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Swiss Capital Markets: New Rules regarding Swiss Withholding Tax

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A bond issued by a foreign resident issuer but guaranteed by its Swiss resident parent company is reclassified as a domestic issuance and subject to 35 percent withholding tax if the proceeds raised under such bond are used in Switzerland. According to new rules which entered into force on 1 April 2017, it is possible to use the proceeds in Switzerland up to an amount equal to the equity of the foreign issuer and to still avoid a reclassification.

By Stefan Oesterhelt

1) Introduction

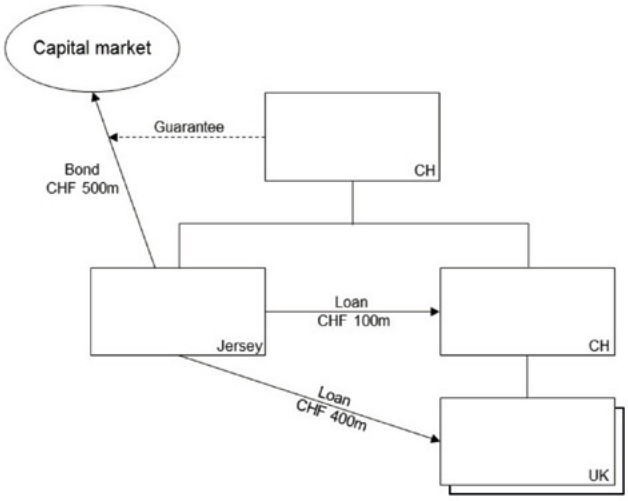
Switzerland levies a 35 percent withholding tax (*Verrechnungssteuer*) on interest payments with respect to bonds. International capital markets generally do not accept bond issuances subject to such deduction of Swiss withholding tax. As a consequence, it is common for Swiss multinational groups to issue bonds through a foreign subsidiary. This is accepted by the Swiss federal tax administration as long as the proceeds raised under such foreign issuance are used outside of Switzerland at all times while the bonds are outstanding. New rules which entered into force on 1 April 2017 added additional flexibility in this respect.

2) General Principles

A bond issued by an entity resident outside of Switzerland will be (re-)characterized as domestic issuance if such bond is guaranteed by the Swiss parent company and the proceeds from the issuance are used in Switzerland. In such a case, the Swiss guarantor will have to pay 35 percent Swiss withholding tax on any interest payments (53.8 percent in case of a gross-up) to the Swiss federal tax administration.

Any direct or indirect on-lending to a Swiss group company is considered as a potentially harmful "use of proceeds in Switzerland" for these purposes. In the case of such an "use of proceeds" in Switzerland, the bond will be reclassified in its entirety as a domestic issuance (see Figure 1).

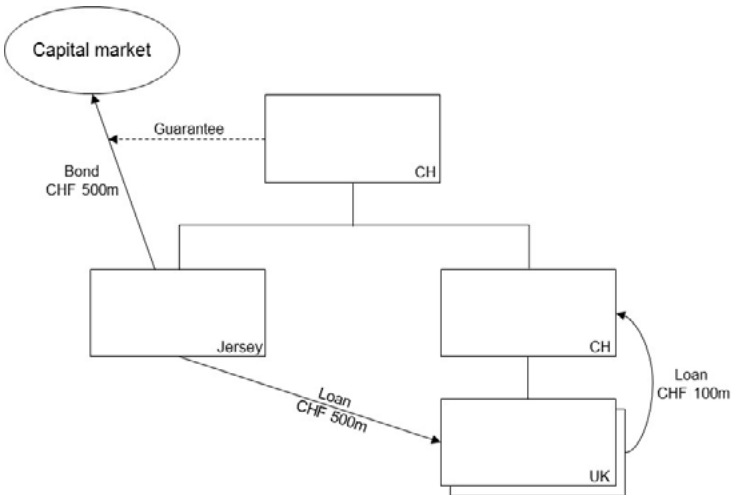
Figure 1: **Partial on-lending to Switzerland**



Despite the fact that only 20 percent of the issuance is used in Switzerland, all interest payments of the bond will be subject to 35 percent Swiss withholding tax.

A foreign bond is reclassified in a domestic issuance subject to withholding tax even if there is no direct on-lending to Switzerland but an indirect on-lending to Switzerland (see Figure 2).

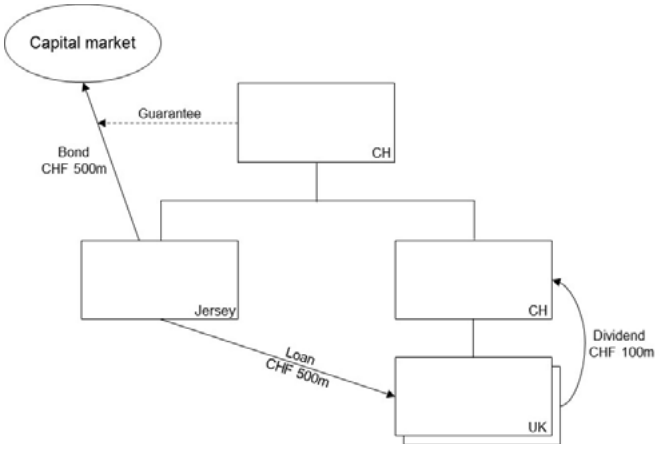
Figure 2: **Indirect on-lending**



The foreign issuance is reclassified in a domestic issuance despite the fact that there is no loan between the foreign issuer and the Swiss companies.

A use of proceeds in Switzerland is only potentially harmful if there is a (direct or indirect) on-lending to Switzerland. Equity contributions or dividend distributions are not harmful (see Figure 3).

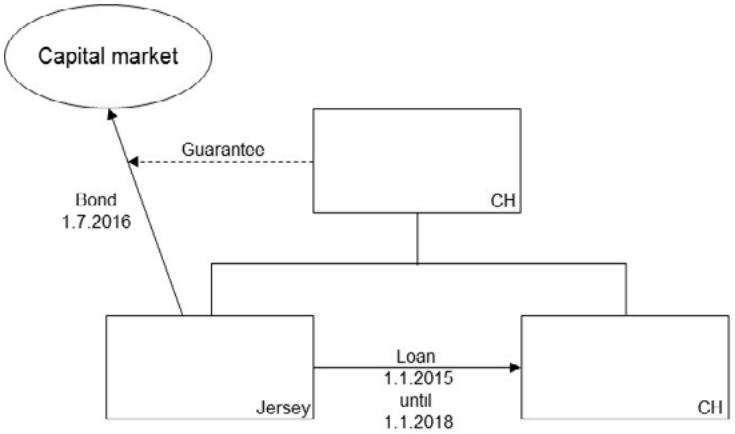
Figure 3: **Dividend distribution to Switzerland**



The bond will not be reclassified in a domestic issuance irrespective of the fact that the liquidity for the dividend distributed by the UK subsidiary to the Swiss parent derives from the foreign bond issuance.

A connection between the foreign bond issuance and the on-lending to Switzerland is not necessary for such a reclassification of the bond. Even pre-existing on-lending to Switzerland is potentially harmful (see Figure 4).

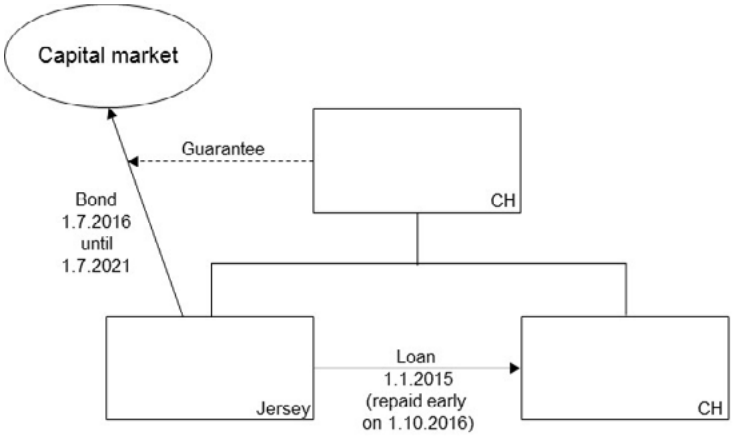
Figure 4: **Preexisting debt**



The bond will be reclassified in a Swiss issuance subject to Swiss withholding tax despite the fact that the on-lending to Switzerland already existed at the time when the bond has been issued.

Once there has been a harmful "use of proceeds in Switzerland" and consequently a bond has to be reclassified as a domestic issuance, the bond will keep this classification until maturity (see Figure 5). A repayment of the on-lending to Switzerland does not cure the reclassification.

Figure 5: **No change in qualification of domestic issuance**

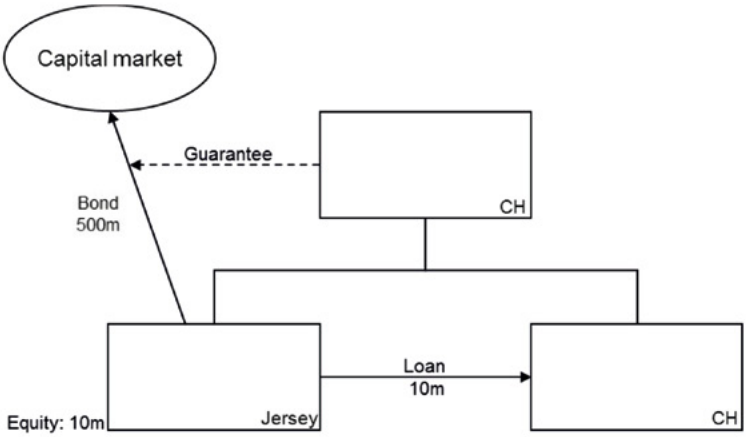


There has been an on-lending to Switzerland at the moment when the bond has been issued. The repayment of the loan does not cure the reclassification of the bond as a "domestic issuance". Interest payments will be subject to 35 percent withholding tax until maturity of the bond.

3) New Rules

The rules which entered into force on 1 April 2017 introduce a new safe harbor rule for on-lending into Switzerland. Under this rule, it is permissible to on-lend to Switzerland up to an amount equal to the amount of the equity of the foreign issuer (see Figure 6).

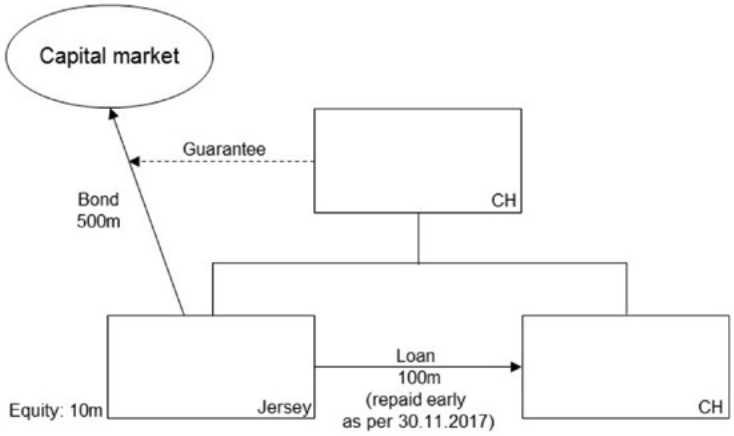
Figure 6: **New safe-harbor-rule**



On-lending to Switzerland only results in a reclassification of a bond into a domestic issuance if the amount of the on-lending exceeds the IFRS equity of the foreign issuer.

Under the new rules, the equity of the foreign issuer *at the end of the business year* of the foreign issuer is decisive. Consequently, any on-lending to Switzerland which is repaid before year-end is not harmful (see Figure 7).

Figure 7: **Year-end view**



On-lending to Switzerland in excess of the foreign issuer's IFRS equity now only results in a reclassification of a bond if it is not repaid prior to the end of the business year of the foreign issuer. If the on-lending would have occurred prior to 1 April 2017, the bond would have been reclassified in a domestic issuance subject to 35 percent withholding tax until the maturity of the bond.

The new rule is subject to the abuse of law principle, however. The Swiss Federal Tax Administration would still reclassify a bond into a domestic issuance if the proceeds of the bond are used in Switzerland most of the time (but never over year-end date).

4) Appraisal

The general rule that on-lending to Switzerland is not permissible if a foreign issued bond is guaranteed by a Swiss parent company has not been given up by the legislative change which entered into force on 1 April 2017. However, the flexibility introduced with the new rules regarding intra-year on-lending as well as the new safe harbor rule is highly welcome.

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Cross-Border Transactions in Intermediated Securities: Switzerland Maintains its Lead (Part 2/2)

Reference: CapLaw-2018-02

"The transnational nature of collateral goes beyond the mere (but important) fact that the parties to a swap are often incorporated in different jurisdictions. Collateral may be posted in different currencies, or in the form of government bonds issued by different governments. The collateral is held with intermediaries often incorporated in yet other jurisdictions, with places of business in still other locales. These intermediaries book the collateral in computerized ledgers maintained on servers that may be located elsewhere in the world. And if, as is permitted under the law of some countries, the pledgee (the party that receives the collateral) "repledges" the collateral to yet another party to satisfy its own obligations, which then repledges it again, then lawyers are left to make sense of a constant global movement of collateral in and out of accounts in many jurisdictions in terms of legal rules created to address a far more stationary and localized conception of property and contract rights."

Annelise Riles, Collateral Knowledge: Legal Reasoning in the Global Financial Markets, p. 43 (University of Chicago Press, 2011)

By Thomas Werlen / Matthias Wühler / Jonas Hertner

On 1 April 2017, the *Hague Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary* (Hague Securities Convention) entered into force. The entry into force of the Convention coincides with renewed efforts by the European Commission at modernising the conflicts rules for the third-party effects of transactions in book-entry securities and financial claims in the overall context of the Capital Markets Union action plan.

Nearly eight years have passed since the promulgation of the Swiss Federal Act on Intermediated Securities (FISA). This year's entry into force of the Hague Securities Convention again puts a spotlight on the Swiss legislation in this domain which compares favorably with the set of rules prevailing in the EU and its Member States. We wish to take this opportunity to place the Swiss legal framework for intermediated securities in the broader context.

In the first of our two-part contribution, we outlined the prevailing indirect and/or intransparent systems of securities intermediation and reviewed key aspects of the UCC approach to intermediated securities. We begin this brief and final part with an introductory comment on FISA (1). We then turn to the private international law challenges arising in cross-border holdings and transactions (2) as well as the solutions offered by the Hague Securities Convention for a subset of these issues (3). The flexible approach of the Hague Securities Convention contrasts with the rigid nature of Union law

in this domain, and we discuss the European Commission's ongoing attempt at reforming it (4). A brief outlook concludes this article (5).

1) FISA, The Swiss Federal Act on Intermediated Securities

In an effort to adjust Swiss law to the new realities of securities trading, the Swiss lawmakers adopted the Federal Act on Intermediated Securities (FISA). The preparation of FISA occurred in parallel to extensive debates in international fora. In the course of the political debate in Switzerland, a consensus emerged that legal certainty must be improved in light of the new challenges brought by the modernization of securities trading, but that at the same time any new law would need to be flexible enough to sensibly apply to still evolving, new market practices.

FISA introduced a new category of rights – "intermediated securities" – into Swiss law. Before the implementation of FISA, transactions in intermediated securities were governed by the rules governing the transfer of movable property (transfer of ownership in chattel and assignment of choses in action). Article 3(1) FISA defines "intermediated securities" as (1) personal or corporate rights against an issuer which (2) are of a fungible nature, (3) have been credited to a securities account, and (4) may be disposed of by the account holder in accordance with the provisions of FISA. Article 3(2) complements this definition by clarifying that intermediated securities are effective against the intermediary and any third party (erga omnes). While this definition is more restrictive than the definitions in the Geneva Securities Convention, which defines securities as "any shares, bonds or other financial instruments or financial assets (other than cash) which are capable of being credited to a securities account and of being acquired and disposed of in accordance with the provisions of the Convention", FISA is understood to be fully in line with the Geneva Securities Convention in terms of policy and practical effect.

2) Cross-Border Holdings and Transactions in Intermediated Securities: The Conflict of Laws

Numerous intermediaries stand between the ultimate investor and the central securities depository, and their number is larger still in a cross-border setting (for an empirical analysis of a dataset on subcustodian structures in the safekeeping of foreign financial assets collected by a National Competent Authority, see BuBa Discussion Paper No 31/2015). When a custody chain extends across jurisdictions, it is the body of law variously referred to as private international law or conflict of laws that coordinates these jurisdictions.

a) Characterization/Qualification

The custody of and transactions in intermediated securities touch upon several bodies of law, the following of which are of particular importance (and to each of which corresponds a set of conflicts rules):

- The rules governing custody agreements (contract law);
- Insolvency law;
- The rules governing the rights embedded in/underlying the intermediated securities (corporate law, contract law); and
- The rules governing the legal nature and effects against an intermediary and third parties of the rights resulting from a credit of securities to a securities account or of a disposition of intermediated securities (hereinforth referred to as the "Law of Intermediated Securities").

As to the rules designating the proper law of custody agreements, they are the rules of international contract law which follows the primacy of party autonomy and poses little problems in terms of internationally harmonized conflicts rules.

The conflicts rules designating the law governing the bundle of rights embedded in/underlying the intermediated securities depend on the type of security at issue. The rights embedded in bonds are contractual in nature, so the conflicts rules are those in the international law of contracts. The rights embedded in equity securities are membership/corporate rights. The law governing these membership rights is the personal law of the company (*lex societatis*), the corresponding conflicts rules are the rules of international company law.

In a cross-border setting, the *lex societatis* and the Law of Intermediated Securities must be clearly distinguished. The intensity at which securities are traded on secondary markets and the prevalence of securities finance and wholesale collateral management inside current systems of securities intermediation imply that the Law of Intermediated Securities will change frequently. Where the applicable Law of Intermediated Securities is determined separately at each layer of a given chain of intermediation, this further compounds the issue. Whether an investor must be recognized as the shareholder of an issuer corporation, corporate actions, all issues that involve the relationship between the issuer of the security and the ultimate investor cannot be subject to constantly changing laws.

b) Connecting Factors

In coordinating national laws, one may depart from either of two questions:

– To which territory is an "intermediated security" most closely connected?

– What conflicts rule best serves the interests of the parties involved?

Both perspectives resonate in discussions over appropriate connecting factors along with the usual concerns accompanying legal policy discussions (practicability, cost etc.).

Once a multi-tiered system of securities intermediation is established, it is arguably the interests of intermediaries that should inform the formulation of appropriate conflicts rules. To simplify, let us establish three categories of parties involved: issuers, securities intermediaries (with intermediaries also filling in for central banks) and investors. Further, let us assume that the interests of issuers are fully served by a clear delineation of the Law of Intermediated Securities and its associated conflicts rules from the *lex societatis*, the law applicable to the terms of its bonds, notes and other issuances, and the conflicts rules corresponding to the latter bodies of law. That is to say that predictable and clear characterization suffices to serve the interests of issuers.

These assumptions leave us with two types of Parties concerned, intermediaries and investors. The interests of investors arguably do not extend to the inner layers of the securities intermediation system. As discussed in Part 1, indirect/intransparent systems of securities intermediation provide that an investor may only exercise his or her rights to an intermediated security throught the custodian. An investor's creditors cannot effect so-called upper-tier attachments.

The interests of intermediaries are a product of their activities at the inner layers of the system, in particular securities finance and wholesale collateral management. Intermediaries want a legal framework permitting the use of diverse pools of securities as collateral at low cost. On a general level (brushing over the refinement of alternative solutions such as the *lex creationis* approach developed by *Ooi*), there is a tradeoff. What is a multitude of laws from the perspective of a bystander observing the chain of intermediation for a given security in full, becomes a single law applicable to all securities in the portfolio from the perspective of an intermediary within that chain. Conversely, if a single law were to govern each level of chain of intermediation for a given security (by operation of a connecting factor situated at the top of the chain), an intermediary within said chain would be faced with laws as diverse as the pool of securities it is working with.

The needs of securities intermediaries are seen to require what has come to be known as PRIMA (Place of the Relevant Intermediary Approach). Under PRIMA, the law applicable to the (third-party) effects of transactions in intermediated securities must be determined separately at each layer of the system, at the level of the *relevant* intermediary. PRIMA implies that different Laws of Intermediated Securities apply at different levels of a given chain of intermediation.

PRIMA as adopted by the Hague Securities Convention differs from PRIMA as adopted by the Union law instruments addressing the needs of securities intermediaries. This eventual divergence of approaches was not foreseen by the European Union at the start of the negotiations over the Hague Convention, which were conducted in parallel with negotiations in Brussels over the Financial Collateral Directive. It was expected that the Hague Convention would harmonize internationally the localization of the relevant intermediary. The Explanatory Report on the Hague Securities Convention (*Int-43 et seq.*) provides background:

> *The reference to the place of the relevant intermediary suggested that a single situs of the relevant intermediary or the securities account it maintains for the account older had to be determined. The history of the negotiations leading to the Convention clearly revealed, however, that there is no criterion – generally acceptable on a global basis for the vast majority of transactions – to precisely and unequivocally determine the location of a securities account or the office of an intermediary that maintains a specific securities account. (...)*
>
> *In such a situation, if the criterion for determining the applicable law were the location of the securities account (...), no certainty could be achieved and such a test would invite litigation in which courts would be required to make fact-intensive inquiries. The risks and burdens presented to a potential collateral taker are readily apparent.*

3) The Hague Securities Convention Approach

a) Substantive Scope of the Convention

The Hague Securities Convention applies (only) when securities are credited to a securities account, article 2(1), article 1(1) lit. f). Once a security is credited to a securities account, the Convention applies, regardless of whether the law it designates qualifies *rights resulting from a credit of securities to a securities account* as a matter of contract or property, or qualifies them yet differently.

Article 2(1) lists the issues to which the Convention applies, i.e. the issues which the law the Convention designates is called to regulate. These issues include:

- The legal nature of the rights in intermediated securities;
- The legal nature and effects of transfer and hypothecation;
- Perfection requirements;
- Priority of interest; and
- The admissibility or not of an upper-tier attachment.

None of the issues listed in article 2 (1) are issues adressed by the *lex societatis*, the law governing terms and conditions of bonds, or any other law that may govern the rights embedded in/underlying the intermediated security. The Convention does not address any of the rights and duties of an issuer, as reiterated in article 2(3) lit. c).

Article 8 delineates the boundary between the Convention law and the applicable insolvency law. An interest perfected under the law designated by Convention prior to the opening of an insolvency proceeding cannot be disregarded, article 8(1). After the opening of an insolvency proceeding, the consequences of an interest perfected before the opening (how an interest can be exercised and whether it enjoys priority over other creditors) fall to be determined exclusively by the applicable insolvency law, for which the Convention containts no conflicts rules.

b) Connecting Factors

The novelty of the Hague Securities Convention (from a continental perspective) is in its primary connecting factor, a choice of law between the parties to the relevant account agreement. According to article 4(1):

> *The law applicable to all the issues specificied in Article 2(1) is the law in force in the State expressly agreed in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law.*

The third-party effects of transactions in intermediated securities may therefore, as long as there is no credit to the counterparty's securities account at its relevant intermediary, be subject to a law over which a third party has no control. The freedom to choose the governing law is tempered by the Qualifying Office requirement or "reality test" in article 4(1), second sentence and article 4(2).

In the absence of a choice of law meeting the requirements in article 4, the fallback rules in article 5 determine the applicable Law of Intermediated Securities with the help of objective connecting factors. Article 5(1) connects to a Qualifying Office expressly and unambiguously identified in an account agreement as the office through which the intermediary entered into the account agreement. Article 5(2) looks to the laws of the relevant intermediary's jurisdiction of incorporation. If both objective tests fail, article 5(3) designates the laws in force at the relevant intermediary's place of business.

4) EU Law and EU Reform Discussion

The EU is not a party to the Hague Securities Convention. The comprehensive coverage and flexible approach of the Convention contrasts with the fragmented state of Union law and its more rigid approach to finding the proper Law of Intermediated Securities.

a) Settlement Finality and Financial Collateral Directives

There is no comprehensive body of harmonized private international on intermediated securities within the EU. Catering to the needs of the Eurosystem and securities intermediaries, the EU legislated for harmonized conflicts rules in specific domains. Leaving aside the sector-specific provisions in Articles 24 and 31 Directive 2001/24/EC (Winding-up of credit institutions) and article 291 Directive 2009/138/EC (Solvency II), the harmonized EU conflicts rules for intermediated securities are found in the

- Settlement Finality Directive (Directive 98/26/EC) and the
- Financial Collateral Directive (Directive 2002/47/EC).

The Settlement Finality Directive is concerned with legal risk in payment and securities settlement systems. In order to reduce systemic risk, the Settlement Finality Directive protects qualifying settlement systems from the consequences of insolvency of participants, and creates certainty as to the law governing collateral used in qualifying systems.

Depending on the national implementing legislation, the Settlement Finality Directive governs the highest/higher layers of the securities intermediation pyramid. Article 9(2) introduced the PRIMA approach into Union law. It provides (emphasis added):

> *Where securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Members States or the future European central bank as described in paragraph 1, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State.*

The Financial Collateral Directive harmonizes the law of property, insolvency laws and private international law insofar as they have a bearing on financial collateral more generally. Recital 8 explains the motivation for mandating PRIMA:

> *The lex rei sitae rule, according to which the applicable law for determining whether a financial collateral arrangement is properly perfected and therefore good against third parties is the law of the country where the financial collateral is located, is currently recognized by all Member States. Without affecting the application of this Directive to directly-held securities, the location of book entry securities provided as financial collateral and held through one or more intermediaries should be determined. If the collateral taker has a valid and effective collateral arrangement according to the governing law of the country in which the relevant account is maintained, then the validity against any competing title or interest and the enforceability of the*

> *collateral should be governed solely by the law of that country, thus preventing legal uncertainty as a result of other unforeseen legislation.*

Article 9(1) Financial Collateral Directive provides that the legal nature and effects of collateral over intermediated securities, perfection requirements, priority and issues of realization of security interest in intermediated securities,

> *shall be governed by the law of the country in which the relevant account is maintained. (...)*

b) Reform Discussions

In April 2017 the Commission launched a public consultation (*Consultation on conflict of laws rules for third party effects of transactions in securities and claims*) and established an Expert group (E03506) on conflict of laws regarding securities and claims.

The current consultation is part of a tradition of EU attempts to arrive at a harmonized set of conflict of law provisions for intermediated securities. On 15 December 2003, the Commission had submitted to the Council a proposal (COM(2003) 783 final) for a Council Decision concerning the signing of the Hague Convention. On 3 June 2006, the Commission published a Commission Staff Working Document on the *Legal assessment of certain aspects of the Hague Securities Convention* (SEC(2006) 910). The Executive Summary stated:

> *(...) On the basis of these findings, the Commission services remain convinced that adoption of the Convention would be in the best interest of the Community.*

By notification in the Official Journal of 25 March 2009 (C 71/17), the proposal to sign the Hague Securities Convention was suddenly withdrawn. Having given up on its proposal to sign the Hague Securities Convention, the Commission started working on a comprehensive Securities Law Directive (SLD). The Commission's latest consultation document suggests three ways forward:

- Leaving the status quo unchanged;
- Targeted amendments to the acquis to address specific shortcomings (clarifying which account or accounts constitute the *relevant* account; defining in more detail the criteria by which to locate such relevant account); and
- Establishing a comprehensive conflict of laws framework at Union level (joining the Hague Securities Convention or devising a comprehensive framework autonomously).

5) Outlook

Which of the approaches suggested by the Commission in its current consultation document the EU will pursue is as yet unclear. Reactions to the Commission's 2017 consultation have been mixed. They range from renewed calls for the EU to sign the Hague Securities Convention to cautious assessments of the likelihood the EU would succeed in devising an appropriate comprehensive set of conflicts rules autonomously.

The discussion is highly politicized. There appear to be concerns that amending the acquis communautaire in the direction of the Hague Securities Convention or joining the Hague Securities Convention would entrench systems of securities intermediation perceived as inadequate and further disenfranchise investors from publicly listed companies.

The underlying concerns are forcefully expressed in the Consultation Response submitted by EuropeanIssuers on 30 June 2017 (http://www.europeanissuers.eu/positions/files/view/595a11785e3d4-en):

> *The European Union should never become a party to the Hague Securities Convention because such convention eventually would lead to the expropriation of European investors to the benefit of non-European custody banks. The Hague Convention is seriously and essentially flawed because:*
>
> – *it does not acknowledge the importance of the laws under which securities are created;*
>
> – *it does not acknowledge the interests of end investors but its application deprives them of their property rights to the benefit of international custody banks;*
>
> – *it does not account for the imbalanced negotiation power of end investors on one side and large international banks on the other side; (...)*
>
> *The Hague Securities Convention should not be supplemented, it should be completely disregarded.*

This statement, although seriously flawed, illustrates a certain hostility towards the Hague Securities Convention prevailing in parts of the EU as well as the fundamental concerns driving this opposition.

The eminent expert Joanna Benjamin recently gave her assessment of the likelihood of convergence (LSE Legal Studies Working Paper No. 7/2017):

> *Three major law reform initiatives have sought to address (among other things) the rights of the investor in indirectly held securities. These are: on choice of law (internationally), the Hague Convention; on substantive law rules (internationally), the*

Geneva Securities Convention; and generally (in the EU), the proposal for Securities Law Legislation. At least in their original conception, each of these has favoured the collateral taker.

All these projects have stalled following the polarisation of opinion and the politicisation of the debate. In the past I have understood the failure of these projects to come to fruition as stemming from cultural differences between civilians and common lawyers. On reflection, the heart of the matter is more specific. If we are playing a zero sum game between investors and collateral takers, consensus will continue to elude us.

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Basel III Implementation in Switzerland: Leverage Ratio and Liquidity

Reference: CapLaw-2018-03

As of 1 January 2018, further elements of the Basel III international regulatory framework for banks on capital and liquidity entered into effect in Switzerland. Notably, the unweighted capital adequacy requirement (leverage ratio) was extended from systemically relevant banks to all banks by requiring a minimum core capital (Tier 1 capital) to total exposure ratio of 3%. As of the same date, the liquidity coverage ratio (LCR) requirement were adjusted to provide for certain simplifications, which will primarily benefit smaller financial institutions. The risk diversification requirements of Basel III measured against Tier 1 capital will enter into effect in Switzerland in 2019. The introduction of the net stable funding ratio (NSFR), which was originally planned for 1 January 2018, has been postponed.

By René Bösch / Benjamin Leisinger / Lee Saladino

1) The Implementation of Basel III in Switzerland Generally

The comprehensive set of reform measures developed by the Basel Committee on Banking Supervision (BCBS) to strengthen the regulation, supervision and risk management of the banking sector (Basel III: international regulatory framework for banks (Basel III)) was implemented in Switzerland in 2013. Since then, Switzerland has implemented step-by-step elements of the Basel III reform package. Consequently, the BCBS's *Thirteenth progress report on adoption of the Basel regulatory framework* of October 2017 demonstrates that Switzerland has made good progress in this area.

2) Leverage Ratio

On 1 January 2018, a leverage ratio requirement of 3% for all banks entered into effect. The leverage ratio is calculated on the basis of the bank's core capital (Tier 1 capital, *i.e.*, common equity tier 1 (CET1) capital and additional tier 1 (AT1) capital instruments) to total exposure. The total exposure consists of a bank's unweighted balance sheet exposure, derivative exposure, and securities financing transactions exposures, as well as certain off-balance sheet items. By contrast, the capital adequacy requirement prescribed for all banks is calculated on the basis of the bank's risk-weighted assets (RWA) only, the amount of which increases with the bank's size. The leverage ratio requirement is intended to function as a safety net and, as all banks have been reporting their leverage ratio over the past years, we know that almost all Swiss banks have already been meeting or exceeding the 3% leverage ratio requirement for several years.

The systemically important Swiss banks have been subject to a leverage ratio requirement since 2013. Since July 2016, this leverage ratio requirement consists of a *minimum requirement* of 3%. On top of that, systemically important Swiss banks must hold a buffer of 1.5% of their total exposure, leading to a so-called *base requirement* of 4.5% of their total exposure, and an additional buffer surcharge, which reflects the relevant bank's systemic importance. For the two globally systemically important Swiss banks, Credit Suisse and UBS, this currently translates into a 5% leverage ratio requirement. In general, this leverage ratio requirement for systemically important Swiss banks must be met by CET1 capital. Up to 1.5% of the total exposure of the 3% minimum requirement may be held in the form of AT1 capital instruments that automatically convert into common equity or written down pursuant to their terms if the CET1 ratio falls below 7%.

While, since 2016, globally systemically important Swiss banks also have to comply with a gone concern leverage ratio requirement in the same amount that has to be primarily met in the form of bail-in bonds, such requirement does not apply to nationally systemically relevant banks, yet, or other banks.

3) Risk Diversification

As of today, the risk diversification requirement and large exposure limits for all Swiss banks are measured against their total adjusted eligible capital (CET1 capital, AT1 capital and Tier 2 capital). Accordingly, a large exposure exists if the bank's aggregate exposure to a single counterparty, or a group of related counterparties, is equal to or greater than 10% of the bank's adjusted eligible capital. The upper limit for any large exposure, which may only be exceeded in limited cases, is currently 25% of the relevant bank's adjusted eligible capital.

Under the new regime, which will only become effective on 1 January 2019, Tier 2 capital will no longer be taken into account for purposes of measuring a bank's risk diversification and large exposures. Instead, a large exposure will be determined, and the upper limit for any large exposure will be calculated, on the basis of a bank's Tier 1 capital only. To take certain Swiss (regulatory) requirements into account, certain exposures, *e.g.*, to central banks or qualified central counterparties, will be exempted from the risk diversification requirement and large exposure upper limit. Under the new regime, the circumstances in which a bank may exceed the upper limit of 25% of its Tier 1 capital will be even more limited, *i.e.*, if the large exposure either (i) is related to client payment services and covered by unencumbered eligible capital, or (ii) results from the affiliation of previously unconnected counterparties or from an affiliation between the bank and other entities active in the financial sector and is not actively being increased. If one of the bank's large exposures at any time exceeds the upper limit, such event must be reported to FINMA and the bank's regulatory auditor. Additionally, certain smaller banks (category 4 and 5 under annex 3 of the Banking Ordinance) will benefit from an increased upper limit of 100% of their Tier 1 capital with respect to any large exposures to non-systemically important banks or broker dealers. This increased upper limit is intended to allow these smaller banks to maintain both their network of correspondence banks and their access to the inter-bank market.

The new regime will also introduce a requirement to identify, monitor and report so-called large credit risks, including intra-day.

Additional changes that will come into effect under the new regime relate to rules on the weighting of certain assets and calculation of certain positions when calculating the exposure, as well as the adjustment of some special rules for systemically important Swiss banks.

4) Liquidity Coverage Ratio

Liquidity risk management and the monitoring of Swiss banks has been governed by the Swiss Liquidity Ordinance since 2012. The liquidity coverage ratio (LCR) requirement was introduced into Swiss law in 2014 and is has been effective since January 2015. Accordingly, Swiss banks must meet both qualitative and quantitative liquidity requirements.

The changes to the Swiss liquidity regime that entered into effect in January 2018 are restricted to certain changes required to facilitate matters specifically for smaller banks and minor adjustments that have proven necessary over the past few years. Most importantly, FINMA has the power to grant smaller banks (category 4 and 5 under annex 3 of the Banking Ordinance) certain easing of the requirements related to, *e.g.*, the complexity and liquidity requirements on a stand-alone and consolidated basis.

5) Net Stable Funding Ratio

According to the BCBS's original implementation date, the Basel III standards regarding the net stable funding ratio (NSFR) should also have entered into force on 1 January 2018. In light of the delay introducing the NSFR in both the European Union and the United States, the Swiss Federal Council decided not to amend the Liquidity Ordinance to introduce NSFR provisions at this stage, but rather to consider next steps on that topic at the end of 2018.

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New Swiss financial market regulation: Consequences on pension funds, investment foundations, their asset managers and advisors

Reference: CapLaw-2018-04

The new Swiss financial market regulation will take effect in the second half of 2019 or in 2020. The new acts, namely the Financial Services Act and the Financial Institutions Act are particularly relevant to external asset managers of pension funds and investment foundations. The pension funds and investment foundations themselves will not be directly impacted, but will indirectly benefit from increased conduct and transparency rules and the fact that their external asset managers henceforth will be subject to supervision by FINMA or a FINMA-authorized supervisory organization.

By Sandro Abegglen / Evelyn Schilter

Since 1 January 2014, external persons and institutions may only be entrusted with the asset management of pension funds if they are subject to supervision by a financial market authority or have been granted a permit by the Federal Supervisory Commission Occupational Pension Benefits (*Oberaufsichtskommission Berufliche Vorsorge OAK BV*). In essence the permit by the OAK BV consists of a one-time review of the fit and proper status (*Gewährsprüfung*) on the occasion of granting the permit (which is limited to three years and can be renewed) as opposed to a continuous supervision as carried out by FINMA, for example. An asset manager qualifies as someone who holds a power of attorney for the independent, discretionary investment of pension assets, or the purchase or sale of real estate, but not an advisor, real estate manager, or real estate agent. An asset manager must, in particular, have a good reputation, guarantee proper business conduct, and be free of conflicts of interest (see article 51b of the Occupational Pension, Survivors' and Disability Benefits Act (OPA)). The legislator thereby

wanted to ensure competent and professional asset management in the field of occupational pension benefits, where large sums are held in trust.

Within the new Swiss financial market regulation, external asset managers previously subject to the authorization by the OAK BV shall now also become subject to continuous financial market regulation supervision by FINMA or a FINMA-authorized supervisory organization and shall be required to satisfy certain requirements, particularly regarding rules of conduct and organization. This new regime is expected to come into effect in the second half of 2019 or in 2020. As such, this article is based on the drafts of the Financial Services Act (FinSA) and the Financial Institutions Act (FinIA) pursuant to the dispatch of the Federal Council dated 4 November 2015, as modified by the Council of States on 14 December 2016 and by the National Council on 13 September 2017.

1) FinSA and FinIA as part of the new Swiss financial market infrastructure

The FinSA and FinIA are part of the new Swiss financial market infrastructure, which consists of the following areas (i) supervision (Federal Act on the Swiss Financial Market Supervisory Authority (FINMASA) dated 22 June 2007 and already in effect), (ii) infrastructure (Financial Markets Infrastructure Act (FMIA) dated 19 June 2015 and already in effect), (iii) services (FinSA), and (iv) controlled institutions (FinIA). The FinSA contains rules about the offering of financial services and the marketing of financial instruments across sectors. These rules follow largely the EU regulations (MiFID II, Prospectus Directive, project PRIIP). The goal is to establish an equivalent regulation, but also one that takes the Swiss circumstances into consideration. Requirements for the loyal, diligent, and transparent delivery of financial services are outlined in the rules. Specifically, financial service providers will have to abide by supervisory rules of conduct, particularly with regard to duties of information and of appropriateness and suitability, which will be tiered by client segments. The FinSA distinguishes between private clients, professional clients and institutional clients.

The FinIA will regulate the institution-related requirements of all financial service providers (except banks and insurers, which remain regulated by their existing regimes, i.e., the Banking Act, Insurance Supervision Act, but will also be subject to FinSA). All financial service providers will be subject to licensing by FINMA, specific authorization requirements and ongoing supervision by FINMA, directly or by a FINMA-authorized supervisory organization. With regards to the organizational and financial requirements for a license, distinctions are made between simple asset managers, managers of collective assets, fund management companies and investment firms.

Both laws aim to create consistent competitive conditions, improve customer protection, promote the international competitiveness of Switzerland as a financial center, and stipulate certain penal sanctions in case of infringements.

The Federal Council adopted the dispatch on the FinSA and the FinIA on 4 November 2015. The bill is currently under consideration in parliament, with deliberations concluded both in the Council of States and the National Council. Currently, the procedure for reconciling the positions of the Council of States and the National Council is ongoing. It is planned that the bill will be further deliberated by the Council of States and that remaining differences will be reconciled thereafter. Accordingly, certain changes to the version as resolved by the National Council on 13 September 2017 will take effect and it is to be expected that both laws will not go into effect before the second half of 2019 and that the accompanying implementing ordinances will only be available towards the end of 2018 or early 2019.

2) What is new for asset managers?

External managers of assets of pension funds and investment foundations pursuant to article 53g OPA will become subject to FINMA licensing and financial market regulations, as is the case for asset managers of investment funds or simple asset managers – i.e. their special regime as described above with OAK BV registration will be abandoned. In principle, they will qualify as more strictly regulated managers of collective assets subject to FINMA supervision. The less regulated status of the (simple) asset managers on the other hand is legally designed as an exception for "small" asset managers.

(Simple) Asset Managers (Art. 16 para. 1 FinIA)	**Managers of Collective Assets** (Art. 20 para. 1 FinIA)
Eased requirements	Requirements same as for today's asset managers of collective investment schemes under Collective Investment Schemes Act (CISA)
– AuM of pension funds and investment foundations of a total amount no higher than CHF 100 million, *and* – No more than 20% of assets of any one individual pension fund in the mandatory part of the occupational pension benefits system	– AuM of pension funds and investment foundations of a total amount above CHF 100 million, *or* – More than 20% of assets of an individual pension fund in the mandatory part of the occupational pension benefits system
– Authorization by FINMA – Continuous supervision by a FINMA-authorized supervisory organization – Enforcement by FINMA	– Authorization by FINMA – Continuous supervision by FINMA – Enforcement by FINMA
▼ Status for sub-AuM threshold asset managers of pension funds and investment foundations	▼ Status for all other asset managers of pension funds and investment foundations

Aside from the institution-related permit requirements, the adherence to which will now continuously be supervised, both types of asset managers will need to abide by the FinSA's rules of conduct in the future (see below); infringements will result in regulatory and partly criminal sanctions.

The most important rules of conduct for external asset managers under the FinSA are duties of information, the obligation to conduct an appropriateness and suitability test, duties of documentation and accountability and the duty to avoid conflicts of interest. The latter includes the duty to fully pass on any third party compensation (retrocessions, etc.) to the client, unless the client has previously been explicitly informed about and has waived such third party compensation.

It is to be expected that the heightened requirements on external managers of pension funds and investment foundations will result in a certain consolidation amongst external asset managers. At the same time, they will also gain improved opportunities of access to the European market.

It should be noted that the new regime will only apply to external asset managers of pension funds and investment foundations. For the supervision of pension funds, investment foundations, and their adherence to investment management requirements under pension and investment foundation laws, the cantonal supervisory authorities or the OAK BV, respectively, will remain the competent authorities. This results in a certain parallelism of the various supervisory activities by different authorities. These overlapping supervisory activities will likely result in certain delimitation issues.

3) Consequences for pension funds and investment foundations

Under the FinSA, pension funds and investment foundations are not considered institutional clients. Rather, they are considered professional clients if they have a professional treasury, or private clients otherwise (see article 4 FinSA). According to the dispatch of the Federal Council on FinSA and FinIA dated 4 November 2015 (p. 8949), a professional treasury exists if the pension fund or investment foundation entrusts at least one experienced financial expert with consistently managing its financial resources. Thus, pension funds whose assets are managed exclusively externally are considered private clients, and they therefore benefit from the highest possible customer protection under the FinSA. It remains to be seen whether banks and brokers may also qualify a pension fund or investment foundation with an external asset manager as professional client.

Opting out of the private client segment into the segment of professional clients will be possible under certain circumstances. If pension funds are considered professional clients, they can also declare that they want to be considered institutional clients. Opting

into the private client segment and therefore a higher level of protection will always be possible for professional clients.

Disputes regarding legal claims between a pension fund or investment foundation and an external asset manager can be brought before an ombudsman's office and will be dealt with in a proceeding that is non-bureaucratic, fair, quick and cost effective for the pension fund or investment foundation. Recourse to the courts is thereby not excluded. Thus, as a result of the new rules the legal protection for the pension funds and investment foundations will likely be improved.

As mentioned, the pension funds themselves, as opposed to their external asset managers, will not be subject to the FinIA and will thus not be considered financial institutions pursuant to the FinIA, therefore not needing a respective FINMA license. The same is true for investment foundations. However, pension funds and investment foundations will henceforth need to verify that their external asset managers are in possession of the necessary FINMA authorizations.

Asset managers and portfolio managers who are employed by a pension fund or investment foundation will not be subject to authorization requirements according to the FinIA, nor will they be subject to the rules of the FinSA. However, it may not be excluded that the heightened requirements on external asset managers will indirectly raise the requirements on internal asset managers as well. The foundation board and management of a pension fund will need to take this development into account within the scope of their legal duties in connection with the management of pension fund assets under the occupational pension benefits law.

4) Note on (investment) advisors

Advisors who provide advisory services that qualify as financial services as defined by the FinSA (typically investment advisory services) without being regulated themselves as (simple) asset managers or higher, will not be subject to supervision, but they will have to be registered in an advisors' register. In addition they will have to abide by the FinSA's rules of conduct, the breach of which will be punishable.

This regime will result in issues of delimitation toward the "top", i.e. toward regulated asset managers (be it simple ones or managers of collective assets), but also toward the "bottom", i.e. toward such advisors of pension funds or investment foundations who do not provide financial services according to the FinSA.

5) Need for action

Pension funds and investment foundations can and must make use of the upcoming changes and take the opportunity to examine the pros and cons of internal and external

asset management and to adapt existing solutions if necessary and/or to review their external asset management mandates and modify them if need be.

Smaller external asset managers should determine under which asset manager status they will want or have to provide their services in the future and make the appropriate adjustments to their business model.

Bigger asset managers who will be considered managers of collective assets should check to what extent the new regulations contain additional requirements and plan for the necessary adjustments.

Advisors should first assess whether they provide financial services according to the FinSA, particularly investment advice, in order to gain clarity about their future status. Secondly, they should evaluate whether they do, de facto, provide asset management services, in which case the two preceding paragraphs are relevant.

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Valora Holding CHF 166 million Rights Offering

Reference: CapLaw-2018-05

On 9 November 2017, Valora Holding AG (Valora) launched its right offering of up to 687'119 registered shares. On 21 November 2017, Valora Holding AG completed the capital increase raising net proceeds of approximately CHF 166 million. The capital increase was executed as an "at market" rights offering. The offer price for the new shares of CHF 310 per new share was determined following a bookbuilding process for the shares not taken up by existing shareholders. Credit Suisse and J.P. Morgan acted as Joint Global Coordinators and Joint Bookrunners. Valora is listed on the SIX Swiss Exchange. It runs a retail network of convenience and food-service outlets in Switzerland, Germany, Austria, Luxembourg, the Netherlands and France, and is also a leading producer of pretzels. Valora will use the proceeds from the capital increase to refinance its recent acquisition of BackWerk, to finance the expansion of production capacities, to refinance existing capital market instruments and for general corporate purposes. The newly issued shares were be traded on the SIX Swiss Exchange for the first time on 22 November 2017.

St.Galler Kantonalbank AG successfully issued CHF 100 million Additional Tier 1 Notes and CHF 100 million Tier 2 Notes

Reference: CapLaw-2018-06

On 16 November 2017 St.Galler Kantonalbank AG (SGKB) launched, and on 30 November 2017 successfully completed, the issuance of CHF 100 million 1.70 per cent. Perpetual Additional Tier 1 Notes and CHF 100 million 1.00 per cent. Tier 2 Notes due 2027 (collectively, the Notes). The Notes are governed by Swiss law, eligible to count towards SGKB's Swiss going concern requirement, and exempted from the Swiss withholding tax regime. They will be listed on the SIX Swiss Exchange. Zürcher Kantonalbank acted as Sole Structuring Advisor and Lead Manager on the transaction.

Dufry CHF 3.4 billion refinancing

Reference: CapLaw-2018-07

On 3 November 2017, the Dufry group concluded the refinancing of its main bank credit facilities of CHF 3.4 billion. The refinancing of the bank credit facilities concluded the restructuring of Dufry's financing structure, including the issuance of the EUR 800 million Senior Notes on 24 October 2017.

ADC Therapeutics SA USD 200 million private placement

Reference: CapLaw-2018-08

On 23 October 2017, ADC Therapeutics SA, an oncology drug discovery and development company that specializes in the development of Antibody Drug Conjugates (ADCs) targeting major cancers, announced that it has raised USD 200 m through a private placement of shares. According to BioWorld.com, the placement is the fourth largest private financing round on record for a European biopharmaceutical firm and the second largest private equity round in European biopharma so far in 2017.

Swiss Takeover Board asserted partially untrue respectively incomplete information about HNA Aviation (Hong Kong) Air Catering Holding Co., Ltd in the Offer Prospectus for gategroup Holding AG

Reference: CapLaw-2018-09

With its decision dated 22 November 2017 (0630 / 03 - gategroup Holding AG), the Swiss Takeover Board (TOB) asserted that the information about the offeror, HNA Aviation (Hong Kong) Air Catering Holding Co., Ltd., as disclosed in the Offer Prospectus dated 20 May 2016 is partially untrue respectively incomplete. The review body Ernst & Young AG is mandated to examine whether the controlling group has complied with the minimum price rules and the Best Price Rule.

ChemChina completes acquisition of Syngenta

Reference: CapLaw-2018-10

On 10 January 2018, China National Chemical Corporation (ChemChina) completed its acquisition of the Swiss agrochemical and seeds company Syngenta AG (Syngenta), with the settlement of the squeeze-out of Syngenta's remaining public shareholders. The public tender offer valued Syngenta's share capital at over USD 43 billion and was the largest overseas acquisition by a Chinese company, one of the largest all-cash transactions worldwide and the largest public tender offer for a Swiss company in history.

Issuance of CHF 300 million 0.325% convertible bonds due 2025 by Swiss Prime Site

Reference: CapLaw-2018-11

On 16 January 2018, Swiss Prime Site AG successfully placed CHF 300 million 0.325% convertible bonds due 2025. The bonds were issued at 100% of their principal amount and will mature on 16 January 2025. Bondholders who convert their bonds will receive the bonds' par amount in cash and any excess amount in registered shares of Swiss Prime Site (Net Share Settlement), subject to the issuer's right to elect to settle any exercise of conversion rights with any combination of cash and shares. Credit Suisse, UBS and Bank Vontobel acted as joint bookrunners in this transaction.