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Switzerland to review introduction of foreign direct investment controls:

Inspired by recent global protectionist trends, including the tightening of investment controls in numerous jurisdictions, the public debate around foreign cross-border direct investments emerged (again) also in Switzerland. Although, as for now, Swiss legislation does not provide for any investment controls (outside of specific financial market regulations and in the area of residential real property), this open-minded approach towards cross-border investments is in the process of being reviewed. In its decision dated 3 March 2020, the Swiss Parliament tasked the Swiss Government with proposing a draft bill for the introduction of investment controls and the set-up of a respective licensing authority, all within the forthcoming 2 years.



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Swiss Federal Council to Submit Proposal for the Introduction of Investment Controls upon Motion of Swiss Parliament

Contrary to numerous jurisdictions around the globe, the Swiss legal framework currently does not provide for any foreign direct investment controls outside of limited sector specific regulations. This liberal regime is now under review.

In its recent session held on 3 March 2020, the Swiss National Council (lower chamber of the Swiss Parliament) followed the Swiss Council of States' (upper chamber) decision dated 17 June 2019 and resolved to task the Swiss Federal Council with proposing a new legal basis for the control of foreign direct investments in Swiss companies (also referred to as "Lex China" by Swiss media) by, among other things, setting up a licensing authority for respective transactions.

This motion of the Swiss Parliament represents the provisional conclusion of a series of parliamentary initiatives that have resulted in the Swiss Federal Council publishing a comprehensive report on foreign investments and investment control on 13 February 2019 already. In this report, the Federal Council reaffirmed Switzerland's open-minded position towards foreign direct investments and rejected to introduce investment controls (i.e. the systematic review of contemplated investments by a specific governmental review body) by generally making foreign direct investments subject to governmental approval requirements. The Swiss Federal Council highlighted the overall beneficial economic effects of free cross-border capital flows and (based on a risk assessment) deemed current sector specific regulations to be sufficient to safeguard public interests.

In the light of the Swiss Parliament's decision and although, as for now, direct investments into Swiss companies are not subject to investment controls, the Swiss Federal Council will be required to review its position and propose draft legislation to the Swiss Parliament. In doing so, it will have a wide range of discretion, in particular when limiting investment controls to certain critical industries and making reporting/approval requirements subject to fulfilment of certain materiality thresholds.

I. Status Quo: No General Investment Controls...

With foreign direct investments into Swiss companies amounting to CHF 1,088 billion and Swiss direct investments made into foreign companies amounting to CHF 1,228 billion (both in 2017), Switzerland ranks amongst the world's largest direct investors as well as amongst the world's largest recipients of foreign direct investments. Embracing direct cross-border investments, Switzerland refrained (as opposed to other countries such as for instance the United States, Germany, the UK, France, Austria, Italy, Finland, Norway, China and Japan etc.) from introducing costly and (often) ineffective investment controls, despite proponents of such investment controls typically highlighting that direct investments bear (i) the risk of losses of jobs and know-how and (ii) national security threats due to loss of critical infrastruc-

tures (i.e. processes, systems and facilities that are essential for the functioning of the economy and the well-being of the population).

As described below, instead of introducing investment controls, Switzerland relied (and continues to do so as for now) on a set of sector specific measures (state-ownership of critical infrastructures) and regulations (merger control, financial market regulations and restrictions on the acquisition of real estate by foreigners), thereby taking an investor friendly approach. Following the principle of proportionality, the focus of such governmental measures/regulation lies on the protection of critical infrastructure and system relevant enterprises.

II. ...but Limited Sector Specific Controls

Critical Infrastructures: State-Ownership and Merger Control

In substance, state ownership is the strongest form of investment control, since only the legislator is competent to create a respective legal basis for a sale of state-owned enterprises/facilities to foreign buyers and can, therefore, mitigate the risk that critical infrastructures are no longer available due to a sale of such infrastructures. The overwhelming majority of enterprises that provide critical infrastructure for the Swiss population are already state-owned and consequently, the Swiss Federal Council previously concluded in its report that there is no need for imminent action. Well known examples for state-owned enterprises are for instance SBB (railway), RUAG Holding AG (i.a. defence industry), Swisscom (telecommunication) and Schweizerische Post (postal service).

In addition, Swiss merger control legislation also mitigates the risk that critical infrastructures are no longer available by regulating the formation of critical infrastructures in the first place. Consequently, the Federal Council concluded that the government's current strategy (protec-

tion of critical infrastructure by way of state-ownership of enterprises active in industries of great importance such as education, energy, insurance, health, information and communication, nutrition and public safety etc.) and legislation (merger control as provided for by the Swiss Antitrust Act) are sufficient to protect critical infrastructures.

Systemically Relevant Enterprises: Financial Market Regulations

As highlighted before, not all systemically relevant enterprises are state-owned. After the financial crisis 2007/08 great effort has been put into the identification of such system relevant enterprises (i.e. enterprises that are "too big to fail") with the conclusion that respective privately held systemically relevant enterprises exist in Switzerland only in the banking and financial market services industry.

Currently, the following (not state-owned) banks are deemed to be systemically relevant enterprises: UBS, Credit Suisse and Raiffeisen (in addition state-owned banks Zürcher Kantonalbank and Post-Finance have the same status). The only systemically relevant financial market infrastructures are (i) the payment system Swiss Interbank Clearing (SIC) operated by SIX Interbank Clearing AG, (ii) the securities settlement system SECOM operated by the central securities depository SIX SIS AG and (iii) the central counterparty SIX x-clear. All these systemically relevant financial market infrastructures are ultimately controlled by SIX Group AG, which is owned by approx. 130 national and international financial institutions.

In general, foreign direct investments into Swiss banks and financial market infrastructures are governed by sector specific financial market regulations. Banks that are (after their incorporation) ultimately controlled by non-Swiss persons require, in addition to a standard banking license, an additional license from the Swiss Financial Market Supervisory

Authority (FINMA) and a supplementary approval in case of a change of the foreigners holding qualified shareholdings. Given that FINMA (and in case of systemically relevant financial market infrastructures, in addition, also the Swiss National Bank) supervises respective holders of regulatory approvals (and continuously monitors the fulfilment of the requirements for a respective regulatory approval), the Swiss Federal Council concluded that investment controls would be redundant, since FINMA can already under current legislation take appropriate measures to safeguard the interest of the financial market, investors and the public.

Real Estate: Lex Koller

Acquisition of real estate (other than business premises or premises that serve as the principal residence of the purchaser at his lawful and effective place of residence) located in Switzerland by foreign persons requires (subject to certain exceptions) approval of a governmental body designated by the respective canton. The Federal Act on the Acquisition of Real Estate by Foreign Persons (so called "Lex Koller") restricts the acquisition of real estate by persons from abroad in order to prevent the alienation of domestic land by setting forth specific reasons based on which an approval shall not be granted (i.a. in case the respective real estate serves as an inadmissible investment or the acquisition contradicts political interests).

Accordingly, since also indirect acquisitions of real estate can fall within the scope of Lex Koller, the aforementioned regulations can lead to an approval requirement of direct investments, in case a target owns respective real estate. Again, however, the legislator chose a balanced approach by regulating only specific constellations of particular importance.

III. Next Steps

Although, the Federal Council concluded in its report of February 2019, after having assessed the current legal framework applicable to direct investments, that the current approach, i.e. (i) state-ownership of critical infrastructures and merger control, (ii) sector specific regulation for systemically relevant banks and financial market infrastructures and (iii) restrictions on the acquisition of real estate by foreign citizens/persons under foreign control, sufficiently protects public interests and the introduction of investment controls is, therefore, not required, it must now review its position within 2 years and propose draft legislation for the introduction of investment controls to the Swiss Parliament.

It is expected that the Swiss Federal Council (traditionally taking an investor friendly approach towards cross-border investments) will be guided by the principle of proportionality when drafting the proposal of the newly to be created Swiss investment control regime, i.a. by making reporting/approval obligations subject to reaching or exceeding certain materiality thresholds and limiting such obligations to certain industries, critical infrastructures and system relevant enterprises.

Once submitted to the Swiss Parliament, the draft bill will be debated in the two chambers of the Swiss Parliament and, if passed by both chambers, the bill might be subject to a public referendum. It is expected that this legislative process will take several years and it is currently not possible to foresee the outcome of the proceedings, i.e. whether foreign direct investment controls will ultimately be introduced in Switzerland. For the time being, Switzerland continues to apply its liberal approach welcoming foreign direct investments without any generally applicable controls.

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