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Editors:
René Bösch
Thomas U. Reutter
Philippe A. Weber
Thomas Werlen

New Guide on Going Public on SIX Swiss Exchange

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In late 2011, SIX Swiss Exchange published a comprehensive guide on *Going Public on SIX Swiss Exchange.* The guide is the product of a collaboration among some of the leading banks, law firms, audit companies and PR consultants in Switzerland, and provides valuable and interesting in-depth information for companies that are considering going public on SIX Swiss Exchange. The guide has a clear structure and short, but informative, articles complemented with helpful tables and overviews on all important topics that need to be considered in connection with a listing process.

By Till Spillmann

Under the leadership of the SIX Swiss Exchange, the leading Swiss investment banks, the leading Swiss law firms, as well as two of the big four audit firms and PR consultants have issued a comprehensive guide on going public on SIX Swiss Exchange: *Going Public on SIX Swiss Exchange*. The guide is free to download at SIX Swiss Exchange's *website*. The reference contains valuable information for companies that are considering going public, as well as financial, legal and tax advisers on the process of listing and going public on SIX Swiss Exchange.

The publication provides detailed information on the entire process of a listing, everything from the evaluation through the preparation phase, through the marketing, and finally considerations on the aftermarket.

The guide starts with a preface by Johann Schneider-Ammann, Federal Councilor and Head of the Federal Department of Economic Affairs, who emphasizes that not only is Switzerland one of the most competitive economies, but is also one of the most attractive places in the world to do business. In particular, he underscores Switzerland's appeal as a location for businesses due to a combination of mutually reinforcing factors, including: innovation, excellent infrastructure, access to a highly skilled workforce, easy access to authorities, and a well-functioning financial market. The preface is followed by further introductory contributions by the Chairman of the Swiss Association for Location Management, and words of welcome from the CEO of SIX Swiss Exchange, both of whom further stress the advantages of the Swiss financial market, and the SIX Swiss Exchange, in particular. Christian Katz, the CEO of SIX Swiss Exchange, offers an overview of the reasons why he believes the SIX Swiss Exchange is just the right place for a company to go public. Apart from the fact that SIX Swiss Exchange is among the largest stock exchanges in terms of capitalization of its listed companies, he aptly points out that it also enjoys high visibility and recognition of the listed companies among international investors, analysts and the media. He also highlights the unique regulatory regime of self-regulation in Switzerland which enables SIX Swiss Exchange to ensure a smooth and fast listing process through its independent division SIX Exchange Regulation and to be close to the market and its needs.

Apart from these introductory contributions, the IPO guide is divided into the following four sections: Why consider an IPO; Preparation; Marketing and The Aftermarket.

1) Why consider an IPO?

The main section of the IPO manual begins with the question why a company should consider an IPO. The authors underscore that the predominant motivation for a company to go public is to get access to the public capital market. In addition, a diversified investor base, enhanced funding flexibility and the option to set clear market signals make an IPO one of the most attractive forms of financing. On the other hand, it is also noted that an IPO involves considerable additional costs, not only in relation to the IPO process itself, but also due to higher costs associated with increased investor relations maintenance and ongoing obligation requirements from the stock exchange.

2) Preparation

The second part of the guide deals with preparation work and, apart from setting out the prerequisites for a successful IPO, contains an IPO readiness check with a helpful introduction on what going public really means for a company.

Numerous articles offer valuable in-sights into the various preparatory works and aspects that should be taken into account, ranging from the process timeline, pre-deal research, capital structure, corporate governance, valuation, the investment case, the structure of the IPO, and the importance of investor relations and public relations. The section also contains interesting articles on how to manage risks, directors' and officers' liability insurances, tax structuring and due diligence defense. Additionally, the reader can learn about the content and the purpose of the offering document, as well as the main legal agreement on the basis of which the shares are underwritten and offered to investors in Switzerland and abroad, i.e. the underwriting agreement.

The section contains a detailed description of the listing process of Wheatherford International Ltd. This 2010 case study is particularly illustrative since numerous issues arose in connection with its listing process because Weatherford had redomiciled from Bermuda to Switzerland in 2009. With the redomiciliation, Wheatherford not only aimed to reinforce its Swiss presence for tax reasons, but also to elevate its corporate profile across Western Europe. Originally, Weatherford was listed on the NYSE. It then undertook a cross listing on NYSE Euronext in 2009 and completed its stock exchange presence with a dual primary listing on SIX Swiss Exchange in November 2010, all done to broaden its European investor base and to increase demand and trading volumes in its shares. The study touches on, inter alia, the tackling of high demand from index tracking funds and the compilation of selected financial data inasmuch as Weatherford's track record as a Swiss company was not in line with the minimum track record requirement of three years for companies that want to list their shares according to SIX Swiss Exchange's Main Standard.

3) Marketing

The second section of the guide deals with topics surrounding a company's investment case and a typical IPO marketing campaign. The great importance of well-prepared marketing activities to make an IPO a success is underscored not only when it comes to demand creation, and the achieving of a good price for the shares in the offering, but also in connection with the investor base and the positioning of a company post-IPO.

Along a typical timeline of a marketing campaign, the articles in this section touch on how to prepare and market the investment case; the analyst presentation; pilot fishing and the anchor investor process; investor education; all followed by the price range setting, the management road show and the bookbuilding which is concluded by the pricing and the allocation.

As shown in this section of the IPO guide an important element is the analyst presentation, i.e. the presentation of the company's management to the syndicate equity research analysts with the objective to educate the analysts on the company's investment case. The presentation kicks-off the preparation of the pre-deal research reports by the independent syndicate equity research departments. These reports contain a whole array of information on the company, e.g. a description of the company's business, its positioning, competitors, and most importantly, a section on valuation which contains a key document used during the investor education process. Additionally, together with feedback from the analyst presentation, pilot fishing or anchor marketing presentations give the company valuable information in order to decide on go/no-go for the publication of the intention to float, as well as the determination of the price range.

The section concludes with the 2010 Orior IPO case study. It contains an overview of Orior's equity story and how Orior positioned itself prior to the IPO. This case study provides interesting insights as to when and how demand was created during the bookbuilding, and the simultaneously organized road shows and one-on-one meetings with investors. A summary of the offering terms complements the case study.

4) The Aftermarket

The forth section of the IPO guide is divided into two sub-sections: Obligations of a Public Company and Liquidity in the Market.

The first part of the section offers an overview of the ongoing obligations of a listed company as opposed to the regime applicable to private companies. It touches on regular reporting obligations, such as annual and biannual financial reporting obligations, the annual reporting on corporate governance as part of the annual report, as well as the duty to report potentially price-sensitive information according to the rules on ad hoc publicity. Furthermore, it offers a short introduction to the obligations under the management transaction regime that requires directors and managers to report their transactions in securities of the listed companies. Additional articles provide information on ownership reporting of shareholders, corporate governance, the public takeover regime and more technical considerations about registered shares and share ownership mechanics. The section is complemented by a contribution on shareholder activism highlighting the reasons, potential goals, instruments of the various types of activist shareholders and how companies can mitigate the risk of becoming a target of activist shareholders.

The second part of the section touches on aspects surrounding liquidity in the market, and provides useful introductions to share buy-backs, secondary sales and the capital raising by public companies. Interesting insights are provided on the importance of liquidity and how liquidity can be maintained at a high level and what investors generally expect from a company listed according to the Main Standard of SIX Swiss Exchange.

In a nutshell, the IPO guide shows that listing continues to be one of the most important sources of equity financing for companies looking to secure independent growth for the future. With its globally networked, financially powerful and efficient capital market, the guide also underscores that Switzerland and SIX Swiss Exchange offers ideal conditions for a listing.

It is fair to say that SIX Swiss Exchange's IPO Guide *Going Public on SIX Swiss Exchange* is an excellent publication and a very helpful tool for companies considering an IPO, as well as financial, legal, tax and PR advisers. It offers valuable insights from market participants who are at the forefront of helping companies seeking to go public. The guide has a clear structure and contains a number of short and informative articles, complemented with helpful tables and overviews on all important topics that need to be considered in connection with a listing process. The publication underpins the professional and, at the same time, pragmatic approach authorities, advisers and other market participants generally require when helping companies to go public on SIX Swiss Exchange. Clearly one of the competitive advantages for which Switzerland and its financial centre is best known.

Till Spillmann (till.spillmann@baerkarrer.ch)

Proposed New Capital Adequacy Rules Remodel Swiss Regulatory Capital Framework

Reference: CapLaw-2012-2

The Federal Department of Finance recently published different proposals with respect to new rules on capital adequacy for Swiss banks, including detailed provisions aimed at mitigating the too-big-to-fail conundrum. The suggested changes strive to raise both the quality and quantity of the regulatory capital base and enhance the risk coverage of the capital framework. Whereas overall the proposed changes are welcomed insofar as they are aimed at implementing the new capital adequacy rules of the international Basel III framework, some amendments are criticizable as they would result in stricter requirements for Swiss banks than required under Basel III for no apparent good cause. In addition, the stricter capital adequacy rules for systemically important banks seem to depart from the final report of the expert commission with respect to a number of important points and, if implemented, may put significant constraints on Switzerland's two large banks.

By René Bösch / Jonas Oggier

1) Introduction

On 24 October 2011, the Federal Department of Finance (FDF) submitted a draft of the revised Capital Adequacy Ordinance (CAO) for public consultation. Simultaneously, FINMA launched a consultation on a new circular governing eligible equity capital and on the amendments to the circulars governing market and credit risks, disclosure and risk diversification. In a subsequent separate consultation, the FDF published its proposal with respect to the introduction of a countercyclical buffer and stricter risk weightings for mortgages on residential properties. The suggested changes are mostly aimed at implementing the new capital adequacy rules of the international Basel III framework (Basel III). On 5 December 2011, the FDF started a further, separate consultation in relation to a set of new rules which are aimed at implementing the legislative changes to the Banking Act (BA) enacted by Parliament on 30 September 2011 in relation to the too-big-to-fail conundrum and which shall thus be exclusively applicable to systemically relevant banks. All consultations with respect to the CAO and the FINMA circulars ended on 16 January 2012, and the new rules are to enter into force on 1 January 2013. However, it is contemplated that the different transitory periods provided for by Basel III will (to a large extent) be reflected under the new rules. This contribution aims at providing an overview of the main novelties of the suggested new Swiss rules on capital adequacy and discussing some controversial issues.

2) Background of Proposed New Rules on Capital Adequacy

In the past, Switzerland closely implemented the international Basel framework on capital adequacy into national law, however, not without providing for stricter rules with respect to certain aspects of the capital adequacy regime applicable to Swiss banks, notably in terms of higher risk weights for certain credit positions. The implementation of more stringent rules (in particular in the form of add-ons and other special regulations) than requested under Basel III, generally known as the «Swiss finish», was primarily justified by reference to the relative and absolute importance of the financial services industry in Switzerland and the corresponding heightened risk exposure for the Swiss economy.

As a consequence of the recent economic and financial crisis, the Basel Committee substantially revised its capital adequacy framework in order to improve the resilience of the banking sector, notably by raising both the quality and quantity of the regulatory capital base and enhancing the risk coverage of the capital framework. In December 2010, the Basel Committee published the conclusions reached during the revision process in a document entitled "Basel III: A global regulatory framework for more resilient banks and banking systems" (slightly revised in June 2011). Other documents, such as the press release dated 13 January 2011 entitled "Final elements of the reforms to raise the quality of regulatory capital issued by the Basel Committee" contain further important elements of the new Basel III framework.

The proposed changes to the Swiss capital adequacy framework (*i.e.,* the CAO and the FINMA circulars) are mostly aimed at implementing the new rules promulgated by the Basel Committee, in particular with respect to the minimum capital requirements, the capital conservation buffer and the countercyclical buffer. However, contrary to the technique of the "Swiss finish" employed hitherto, the FDF and FINMA suggest implementing the Basel III framework largely without Swiss specific conceptual modifications, merely adding Swiss specific capital buffers depending on the size of the bank to the minimum capital requirements provided for by Basel III. One important element of the current "Swiss finish" is the so-called "Swiss Standard Approach" (SSA), which was hitherto used by some banks in relation to the determination of credit risks, non-counterparty risks and large exposures. As the SSA has never been recognized on an international level, it is suggested that going forward only the Basel III compliant "International Standard Approach" shall be applied. This conceptional change, while being only one element of the "Swiss finish" to be abolished, will bring the Swiss capital adequacy framework closer to international standards and contribute to greater transparency and comparability on a cross-border level.

The suggested changes to the Swiss capital adequacy framework do not address all new policy elements promulgated by Basel III. In particular, the introduction of an unweighted leverage ratio and new liquidity minimum standards (notably the introduction of the net stable funding ratio required under Basel III) are subject to preceding monitoring periods on an international level and will only be implemented in Switzerland over the coming years (to the exception of an unweighted leverage ratio for systemically relevant banks, the implementation of which the FDF advocates substantially earlier than its introduction under Basel III; cf. Section 3.d) below).

3) Overview of Proposed New Rules on Capital Adequacy

The following sections outline some of the main novelties proposed by the FDF and FINMA. These changes are contemplated to be implemented by way of amendments to the existing CAO (Draft-CAO or D-CAO) and to the circulars governing market and credit risks, disclosure and risk diversification, as well as through the enactment of a new circular governing eligible equity capital.

a) New Rules Regarding Eligible Capital

The proposed new Swiss rules reflect the new regulatory capital structure promulgated by Basel III. Pursuant to article 16 (1) D-CAO, total regulatory capital will be composed of tier 1 capital (going-concern capital; T1) and tier 2 capital (gone-concern capital; T2). Tier 1 capital is further divided into common equity tier 1 (CET1) and additional tier 1 capital (AT1). Tier 2 capital will no longer be subdivided into lower tier 2 and upper tier 2 capital, and the currently existing tier 3 capital will no longer be eligible for regulatory capital purposes.

CET1, which is mainly composed of paid-in corporate capital, open reserves (including share premiums), reserves for general bank risks and retained earnings (article 19 (1) D-CAO), remains largely unchanged as compared to the existing definition of common equity, save for a few clarifications. By way of example, it is suggested to specify that preference shares *(Vorzugsaktien)* and participation certificates *(Partizipationsscheine)* may qualify as CET1 if, *inter alia,* they hold no privilege whatsoever over common shares (cf. article 21 (2) D-CAO), and that the endowment capital of cantonal banks may only be eligible for regulatory capital purposes if a possible maturity of such capital is solely destined to re-determine the capital conditions (cf. article 22 D-CAO).

In certain ways, AT1 is the successor category of hybrid tier 1 capital under the existing CAO (cf. article 19 CAO). In the recent financial and economic crisis, hybrid tier 1 capital was—for a variety of reasons—much less loss-absorbing than originally intended. As a result, capital instruments will need to fulfill stricter requirements in order to qualify as AT1 under the Draft-CAO. Typical eligible instruments will be corporate capital instruments such as preference shares and participation certificates if they cannot qualify as CET1, as well as certain debt instruments (cf. article 24 D-CAO).

Compared to the existing hybrid tier 1 capital, AT1-compliant instruments which are classified as liabilities for accounting purposes (*i.e.,* not preference shares or participation certificates) need to have principal loss absorption at a pre-specified trigger point, but at the latest upon falling below a CET1-threshold of 5.125% of risk-weighted assets (RWA), through either (i) conversion into common equity or (ii) a write-down mechanism which allocates losses to the instrument, in each case after decision of the FINMA (cf. article 24 (1) (f) D-CAO). In addition, the terms and conditions of AT1 instruments must have a provision that requires such instruments to be either written off or converted into common equity at the point of non-viability (PONV), which is defined as the earlier of (i) the moment shortly before a public sector capital injection or equivalent support in favour of the bank or (ii) FINMA deeming such write-off or conversion to be necessary (cf. article 26 D-CAO). Therefore, AT1 instruments which are classified as liabilities for accounting purposes will need to provide for two different conversion or write-off triggers: the pre-specified trigger of article 24 (1) (f) D-CAO (the AT1-Trigger) and the PONV-trigger of article 26 D-CAO (the PONV-Trigger). The PONV-Trigger serves as some sort of backstop trigger in case the AT1-Trigger is not activated. Both of these loss-absorption mechanisms are based upon Basel III requirements, however, the Draft-CAO seems to depart from the Basel III framework in a number of ways, notably by giving FINMA greater latitude of judgment than strictly necessary.

The draft FINMA circular 2013/x governing eligible equity capital (D-CEEC) provides that a partial write-down upon the triggering of both the AT1-Trigger and the PONV-Trigger will be possible (no 6.19 D-CEEC). However, only the maximum write-down amount will be eligible for regulatory capital purposes in such case (no 6.20 D-CEEC). The terms and conditions of AT1 instruments may also provide for a so-called "write-up feature", in order that investors may participate in an improvement of the bank's condition after the successful implementation of a write-down, by way of an increase of the nominal amount of their claim which was previously (partly or entirely) written down (cf. no 6.27 and 6.28 D-CEEC). Such a write-up feature, which may potentially enable banks to raise capital at better terms without prejudice from a regulatory standpoint, may in our view be implemented in the form of participating loan features or profit certificates *(Genussscheine)* or by way of issuing warrants entitling to subscribe for shares at beneficial terms.

T2 instruments are similar to AT1 instruments, but are subject to less stringent regulatory conditions (*e.g.,* minimum maturity of only five years compared to unlimited duration of AT1 instruments). T2 instruments are required to provide for a PONV-trigger identical to the PONV-Trigger for AT1 instruments (cf. article 27 (3) D-CAO).

The Draft-CAO stipulates that AT1 and T2 instruments issued before 12 September 2010 will be phased-out over a period of ten years, leading to a yearly reduction in regulatory capital recognition of 10% (article 125c (3) D-CAO). Instruments issued between 12 September 2010 and 31 December 2011 will also be phased-out over the same period, provided that they qualify as regulatory capital instruments under the new rules except for the inclusion of a PONV-trigger (article 125c (4) D-CAO). Instruments issued after 1 January 2012 need to fulfill all requirements under the new rules in order to qualify as regulatory capital instruments and specifically need to include the PONV-trigger (cf. article 125c (2) D-CAO). The proposed implementation schedule of the Basel III rules is criticizable, as the PONV-trigger requirement has to be implemented by Swiss banks one year ahead of the Basel III schedule (according to which implementation only starts in January 2013). Hence, since 1 January 2012 Swiss banks are required to issue instruments containing PONV-triggers, which may lead to competitive disadvantages in terms of financing costs compared to foreign banks.

With respect to reductions applicable to eligible capital instruments, the new rules (generally implemented from Basel III) focus on eliminating non loss-absorbing capital elements from regulatory capital eligibility (*e.g.,* deferred tax assets, which only become loss-absorbing if the bank generates profits in the future, which by definition is uncertain).

b) New Rules Regarding Required Capital

The proposed new Swiss rules on capital adequacy reflect the calibration of the minimum capital requirements under Basel III. Therefore, Swiss banks after expiry of the transitory period in December 2018 will have to comply with a minimum CET1 ratio of 4.5% of RWA, a T1 ratio of 6% of RWA and a total regulatory capital ratio of 8% of RWA (article 33 (3^{bis}) D-CAO), although FINMA will require add-ons depending on the size of the bank as is already the case under current law (article 34 D-CAO).

Based on the new Basel III rules, the introduction of a capital conservation buffer is contemplated, which would require Swiss banks to permanently hold additional CET1 of 2.5% of RWA (article 33a D-CAO). If a bank's CET1 ratio temporarily falls into this buffer range by reason of unexpected and special circumstances (such as a crisis of the international or Swiss financial system), FINMA will set the bank a deadline after expiry of which the buffer will need to have been restored. It is worthwile noting that the implementation of the capital conservation buffer in Switzerland seems to conceptually depart from the Basel III rules. Under Basel III, banks will be able to conduct business as normal when their capital levels fall into the conservation range as they experience losses, since only certain constraints will be imposed on banks with respect to distributions (*e.g.,* limitations on dividend and discretionary bonus payments). The Basel Committee explicitly did not want to impose constraints that would be so restrictive as to result in the buffer range being viewed as establishing a new minimum capital requirement. However, the suggested Swiss approach would *de facto* result in the establishment of such a new minimum capital requirement (*i.e.,* 7% CET1 of RWA), as banks falling into the conservation range will need to demonstrate the existence of "unexpected and special circumstances", which proof may be hard to come by in practice.

Furthermore, the FDF suggests introducing a countercyclical buffer aimed at (i) improving the resilience of the banking sector in times of excessive credit growth and (ii) limiting excessive credit growth. According to the proposed new legislation, a CET1 buffer of a maximum of 2.5% of RWA in Switzerland could be activated by the Federal Council on an as-needed basis upon request by the Swiss National Bank (article 33b (2) D-CAO). If a bank's CET1 ratio falls into the buffer range as determined by the Federal Council, FINMA will set the bank a deadline after expiry of which the buffer will need to have been restored. Similar to the capital conservation buffer, this results in the establishment of a criticizable) new minimum capital requirement of 9.5% CET1 of RWA (*i.e.,* the sum of the minimum capital requirement, capital conservation buffer and countercyclical buffer). It is planned that the provisions regarding the countercyclical buffer shall enter into force on 1 March 2012 (although in a slightly less extensive form) in order to enable the Federal Council to already activate the buffer in 2012 if need be, compared to a coming into effect in January 2013 as provided by Basel III. The introduction of a countercyclical buffer, with the at least implicitly understood aim of being a directive measure *(Lenkungsmassnahme),* raises questions with respect to its constitutionality and whether the BA provides a sufficient legal basis for that undertaking.

A key destabilising factor during the recent financial and economic crisis was that major on- and off-balance sheet risks, as well as derivative related exposures, were not adequately captured by the capital framework. By introducing measures to strengthen the capital requirements for counterparty credit exposures arising from banks' derivatives, repo and securities financing activities, the proposed new Swiss rules strive to implement the adjustments developed under Basel III for Switzerland. In particular, counterparty credit risks will need to be assessed using stressed inputs (article 45 D-CAO), and banks will be subject to a capital charge for potential mark-to-market losses associated with a deterioriation in the creditworthiness of a derivatives counterparty (article 41a D-CAO; no 392 et seq. draft circular 2008/19 governing credit risks (D-CGCR)). Further, stricter requirements for collateral management and margining are proposed (no 115.1 et seq. D-CGCR) and claims against central counterparties in relation to derivatives and repo activities will be attributed a risk weight of 2% instead of 0% (article 56–56a D-CAO; no 399 et seq. D-CGCR).

c) New Rules Regarding Large Exposures

The proposed new Swiss rules on capital adequacy (cf. articles 83 et seq. D-CAO) also provide for various stricter requirements with respect to large exposures *(Klumpenrisiken),* some of which are outlined hereafter. First, as the Swiss standard approach shall be deleted (cf. Section 2) above), a *risk-weighted* determination of the required capital in relation to the coverage of large exposures will no longer be accepted. Under the new rules, the 25% maximum limit on large exposures (article 86 D-CAO) will need to be complied with on an unweighted basis, in accordance with the "International Standard Approach". This conceptual change has an important effect in particular on interbank claims, which hitherto typically were attributed a risk weight of only 25% (compared to 100% under the new approach), leading to substantially stricter requirements in particular for banks with eligible capital higher than CHF 250 million. Further, to date, internal claims against adequately regulated group companies in principle were not subject to the rules regarding large exposures. FINMA believes that this broad exemption is no longer justified, as claims among group companies are not necessarily less risk prone than claims against third parties. For instance, foreign regulators tend to preemptively block assets of a troubled banking group in their respective jurisdictions, which may result in a Swiss-based lending entity not being able to recover its assets located in group companies abroad. It is therefore suggested that cross-border claims against group companies shall be limited to the extent necessary to ensure that the Swiss entity does not fall into bankruptcy in case of a failure of the foreign entity (cf. article 89 D-CAO). Finally, the privileged maximum limits on large exposures (up to 100% instead of 25%) applicable to small and medium banks with respect to claims against other banks and securities dealers will no longer be available with respect to claims against Swiss or foreign systemically important banks (article 115a D-CAO). This change aims at inducing small and medium banks to reduce their credit exposure towards systemically important banks and to achieve higher diversification.

d) Additional Rules for Systemically Important Banks

The Basel Committee has only recently published additional policy measures aimed at addressing negative externalities posed by global systemically important financial institutions, which measures are planned to be phased-in between 2016 and 2018. On 5 December 2011, the FDF launched a consultation in relation to a set of new rules which shall be exclusively applicable to systemically important banks (SIBs). These new rules are to enter into force on 1 January 2013, *i.e.*, before the new Basel III rules will become effective.

Swiss SIBs (currently only UBS and Credit Suisse) will be required to comply with substantially stricter capital adequacy rules compared to non-systemically important banks. The capital adequacy rules for SIBs will be composed of three components: (1) a basic capital requirement in CET1 of 4.5% of the institution's RWA (article 123e D-CAO), (2) a capital conservation buffer of 8.5% of RWA that must be satisfied with CET1 in the amount of 5.5% of RWA and may be satisfied by CoCo's in the amount of up to 3% of RWA (article 123f D-CAO), and (3) a variable progressive component depending on the degree of systemic importance of the respective financial institution (article 123g D-CAO).

To a large extent, the proposed new rules for SIBs are based on the compromise reached by the expert commission on too-big-to-fail (in which UBS and Credit Suisse were represented) in its final report dated 30 September 2010. However, the FDF in its suggested amendments to the CAO seems to depart from the final report of the expert commission with respect to certain important points. For instance, the progressive component (article 123h D-CAO) seems to rely on a different basis for calibration compared to the proposals of the expert commission, without adjustment of the actual calibration of the progressive component. It should be ensured that given this new calibration, total capital requirements for SIBs will not be higher than 19% of RWA upon introduction of the new rules, in accordance with the compromise reached by the expert commission and parliamentary debates. Furthermore, the FDF proposes the introduction of an unweighted leverage ratio for SIBs as early as 2013 (article 123j et seq. D-CAO), notwithstanding the fact that the introduction of the leverage ratio is subject to preceding monitoring periods under Basel III. Both the expert commission and Parliament agreed that the leverage ratio should result in capital requirements slightly below the requirements according to the risk-weighted rules at the time of implementation, and not be a further constraining element under normal circumstances. The new rules put forward by the FDF should reflect this core principle in order to ensure that the calibration of the leverage ratio does not lead to total capital requirements higher than 19% of RWA. Finally, the FDF proposes the introduction of stricter requirements for SIBs than for non-SIBs with respect to the rules on large exposures *(Klumpenrisiken)* (article 123m D-CAO). Given that the issue of large exposures is not a too-big-to-fail specific problem and that the expert commission did not deem it necessary to suggest stricter rules in this respect, a tightening of the rules on large exposures for SIBs does not *prima facie* seem to be justified.

René Bösch (rene.boesch@homburger.ch)
Jonas Oggier (jonas.oggier@homburger.ch)

FINMA Decision in the Matter of KPT

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In January 2012 FINMA announced that it sanctioned a Swiss insurance company and its directors for their improper behaviour relating to an employee participation program in connection with a contemplated merger with another Swiss health insurance carrier. This article discusses the cause for this decision and its legal foundations.

By Stefan Breitenstein

With decision dated 6 January 2012 (Press Release of FINMA dated 11 January 2012) the Swiss Financial Markets Supervisory Authority FINMA (FINMA) closed its administrative investigation started in 2010 against KPT Versicherungen AG (KPT Insurance), a Swiss insurance company, and its board members by finding serious violations of fiduciary duties. The decision related to the fixing of the repurchase price of company shares forming part of an employee participation program in connection with a contemplated merger with another Swiss health insurance carrier as well as mandate agreements with board members. In both cases FINMA held that rules relating to conflicts of interests were not sufficiently observed. As a result, FINMA banned two former board members for four years from acting in a high level function in the financial sector and ordered the disgorgement of illegal profits. Further, FINMA appointed an official administrator for the purpose of assuming the functions of the board of directors and for duly selecting new board members. The day-to-day operation of the insurance company and its solvency were not affected by the decision.

The FINMA decision related to a typical corporate self-dealing case, the facts of which can be summarized as follows. KPT Insurance is part of the KPT Health Insurance Group. At the top of the group are the KPT Insurance Cooperative and the KPT Health Insurance Cooperative. They hold together 100% of KPT Holding AG (KPT Holding) which, in turn, holds 91% of KPT Insurance and 100% of two health insurance companies as well as a number of auxiliary service companies. 9% of KPT Insurance was held by a management participation plan in the form of a foundation. Under this management participation plan the board members, the executives and employees of KPT Insurance could purchase shares for a price of CHF 28 in 2006 and CHF 40 in 2007. The twelve top persons held 27.7% of the plan shares, the remaining plan shares were held by 350 employees. As late as in spring 2010, members of the board purchased plan shares at favourable terms. In summer 2010, KPT Group agreed on a merger with another Swiss health insurance carrier whereby, as a pre-condition of the merger, the 9% minority stake held by the management participation plan had to be repurchased by KPT Holding. Based on external valuations, the board of KPT Insurance fixed the purchase price for the plan shares at CHF 600. According to press reports, this would have led to a payout to board members, executives and employees of CHF 50 million in the aggregate. The proposed transaction would have generated gains of 2,000% respectively 1,400% in four respectively three years. According to press reports, the former chairman of the board would have made a gain of CHF 1.2 million. This deal caused widespread concern in the industry and prompted FINMA to intervene by stopping the repurchase and launching an investigation.

As a health insurance carrier, KPT Group has two supervisors. The part of the group that provides for the Swiss compulsory health insurance program is supervised by the Swiss Federal Social Insurance Department while the part of the group that offers compulsory private insurance programs is supervised by FINMA in its capacity as regulator for insurance companies. As a requirement to obtain and continuously hold an insurance licence, the board of directors and the executives of an insurance company as well as the company itself must ensure proper business conduct *(einwandfreie Gewähr).* This broad and open notion applies not only to insurance companies but also to banks and other FINMA licensed financial companies. By applying this broad notion, FINMA and its predecessors have developed a considerable case law which requires licensed companies and their board members and executives not only to comply with special financial regulations but also with general principles of corporate and contract law including rules and principles regarding conflicts of interests and self-dealing.

FINMA held that the board of directors of KPT Insurance seriously violated its fiduciary duties:

- By approving the repurchase of plan shares. FINMA, in particular, argued that the board members still purchased plan shares in spring 2010 when the proposed repurchase, as part of the merger, was already contemplated. Accordingly, FINMA held that the board not only seriously violated its fiduciary duties when fixing the repurchase price but also when buying plan shares immediately prior to the proposed merger;
- by authorizing payments to board members in addition to regular board fees and bonuses under mandate agreements without that additional services were actually provided;
- by using technical reserves for financing the repurchase of plan shares; and
- by providing a loan to KPT Holding to effect the repurchase.

The decision of FINMA is not yet published and the chairman of the board has, according to press reports, announced to appeal against the decision before the Swiss Federal Administrative Court. Only when the decision of FINMA is published and has become final, a detailed review of the reasoning of FINMA and the broader implications on the financial industry can be made.

Stefan Breitenstein (stefan.breitenstein@lenzstaehelin.com)

FINMA Opens Consultation on Banking Insolvency Ordinance FINMA

Reference: CapLaw-2012-4

On 16 January 2012 the Swiss Financial Market Supervisory Authority FINMA has opened the consultation on the global revision of the Banking Insolvency Ordinance FINMA (BIO-FINMA). The revision becomes necessary due to the following amendments to the Banking Act:

– On 1 September 2011, important new provisions on bankruptcy and restructuring laws provided in the Banking Act entered into force (referred to as deposit protection scheme bill).

– As per 1 March 2012 various parts of the Banking Act have again be amended as part of the "too-big-to-fail" bill.

The proposed draft of the BIO-FINMA shall implement more detailed provisions in particular with respect to restructuring proceedings and the restructuring plan in line with the amendments stemming from both bills mentioned above. As the new BIO-FINMA applies to all banks and securities dealers, the FINMA Bank Bankruptcy Ordinance of 30 June 2005 is to be renamed Ordinance on the Insolvency of Banks and Securities Dealers.

A novelty proposed under the BIO-FINMA is that in an insolvency case it will no longer only be possible to restructure the entire bank, but FINMA can also ensure that important individual banking services are transferred to other legal entities with the goal to protect the financial system and the Swiss economy. In order to raise the capital required for a restructuring, the bank shall be given new contractual instruments: in particular, it will be able to trigger debt-to-equity swaps and statutory bail-ins. The BIO-FINMA shall further provide that in certain cases, FINMA may also temporarily suspend existing contractual termination rights of the bank's counterparties. Other changes aim to result in quick and efficient proceedings, tailored to the relevant case.

The proposed amendments derive to a large extent from the international rules issued by the Financial Stability Board.

The consultation period has ended on 2 March 2012.

Petra Ginter (petra.ginter@nkf.ch)

"Too Big To Fail" Bill Will Enter Into Force on 1 March 2012

Reference: CapLaw-2012-5

On 15 February 2012, the Federal Council decided that the draft bill "Too Big To Fail" resulting in an amendment of the Banking Act will enter into force on 1 March 2012. This amendment was passed by parliament on 30 September 2011. Under the new rules systemically important banks will have to meet more stringent capital, liquidity and organisational requirements in the future. At the same time, the Federal Council adopted ordinance amendments that implement the tax measures set out in the amended legislation.

Exchange Offer and Issue of Basel III Compliant Bonds with a PONV Write-down Feature by EFG International

Reference: CapLaw-2012-6

EFG International, a global private banking group headquartered in Zurich with EFG International AG's registered shares listed on the SIX Swiss Exchange, made an exchange offer to proactively manage and strengthen the quality of its regulatory capital in light of the transition to the Basel III Framework by converting regulatory capital subject to a 10 year phase out into fully Basel III compliant regulatory capital. Both the extraordinary meeting of shareholders of EFG International AG and the meeting of holders of the EFG Fiduciary Certificates have approved the offer on 10 January 2012.

In the exchange offer, EFG International invited holders of the Euro 400 million EFG Fiduciary Certificates listed on the Luxembourg Stock Exchange to exchange Fiduciary Certificates into new Tier 2 Notes issued by its subsidiary EFG International (Guernsey) Limited and guaranteed by EFG International AG on a subordinated basis. The new Tier 2 Notes include a so-called PONV write-down feature making them the first issue of this kind in Europe from a non "Too Big To Fail Bank". The PONV write-down feature is a contractual provision where investors waive their rights under the Tier 2 Notes upon the "point of non-viability", *i.e.* (i) if the Swiss Financial Market supervisory authority FINMA decides that a write-down of the Tier 2 Notes is necessary to maintain the viability of the Bank; or (ii) upon the decision to make an injection of public sector capital without which the Bank would become non-viable.

A total of 135,219 EFG Fiduciary Certificates, representing approximately 33.8% of the outstanding principal amount of EFG Fiduciary Certificates, were validly tendered and accepted for exchange by EFG International (Guernsey) Ltd. In exchange EFG International (Guernsey) Ltd. issued Euro 67,604,000 principal amount of Basel III compliant Tier 2 bonds on settlement of the exchange offer on 13 January 2012. The new bonds have a maturity of 10 years and for the first 5 years pay an annual interest coupon of 8%. The outstanding number of EFG Fiduciary Certificates reduced from 400,000 to 264,781, representing a total nominal amount of approximately Euro 265 million.

ZKB issues CHF 590,000,000 3.50% Tier 1 Perpetual Subordinated Bonds

Reference: CapLaw-2012-7

On 18 January 2012, Zürcher Kantonalbank (ZKB) launched a CHF 590m 3.50% Tier 1 Perpetual Subordinated Bonds transaction in the Swiss market, placed through UBS AG and ZKB as Joint-Lead Managers. These Tier 1 Perpetual Subordinated Bonds are a novel instrument, in particular providing for a write-down if ZKB's CET 1 capital falls below 7% of its risk-weighted assets. Their terms comply with the requirements of Basel III as envisaged to be implemented in Switzerland and qualify as Additional Tier 1 Capital under the new Basel III framework. The Tier 1 Perpetual Subordinated Bonds will also be written down at the "point of non-viability", *i.e.* if FINMA determines that ZKB requires public sector support to prevent it from becoming insolvent, bankrupt or unable to pay a material amount of its debt or similar circumstances. Since Swiss law does not provide for a concept of a unilateral waiver of a right *(Forderungsverzicht),* the write-down mechanism is documented as an agreement between the bondholders and ZKB that the bondholders' rights to claim the principal shall be cancelled if and when an event triggering the write-down occurs.

Swiss Reinsurance Company Ltd Places CHF 320,000,000 Perpetual Subordinated Notes with Stock Settlement

Reference: CapLaw-2012-8

On 9 February 2012, Swiss Reinsurance Company Ltd (Issuer) successfully completed the issuance and placement of CHF 320,000,000 perpetual subordinated notes with stock settlement (Notes). Under the terms and conditions (Conditions) of the Notes, the Issuer may initiate a stock settlement procedure which combines a write-down of the principal amount of the Notes with the conversion into registered shares of Swiss Re Ltd (Shares), the SIX Swiss Exchange listed holding company of the Swiss Re group. The Conditions provide for an at-market stock settlement, which may be initiated at any time, as well as a stock settlement following the occurrence of a solvency event (which includes the failure to comply with the applicable minimum solvency margin), in which case the conversion of the Notes into Shares is based on a floor price. The Notes qualify as upper additional capital pursuant to the Insurance Supervision Ordinance.

9. Zürcher Aktienrechtstagung: Die aktienrechtlichen Themen 2012 in Gesetzgebung und Praxis (9th Zurich Corporate Law Seminar: The Corporate Law Topics 2012 in Legislation and Practice)

Thursday, 29 March 2012, 11.00 h–17.45 h, Park Hyatt, Zurich

http://www.eiz.uzh.ch

6. Schweizerische Tagung zum Wirtschaftsstrafrecht: Geldwäscherei – Asset Recovery (6th Swiss Seminar on the Law Relating to Economic Offenses: Money Laundering–Asset Recovery)

Thursday, 12 April 2012, 9.00 h–17.15 h, Lake Side Casino Zürichhorn, Zurich

http://www.eiz.uzh.ch

Bank regulation and ring-fenced banks: the British experience

Friday, 27 April 2012 (Luncheon), 12.15 h–13.45 h, CS Forum St. Peter, Zurich

http://www.eiz.uzh.ch