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# **Regulation of Financial Services**

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**The Comparative Law Yearbook of International Business**

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**General Editor**

**Dennis Campbell**

*Director, Center for International Legal Studies  
Salzburg, Austria*



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The Editor  
Comparative Law Yearbook of International Business  
office@cils.org

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## **Editor's Note**

Given the turmoil of recent years in the financial services sector, the editors of the Comparative Law Yearbook of International Business believe it is appropriate to review developments in the regulation of financial services in selected jurisdictions.

Accordingly, practitioners from Brazil, Bulgaria, China, Germany, Indonesia, Italy, Mexico, Portugal, Romania, Spain, Switzerland, Turkey, and the United Kingdom have provided chapters examining the current state of play in the financial services sector in their respective jurisdictions.

**Dennis Campbell, General Editor**  
**Center for International Legal Studies**  
**Salzburg, Austria, Europe**

# Switzerland

**Thomas S. Müller**  
**Walder Wyss Ltd.**  
**Zurich, Switzerland**

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## Introduction

Switzerland has long been proven to be an important and reputable financial marketplace. In very recent years, the Swiss banking sector contributed more than six per cent to the gross value added in Switzerland. Taking into account insurance companies and other financial service providers (e.g., asset managers and fund managing companies), the financial sector generated almost twelve per cent of the Swiss gross value added (representing approximately CHF 61,000,000,000 in 2011).

At an international level, both Zurich and Geneva still rank among the top ten financial centers of the world.<sup>1</sup> While Zurich is seen as a universal financial center, financial institutions located in Geneva largely specialize in asset management (including hedge funds), commodity trade finance, and private banking. With more than CHF 2,000,000,000,000 foreign assets under management (representing almost one-third of the world's total managed funds in international private banking), Swiss banks remain the largest asset managers in crossborder banking.

At present, this figure has decreased slightly following the financial crisis of 2007–2008 and the ongoing discussion between Switzerland and the United States, Germany, the United Kingdom, and other European states on entering into an agreement for the regularization of previously untaxed assets and the taxation of future investment income. These withholding tax agreements have been proposed as an alternative to the automatic exchange of information.

As of today, approximately 300 banks are licensed in Switzerland, among which twenty-four are (partly) state-owned cantonal banks, approximately 140 are foreign-owned banks, and Credit Suisse AG and UBS AG are the two global players located in Switzerland.

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<sup>1</sup> According to the Global Financial Centers (GFI) Index 12 (September 2012), available at <http://www.longfinance.net/Publications/GFCI%2012.pdf>.

Recent developments in the regulation of financial services in Switzerland have largely focused on the restructuring and liquidation regime of banks in general and systemically important financial institutions (SIFIs) in particular, and on the enhancement of the capital adequacy and solvency requirements.

In terms of consumer protection, a bill to amend the Banking Act (the Banking Act Reform Bill) has been implemented to enforce the deposit protection scheme. More recently, a reform bill to the Collective Investment Schemes Act (the CISA Reform Bill) has been passed which, *inter alia*, aims to limit the private placement rules of foreign funds.

From a long-term perspective, an initiative has been launched to draft and implement a new act on financial services. This act should cover the contractual relationship between the financial institution and the client, as well as the requirements on the distribution and content of a financial product. This new law will not be enacted (if it ever is) before 2014.

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## Regulatory Framework

### Legal Framework

Financial services in Switzerland are governed by the following statutes:

- (1) Banking Act;<sup>2</sup>
- (2) Stock Exchange Act (SESTA);<sup>3</sup>
- (3) Collective Investment Schemes Act (CISA);<sup>4</sup>
- (4) Anti-Money Laundering Act (AMLA);<sup>5</sup> and
- (5) Financial Market Supervision Act (FINMASA).<sup>6</sup>

While most of these federal acts largely deal with the rights and duties of the participants in the financial markets, the FINMASA establishes the Swiss Financial Market Supervisory Authority (FINMA) as the

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2 Federal Act on Banks and Savings Banks of 8 November 1934 (current status as of 1 March 2012).

3 Federal Act on Stock Exchanges and Securities Trading of 14 March 1995 (current status as of 1 September 2011).

4 Federal Act on Collective Investment Schemes of 23 June 2006 (current status as of 1 September 2011).

5 Federal Act on Combating Money Laundering and Terrorist Financing in the Financial Sector of 10 October 1997 (current status as of 1 October 2012).

6 Federal Act on the Swiss Financial Market Supervisory Authority of 22 June 2007 (current status as of 1 January 2009).



regulator of Swiss financial markets. The provisions of these statutes are supplemented by various ordinances enacted by the Federal Council and its administration and also by a number of circulars issued by the FINMA. The FINMA circulars address more technical issues, but generally do not regulate the contractual relationship between financial institutions and their clients. This contractual relationship is governed by civil law.

### **Regulatory Bodies**

The supervision of the financial market is undertaken by the FINMA, as the regulatory body established by law. The FINMA was founded at the beginning of 2009 by a merger between the Swiss Federal Banking Commission, the Federal Office of Private Insurance, and the Anti-Money Laundering Control Authority. The reason for this merger was the tendency to implement a bank insurance model by some of the major Swiss financial institutions approximately a decade ago (a business model which had already been abandoned before the FINMA was actually launched).

The FINMA is a public institution independent of the federal administration and has a separate legal personality. It covers its operating costs by fees and duties levied on the supervised institutions. The FINMA reports directly to the Federal Council. The Federal Council has to approve the FINMA's strategies and objectives and appoints the members of the board of directors. The FINMA's activities are monitored by the Swiss Parliament.

Despite this system of checks and balances, the FINMA has the duty to supervise and regulate the Swiss financial market and its participants independently from the administration and politics. Its primary tasks are to ensure the protection of investors, creditors, and insurance policyholders, and to strengthen the reputation of and confidence in the Swiss financial center.

Due to the relatively lean personnel structure (employing approximately 400 people), the FINMA has to rely strongly on external auditors when supervising each of the regulated financial institutions. This supervision system is often referred to as the "dual supervision model": while the appointed external auditors examine the annual financial statements of a financial institution and its compliance with the applicable regulation, the FINMA enforces sanctions against any breach of the law and regulations by that financial institution. The measures ordered by the FINMA are based on the detailed annual

reports of the external auditor or on the examination executed by a FINMA-appointed investigator (often an independent auditing firm or a law firm).

As a result of the recent financial crisis, the role of the Swiss National Bank (SNB) in supervising the Swiss financial market has been strengthened. The SNB has the task of contributing to the stability of the financial system and of overseeing systemically important payment and securities settlement systems.

In addition, the SNB acts as the lender of last resort, in which function it can provide liquidity assistance against collateral if domestic banks are no longer able to refinance their operations in the market. As such, the SNB has been (and still is) heavily involved in the rescue of UBS back in 2008 by establishing a "bad bank" to take over non-performing assets from the balance sheet of UBS.

The FINMA and the SNB cooperate in the field of financial stability. The role of both institutions is set out in a recently revised memorandum of understanding (MoU) entered into on 23 February 2010. Under the terms of the MoU, the SNB is responsible for monitoring developments in the overall banking system as they affect the overall economy, for the conduct of monetary policy, and for the oversight of interbank and securities clearing systems. The FINMA is responsible for setting prudential standards:

The MoU specifically provides for the sharing of information on macro risks, risk exposures of financial institutions, and on their respective capital adequacy requirements. From a macroprudential perspective, it is fair to say that the SNB assumes a leading role, while the FINMA is predominantly the enacting body.

In addition to the FINMA, a group of self-regulatory bodies that are in turn partly licensed and supervised by the FINMA may issue binding guidelines for market participants. The most important licensed self-regulatory body is most likely the regulatory body of the Swiss stock exchange (the SIX regulatory body), the SIX Swiss Exchange, located in Zurich.

The SIX regulatory body supervises and enforces compliance with the listing rules of the SIX Swiss Exchange (the SIX Listing Rules). The SIX Listing Rules contain, *inter alia*, strict capital, liquidity, and track record requirements as well as transparency and reporting obligations.

A further regulatory body of importance is the Swiss Takeover Board (TOB). The TOB is a Swiss federal commission established under the SESTA. It has jurisdiction to issue general rules and ensures

compliance with the provisions applicable to public takeover offers. Appeals against decisions by the TOB must be addressed to the FINMA.

Other self-regulatory bodies are responsible for the supervision of asset managers in the field of money laundering issues. The Swiss Bankers Association and the Swiss Fund Association have issued self-regulatory guidelines to their members, which, after having been recognized by the FINMA as minimum standards, are binding for all banks located in Switzerland.

### **Regulated Activities**

In general terms, Swiss law and regulation distinguishes between the following financial institutions:

- (1) Banks;
- (2) Domestic and foreign securities dealers;
- (3) Insurance companies;
- (4) Fund management companies and asset managers of Swiss or foreign investment funds; and
- (5) Independent asset managers, acting exclusively in their clients' names based on powers of attorney.

Independent asset managers may not act in their own names, may not hold omnibus accounts, and may not manage the assets of their clients by accepting them in their books and opening mirror accounts (in which case they will be viewed as securities dealers).

As a rule, the first four categories need to obtain an authorization from the FINMA before starting business activities in or from Switzerland. The fifth category of independent asset managers are, in principle, not required to obtain an authorization from the FINMA for such limited activities, but are subject to anti-money laundering regulations.

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## **Banks**

### **Qualifying Financial Institutions**

Under Swiss law, banks are defined as entities that are primarily active in the area of finance. In particular, entities that qualify as banks (although under a non-exclusive understanding) are financial institutions that accept deposits from the public on a professional basis or

solicit deposits publicly in order to finance in any way, for their own account, an undefined number of unrelated persons or enterprises with whom they form no economic unit.

Financial institutions that refinance themselves to a substantial degree from third parties in order to provide any form of financing for their own account to an undefined number of unrelated persons and institutions also qualify as banks. Substantial financing by third parties may be presumed if more than five banks provide loans or other ways of financing to the financial institution in the amount of at least CHF 500,000,000, on an average, in the last year.

Offering banking services in or from Switzerland is subject to prior authorization and ongoing supervision by the FINMA. Once a banking license has been obtained, the financial institution may execute all banking activities, including retail and investment banking, brokerage, lending business, and asset management.

Recent political discussions on requiring banks to separate their investment banking business from their general banking business were silenced after the implementation of the stricter regulations applicable to SIFIs. A bank that intends to engage in securities trading activities will require additional authorization as a securities dealer.

### **Crossborder Banking**

Crossborder activities by a non-Swiss banking institution in Switzerland do not generally require authorization from the FINMA or from any other regulatory authority in Switzerland. Crossborder banking activities are permissible without any license as long as the non-Swiss banking institution does not have a physical presence in Switzerland.

In the event of no physical presence in Switzerland, employees from a foreign bank traveling occasionally to Switzerland to promote the foreign bank and conduct business would be classified as a crossborder activity not requiring a license.

A foreign bank is considered to be physically present if it establishes a branch, a representative office, or an agency in Switzerland. A Swiss branch is deemed to exist if individuals located permanently in Switzerland and acting in a professional capacity in or from Switzerland enter into transactions for the foreign bank, maintain client accounts, or have the authority to act on behalf of the foreign bank.

Typically, the licensing requirement is triggered when the foreign bank maintains staff on a permanent basis in Switzerland (i.e., employs either personnel on a permanent basis or appoints persons

located in Switzerland that may act on behalf of the foreign bank). The FINMA may approve the establishment of several Swiss branches. In this event, the foreign bank will have to designate one branch to represent all its Swiss branches and to be responsible for all communication with the FINMA.

A Swiss branch of a foreign bank may establish one or several agencies in Switzerland. The services rendered via an agency need to be client-related. The conduct of back-office services (e.g., accounting services, strategic planning, or administrative activities) in a location other than a branch does not qualify as an agency. The establishment of an agency must necessarily be connected to the Swiss branch of a foreign bank and is subject to the FINMA's prior approval. The FINMA has to approve the establishment of each agency.

In contrast to a Swiss branch, the individuals forming a representative office of a foreign bank are not entitled to maintain client accounts or to act on behalf of the foreign bank. The purpose of a representative office is to support business development by other means, such as by passing on client orders or by marketing the services of the foreign bank.

A foreign bank that has already established a Swiss branch may not additionally establish representative offices in Switzerland; such offices would have to be established as agencies of the Swiss branch. The FINMA may approve the establishment of several Swiss representative offices of a foreign bank. In this case, the foreign bank will have to designate one representative office to represent all its representative offices and to be responsible for all communication with the FINMA.

### **Banking Secrecy**

The relationship between a bank and its customer is usually contractual in nature and governed by a number of provisions as contained in the Swiss Code of Obligations. In essence, the bank must treat any information that a customer (or prospective customer) provides to it in connection with its contractual agreement (mandate) as confidential under the banking relationship.

The privacy rights of any person are generally protected by the Swiss Civil Code and the Swiss Federal Data Protection Act (FDPA).<sup>7</sup>

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<sup>7</sup> Swiss Federal Act on Data Protection of 19 June 1992 (status as of January 2011). There may be certain contractual arrangements between the customer and the bank that may entail additional interpretation, regardless of whether or not a bank is under a contractual duty of confidentiality, but it is fair to say that a standard banking contractual arrangement is subject to the confidentiality obligations of banks.

Article 47 of the Banking Act stipulates that a breach of bank confidentiality (Swiss banking secrecy) is a crime and states that whoever "discloses a secret entrusted to him in his capacity as officer, employee, agent, liquidator, or commissioner of the bank, as representative of the FINMA, officer or employee of a recognized auditor, or who has become aware of such secret in this capacity", and whoever "tries to induce others to violate professional secrecy", will be punished by a prison term not exceeding three years or by a fine not exceeding CHF 1,080,000.

Swiss banking secrecy, in essence, reinforces privacy and contractual confidentiality obligations of a bank in relation to its customers. Accordingly, Swiss banking secrecy encompasses information provided to the bank by a prospective customer, a customer, and a former customer. Furthermore, unless the context clearly indicates otherwise, it is generally assumed that any and all information provided to the bank by customers or prospects is subject to Swiss banking secrecy.

Article 47(4) of the Banking Act expressly reserves federal and cantonal provisions on the duty to testify or disclose information to public authorities in connection with civil, administrative, and criminal proceedings. For all these proceedings, federal and cantonal laws have developed relatively complex and detailed standards as to what information a bank may disclose and whether it should disclose that information at all.

As the customer or prospect is the "master" of the confidential information, the customer's consent to its disclosure will basically release the bank from its confidentiality obligations. In theory, such consent may be explicit or implied and may even be given following the disclosure of the information to remedy/justify a potential breach.

However, it is generally accepted by legal scholars and supported by case law that a waiver of banking secrecy by a customer should be reasonably specific and allow the customer or the prospect to provide "informed consent". Conversely, general waivers of banking secrecy without regard to what information will be disclosed are deemed to be problematic.

Therefore, it is important that the bank receives specific consent from the customer or prospective customer, normally in writing and prior to the disclosure of confidential information, in order to mitigate the risk of an alleged breach of Swiss banking secrecy.

Today, Swiss banking secrecy is under considerable pressure. At the beginning of 2009, the Federal Council announced that it would comply with Article 26 of the Organization for Economic Cooperation

and Development (OECD) Model Tax Convention.<sup>8</sup> In the meantime, a number of adopted double-taxation treaties between Switzerland and third-party states have been passed by the Swiss Parliament.

Under these revised double-taxation treaties, bank account information will now be produced to the requesting foreign state in cases of suspicions of tax offenses, and Swiss banking secrecy will be lifted in such situations.

In July 2012, the OECD Council issued an update on Article 26 of the OECD Model Tax Convention and on its Commentary. According to the update, requests in relation to a group of taxpayers are now included in the standard of "foreseeable relevance". In the case of requests in relation to a group, the persons concerned must be identified by means of specific search criteria. So-called fishing expeditions (i.e., requests without concrete indications) should remain expressly prohibited. Switzerland is working to implement this new standard into its laws.

### **Outsourcing**

The FINMA has issued Circular Number 2008/7 on 20 November 2008 (Circular 2008/7), which describes the test to decide whether outsourcing arrangements of banks comply with the requirements of proper conduct, Swiss banking secrecy, and data protection without requiring separate approval from the FINMA. For the purpose of Circular 2008/7, outsourcing of business activities by a bank means the retention of a service provider to provide, on an ongoing basis, services that are "significant" for the bank. Services are deemed to be significant if they have an impact on credit, market, operational, legal, or reputational risks.

If customer information is disclosed across borders in connection with an outsourcing activity, Circular 2008/7 states that before customer data is transferred, the bank must inform its customers in detail in a separate letter, indicating the security measures put in place. In this case, the customer must be offered the opportunity to terminate the contractual relationship with the bank within a reasonable period and without suffering any disadvantages.

In essence, Circular 2008/7 sets out several guidelines that banks must follow when outsourcing certain business activities. To begin with, the business area to be outsourced has to be defined in the

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<sup>8</sup> OECD Model Tax Convention on Income and Capital.

agreement between the bank and the service provider. The bank must ensure that the performance of the service provider can be measured and evaluated on the basis of predefined qualitative and quantitative characteristics.

The bank has to select, instruct, and control the service provider carefully. The bank has to request the service provider to guarantee sound and reliable services. The outsourced business activities are to be integrated into the internal control system of the bank. Any subcontracting by the service provider has to be subject to prior approval by the bank. The guidelines of Circular 2008/7 will have to be complied with in the event of any subcontracting.

Notwithstanding the outsourcing arrangement, the bank will remain responsible *vis-à-vis* the FINMA regarding its regulatory obligations as if the bank were carrying out the outsourced business activities itself.

The bank and the service provider have to agree on the requirements regarding security and must develop a security framework. The proper conduct of business operations must be ensured at all times.

Crossborder (offshore) outsourcing requires that technical and organizational measures must ensure compliance with the Swiss regulations on banking secrecy and data protection. If the service provider offers its services to several clients, it will have to ensure by special technical, personnel, and organizational measures that the confidentiality of the data remains assured *vis-à-vis* third parties and all its other clients.

In any outsourcing arrangement, bank customers whose data is transmitted to the service provider will have to be informed of the outsourcing arrangement. This requirement is the same as the one for crossborder (offshore) outsourcing.

The bank has to ensure that the bank itself, its statutory auditors, and the FINMA may execute a complete review and control of the outsourced business activities at any time. The auditor of the service provider may be requested to conduct this review.

In the event of crossborder outsourcing, the bank has to show that the bank itself, its statutory auditors, as well as the FINMA may assume and legally enforce their control rights *vis-à-vis* the service provider. The bank may support this requirement by a legal opinion or confirmation of the foreign regulator.

Finally, an outsourcing arrangement requires a written contract between the bank and the service provider that meets the necessary requirements established by the FINMA.



## Obtaining a Banking License

### Licensing Procedure

Under the Banking Act, a banking license can only be obtained for a bank that is established in Switzerland as a corporation (held by either Swiss or foreign shareholders) or as an agency or representative office of a foreign bank.<sup>9</sup> A Swiss bank is typically set up in the form of a joint-stock company.

According to Swiss law, a joint-stock company is incorporated by the founders declaring the establishment of the company in a notarized deed, by adopting the articles of incorporation and by appointing the corporate bodies (board of directors and auditors). The relevant commercial register will not register the new company without a prior license issued by the FINMA.

The license application must be submitted to the FINMA in writing, in one of Switzerland's official languages (German, Italian, or French). The procedure for obtaining a banking license will take approximately six months, though this estimate is subject to the level of preparation by the applicant. In more complex cases, the licensing process may require up to one year or more. In the course of the licensing process, a physical meeting with the FINMA's representatives may be required.

It is not possible to obtain a banking license for a company that is an empty shell and to build up substance only after having obtained the license. The FINMA grants the banking license based on proof that the required corporate documents, staff, capital, and infrastructure are available to run the banking business.

### Licensing Requirements

In order to obtain a Swiss banking license, a number of requirements have to be fulfilled. Numerous forms of relief apply if the license required is only for a Swiss branch or a representative office of a foreign bank.

*Capital Requirements* The applicant must show a minimal fully paid-in share capital of CHF 10,000,000. In practice, the FINMA requires a minimum share capital of at least CHF 15,000,000, to anticipate a certain capital buffer. Depending on the nature and scope of the contemplated

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<sup>9</sup> Agencies and representative offices are discussed in the subsection "Crossborder Banking", above.

banking activities, an even higher capital may be requested to cover the bank's market, credit, and operational risks.

Customers' deposits in Swiss banks are protected by the Swiss deposit protection scheme in an amount up to CHF 100,000 per customer. In the event of a Swiss bank's bankruptcy, this amount is guaranteed by all other banks under the deposit protection scheme. Their contribution will be paid back from proceeds of the liquidated bank. To assure that sufficient assets are held in Switzerland, Swiss banks are required to cover the total amount of protected deposits with assets held in Switzerland equivalent to 125 per cent of the covered deposits.

*Business Activity and Internal Organization* The applicant's articles of association, bylaws, organizational chart, and business rules must provide a clear definition of the material and geographical scope of the intended banking business. The organizational documents must establish an organization that is adequate for the proposed business activities. In a nutshell, the license request submitted to the FINMA must include information on:

- (1) Personnel (staff, board of directors, management body);
- (2) Infrastructure, logistics, and information technology systems;
- (3) Outsourcing arrangements;
- (4) Internal systems regarding risk management and control;
- (5) Segregation of functions (in respect of trading, asset management and settlement, and similar matters);
- (6) Adherence to obligations of due diligence; and
- (7) Organization, sphere of authority, and activity of the internal auditor.

The applicant must provide a business plan covering the first three financial years. The plan must include the development of business operations, targeted clients, staff, and organization. Budgets for the first three years — consisting of a provisional balance sheet and profit and loss accounts — also have to be prepared and submitted to the FINMA.

**Board of Directors** The board of directors has ultimate accountability for the bank's business and is responsible for the proper organization and supervision of the bank's management. In order to ensure proper supervision of the management of the bank, at least one-third of the board members must be independent, although exemptions may apply under certain circumstances.

A member of the board is considered to be independent if he is not currently employed by the bank and was not employed by it at least two years prior to his appointment, has not been an auditor of the bank during the same two-year period, does not have any business relationships that lead to a conflict of interests, and does not hold more than ten per cent of the bank's shares.

The board of directors must consist of at least three members, at least one of whom must be a Swiss resident. Due to the segregation between the board of directors and the management of the bank, the board of directors may generally not intervene directly at the level of operational activities. The board has primary responsibility for all matters of compliance (including internal anti-money laundering rules) and risk management. The board of directors also must appoint an internal auditor.

The license application must include the following information on the bank's board of directors:

- (1) Composition, disclosing the chairman, the vice chairman, and any committee members;
- (2) Personal data of each member (nationality, place of residence, and date of birth);
- (3) Signed curriculum vitae of each member (listing personal data, school and professional education, summary employment record with a short description of previous professional activities, and mandates);
- (4) Certificate of good standing (i.e., extract from the criminal register and references) for each member;
- (5) List of court or administrative proceedings (completed or pending) if the proceedings are of commercial relevance or could adversely affect the guarantee of proper conduct of business; and
- (6) Qualified or decisive participations (generally, shareholdings of more than ten per cent) that any member holds in other companies, particularly in any companies operating in the financial sector.

**Management** The management body of the bank is responsible for its business operations. Its responsibilities include, *inter alia*, internal control, enforcement of compliance at an operational level, and risk management at an operational level.

The FINMA requires the management body to consist of at least two members, both of whom may not be members of the management of another bank. In practice, a bank will have to have at least five to ten employees to fulfill all these requirements.

The members of the management body of the bank must enjoy a good reputation and assure the proper conduct of the bank's business operations. This requirement also may extend to other employees of the bank if they might endanger the continued existence of the bank due to responsibilities granted to them.

The persons entrusted with management must have their domicile in a place where they may exercise the management in a factual and responsible manner. The bank has to be factually managed from Switzerland, though certain instructions and decisions may be made by the parent company within the group, provided that the group is subject to consolidated supervision by the regulator in its home country.

In addition to the information to be disclosed on the members of the board of directors, the application must contain the following information and documents on the each member of the management body:

- (1) Signed curriculum vitae with a complete chronological employment record, stating previous professional activities, names of one or more previous superiors, number of subordinates at former employers (if any), and reason for changing the job;
- (2) Employer's references; and
- (3) Address where the management activities will actually be carried out and, for members domiciled abroad, evidence that the domicile does not affect the actual management of the bank.

**Qualified Shareholders** Natural persons or legal entities holding a direct or indirect qualified participation of at least ten per cent in the bank have to show that their influence will not have any negative impact on the bank's prudent and sound business activity. Qualified shareholders must enjoy a good personal and professional reputation, similar to persons in charge of the bank's supervision and management.

In addition to the evidence on qualified shareholders, the application must enclose a list of all shareholders holding more than five per cent shareholdings and information on any shareholders' agreement and other arrangement by which control or decisive influence can be exercised in any other way.

**Auditors** External auditors will have to be mandated by the bank to control and review the contemplated setup and the prepared budgets to be submitted to the FINMA (i.e., report of the auditors on the articles of association, business regulations, and the planned organization). The bank also will have to mandate different auditors to the one executing the setup audit. Furthermore, the bank is required to have internal auditors that must be appointed by the board of directors.

### Requirements for Foreign-Controlled Banks

There are a number of additional requirements for foreign-controlled banks. The FINMA may refuse to license a Swiss bank under the control of a foreign entity if the home jurisdiction of the controlling shareholders does not offer reciprocity. Reciprocity is fulfilled if a Swiss bank is entitled to operate in the foreign jurisdiction, and when that Swiss bank is not subject to more restrictive provisions compared to foreign banks in Switzerland.

The reciprocity requirement is subject to any obligations to the contrary in governmental treaties and is therefore not applicable to WTO Member States.

If the foreign entity establishing the Swiss bank primarily offers financial services, the banking license in Switzerland also is dependent on confirmation by the applicant that the group is subject to consolidated supervision by the foreign regulator. Furthermore, the foreign regulator should approve the establishment of the Swiss subsidiary and provide the FINMA with judicial assistance, if required.

### Requirements for a Swiss Branch

The FINMA will grant a foreign bank a license to open a branch in Switzerland if the foreign bank meets certain requirements. The foreign bank must be organized appropriately and possess adequate qualified staff and financial resources to operate a branch in Switzerland. "Adequate" is understood to mean that the staff and financial resources are appropriate for the continuing operation of the branch. The foreign bank also must have adequate supervision, which extends to the Swiss branch.

The competent foreign supervisory authorities for the applicant should make no objection to the establishment of the branch. The FINMA will obtain the foreign regulator's approval directly, although the recommended practice is to provide the FINMA with the contact details of the foreign regulator.

The competent foreign supervisory authorities for the applicant must state that they will immediately inform the FINMA in the event of circumstances arising that may seriously jeopardize the interests of the bank's creditors. The competent foreign supervisory authorities also must be able to provide the FINMA with official support, such as delivery of information and collaboration on enforcement measures.

The conditions governing reciprocity and company name of the branch must be met. The foreign bank must provide evidence that the name of the branch qualifies for entry in the commercial register.

The persons charged with the administration and the management of the Swiss branch must enjoy a good reputation and assure the proper conduct of business operations. They must have their domicile in a place where they may exercise the management in a factual and responsible manner (this can be anywhere in Switzerland). The branch also must possess a regulation that precisely defines its business activities and provides for adequate organization.

#### Requirements for a Swiss Representative Office

As a representative office is not permitted to enter into business relationships with customers, there are fewer license requirements when compared to a branch. The FINMA will grant a foreign bank a license to open a representative office in Switzerland when certain conditions are met.

The foreign bank must be subject to adequate supervision in its home country. Supervision by authorities in the United States and European Union (EU) Member States is considered adequate. The foreign supervisory authority should not raise any objections to the establishment of the Swiss representative office.

The persons in charge of the administration and management of the bank must enjoy a good reputation and assure the proper conduct of the business operations. The conditions governing reciprocity also must be met.

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### **Securities Dealers**

For licensing purposes, Swiss law distinguishes between banks and securities dealers. Securities dealers are natural persons, entities, or partnerships that:

- (1) Buy and sell securities in a professional capacity, on the secondary market, either for their own account with the intent of reselling them within a short time period or for the account of third parties;
- (2) Make public offers of securities on the primary market; or
- (3) Offer derivatives to the public.

The law provides for five categories of securities dealers: own-account dealers, issuing houses, derivatives firms, market makers, and client dealers.

Own-account dealers are securities dealers (generally perceived as dealers) that, in a professional capacity, trade in securities for their own account on a short-term basis, with an annual turnover of at least CHF 5,000,000,000.

Issuing houses are securities dealers that, in a professional capacity, underwrite securities issued by third parties on a firm basis or against commission and offer them to the public on the primary market.

Derivatives firms are securities dealers that, in a professional capacity, create derivatives and offer them to the public on the primary market for their own account or for the account of third parties.

Market makers are securities dealers that, in a professional capacity, trade in securities for their own account on a short-term basis and maintain firm bid and offer prices in given securities, permanently or on request.

Client dealers are securities dealers (generally perceived as brokers) that act in a professional capacity for more than twenty clients. They may trade in securities in their own name for the account of clients and maintain accounts for these clients themselves or with third parties for the settlement of transactions. Alternatively, they may trade in securities in their own name for the account of clients and hold securities of these clients in safe custody themselves or with third parties in their own name.

Entities or persons that are not considered clients within the meaning of "client dealers" include domestic and foreign banks, securities dealers, and other enterprises under government supervision; shareholders or partners with significant interest in a borrower and persons with business or family ties to them; and institutional investors with professional treasury operations.

Depending on its activities, a securities dealer can belong to more than one of the five assigned categories. Only one authorization is needed for approval as a securities dealer, even when the dealer is active in more than one category (i.e., a securities dealer needs to describe and specify its proposed business activities in the license application).

However, if, after having obtained authorization, a securities dealer wishes to be active in a category other than the one initially foreseen, it will, in most instances, be required to have its license re-approved. A new or different regulated activity cannot be assumed unless previously licensed.

The licensing requirements for a securities dealer largely follow the licensing procedure for a bank. However, the applicant must have a minimum equity capital and secured deposits or guarantees in the amount of CHF 1,500,000. The relevant amount of equity (capital adequacy requirements) will be established by the FINMA pursuant to the business plan submitted by the applicant and could exceed CHF 1,500,000.

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## Collective Investment Schemes

### Overview

Along with banks and securities dealers, the FINMA supervises collective investment schemes. The FINMA is responsible for the authorization and supervision of all collective investment schemes set up in Switzerland and the distribution of shares or units in collective investment schemes in and from Switzerland.

Domestic collective investment schemes and any party responsible for managing such a scheme (i.e., fund management companies, asset managers, and distributors) or for safekeeping the assets of a collective investment scheme (i.e., custodian banks) require a license and are supervised by the FINMA. The investment products distributed by each collective investment scheme, including its related documents, require prior approval from the FINMA. The different types of collective investment schemes provided by law are subject to investment and borrowing restrictions.

The legal framework provides for four types of domestic collective investment scheme. Swiss funds can be established as open-ended collective investment schemes or as closed-ended investment schemes. In open-ended investment schemes, investors have either a direct or indirect legal entitlement, at the expense of the collective assets, to redeem their units at the net asset value. In closed-ended investment schemes, investors have neither a direct nor an indirect legal entitlement at the expense of the collective assets to the redemption of their units at the net asset value.

Open-ended investment schemes may be in the form of a contractual investment fund or an investment company with variable capital (*Société d'investissement à capital variable* — SICAV). Closed-ended investment schemes may be in the form of an investment company with fixed capital (*Société d'investissement à capital fixe* — SICAF) or a limited partnership for collective investment (LP).



Irrespective of their legal status, foreign collective investment schemes that are publicly offered and distributed in or from Switzerland also are subject to regulation and require authorization from the FINMA.

### Contractual Investment Funds

Contractual investment funds are open-ended collective investment schemes based on a collective investment agreement (fund contract) between an investor, a fund management company, and a custodian bank. Under the fund contract, the fund management company commits itself to involving investors in accordance with the number and type of units which they have acquired in the fund and to managing the fund's assets in accordance with the provisions of the fund contract.

Under the Code of Obligations, the fund management company is required to be a joint-stock corporation with its registered office and main administrative office in Switzerland. The fund management company must have a share capital of at least CHF 1,000,000 that is fully paid in cash. The custodian bank is responsible for the safekeeping of the fund's assets, the issue and redemption of units, and payment transfers on behalf of the investment fund. The custodian bank must be a bank authorized under the Banking Act.

Contractual investment funds can be set up as securities funds, real estate funds, or other funds for traditional or alternative investments.

Securities funds may invest in transferable securities issued on a large scale and in non-securitized rights having the same function (uncertified securities) which are traded on a stock exchange or other regulated market open to the public and in other liquid financial assets. With certain restrictions, securities funds also are entitled to conduct transactions in derivatives. However, a securities fund's overall exposure associated with derivative financial instruments may not exceed 100 per cent of the net assets.

Direct short selling of investments and investments in precious metals, or precious metals certificates and commodities, or commodities certificates is not permitted. However, securities funds may carry out indirect short selling of investments by entering into total return swaps or contracts of difference. Under the applicable law, securities funds also are entitled to invest ten per cent of the fund's total assets in "other assets" than these.

In the absence of a consistent code of practice, it is not clear whether this so-called "trash quota" leads to more flexibility for investments of

securities funds. Some scholars believe that the provision also allows a broad range of investments — for example, short selling investments and investments in precious metals and commodities — as long as such investments do not exceed ten per cent of the fund's total assets. Other scholars holding a more restrictive opinion state that all investments of securities funds need to be in line with the defined investment policy of the relevant securities fund.

Other funds for traditional investments and for alternative investments are defined as open-ended collective investment schemes that are neither securities funds nor real estate funds. Other funds for traditional investments and for alternative investments are both permitted to invest in securities, precious metals, real estate, commodities, derivatives, units of other collective investment schemes, and other assets and rights.

In particular, other funds for traditional investments and for alternative investments may carry out investments that have only limited marketability, are subject to strong price fluctuations, exhibit limited risk diversification, and are difficult to evaluate.

Other funds for traditional investments and for alternative investments are permitted to engage in short selling and benefit from extensive investment techniques and relatively low restrictions. For example, other funds for alternative investments may commit to an overall exposure of up to 600 per cent of the fund's net assets. The majority of hedge funds in Switzerland are set up as other funds for alternative investments.

Other funds for alternative investment are subject to additional regulations in relation to risk disclosure and transparency. They are obliged to disclose the special risks involved in alternative investments in the fund's name, in the prospectus, and in advertising material. The prospectus must be offered voluntarily and free of charge to interested persons, prior to an agreement being concluded or prior to subscription.

#### Investment Company with Variable Capital

A SICAV has the form of an open-ended collective investment scheme under company law, similar to the SICAV under Luxembourg law. A SICAV has its own legal structure as a legal entity based on the CISA. Other than a SICAF, a SICAV does not constitute a corporation under the Code of Obligations.

A SICAV may either be self-managed or be externally managed by a licensed fund management company. Self-managed SICAVs require a minimum investment of CHF 500,000 on formation. Under the CISA, externally managed SICAVs require a minimum investment of CHF 250,000.

As an open-ended collective investment scheme, a SICAV's share capital is variable and the investors are entitled (by direct or indirect legal entitlement) to redeem their units at the net asset value. A SICAV has two types of shareholders: company shareholders and ordinary shareholders. Company shareholders act as promoters or sponsors of the SICAV and are required to pay in the minimum investment amount at the time of formation.

With regard to the investment policy and the investment strategy, the Ordinance on Collective Investment Schemes refers to the provisions set out for contractual investment funds.<sup>10</sup> Therefore, a SICAV generally also qualifies to pursue a hedge fund strategy.

#### Investment Company with Fixed Capital

Under the Code of Obligations, a SICAF has the form of a joint-stock corporation. A SICAF qualifies as a closed-ended collective investment scheme, and investors are therefore not entitled to redeem their units at the net asset value. As an investment company, a SICAF is not subject to the CISA if it is listed on a Swiss stock exchange and when only qualified investors hold its shares,<sup>11</sup> or if it meets the requirements of an investment club under the CISA. In general, the provisions of the Code of Obligations are applicable to a SICAF if the CISA does not regulate it differently.

A SICAF must appoint a custodian and a payment agent. However, other than custodian banks under the Banking Act, the custodian and paying agent of a SICAF currently do not need to be supervised by the FINMA.

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<sup>10</sup> Swiss Federal Ordinance on Collective Investment Schemes (CISO) of 22 November 2006 (current status as of 1 January 2009); FINMA Ordinance on Collective Investment Schemes (CISO-FINMA) of 21 December 2006 (current status as of 1 January 2009). Both, the CISO and the CISO-FINMA are subject to revision.

<sup>11</sup> Under the current law, applicable up to the time the CISA Reform Bill comes into force in early 2013, qualified investors are regulated financial institutions, companies with professional treasury operations, and high net-worth individuals with financial assets of at least CHF 2,000,000.

With regard to the risk profile of the permitted investments of a SICAF, the CISA refers to the respective provisions that apply to other funds for traditional investment and for alternative investments, and therefore the same regulations apply.

### Limited Partnership

An LP is a closed-ended collective investment scheme in the form of a limited partnership. At least one partner (the general partner) bears unlimited liability, while the other partners (limited partners) are liable only up to a specific capital contribution. The general partner is considered to be the manager of the LP and the limited partners have the role of investors.

Under the Code of Obligations, a general partner must be a joint-stock corporation with its registered office in Switzerland and it is only entitled to be active as a general partner in one LP. As with SICAFs, LPs are only obliged to appoint a custodian and a payment agent, and neither has to be authorized or supervised by the FINMA.

An LP is considered by the legislator to be a vehicle for risk capital, such as direct or indirect financing for start-ups, venture capital, private equity, hedge funds, and real estate, with the expectation of generating above-average capital gains and added value. The CISA does not contain provisions on investment restrictions and thus offers a wide range of flexibility to the management body. As an LP is created to invest in risk capital and is a closed-end investment scheme (i.e., investors have no entitlement to the redemption of their participation), only qualified investors may be limited partners.<sup>12</sup>

### Authorization and Licensing Requirements

In general terms, all types of domestic collective investment schemes, as well as any party responsible for managing or safekeeping the assets of a domestic collective investment scheme, require authorization from the FINMA. Any party applying for an authorization must, depending on the applicant's nature, file the relevant documents with the FINMA.

Fund management companies, SICAVs, and SICAFs must file their articles of association and bylaws. LPs must file their partnership

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<sup>12</sup> Qualified investors have been defined in the previous subsection.

agreement. Asset managers and distributors of collective investment schemes must file the relevant organizational documents.

However, authorized fund management companies and banks are exempted from the duty to obtain authorization for asset managers, representatives of foreign collective investment schemes, and distributors. In principle, authorization is granted if specified conditions are met.

The persons responsible for the management and business operations must be of good reputation, with the necessary professional background. They also should be able to guarantee good management and business conduct.

Significant investors (i.e., investors holding, directly or indirectly, ten per cent or more of the equity) must have a good reputation and may not exert their influence to the detriment of prudent and sound business practice.

The internal regulations and the organizational structure must comply with the applicable legal requirements. There must be sufficient financial guarantees available. The licensee is deemed to have sufficient financial guarantees if it meets the relevant provisions regarding the minimum capital or minimum investment amount.

In addition, the fund regulations must comply with a format that the FINMA has recognized as being the minimum standard or with a set of standards that the FINMA has recognized as binding in relation to the relevant standards.

If the requirements for a simplified authorization procedure are met, domestic collective investment schemes for qualified investors can be approved within four weeks following receipt of the application and within eight weeks for public investors. If the simplified approval procedure does not apply, the process can take between three and six months, or even longer in some instances.

### **Asset Management for an Investment Fund**

A fund management company may delegate part of its duties, including investment decisions and specific tasks, to a third party, the asset manager (investment management). The asset manager acts based on a written asset management agreement with the fund management company and manages the assets of the fund (e.g., by executing trades), which are held with a bank or a securities trader, in the interest of the fund.

The assets of the fund may be held either in the account of the fund or the account of the asset manager. In the former case, the assets manager

acts based on a power of attorney granted by the fund management company. In the latter case, the asset manager may further qualify as securities manager and, as such, is supervised by the FINMA. In both cases, investment decisions lie with the asset manager, and not with the fund management company.

An asset manager that provides services for Swiss investment funds must be licensed by the FINMA. As a financial intermediary, the asset manager must comply with the Swiss anti-money laundering provisions.

Under the previous provisions of the CISA, asset managers for funds administrated outside of Switzerland did not require a license from the FINMA, although they could apply for a license if the home country of the fund required the asset manager to be licensed. This provision enabled Swiss financial services providers to manage undertakings for collective investment in transferable securities (UCITS) under the EU UCITS Directives.<sup>13</sup>

In March 2012, the Swiss Federal Council published a proposal on a reform bill to the CISA, the CISA Reform Bill. The primary goal of the partial revision was to align the rules regarding the management, safekeeping, and distribution of collective investment schemes to international standards, in particular the European Alternative Investment Fund Managers Directive (AIFMD).<sup>14</sup> The proposal also aimed to strengthen investor protection and the competitiveness of the Swiss fund industry and to ensure access of Swiss financial services providers to the European market.

The Federal Council's proposal was heavily criticized by the fund industry for exceeding its intended purpose. Market participants argued that the proposed new provisions of the CISA were too strict compared to the requirements under the AIFMD and would negatively affect Switzerland as an asset management center.

The Swiss Parliament subsequently revised the original proposal. Both chambers of the Swiss Parliament voted in favor of a lean reform bill to the CISA, which nonetheless has notable implications for the distribution rules of foreign funds in Switzerland and the regulation of Swiss asset managers of such funds.

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<sup>13</sup> Directive 2001/107/EC and Directive 2001/108/EC of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

<sup>14</sup> Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers, OJ 2011 L 174/1–73.

The new rules are expected to be implemented in March 2013. The final federal ordinance (CISO) which will specify the new provisions has not yet been published in final form.

The CISA Reform Bill changes the licensing and supervision scheme for asset managers of funds administrated outside Switzerland from voluntary to mandatory. In general, asset managers of foreign collective investment schemes will have to obtain a license from the FINMA. In order to obtain the license, the asset manager must, *inter alia*, demonstrate equity capital of at least CHF 500,000.

The revised CISA includes some exceptions regarding the duty to obtain a license. For instance, asset managers of funds limited to qualified investors are excluded from the licensing requirement under one of three conditions: first, the assets under management (including assets acquired through the use of leverage) may not exceed CHF 100,000,000; second, the assets are less than CHF 500,000,000 (provided that the managed portfolio is not leveraged and that investors do not have redemption rights exercisable for a period of five years following the date of the initial investment); or, third, all investors belong to the same financial group as the asset managers.

These provisions are in line with the *de minimis* rule introduced by the AIFMD, under which voluntary licensing by the asset manager remains possible. In addition, in certain justified cases the FINMA may, on request, partially or completely exempt asset managers of foreign funds from the provisions of the revised CISA.

When a cooperation agreement is required by a foreign jurisdiction, a Swiss asset manager may delegate its services to a foreign entity, provided that a cooperation agreement between the FINMA and the foreign entity's regulator is in place.

A foreign asset manager may open a branch office in Switzerland, subject to a license from the FINMA, and subject to adequate consolidated supervision of that branch by the home regulator. This possibility aims to strengthen Switzerland as an asset management center.

The new provisions of the CISA will most likely enter into force in March 2013, with the goal of preserving the quality and competitiveness of Swiss asset management services. The Swiss Parliament's passage of a reform bill that should not overly burden the Swiss asset management industry is certainly welcome; however, it is difficult to understand why stricter rules on private placement will now be implemented in Switzerland, while national private placement rules of the EU Member States under the AIFMD will potentially only phase out in 2018.

Recent revisions of the Swiss regulation of collective investment funds have not brought the hoped-for positive results, but instead have had a negative impact on the Swiss investment fund market. It is difficult to say whether the CISA Reform Bill will meet expectations this time. First, the new rules lack provisions concerning the remuneration of asset managers, which is required under the AIFMD.

Whether Swiss alternative investment fund managers will be able to benefit from a pan-European passport with regard to their marketing and management activities from 2015 onward thus remains open, and also depends, *inter alia*, on cooperation agreements between regulators, sharing of tax information, and the progress of implementing the Level-2 measures under the AIFMD, which are yet to be finalized.

A fund management company also may delegate part of the research to a separate investment advisor, but keep the responsibility with regard to the investment decision. The investment advisor will only give recommendations on possible investments. Delegation of the investment advisory function by a fund to an investment advisor that does not take any investment decisions is not subject to any authorization requirements by the FINMA, irrespective of whether the investment advisory is addressed to a Swiss or to a foreign fund.

### **Distribution of Shares or Units of Investment Funds**

The Swiss Parliament has recently passed the CISA Reform Bill, which will most likely be enforced in early 2013. The CISA Reform Bill will amend the distribution rules of shares or units of investment funds in and from Switzerland.

According to current laws and regulations, public distribution or advertisement of a Swiss or non-Swiss investment fund in or from Switzerland triggers authorization and licensing requirements for both the fund and the Swiss distributor. Safe harbor rules are provided for private placements of foreign fund units.

Under the private placement rules, no license or authorization is required if the solicitation targets "qualified investors", as defined in the CISA, and only marketing materials or activities that are typical for qualified investors are used. Under the current law in place before enforcing the CISA Reform Bill in early 2013, regulated financial institutions, companies with professional treasury operations, and high net-worth individuals (i.e., individuals with financial assets of at least CHF 2,000,000) are considered qualified investors. The distribution of



foreign fund units to such companies or individuals currently falls under the private placement regime.

Under the revised CISA, distribution of fund units will generally be subject to regulation, but the Swiss Parliament has now decided that, in contrast to the original proposal of the Swiss Federal Council, a safe harbor rule for private placements will remain in force.

Distribution of fund units to licensed financial institutions (banks, securities dealers, fund managers, asset managers of investment funds, and the central bank) will continue to be covered by the private placement regime and will not be regulated.

In addition, three other activities will fall under the private placement regime: providing information to an investor on that investor's request (reverse solicitation); providing information to and the distribution of funds to investors that have concluded a written discretionary asset management agreement with a licensed financial institution (i.e., a bank); or providing information to and the distribution of funds to investors that have concluded a discretionary asset management agreement with an independent asset manager, provided that:

- (1) The asset manager, in its capacity as financial intermediary, is subject to the AMLA; and
- (2) The asset manager is governed by the code of conduct employed by a specific self-regulatory body, such code of conduct being recognized by the FINMA as the minimum standard, and the discretionary asset management agreement complies with the recognized standards of the self-regulatory body.

Publishing of prices, indexes, net asset values, and tax information by a regulated financial institution, and the offering of stock option plans to employers, does not qualify as distribution.

Any distribution of a foreign investment fund in or from Switzerland that falls outside the revised limited private placement regime requires the appointment of both a Swiss representative and a Swiss paying agent and generally requires prior authorization of the investment fund by the FINMA.

The Swiss representative must serve as a point of contact for the investors in Switzerland and must obtain a license from the FINMA. The distributor of the fund units also must be licensed by the FINMA if it is not already licensed in its home country.

Furthermore, units of a foreign fund may only be distributed in Switzerland if the fund manager is located in a jurisdiction that has a cooperation agreement with the FINMA.

Prior authorization of the foreign investment fund by the FINMA and the cooperation agreement will not be required when the fund's shares or units are to be distributed to qualified investors only. The term "qualified investors" encompasses (besides regulated financial institutions) regulated insurance companies, public entities and pension funds with professional treasury operations, and companies with professional treasury operations.

High net-worth individuals will no longer be deemed qualified investors, but will have the opportunity to "opt-in" (i.e., explicitly waive the enhanced protection provided for retail investors by a written declaration. In the event of an opt-in, fund units may be distributed to such high net-worth individuals without the foreign investment fund being authorized by the FINMA and without the fund's offering documents being filed or reviewed; however, a Swiss representative and paying agent still must be appointed.

For investors having concluded a written discretionary asset management agreement with a regulated financial institution (including asset managers falling under the AMLA provisions), the CISA Reform Bill provides for an "opt-out" right. Such an investor may state in a written declaration that he should not fall under the term "qualified investor". Investors having opted out will fall outside of the private placement rules.

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### **Independent Asset Manager**

The activity of an independent asset manager is, for the time being, not a regulated activity subject to supervision under Swiss law, except for the rules applicable to the prevention and combating of money laundering according to the AMLA.

There is no clear legal definition of "independent asset manager" under Swiss law, except for a very broad definition in the AMLA stating that this should include any person who professionally manages assets. Generally, an independent asset manager has been defined as one who manages the assets of clients without having a license as a bank or as a securities dealer for account management and custodial services that are authorized.

While account management and custody of the client's assets (technical administration) necessarily have to be held with a regulated institution, an independent asset manager is responsible for the financial administration of the client's assets. Unlike banks and securities

dealers, an independent asset manager does not accept third parties' monies or securities in his own name, but for the client's account.<sup>15</sup>

Although independent asset managers are not a regulated institution under Swiss law, they have to comply with the anti-money laundering provisions foreseen by the AMLA. The AMLA applies, in very general terms, to any financial intermediary that "undertakes asset management". In principle, the concept of asset management covers cases where a person entrusts an agent with the management of its assets in an independent manner.

A typical example of an activity that is governed by the AMLA is that of an external asset manager (i.e., working outside a bank) who, based on a mandate agreement, manages the client's assets deposited with a bank in an account in the client's name. In general, the asset manager is given a limited power of attorney, enabling him to manage the assets but not to take on any debts or to dispose of the clients assets in any way other than for investment purposes.

The AMLA foresees obligations of diligence for all persons subject to its scope of application, including independent asset managers. These obligations aim at preventing money laundering and include the verification of the identity of the contracting party and the identification of the economic beneficiary, the renewal of such verification of the identity, and specific clarification duties.

The AMLA also defines documentation and organizational responsibilities, as well as an obligation to communicate suspicions of money laundering to the Money Laundering Reporting Office. Further obligations include the blocking of the client's accounts in suspicious cases and the prohibition on informing the client.

The supervision of asset managers is ensured by the FINMA and by self-regulatory bodies that are recognized by the FINMA. An independent asset manager has to be affiliated to a recognized self-regulatory body or submit itself to the FINMA's supervision with respect to anti-money laundering issues.

The FINMA published Circular Number 2009/01, titled "Guidelines on Asset Management" (Circular 2009/01), on 15 January 2009, establishing the benchmarks for minimum standards for self-regulation in the asset management industry and the procedure for recognizing such minimum standards. The benchmarks define a code of conduct for self-regulation, which asset management industry organizations

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<sup>15</sup> Report of the Swiss Federal Banking Commission, "Incentive systems and conflicts of interest in the sale and distribution of financial products" (August 2008), Chapter 6.

have drawn up for the FINMA to recognize as minimum standards. The Circular therefore addresses the self-regulation administration, but not asset managers directly.

In Circular 2009/01, the FINMA sets out minimum standards to guide industry organizations in drawing up their own self-regulatory provisions. The Circular defines minimum requirements, in particular with respect to duties of loyalty, due diligence, obligations on information provision, and remuneration for asset managers.

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## Recent Developments

### The Swiss Bank Insolvency Regime

Since the revision of the Swiss bank rehabilitation and insolvency regime in 2004, the Banking Act provides for detailed rules concerning the bankruptcy and insolvency proceedings of banks and branches of foreign banks established in Switzerland outside the regular Debt Enforcement and Bankruptcy Act (DEBA).<sup>16</sup>

The DEBA is only applicable to the extent that the Banking Act does not provide for special rules. In addition, the FINMA may deviate from the rules of the DEBA when it deems it appropriate, although such derogation is mostly of a formal nature.

The Banking Act grants broad powers to the FINMA, which is authorized to handle most insolvency proceedings against banks and securities dealers. In particular, the FINMA has the authority to implement protective measures, reorganization proceedings, or solvent or insolvent liquidation proceedings relating to banks.

Protective measures may include a broad variety of mechanisms such as, in particular, a bank moratorium or maturity postponement, and may be ordered by the FINMA either on a stand-alone basis or in connection with reorganization or liquidation proceedings. The FINMA determines, at its own discretion, the appropriate measures to be taken against a distressed bank. Such measures can consist of:

- (1) Issuing instructions to the bank;
- (2) Appointing an investigator;
- (3) Removing the bodies of the bank or divesting them of their power and authority to act on behalf of the bank;
- (4) Removing the auditors;

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<sup>16</sup> Swiss Federal Act on Debt Enforcement and Bankruptcy of 11 April 1889 (current status as of 1 January 2012).

- (5) Limiting the bank's business activities;
- (6) Interdiction on the bank's payment or receipt of funds or on conducting transactions;
- (7) Closing down the bank; or
- (8) Postponing the due dates of the bank's debts.

The aim of a rehabilitation proceeding is the restructuring and recovery of a bank. A rehabilitation proceeding may be carried out only if there is prospect for recovery. The proceeding is ordered by the FINMA and conducted by a trustee appointed by the regulator.

The trustee will be in charge of drawing up the rehabilitation plan, which will have to be approved by the FINMA. Generally, the approval will be granted if the customary requirements for rehabilitation are fulfilled, particularly the possibility of the creditors being in a better position compared to a bankruptcy proceeding and the assurance of an effective and controlled rehabilitation procedure.

The rehabilitation plan must not be rejected by creditors who represent more than fifty per cent of the unsecured and unprivileged claims as recorded in the bank's books. In the event that the creditors reject the rehabilitation plan, the FINMA may order the bank's liquidation.

If there is no reasonable chance of rehabilitation, if the rehabilitation fails, or if bank operations have been undertaken without a banking license or after the withdrawal of a banking license, the FINMA will order the bank's liquidation (i.e., the adjudication of bankruptcy). With the issue of this order, the bank will no longer be entitled to dispose of its assets. The FINMA will appoint a liquidator who will be responsible for conducting and implementing the liquidation proceeding.

Certain deviations from the general bankruptcy regime that are set forth in the DEBA deserve special consideration. Claims of bank customers up to the amount of CHF 100,000 are privileged under the deposit protection regime and are therefore treated as priority dues. Third-party assets deposited with the bank do not form part of the bank's bankruptcy estate, but will be separated and released to the owners.

Claims which are recorded in the books of the bank do not need to be lodged additionally upon the call to creditors; the liquidator will consider them in each case when drawing up the schedule of claims. A creditors' meeting is not mandatory, although a creditors' committee, if any, may be appointed by the FINMA.

Rules regarding these insolvency proceedings of banks are not meant to affect close-out netting arrangements. In particular, in a

liquidation procedure ordered by the FINMA, the relevant provisions of the DEBA governing netting arrangements will remain applicable. Article 27(3) of the Banking Act provides that netting arrangements as well as agreements providing for a right to liquidate collateral by private sale will not be affected.

### **Revision of the Deposit Protection Scheme**

In the midst of the financial crisis of 2007–2008, the Swiss Parliament passed an emergency law in December 2008 to enhance protection for Swiss bank depositors and to stabilize and strengthen the Swiss financial system. On 18 March 2011, the Swiss Parliament voted for the Banking Act Reform Bill to implement the emergency law (almost unchanged) on a permanent basis. The new rules were set into force on 1 September 2011.

The Banking Act Reform Bill increases depositors' bankruptcy privileges to CHF 100,000 per depositor and bank and raises the maximum amount covered by the Swiss Banks' and Securities Dealers' Deposit Protection Association (DPA) from CHF 4,000,000,000 to CHF 6,000,000,000. The DPA is a self-regulatory organization of the banking industry.

Any Swiss bank that accept deposits is required to become a member of the DPA. If a bank fails, the DPA solicits contributions from its members, based on the relative size of the members' deposit base, to cover the guaranteed amount of deposits. These contributions are then transferred by the DPA to the administrator of the failed bank for payment to depositors.

Additionally, the Banking Act Reform Bill requires banks to hold assets in Switzerland in an amount equal to 125 per cent of the amount of the protected deposits. This essentially constitutes an additional liquidity measure directly aimed at supporting bank creditors, presumably with an indirect additional liquidity cushion effect on the overall liquidity management requirements of Swiss banks.

This ring-fencing directly results from the experience of the liquidation proceedings of the Swiss branch of Kaupthing Bank Luxembourg Ltd., where the assets held in Switzerland turned out to be insufficient to pay the depositors. Enormous efforts were required to get the required additional funds transferred from the foreign parent company to Switzerland in order to cover the losses.

According to the International Association of Deposit Insurers, explicit bank deposit protection measures have been adopted in more

than 100 countries, and many countries have recently increased their deposit protection schemes. Although many of these schemes are said to reinforce investors' confidence or strengthen the resilience of the banking sector, legal doctrine continues to question their viability and effectiveness.

Critics contend that deposit protection increases "moral hazard", the risk that bankers will not act prudently, and that a deposit protection fund cannot cope with systemic financial crises because the failure of a single large bank or a few medium-sized banks would result in losses far greater than the deposit protection fund. Another contention is that deposit protection funds impose undue costs on banks, resulting in lower interest rates on deposits or higher interest rates on loans (or both) and hinder a banks' accumulation of additional capital, and that deposit protection results in the unproductive hoarding of funds by governmental agencies.

It is at least doubtful whether deposit protection significantly increases moral hazard in the banking sector. The financial crisis has shown that governments are reluctant to allow banks to fail. Such implicit governmental guarantees would appear to be a greater contributor to the moral hazard theory than the existence of deposit protection or its subsequent increase in a crisis.

Many economic arguments against deposit protection — such as penalty on profits, hindering of capital accumulation, and misallocation of funds — are directed at the scope of an existing scheme, how and when it should be funded, and by whom, rather than at the core issue, which is whether there should be deposit protection at all.

Deposit protection seems marginally relevant for SIFIs, as they are perceived to have an implicit governmental guarantee, and — in the event such bank will be wound up in any case — a deposit protection fund is unlikely to be large enough to protect all its depositors. In light of this, deposit protection should instead be an instrument to protect depositors in banks that are small enough to fail, and the limit of a deposit protection scheme should be scaled accordingly.

### **New Bridge Bank Legislation**

In addition to the enhancement of the deposit protection regime, perhaps the most important amendment in the Banking Act Reform Bill is the FINMA's authority to continue certain bank services of a failing bank (for the benefit of the depositors) as one of the options available under the restructuring proceedings. Therefore, restructuring

proceedings would not only be initiated with a view to carry on the bank's business under the current structure, but also to limit business continuity to certain business units of the bank, while winding-up others or restructuring them separately.

Continuing businesses may either be transferred to a bridge bank that may be established for restructuring purposes, or be merged into an existing bank. Consistent with the current Banking Act, the plan on restructuring would have to be approved by the FINMA. If the restructuring plan could affect creditors' rights, FINMA will submit the plan to the creditors, who may reject it within the deadline set by the FINMA.

The proposed proceedings are very similar to those currently enacted. Assets and liabilities (including real estate and existing contracts) of the failing bank would be transferred to a bridge bank or an existing third-party bank based on the FINMA's approval of the restructuring plan. No other measures, approvals, consents, and formalities would be necessary for the transfer to be valid. In particular, the provisions of the Swiss Merger Act would not apply.

According to an earlier proposal to amend the Banking Act, neither a change of control nor any assignment of contract resulting from such transfer was to be considered as an event of default allowing a third party to terminate an agreement concluded with the failing bank or to apply a close-out netting clause. A respective contractual clause would have been declared void and incompatible with Swiss *ordre public*.

This proposed provision has faced heavy criticism from scholars and practitioners alike, including the author's firm, which applauds the fact that the Banking Act Reform Bill, now passed, no longer includes any such provision affecting the enforceability of close-out netting arrangements in the context of a bank's insolvency.

Furthermore, Article 27(3) of the Banking Act will be amended in order to clarify that any contractual close-out netting arrangements and private sales of securities will not be affected by any protective measures, by any reorganization proceedings (including measures related to the establishment of a bridge bank), or by any solvent or insolvent liquidation proceedings relating to banks.

### **New Too-Big-to-Fail Legislation**

The Banking Act Reform Bill was only the first step to a much more far-reaching proposed amendment to the Swiss banking regulation, and especially to the Swiss bank insolvency regime. On 30 September



2010, the Swiss Too-Big-to-Fail Expert Commission (TBTF Expert Commission) submitted its final report on this topic to the Swiss government. Based on this report, the Swiss Federal Council opened consultation on a Too Big to Fail Banking Act Reform Bill (TBTF Banking Act Reform Bill), which has, to a large extent, taken on the proposals of the TBTF Expert Commission. The TBTF Banking Act Reform Bill entered into force on 1 March 2012.

The TBTF Banking Act Reform Bill basically requires systemically important banks to hold more capital, meet more stringent liquidity requirements, and improve their risk diversification. In an insolvency event of a systemically important bank, these measures, combined with the measures stipulated in the bridge bank legislation, should absorb the negative effects on the Swiss economy. The proposed measures, as a whole, should prevent the Swiss government from any intervention as was required in 2008 to bailout UBS.

According to the TBTF Banking Act Reform Bill, systemically important banks are banks, financial groups, and bank-dominated financial conglomerates whose failure would cause considerable harm to the Swiss economy and the Swiss financial system. Which institution will qualify as systemically important will be designated by the SNB after consultation with the FINMA. In its interim report, the TBTF Expert Commission has primarily identified two major banks, UBS and Credit Suisse, as systemically important banks, primarily because their banking services (particularly the credit business and payment transactions) are essential for the Swiss economy.

In terms of the risk-weighted assets, large Swiss banks are currently required to hold at least sixteen per cent equity. The first part of this equity constitutes the minimal regulatory requirement, while the second part serves as a buffer to absorb possible losses without having to suspend normal business activities. To reduce the probability of insolvency of a systemically important bank, the requirements on capital adequacy will become more stringent.

The TBTF Banking Act Reform Bill proposes that systemically important banks should hold an equity capital of at least nineteen per cent of the risk-weighted assets. The required equity capital will be divided into three different components: a basic requirement, a capital buffer, and a progressive component.

The basic requirement corresponds to an equity ratio of 4.5 per cent of the risk-weighted assets ("common equity"). The capital buffer consists of at least another 5.5 per cent of common equity and a maximum of three per cent contingent convertible bonds ("CoCo bonds").

These CoCo bonds will be converted into equity should the common equity fall below seven per cent of the risk-weighted assets of the systemically important bank. CoCo bonds with a trigger of seven per cent of risk-weighted assets will serve as a supplementary capital buffer.

Additional CoCo bonds with a trigger of five per cent of risk-weighted assets should ensure the necessary capital reserve to finance the maintenance of systemically important functions such as the credit business and payment transactions. CoCo bonds with a five per cent trigger build the additional progressive component of the six per cent equity of the risk-weighted assets.

In the event the losses of a systemically important bank cannot be completely absorbed by the common equity (basic requirement), the CoCo bonds of the buffer will be converted into equity (debt-equity swap). Only if the capital ratio of a systemically important bank falls below five per cent (i.e., in case of imminent insolvency of the bank), will the progressive component, consisting of six per cent CoCo bonds, also be converted into common equity.

The additional equity capital to be implemented by the TBTF Banking Act Reform Bill will ensure sufficient capital for the financial consolidation of systemically important banks and will therefore relieve the government from having to provide any financial support for systemically important banks in case of an imminent financial stress situation.

A SIFI must further demonstrate its ability to maintain the systemically important functions in the event of imminent insolvency by preparing an emergency plan. A SIFI is obligated to implement the organizational measures required to ensure proper continuation of systemically important functions in an insolvency event. The emergency plan should provide for possible transmission of the systemically important functions to a new independent legal entity (bridge bank).

The emergency plan is generally triggered only if the bank's capital ratio falls below five per cent of its risk-weighted assets. In this case, the systemically important functions are transferred to a bridge bank and, simultaneously, the CoCo bonds (as part of the progressive component) will be converted into common equity. The debt-equity swap should insure the implementation of the emergency plan and sufficient capitalization of the reorganized bank.

If a SIFI is unable or unwilling to present an adequate emergency plan, the FINMA may request the required measures from the respective bank. In particular, the FINMA may even order that the required

independent entity that may serve as bridge bank has to be established in Switzerland. In addition, the Swiss regulator may require the bank to outsource the systemically relevant infrastructure to another entity within the group. It may even request the SIFI to unbundle certain functions within the group and to structure these in a way which will smoothen transfer of the relevant banking services to a bridge bank when required in an insolvency event.

On the other hand, the FINMA may reward a bank with "discounts" on the progressive capital requirements if that respective bank is able to show compliance with the required organizational measures and present an accurate emergency plan.

In addition to the capital requirements and the requested emergency plan, SIFIs also will face stricter liquidity requirements and specific rules on the risk diversion resulting from the TBTF Banking Act Reform Bill.

Finally, the TBTF Banking Act Reform Bill will have notable effects on the Swiss tax regulation. In order to promote CoCo bonds and to generally strengthen the Swiss bond market, the application of the Swiss issuance stamp duty will be limited.

The Swiss domestic bond market virtually died after the enactment of the Federal Stamp Tax Act back in 1973. Under the Federal Stamp Tax Act, the issuance of "bonds" by, among others, a Swiss resident company or the Swiss registered branch of a foreign resident company is subject to the Swiss issuance stamp duty levied on the issuer.

Depending on the character of the bond, the Swiss stamp duty triggered amounts up to 0.12 per cent for each full or partial year of its term (loan debentures) or 0.06 per cent for each full or partial year of its term (cash debentures). This tax has to be declared and remitted to the Swiss tax administration by the issuer. For stamp tax purposes, the term "bond" is broader than under the securities law, as it also includes book claims and other debt instruments issued for the purpose of collective fund raising.

Interesting enough, the TBTF Banking Act Reform Bill has implemented the following three tax-related accompanying measures: an abolition of the issuance stamp duty on bonds and money market papers; an issuance stamp duty exemption for participation rights stemming from the conversion of CoCo bonds; and a switch from the debtor principle to the paying-agent principle for the withholding tax on interest payments on bond and money market papers. However, this new exception for the issuance duty on participation rights will be restricted to the CoCo bonds of systemically important banks.

Nevertheless, it is expected that the proposed abolition of the stamp duty (which will most likely cause a net revenue shortfall of several hundred million Swiss francs) may have a very stimulating effect on the Swiss capital market as well as on Swiss issuers of bonds. Should the Swiss Parliament pass the issuance stamp duty reform as proposed by the TBTF Banking Act Reform Bill, Swiss issuers will welcome the possibility to finance themselves on the bond market at a much lower rate than at present.

### **Retrocessions**

In a case published in late 2012, the Swiss Federal Supreme Court ruled that retrocessions or other commissions received by a bank, having concluded a discretionary asset management agreement with its client, would be the property of the client.

In this case, the bank received a commission as portion of the management fees levied periodically by the fund management company from the fund. The commission included a compensation of the bank in its capacity as distributor of the fund units.

The amount of the commission was not calculated based on the actual effort of the bank when distributing the fund products, however, but as a mere percentage of the total amount of fund units credited to the deposits of the clients with the bank. The Swiss Federal Supreme Court decided that, based on the general duty of restitution of the agent (the bank) under the Code of Obligations, the bank must pay out all retrocessions and other commissions received by third parties (the fund management company) to the principal (the client).

In the past, some legal commentators challenged the applicability of the general rules under Swiss contract law on banks as they apply on independent asset managers. The Federal Supreme Court made it clear that basically any agent, including a bank, must pay out any commissions received from any parties (including other legal entities of the same banking group) to its principal under Swiss mandate law.

Nevertheless, the client can validly wave his right to the pay-out of retrocessions, provided that he is informed of the terms of calculating any retrocessions as well as their foreseeable significance in respect of the managed assets. Less experienced clients must be informed of possible conflicts of interest arising from the collection of retrocessions by their financial advisor. The decision of the Swiss Federal Supreme Court will accelerate the tendency to more transparency of financial products.

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## Conclusion

As in most jurisdictions, the regulation of financial services has been enhanced in Switzerland in the aftermath of the financial crisis of 2007–2008. The new laws and regulations address, *inter alia*, the deposit protection scheme, the capital adequacy and liquidity regime of banks, and the liquidation procedure of financial institutions. Investors should benefit from the new rules regarding the distribution of shares and units in collective investment schemes and new standards on asset management.

It is expected that the Federal Council will propose a Financial Services Act in 2013 to extend requirements to produce coherent and standardized prospectuses and to harmonize and further regulate the duties of financial service providers in general. It is expected that this new Financial Services Act will reflect, to a large extent, the provisions of the EU Prospectus Directive<sup>17</sup> and the EU Markets in Financial Instruments Directive (MiFID),<sup>18</sup> and will, therefore, enhance the transparency of the structure of financial products, as well as the protection of the investors.

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<sup>17</sup> Directive 2003/71/EC of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading, OJ 2003 L 345/64–89.

<sup>18</sup> Directive 2004/39/EC of 21 April 2004 on markets in financial instruments, OJ 2004 L 145/1–44.