that no recognition can be granted to EU trading venues effective 1 July 2019. Furthermore, previous recognition of a foreign trading venue automatically ceases once the jurisdiction in which that foreign trading venue has its registered office is included on the list published by the FDF pursuant to the Ordinance. Importantly, the Ordinance includes a

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<sup>3</sup> Specifically, EU investment firms will no longer be permitted to trade on Swiss stock exchanges any equity securities that are (i) admitted to trading on a regulated market or other trading venue in the EU and (ii) traded on such EU trading venues in a way that is not non-systematic, ad-hoc, irregular and infrequent.

grandfathering provision for existing dual-listings. Foreign stock exchanges only are exempt from the recognition requirement for equity securities of Swiss issuers listed on a Swiss stock exchange where, *inter alia*, the equity securities were listed in a dual-listing with the approval of the issuer on such foreign exchange prior to 30 November 2018.

The Ordinance is further deemed to be a financial market act, meaning that enforcement of the Ordinance against supervised entities lies largely with FINMA.<sup>4</sup> Subject to jurisdictional considerations, potential enforcement measures range from declaratory rulings, monetary fines and revocation of licenses to sanctions, including criminal sanctions.

The intended effect of these measures is that trading in the majority of equity securities of Swiss issuers will no longer occur on a regulated market or on a trading venue in the EU after 30 June 2019 (since such regulated markets or trading venues in the EU will not be granted recognition from FINMA). Thus, the EU share trading obligation of MiFIR Article 23 and the need for EU stock exchange equivalence would, therefore, no longer apply to the equity securities of Swiss issuers. As a result, EU market participants could continue to trade the equity securities of Swiss issuers on Swiss stock exchanges and trading venues without breaching EU laws. The same would apply even if a certain trading volume in equity securities of a Swiss issuer remains on EU trading venues, so long as such share trading occurs non-systemically, ad hoc, irregularly and infrequently.

Notably, the Ordinance does not extend to issuers with registered addresses outside of Switzerland that issued equity securities that are listed on a stock exchange in Switzerland. While this is a significantly smaller subset of issuers, the development of trading volume in their equity securities may be impacted with trading potentially flowing more to EU trading venues. However, if such equity securities have historically been trading on EU venues in such a way that would be determined as non-systematic, ad-hoc, irregular and infrequent, EU investment firms may be able to continue trading equity securities of those issuers on Swiss stock exchanges or trading venues. In addition, absent stock exchange equivalence, equity securities issued by European issuers can no longer be traded by EU market participants on Swiss stock exchanges and trading venues, which could negatively affect trading volumes in these equity securities on such venues in Switzerland.

## 5. Outlook / Conclusion

The Swiss Federal Council continues to believe that Switzerland's stock market infrastructure and regulations meet all the conditions for unrestricted recognition by the EU for equivalence and continues to advocate for such recognition. However, in anticipation of the likely expiration of Switzerland's third-country equivalence on 30 June 2019 and in order to protect the functioning of the Swiss stock exchange infrastructure, the FDF has activated the protective measures set out in the Ordinance with effect from 1 July 2019 vis-à-vis trading venues in the EU.

In terms of the immediate impact, trading volumes and liquidity for relevant Swiss issuers may increase on Swiss stock exchanges and trading venues due to the prohibitions implemented by the Ordinance on EU trading venues. Indeed, SIX Swiss Exchange has announced that it is prepared for the activation of the Ordinance and has implemented measures to ensure that trading on the SIX Swiss Exchange of equity securities of Swiss issuers can continue, including through introduction of a "fast track" process to permit new EU investment firms to trade on the SIX Swiss Exchange. This is further supported by the Ordinance, which permits FINMA to grant participants temporary authorization to participate in Swiss trading venues until the end of the authorization procedure, but only for up to one year. EU investment firms have similarly already started taking measures to ensure compliance with the new Ordinance. For example, on 25 June 2019 certain London-based exchange operators announced their intention to delist Swiss stocks from their exchanges.

While the measures adopted by the Swiss Federal Council will likely serve to protect the Swiss stock exchange infrastructure in the short-term, it remains to be seen to what extent foreign trading venues will comply with the Ordinance and how effectively FINMA will be able to enforce it.

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<sup>4</sup> In addition, the Financial Market Supervision Act (FINMASA) confers prosecution authority to the FDF.

Furthermore, the Ordinance remains in effect only until 31 December 2021; thus, the long-term impact for Swiss issuers and Swiss capital markets as well whether a solution can be reached with the EU Commission on this topic remain open.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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