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Switzerland's new financial market architecture – the current status

François M Bianchi, **Thomas A Frick**, **Sandro Abegglen** and **Marco Häusermann** of **Niederer Kraft & Frey** provide an overview over the current status of new financial market regulations in Switzerland and what they mean for market participants

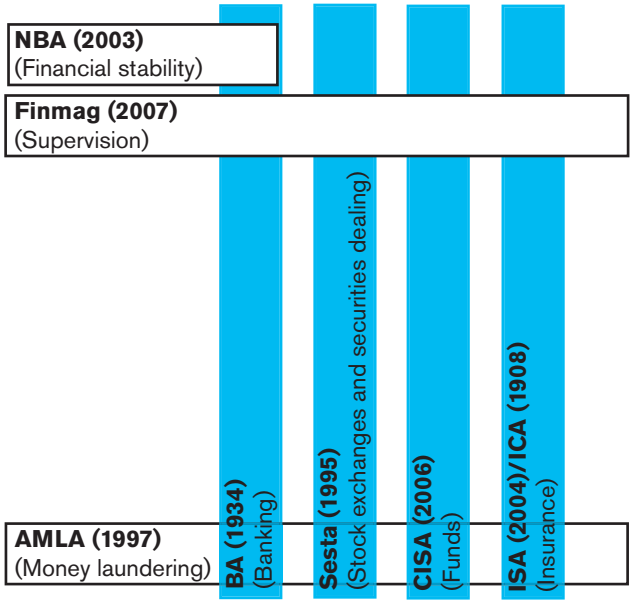
Existing Swiss financial market regulations are in the course of being completely overhauled. New rules for market infrastructures and derivatives trading, as well as new anti-money laundering rules, already became effective on January 1 2016. In addition, the Swiss Government has published drafts for two new statutes, which will completely overhaul the existing Swiss financial market regulation. The drafts still need to go through the legislative process, which is expected to be completed by 2018.

Given the materiality of the changes, participants in the Swiss financial market, whether domiciled in Switzerland or abroad, will need to assess the potential impact of these new rules on their business and take appropriate action.

From old to new: an overview

The following chart serves as illustration of the existing Swiss financial market architecture. 'Horizontal' regulations are only the National Bank Act (NBA), the Financial Markets Supervision Act (Finmag) and the Anti Money Laundering Act (AMLA). The core regulations are in the 'vertical' Banking Act (BA), the Securities Traders and Stock Exchange Act (SESTA), the Collective Investment Schemes Act (CISA) and two acts regulating insurance companies (ISA/ICA).

Chart I: Swiss financial market architecture

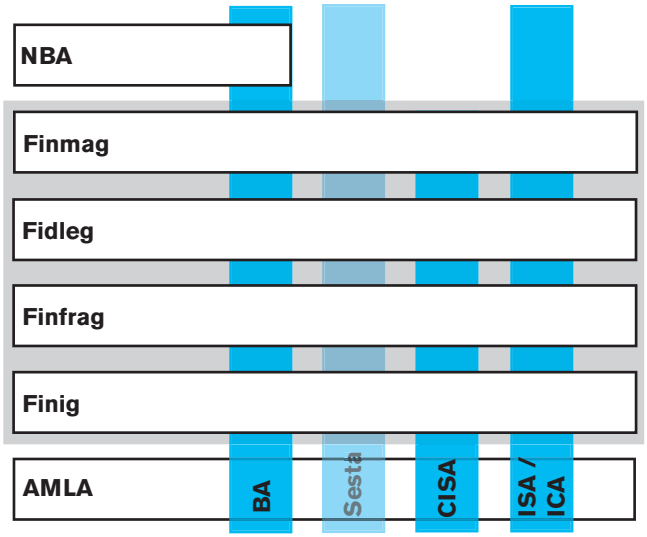


In contrast to the existing pillar model, the new Swiss financial market architecture will work with both vertical pillars and horizontal beams, as it were. While most vertical sector-oriented regulations (such as the CISA) will remain in place, areas suitable for a harmonised regulation across different sectors will be carved out and incorporated into the new horizontal financial market acts.

Four acts will constitute the core of this new horizontal regulation: (i) Finmag for supervision; (ii) the new Federal Financial Services Act (Fidleg) for products and point of sale; (iii) the new Financial Market Infrastructure Act (Finfrag) for infrastructure, derivatives trading, disclosure of shareholding, insider trading and market manipulation and public takeover offers; and, (iv) the new Financial Institutions Act (Finig) for institutions. However, the special acts for banks, funds and insurance companies will remain in force.

The following chart illustrates the so-called pillar and beam model:

Chart 2: so-called pillar and beam model



Finmag

Finmag entered into force on January 1 2009 and is, therefore, not a new regulation. While it has been, and will be, partly amended by the introduction of the Finfrag, Finig, and Fidleg, its core will remain unaffected. It remains undecided whether asset managers (which will become subject to supervision) will be supervised by the Swiss Financial Market Supervisory Authority (Finma) directly or by a new semi-public supervisory authority, which, in turn, would be supervised and guided by Finma (the latter being the current proposal in the draft act).

Amendments made by January 1 2016 include new rules for cross-border information flow. Finma will be entitled to spontaneously (without a formal request) exchange information with foreign authorities (not 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. In administrative assistance proceedings, Finma now has the option not to inform the client before client information is delivered to a foreign authority.

Finfrag

Finfrag became effective on January 1 2016, although there are various transitional periods applicable until new or updated licenses must be obtained or the rules on derivative trading will need to be complied with. Finfrag

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Niederer Kraft & Frey Ltd
Bahnhofstrasse 13 · CH-8001 Zurich
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provides for a more consolidated and comprehensive set of rules for the supervision of financial market infrastructures (FMIs). It will partially replace the existing fragmented regime for FMIs consisting of provisions that can be found in a variety of different acts (such as the Stock Exchange and Securities Dealing Act, and the National Bank Act) and ordinances. Finfrag further introduces new regulations and obligations for market participants in the area of derivatives trading while the existing rules on the disclosure of shareholding, insider trading and market manipulation and public takeover offers have been largely been taken over from previous legislation. The core reason for the new Finfrag is to align the Swiss regime with international standards, in particular with EU regulations such as Mifid II, Mifir, Emir and CSDR, in order to preserve Switzerland's global competitiveness in these areas.

Financial market infrastructures

Finfrag will introduce new licensing requirements and regulations for the following categories of FMIs: trading venues (stock exchanges and multilateral trading facilities [MTFs]), central counterparties (CCPs), central securities depositories (CSDs), trade repositories and payment systems. Further, Finfrag also regulates organised trading facilities (OTFs) as well as the operators of OTFs that are operated within Switzerland. Foreign OTFs and their operators are not subject to Swiss regulations except that they are given the possibility for a voluntary recognition in case the platform trading obligation for derivatives is enacted sometime in the future.

> **Given the materiality of the changes, participants in the Swiss financial market… will need to assess the potential impact of these new rules on their business**

The key differences to the EU regulations under the Swiss regime are the following: (i) self-regulation with respect to trading venues (such as admission of participants) continues to play an important factor; (ii) there is no prohibition for an operator of an OTF to trade on its platform for its own account, but measures must be taken to avoid conflicts of interest in such situations; (iii) links among central securities depositories are subject to regulation; and, (iv) transfer of data between a Swiss trade repository and foreign authorities is more restricted.

Derivatives trading

Switzerland intends to implement equivalent standards on derivatives trading as fully as possible in parallel with other financial centres. The core obligations imposed on Swiss market participants are: (i) the clearing of derivatives transactions through central counterparties; (ii) the reporting of derivatives transactions to trade repositories; (iii) risk-mitigating measures consisting of the posting of adequate collateral to mitigate counterparty risk, the daily valuation of the derivative at market prices and the obligation to organise operations to reduce operational risks; and, (iv) a platform trading obligation (once implemented by Finma).

The key differences to the EU regulations are the following: (i) the concept of small counterparties is established due to the fact that many smaller market participants are active in the Swiss market; (ii) FX swaps and forward transactions only trigger the reporting obligation but no other obligations; (iii) asset managers that do not manage collective investment schemes and investment advisors will qualify as non-financial counterparties, whereas they qualify as financial counterparties under Emir; (iv) group internal transactions are not subject to authoritative approval but compliance with the rules is controlled by the participants' auditor; and, (v) the reporting obligation will not require the disclosure of the beneficial owner.

Finig

Finig is in proposal form and will be subject to parliamentary review in 2016 and 2017. The proposed legislation introduces a differentiated supervisory and regulatory regime for financial institutions (as specified below) that provide asset management services to third parties. It aims to become a framework law that will govern the licensing requirements and further organisational conditions for financial institutions. Finig will provide for harmonised, cross-sectorial regulation in order to "create a level playing field for the supervised institutions". In particular, the following aspects relevant to financial institutions are intended to be regulated under Finig: organisation of institutions; licensing requirements; supervision of institutions; foreign financial institutions doing business in Switzerland; insolvency measures; and, sanctions.

The new Finig will apply to the following financial services providers, irrespective of their legal form: independent asset managers (certain grandfathering exemptions will apply); trustees; managers of collective assets (asset managers of collective investment schemes and asset managers of Swiss occupational benefits schemes); fund management companies; and, securities houses (classified as security traders).

Finig shall not apply to (i) persons providing services to family offices, (ii) persons managing assets in the framework of employee participation plans, (iii) lawyers, notaries and their assistants, (iv) persons managing assets in the framework of a mandate regulated by law, (v) the Swiss National Bank (SNB) and the Bank for International Settlement (BIS), (vi) occupational pension institutions, (vii) social security institutions and compensation funds, (viii) insurance companies in the sense of the Insurance Supervisory Act and (xi) banks in the sense of the BA. Banks continue to be subject to the provisions of the Federal Law on Banks and Savings Banks. The latter will, however, be revised so as to ensure the consistency of content between the Finig and the BA.

Fidleg

Fidleg – currently also in proposal form and on the law making agenda of Swiss parliament in 2016 – will comprehensively govern both the rendering of financial services and the product documentation in respect of financial instruments. Special rules at product level will remain to be set out in CISA for collective investment schemes (CIS) and in the insurance regulation. However, the existing regulation of the distribution of CIS in CISA will be substituted by the general Fidleg rules applicable to any point of sale activity.

More specifically, regarding the scope of Fidleg, financial services are the following activities provided for clients: purchase and sale of, and acceptance and transmission of orders regarding financial instruments; asset management; providing of personal recommendations in respect of financial instruments (investment advisory); any type of marketing for and distribution of financial instruments; and, granting of loans in connection with transactions in financial instruments. The term financial instruments is defined very broadly by the draft and basically includes any type of instruments into which an investment of financial assets may be made, such as shares, bonds, CIS, structured products, life policies with investment component/settlement value, capitalisation or tontine deals, derivatives and money market instruments.

Fidleg provides for a general regulation on the rendering of all services and product offerings done on a pure cross-border basis (without a permanent, substantial presence in Switzerland) from abroad to Switzerland. Client advisers of foreign institutions that wish to conduct cross-border activities will have to register with a registration body, the provider will have to comply with the extensive conduct rules of Fidleg, and fulfil the Swiss product documentation requirements, notably prospectus and basis information sheet requirements.

These conduct and prospectus requirements are quite similar to the respective obligations under Mifid II and, respectively, the EU-prospectus directive, as the Swiss Government wishes to implement a regulation that should be regarded as equivalent by the EU in view of facilitating market access. Conduct duties include comprehensive information duties, appropriateness and suitability obligations at the point of sale, a need for client segmentation, rules on inducement and retrocessions in general, cost transparency requirements, conflict of interest rules and rules on dependent financial service providers versus non-independent ones.

The product documentation requirements are similar to the ones applicable within the EU. A novelty will be that prospectuses for public offerings of financial instruments will need to be approved by an authority, which so far is only the norm in the highly-regulated CIS and insurance world.

Specifically, foreign market participants will have to consider the following key points in respect of their services to the Swiss market: (i) a registration requirement for client advisers of foreign financial services providers (though on this point, the industry associations signalled opposition if such a requirement would also apply for services to institutional clients); and (ii) compliance with the new conduct duties, it being understood that compliance with Mifid rules should *de facto* lead to compliance with the Swiss conduct rules.

In respect of products offered into Switzerland, apart from the specific CISA and insurance regulatory aspects, foreign financial instruments providers should be aware of and prepare for the following: (i) new rules regarding the prospectus requirements for financial instruments that are offered in Switzerland, in particular new duty of prospectus approval for public offerings; (ii) basis information sheets for Switzerland.

AMLA

The most considerable amendments to the Swiss anti-money laundering regulatory framework that entered into force on July1 2015 and January 1 2016 affect the following areas: (i) inclusion of "serious tax crimes" as a predicate offence to money laundering (tax evasion by using substantially incorrect documents and in an amount exceeding Fr300,000); (ii) improved transparency of not-stock-exchange-listed legal entities having issued bearer shares; (iii) stricter rules on the identification of the beneficial owner of (not-stock-exchange-listed) legal entities (the so-called "controlling person"); and, (iv) the implementation of due diligence obligations relating to cash payments to dealers.

Adapting to the sea change

The new regulations, some of which have already become effective, have changed and will fundamentally change the legal framework for any participant in the Swiss financial market, regardless of whether it is a Swiss or foreign entity. Existing business models will need to be reviewed and evaluated as to whether, and to what extent, they need to be adapted to comply with the comprehensive changes to the Swiss regulatory financial market architecture.

François M Bianchi
Partner

Niederer Kraft & Frey
Bahnhofstrasse 13 – CH-8001, Zurich
Switzerland
T: +41 58 800 8352
F: +41 58 800 8080
E: francois.m.bianchi@nkf.ch
W: www.nkf.ch

About the author

François Bianchi specialises in the fields of banking regulatory and capital market transactions. He frequently advises and represents financial institutions in regulatory proceedings before Finma.

He has devoted a substantial amount of time to advising banks, issuers and institutional investors in debt and equity capital market transactions, structuring and registrating of collective investment schemes, structuring of derivative transactions, i.e. straight bond issues, equity-linked bond issues (such as 'Alpine' convertible issues of Japanese issuers), structured finance transactions, EMTN programmes, warrant programmes and structured products programmes.

He regularly advises clients on all aspects of securities law and represents clients in listing and enforcement proceedings before the SIX Swiss Exchange and is a recognised representative for listings thereon. He also serves on the board of various regulated financial services providers.

Thomas A Frick
Partner

Niederer Kraft & Frey
Bahnhofstrasse 13 – CH-8001, Zurich
Switzerland
T: +41 58 800 8349
F: +41 58 800 8080
E: thomas.a.frick@nkf.ch
W: www.nkf.ch

About the author

Thomas Frick specialises in counselling banks and other financial institutions in regulatory, legal and compliance issues with a focus on providing business oriented solutions that help clients to achieve their goals and minimize their risks.

His practice includes regulatory and compliance issues, customer contracts, interbank contracts and syndicated finance. He devotes a substantial amount of time to advising banks, securities traders, asset managers, investment advisors, investment funds and other participants in the financial markets, both in Switzerland and abroad, in a variety of legal issues involving business activities related to the Swiss market.

He supports co-operation of enterprises, in particular with respect to competition law issues, and regularly advises and publishes on issues related thereto. He also represents companies in proceedings with the Swiss Competition Commission, reviews research and development contracts, licensing agreements, agency agreements, mergers and concentrations including joint ventures, internal competition compliance manuals and all other types of agreements and structures relating to corporation of enterprises, including intellectual property issues.

Sandro Abegglen
Partner

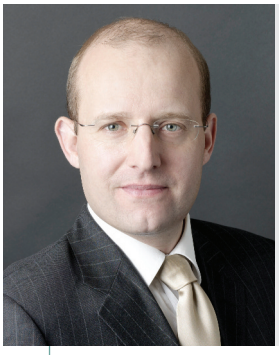
Niederer Kraft & Frey
Bahnhofstrasse 13 – CH-8001, Zurich
Switzerland
T: +41 58 800 8310
F: +41 58 800 8080
E: sandro.abegglen@nkf.ch
W: www.nkf.ch

About the author

Sandro Abegglen advises Swiss and international banks, broker-dealers, asset managers, fund providers, investment foundations, (re)insurers and institutional investors in complex civil and regulatory matters, transactions and proceedings.

He assists banks, broker-dealers, investment funds, investment foundations, asset managers and (re)insurers in obtaining the required regulatory licenses and approvals and assists in establishing investment structures and asset and wealth management services and products. He advises on issues of institutional governance, regulatory compliance, KYC/AML, white money strategy, stock exchange disclosure rules and market conduct laws.

Sandro also renders opinions on critical regulatory and contract law topics in relation to banking, asset/wealth management services, investment funds, and KYC/AML topics. In addition, he advises the self-regulatory bodies of the Swiss banking and funds and asset management industry.



Marco Häusermann
Partner

Niederer Kraft & Frey
Bahnhofstrasse 13 – CH-8001, Zurich
Switzerland
T: +41 58 800 8453
F: +41 58 800 8080
E: marco.haeusermann@nkf.ch
W: www.nkf.ch

About the author

Marco Häusermann is a specialist for banking & finance (regulatory and transactional) matters, debt capital markets transactions and restructuring and insolvency law matters. He frequently advises domestic and international financial institutions and corporates on syndicated debt financings, leveraged finance, asset and project finance and structured finance transactions as well as in work-out and restructuring situations.

He has devoted a substantial amount of time in advising arrangers and issuers on debt capital markets transactions, including public offerings and private placements of innovative debt securities, high yield bonds, regulatory capital instruments, hybrid instruments and EMTN programmes.

His practical experience also includes the support of banks, securities dealers, pension funds, insurance companies, fund management companies and asset managers on domestic and cross-border regulatory aspects and he is in regular contact with representatives of Finma and other competent regulatory authorities with respect to licensing requirements and negative clearance requests.