

Newsletter No.

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Although implementation period of Swiss contractual stay requirements ends, FINMA accepts partial conversion for a limited time under certain conditions:

FINMA has announced on 21 March 2018 that for a limited period until 1 January 2019 for contracts with domestic and foreign banks and securities dealers and until 1 July 2019 for counterparties other than banks and securities dealers to accept if banks forego declaring a trade stop in order to achieve full compliance with the Swiss contractual stay requirements.



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Swiss Contractual Stay Requirements

Under the new Article 30a of the Swiss Banking Act FINMA is enabled to impose a temporary stay on termination of contracts in the case of an impending insolvency of a financial institution. In addition, the Swiss Banking Ordinance newly includes the prohibition of a choice of foreign law or foreign jurisdiction without the contractual recognition of such temporary stay. The new provisions on the temporary stay on termination of contracts have been in force since 1 January 2016. Swiss institutions had to implement these provisions by 1 April 2018 for contracts with banks and securities dealers as counterparties and by 1 October 2018 for contracts with other counterparties.

Executive Summary

After the financial crisis the Swiss regulator concluded that the domestic regulation of financial market infrastructures in many areas no longer fulfilled the new international requirements. The Swiss legislator decided to adapt the architecture of the financial market regulation in Switzerland through the enactment of new regulations.

The Swiss Financial Market Infrastructure Act as of 19 June 2015 (**FMIA**) entered into force on 1 January 2016. The enactment of the FMIA had broad implications on a number of existing regulations which required consequential amendments in order to be in line with the new regulatory and market developments, including amendments to regulations regarding the market stability.

The Swiss Federal Act on Banks and Savings Banks (**BA**) and the Swiss Federal Ordinance on Banks and Savings Banks (**BO**) are among the existing regulations which were amended through the enactment of the FMIA. The new Article 30a BA enables the Swiss Financial Market Supervisory Authority (**FINMA**) to impose a temporary stay on termination of contracts in the case of an impending insolvency of a financial institution. In

addition, the BO newly includes a provision regarding the contractual recognition of such temporary stays (Article 12 para. 2^{bis} BO) substantiated in Article 56 of the Swiss Banking Insolvency Ordinance of FINMA as of 30 August 2012 (**BIO-FINMA**).

The new provisions on the temporary stay on termination of contracts have been in force since 1 January 2016. Swiss institutions must implement these provisions (i) by 1 April 2018 for contracts with banks and securities dealers as counterparties and (ii) by 1 October 2018 for contracts with other counterparties (Article 61a BIO-FINMA).

Bankruptcy and Insolvency Proceedings

The BA sets forth a detailed regime governing bankruptcy and insolvency proceedings against banks and Swiss branches of foreign banks established in Switzerland. If there is a justified concern that a bank is overindebted or has serious liquidity problems or does not fulfil the equity capital requirements (after the lapse of a cure period set by FINMA), FINMA can order (i) protective measures (Article 26 BA), (ii) rehabilitation measures (Article 28 et seq. BA) or (iii) finally, the liquidation of the bank (Article 33 et seq. BA).

Contractual Stay Requirements

Scope of Application

The BA generally applies to Swiss banks, Swiss private bankers and Swiss savings banks, Swiss domiciled group parent companies of financial groups or financial conglomerates as well as to group companies domiciled in Switzerland that fulfil significant functions for activities which are subject to a banking licence. Accordingly, FINMA has the power to impose a temporary stay on termination of contracts with respect to such Swiss institutions.

According to referrals in Article 36a of the Swiss Stock Exchange Act (SESTA) and in Article 88 FMIA the power of FINMA to stay termination of contracts applies to securities dealers and as well as to financial market infrastructures.

Conditions for Application

Pursuant to Article 30a para. 1 BA FINMA can order the stay of the termination of contracts within restructuring proceedings (e.g. bailin measures) as well as in bankruptcy and insolvency proceedings. As a condition for the imposition of a stay, the termination of the contract or the exercise of a contractual termination right must be related to the resolution measures taken by FINMA. This is primarily the case if a contract either includes:

- (a) An automatic termination clause; or
- (b) the possibility to exercise an early termination right once an authority has taken resolution measures.

The stay power may also be imposed if the automatic termination or the early termination right is indirectly related to or derived from the resolution measure of FINMA. This is intended to address the case in which a contract stipulates, for example, additional contractual obligations, such as an obligation to provide additional security if a resolution measure is taken against a bank and non-fulfilment of such obligations could in turn result in the termination of a contract.

Even though the termination of a contract which is stayed must be related to a resolution measure in the above sense, the bank being subject to the resolution measure does not actually need to be a party to the respective contract. A temporary stay is, for example, permitted if the bank being subject to the resolution measure is a guarantor or a contractually stipulated specified entity, provided that the automatic termination or the early termination right refers to such guarantor or specified entity. Cross-default clauses (e.g. the termination right under an agreement with a subsidiary if resolution measures are taken against the parent company) are therefore also covered.

The imposition of a stay is not permitted or a stay lapses where the automatic termination or the exercise of a termination right is not connected to a resolution measure and is the result of the act of either the insolvent bank or the legal entity taking over the contracts in part or in full.

Types of Contracts that may be Stayed

The statutory provision generally applies to all types of contracts. The imposition of a stay on termination may, in particular, be crucial with respect to contracts regarding services which are required for the bank's operations (e.g., IT agreements) or with respect to rental or leasing contracts.

Agreements subject to Foreign Law and Jurisdiction

In an international context, contracts of Swiss banks may be:

- (a) Governed by foreign law; or
- (b) provide for a foreign place of jurisdiction.

With such foreign links there is no guarantee that the temporary stay on termination of such contracts ordered by FINMA would be recognized by foreign courts or authorities. The case could arise that e.g. mandatory provisions con-

flict with such recognition. As a consequence, the continuation of the contractual relationships of Swiss institutions is not guaranteed in a crisis situation. The Swiss legislator has provided for a contractual recognition clause that is aimed at ensuring the international enforceability of the temporary stay on termination of contracts.

Duration of Stay

The maximum period of the stay is two business days. FINMA defines the beginning and the termination of the stay. Saturdays, Sundays and state-approved holidays at the registered seat of the institute are not included in this calculation. The triggering of the deadline, however, can also happen on these lock days.

Continuation of Contract after Expiration of Stay

After the stay has lapsed the respective agreement shall remain in force, however, the termination rights that have been stayed may no longer be exercised (based on the earlier trigger event). This usually applies in the event there is no longer an immanent insolvency risk of the bank. In assessing these questions, FINMA has considerable discretion.

If the legal prerequisites of the banking license or other statutory provisions are not fulfilled after the stay has lapsed, the counterparty of the contract who was subject to the stay is permitted to exercise its contractual termination rights.

Consequences of Swiss Stay Regulation

Mandatory Implementation

For Swiss banks, Swiss domiciled group parent companies of financial groups or financial conglomerates as well as group companies domiciled in Switzerland that fulfil significant functions for activities which are subject to a banking licence, the Swiss stay regulation is mandatory. The same applies to securities dealers and financial market infrastructures.

Swiss banks are under the obligation to draft their contracts in a way that a temporary stay according to Article 30a BA is internationally enforceable. Failure to comply with the requirement could therefore be deemed a violation of the requirement of an adequate risk management or an adequate administrative organisation.

Implementation Form

Overview

Banks may choose between two different standard forms:

- (i) The International Swaps and Derivatives Association, Inc. (ISDA) form; and
- (ii) the Swiss Bankers Association (SBA) form.

Both forms meet FINMA's requirements as they acknowledge FINMA's power to declare a suspension of the termination of agreements.

ISDA

ISDA has launched a Swiss Jurisdictional Module (**Swiss Module**) to the ISDA Resolution Stay Jurisdictional Modular Protocol (**Protocol**). It provides Swiss banks and their counterparties with an efficient mechanism to implement the contractual recognition requirement.

The purpose of the Protocol is to allow market participants to comply with stay regulations in different jurisdictions. The Protocol consists of boilerplate provisions and individual jurisdictional modules.

Such jurisdictional modules amend relevant contracts between entities that are subject to a stay regulation and their counterparties by supplementing the contracts with additional terms.

The Swiss Module covers the contracts which are subject to the recognition requirement under the Swiss stay regulation. A regulated entity adhering to the Swiss Module agrees that the Swiss Module shall apply to all covered agreements between itself and each module adhering party that identifies such regulated entity as a chosen counterparty. A module adhering party, on the other hand, can select the regulated entity or entities it would like to amend the covered agreements with. By adhering to the Swiss Module, the module adhering party agrees to accept a stay on termination rights imposed by FINMA with respect to each covered agreement with a regulated entity it has chosen.

Swiss Bankers Association

SBA has published an acknowledgement letter (**SBA Acknowledgement**). The consenting party acknowledges FINMA's powers pursuant to Article 30a BA to declare a suspension of the termination of agreements in respect of each covered agreement entered into by or before the later of the implementation date and the compliance date.

This acknowledgment is governed by and construed in accordance with Swiss law, except that the acknowledgement of FINMA's powers shall be governed by the law specified as the governing law in the respective covered agreement.

Implementation Period

Under Article 61a para. 1 letter a BIO-FINMA, the requirement to amend existing financial contracts which are governed by foreign law or foreign jurisdiction in accordance with the new contractual stay regulations must be met within 12 months. Since Article 61a BIO-FINMA has

entered into force on 1 April 2017, the implementation period ends on 1 April 2018 for phase 1, including contracts with domestic and foreign banks and securities dealers.

For other counterparties than banks and securities dealers, Article 61a para. 1 letter b BIO-FINMA provides that the new contractual stay regulations are met within 18 months, i.e. as of 1 October 2018 for such phase 2.

Since the conclusion of a new transaction under an existing master agreement already constitutes an amendment to an existing contract, many existing contracts have to be amended in order to allow the conclusion of new transactions. According to FINMA, practice has shown that amending the relevant contracts is a much more time-consuming task than originally assumed. Solely a trade stop would allow to comply with the requirements specified in Article 12 para. 2^{bis} BO in conjunction with Article 56 BIO-FINMA in the absence of an amendment to a contract. Given the high number of counterparties affected by such measures, significant impacts on the Swiss financial market would be expected by FINMA. On that account, FINMA has announced on 21 March 2018 that for a limited period until 1 January 2019 for contracts with domestic and foreign banks and securities dealers and until 1 July 2019 for counterparties other than banks and securities dealers to accept if banks forego declaring a trade stop in order to achieve full compliance. FINMA's precondition for easing the implementation period is that the institutes are taking appropriate measures to make the necessary amendments to contracts as quickly as possible, in particular in relation to professional counterparties and those with high trading volumes. The institutes must demonstrate that sufficient resources are employed as well as that counterparties other than banks and securities dealers have been contacted in the context of the implementation at an early stage.

We therefore recommend to take the following steps:

(a) Organisational measures: A sufficient quantity and quality of human resources have to be recruited or existing employees have to be entrusted with the implementation of the new contractual stay requirements. Such measures need to be mapped in the organisation chart and in the internal directives.

(b) Implementation measures: As soon as the organisational measures have been taken, a list of priority must be created. Implementation with high trading volumes counterparties is at the top followed by the rest of professional counterparties.

(c) Information about measures: According to FINMA, the status of the implemented measures must consecutively be provided in order to demonstrate sufficient progress. We recommend contacting the appropriate FINMA person in order to define the frequency of information reports to FINMA.

In case a counterparty refuses to accept a contractual amendment with the above stated content, such a counterparty must be warned of the consequences. If collaboration still fails, the contractual relationship must be terminated or trading must be suspended by the institute.

Since the first deadline of 1 April 2018 has already expired, it is recommendable to immediately take the steps described above and to get in contact with FINMA to define the details.

The Walder Wyss Newsletter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this Newsletter should seek specific advice on the matters which concern them.

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