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The Regulation of FinTech (Startups)

Reference: CapLaw-2016-31

Financial technologies (FinTech) are in the process of becoming the next chapter of Swiss financial market regulation. The rapid growth of the Swiss FinTech ecosystem, the public spotlight, and the changing perception on the importance and the future prospects of innovative business models in the financial industry have triggered a number of interesting regulatory developments. Currently, the center of the attention lies on FinTech startups. Some startups may have the potential to become serious competitors for traditional financial services providers. This article aims to set out the current state and the ongoing progress concerning FinTech related regulatory aspects.

By Luca Bianchi

1) Introduction

Financial technologies (FinTech) are becoming a new chapter of Swiss financial market regulation. While some FinTech business models have existed for a long time, the broad public spotlight has not focused on FinTech until the last few years. As a result of this increasing public awareness, an ongoing discussion about new business models, regulation, or deregulation of FinTech startups has developed. Furthermore, an impressive number of new FinTech startups, startup accelerators, and sector associations have been, or are in the process of being, established. Thus, interesting times lie ahead of the dynamic and rapidly growing Swiss startup scene.

2) Regulatory Framework

a) Applicability of Financial Market Regulation

Generally speaking, the regulatory framework of FinTech consists of the regular Swiss financial market regulation. In recent years, much has been written about the ongoing regulatory changes towards Switzerland's new financial market architecture. The findings of such publications shall not be repeated in this context.

However, aspiring FinTech entrepreneurs should be aware that, from a regulatory perspective, the first task before starting a new FinTech business should be the evaluation of potential licensing or approval duties as well as further regulatory restrictions for a particular FinTech business model in Switzerland (and in every other relevant country). This regulatory aspect represents a major difference to many non-financial services related technology ventures.

In particular, banking or securities dealer licenses, licenses for financial market infrastructure (e.g., for exchanges, other market places, or trading systems), licenses for fund managers, fund asset managers, or regular asset managers, distribution licenses or product approvals under the Collective Investment Schemes Act (CISA), and other

regulatory requirements may be crucial factors for the success of a new business model under the present or future Swiss financial market regulation.

In addition, FinTech startups must establish whether they are subject to the Anti-Money Laundering Act (AMLA). If that is the case, the startup must either become a member of a self-regulatory organization (SRO) or be supervised directly by the Swiss Financial Market Supervisory Authority (FINMA). Appropriate internal regulations would also have to be established and observed.

Furthermore, other laws and regulations such as the Data Protection Act (DPA) or the Consumer Credit Act (CCA) may be applicable depending on the specific business model.

b) Developments regarding FinTech

A few remarkable developments are noticeable specifically with respect to FinTech. As a first step, FINMA has indicated its positive attitude towards FinTech and its general intention to reduce regulatory obstacles on numerous occasions. In furtherance of this, FINMA has launched a new webpage with information for financial services providers in the FinTech space.

Before this background, the new FINMA Circular 2016/7 – “Video and online identification” should be highlighted (see CapLaw-2016-21). It specifies due diligence requirements for client onboarding via digital channels. The possibility of video or online client identification is a major step for online business models of financial services providers.

Furthermore, FINMA plans the introduction of a banking license “light” which will, presumably, allow lower regulatory requirements for certain innovative business models. In addition, a so called regulatory “sandbox” could permit startups to flourish with fewer regulatory restrictions until they reach a significant size.

Moreover, FINMA has revised its FINMA Circular 2009/1 – “Guidelines on asset management” in order to allow the conclusion of asset management agreements not only in writing (as in the past), but also in any other form demonstrable via text (*i.e.*, in digital form via the internet). The formal requirements related to collective investment schemes as well as the general mandate law continue to apply.

Besides, clarification on FINMA's practice with respect to the application of the existing regulations can be obtained by way of informal requests or applications for regulatory rulings to FINMA.

Last but not least, it should be noted that a motion on the “Risk-adjusted Limitation and Definition of the Term Deposits” is currently being processed on a political level. The

proposed amendments of article 1(2) of the Banking Act (BA) as well as article 2(1) (a) of the Banking Ordinance (BO) may be beneficial to innovative FinTech startups that are not subject to the risks of the interest business of traditional banking (maturity transformation).

3) Selected Case Groups

There are a few topics that seem to be more popular than others at the moment and, therefore, deserve special attention. In particular, the following business model case groups can be identified:

- crowdfunding (e.g., crowdinvesting and crowdlending);
- robo advisers;
- digital payment systems;
- crypto currencies (including bitcoins);
- blockchain; and
- big data.

Of course, the innovative FinTech space is continuously evolving. There exist many other business models that may be looked at as separate case groups. The relevant legal questions can differ substantially and are frequently interdisciplinary. Among other things, regulatory assessments must consider the specific business model, its geographic focus, as well as the type of financial services and products that shall be offered.

4) Conclusion / Outlook

Entrepreneurs, startups, traditional financial services providers, technology companies, legislative bodies, supervisory authorities, and law firms are facing a number of challenges including:

- an international and very dynamic environment with fast developments;
- digital cross-border business models may be difficult to implement due to applicable regulations of several jurisdictions;
- the existing regulatory framework does not “fit” new business models;
- new types of market participants (e.g., “lean” startups) with particular characteristics and needs;

- “vague”, rapidly evolving or pivoting business models;
- many new facts and circumstances, respectively, precedents;
- cyber risks;
- lower margins due to increasing competition;
- consolidation of similar business models; and
- higher costs due to the ongoing general trend towards stricter regulation of financial services.

It is expected that the trends to more digitization and regulation, as well as the “fusion” of different industry sectors (in particular, financial services, technology, telecommunication, media, and e-commerce) will continue in the near future. In particular, the ongoing regulatory developments may have a crucial impact on FinTech startups. Due to the strong momentum of this “new wave” of startup companies the need for a “customized” FinTech (de)regulation will continue to grow.

In addition, due to the current market environment and the changing investor perception the support of FinTech companies through better financing as well as the demand for financial services and products in the FinTech space will, hopefully, further increase over the next years.

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ESMA Issues Positive Advice on the Extension of the AIFMD Marketing Passport to Swiss AIFM and AIF

Reference: CapLaw-2016-32

On July 19, 2016, the European Securities and Markets Authority (“**ESMA**”) published its revised advice to the European Parliament, the European Council, and the European Commission on the extension of the AIFMD marketing and management passport (“**AIFMD Passport**”) to certain non-EU alternative investment fund managers (“**AIFM**”) and alternative investment funds (“**AIF**”). With respect to Switzerland, ESMA confirmed its earlier positive advice and concluded that there are no significant obstacles impeding the potential application of the AIFMD Passport to Switzerland. While this positive advice is an important step towards passporting for non-EU AIFM and AIF, it is now up to the European institutions (Parliament, Council, and Commission) to decide, based on ESMA’s advice, whether or not the AIFMD Passport will be extended to third-countries such as Switzerland.