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Equivalence with Solvency II: Revision of FINMA Regulations for (Re-)Insurers

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This article aims to provide an overview of the amendments in FINMA regulations for (re-)insurers between 2015 and 2016. The amendments followed the entering into force of the revised Swiss Insurance Supervision Ordinance (ISO) on 1 July 2015 which was instrumental to secure the European Commission's recognition of the Swiss insurance supervision system's equivalence with the EU's Solvency II Directive of 5 June 2015. In addition to these required amendments, FINMA had the intention to streamline and simplify some aspects of existing regulations and thus consolidated a number of FINMA circulars. Finally, this article points out a few other recent or ongoing revisions that are relevant for the (re-)insurance industry.

By Petra Ginter

1) First Part of Revisions in 2015 (with Amendments Entering into Force on 1 January 2016)

a) Overview

In summer 2015, FINMA submitted its first part of the revision package for consultation, including a partial revision of the FINMA Insurance Supervision Ordinance (ISO-FINMA) and a series of FINMA circulars (including two new ones). At the same time, FINMA also announced that the SST temporary easing measures granted in 2012 would expire at the end of 2015 and would not be renewed with some of the adjustments being incorporated into permanent regulation.

b) Revised ISO-FINMA

Based on the delegation to FINMA in the revised ISO, the revised ISO-FINMA contains specific industry rules that deviate from the minimum structuring requirements for the annual financial statements set forth in the accounting rules of the Swiss Code of Obligations (CO). The rules in the CO are predominantly aligned to the due dates of the various balance sheet and income statement positions. For the (re-)insurance industry whose main purpose is the risk transfer over time, the due date is, however, of less relevance. The minimum structure of an industry balance sheet should rather reflect the relations between expected obligations on the liability side (insurance technical reserves) and the required values on the assets side. The revised rules in the ISO-FINMA take better account of the specifics of the (re-)insurance business and improve transparency of the financial situation of (re-)insurers.

c) Revision of FINMA Circulars

– **FINMA Circular 2016/5 "Investment guidelines – insurers" (revised):** The circular was reduced in scope and restructured to use a more principle-based approach, including some changes in content. In particular, the investment options for direct insurers, which are obliged to secure claims arising from insurance policies by ring-fencing specific assets, have been expanded. Insurers are now also permitted to invest tied assets in private debt, senior secured loans, insurance-linked securities, infrastructure loans and commodities (including gold). In addition to their own assessments of creditworthiness, insurers may also rely on ratings from uncertified rating providers (usually banks) for a transition period of two years. The long-standing practice to account for claims against reinsurers in the tied assets was finally codified in the circular. Limits for internal reinsurance (IGRs) are, however, lower than limits for external reinsurance (retrocessions).

– **FINMA Circular 2016/4 "Insurance groups and conglomerates" (revised)** consolidated four existing circulars (2008/27 "Organisation – insurance groups", 2008/28 "Structure – insurance groups", 2008/29 "Internal business transactions – insurance groups" and 2008/31 "Insurance group reports") into one and also integrated the FINMA guidelines on group or conglomerate supervision of (re-)insurance companies to create a standardised regulatory framework. FINMA Circular 2008/30 "Solvency I – insurance groups" was repealed in its entirety. The threshold of having to report a substantial participation was changed from an absolute figure to a relative threshold. The creation, acquisition or sale of an exceptionally risk bearing participation (in particular a non-traditional and non-insurance business activity) as well as usually special purpose vehicles are considered substantial irrespective of their size. The substance of reporting intra-group transactions (IGTs) is now determined based on the published equity capital on a group basis as opposed to the solvency margin (as Solvency I was abandoned). Minimum threshold percentages have been introduced for the ad hoc (2%) as well as ordinary, annual (0.1%) reporting of IGTs.

– **FINMA Circular 2016/6 "Life insurance" (revised)** consolidated two existing circulars (2008/39 "Unit-linked life insurance" and 2008/40 "Life insurance"). The key changes relate to pricing aspects, requirements for biometric risk, pricing basis and models, as well as the technical interest rate.

– **FINMA Circular 2016/3 "ORSA" (new)** contains implementing rules on the requirement for (re-)insurers, (re-)insurance groups and conglomerates as well as branches of foreign (re-)insurers to carry out an "Own Risk and Solvency Assessment" (ORSA). This requires them to compile an overall picture of the company from a forward-looking perspective, including details of the risk situation, capital adequacy and the relationships between risk and capital. The ORSA goes beyond the one year time horizon as well as the solvency requirements. It shall cover risks the (re-)insurer is exposed to at the beginning of the planning period, is expected to be exposed to during the planning period based on risk appetite and tolerance or might be exposed to due to deviations from the plan, such as e.g. if the business plan cannot be pursued as initially envisaged. The ORSA is thus an important business steering instrument for the board of directors and the management.

– **FINMA Circular 2016/2 "Disclosure" (new)** provides for the public disclosure of information to facilitate comparisons and increase transparency among the (re-)insurers from a policyholders' perspective. The circular sets out the requirement for (re-)insurers, (re-)insurance groups and conglomerates as well as Swiss branches of foreign (re-)insurers to publish a report on the financial situation on an annual basis. Prior to the amendment of the ISO, (re-)insurers were not obliged to publish their solvency figures.

d) SST Adjustments (Revised FINMA Circular 2008/44 "SST", Appendix 4)

The circular on temporary adjustments to the Swiss Solvency Test (SST) (2013/02 "SST Adjustments"), which was limited to three years, expired automatically on 31 December 2015. FINMA's Board decided not to extend or replace it. However, some of the temporary adjustments included in the circular were incorporated permanently into the existing FINMA Circular 2008/44 "SST". They relate to the intervention thresholds, which define how, and how quick, (re-)insurers are required to act when certain thresholds are no longer met. The adjustment in the circular replaced the temporary with longer permanent deadlines for restoring compliance with the thresholds. In addition, in the orange zone (SST below 80%), dividend payments are no longer permitted. The temporary option in the circular to value insurance obligations using a yield curve subject to counterparty credit risk ceased to apply. The Swiss Federal Council believed that valuation should in principle be carried out using a risk-free yield curve. Assuming that interest rates will remain low for an extended period, FINMA could no longer justify further temporary measures in this area. FINMA further argued that the importance of this measure has progressively declined since its introduction. As of 1 January 2015, it improved the SST ratio across the market as a whole by only a few percentage points. Circular 2008/44 "SST" was revised again in the second part of revisions (see section 2)b) below).

2) Second Part of Revisions (with Amendments Entering into Force on 1 January 2017)

a) Overview

In summer 2016, FINMA opened the consultation for a second revision package in the (re-)insurance sector concluding the revision work initiated in 2015. The revision comprised four FINMA circulars (one new and three fully revised and tightened). One FINMA circular was abolished.

b) Revision of FINMA Circulars

- **FINMA Circular 2017/5 "Business plans – insurers" (new):** This new circular was based on existing business plan practice laid down in various documents and provides for a better overview of the existing requirements. The new provisions refer to the business plan approval stage and to any changes made to them. Some of the business plan forms have also been revised materially. Such as *e.g.* Form C (activity abroad) for which an "activity abroad" shall be determined based on the location of the risk rather than, as in the past, the active business conduct. This change allows for a better distinction between "local activity" and "activity abroad" also when services are offered through internet platforms. No Form C filing is required any longer to conduct a reinsurance activity abroad. *I.e.*, the (re-)insurance carrier is responsible to ensure and appropriately document that such activity is permitted by the regulation in the respective country. Capital outflows (*e.g.* dividends) in excess of 150% of the statutory net income are subject to notification under Form D.

- **FINMA Circular 2017/2 "Corporate governance – insurers" (revised):** This circular sets out corporate governance principles for the organisation, management and control of (re-)insurance companies. Each individual (re-)insurance carrier of an insurance group is now required to comply with the rules under the circular. An implementation at the level of the ultimate parent company is no longer sufficient. Specifically, the circular contains provisions on the composition and organisation of the board of directors, the required number of board members (at least three) and their independence (at least one third needs to be independent) which have to be complied with by 31 December 2019. The circular further defines the key responsibilities of the heads of the control functions (RM, Compliance and Audit). It also incorporates the provisions previously set out in circular "Internal audit - insurers" which was revoked. FINMA has waived the requirement that all business areas and functions of (re-)insurance companies are audited by internal audit at appropriate intervals. Instead, audit frequency will now be aligned to risk.

- **FINMA Circular 2017/3 "SST" (revised):** Current practice, which had previously been defined in a variety of other documents, is now set out in this fully restructured circular. The revision also takes into account adjustments to supervisory practice and the use of models (internal vs. standard) for the SST. It clarifies the provisions of the ISO in relation to the SST and regulates the principles, processes and reporting requirements for the SST. When calculating the SST ratio, the market value margin (MVM) is subtracted from risk-bearing capital instead of added to the target capital, resulting in higher SST ratios and closer alignment to Solvency II. (Re-) insurers have to value the legally binding minimum liabilities at t=1, *i.e.* assuming going-concern for t=0 and run-off at t=1. Such change in the valuation approach for assets and liabilities at t=1 could lead to substantial changes to the calculation process and potentially higher / lower SST capital requirements. The respective transition period ends on 1 January 2020. Finally, the circular provides for revised disclosure requirements in the SST report.

– **FINMA Circular 2017/4 "Appointed actuary" (revised):** This circular defines the requirements related to the work carried out by the appointed actuary. The circular does not introduce new requirements besides the nomination of a deputy of the appointed actuary. The latter must, however, not be authorised.

3) Further Relevant Revisions for (Re-)insurers

a) FINMA Circular on Remuneration Systems (2010/1) (Revised)

The amended FINMA Circular "Remuneration Systems" (2010/1) that sets forth minimum standards for remuneration systems for financial institutes entered into force on 30 June 2017. FINMA expanded the scope of application of the circular to (re-)insurance companies, (re-)insurance groups and conglomerates from CHF 2 billion to CHF 15 billion in required target capital. This means that only the two large insurance groups Zurich and Swiss Re must implement the provisions set out in the circular.

b) FINMA Circular on Direct Transmission (2017/6) (New)

By introducing article 42c into the Swiss Financial Market Supervision Act (FINMASA), the legislator allows supervised institutions to transmit non-public information directly to foreign authorities and entities under certain conditions. Before that, supervised institutes could in most cases only transmit non-public information to foreign authorities based on a prior authorization. Otherwise, such transmission possibly qualified as a criminal offence according to article 271 of the Swiss Penal Code (PC) (non-permitted activity for a foreign state). The new FINMA Circular 2017/6 "Direct transmission" sets forth the standards applicable to article 42 FINMASA in addition to those already laid down in the provisions on the exchange of information with foreign financial market supervisory authorities. FINMA intends to assist financial institutions in autonomously applying article 42c FINMASA and to ensure that the rules set out in this provision are implemented in a uniform manner.

The circular aims to facilitate the transmission of information to financial market supervisory authorities to whom FINMA has already provided international administrative assistance and/or where the courts have already ascertained that international administrative assistance can be provided to those authorities (by assuming that these authorities adhere to the principles of specialty and confidentiality). In addition, the circular focuses in particular on defining the scope of article 42c(1) and (2) FINMASA. It limits the scope of para. 2 by specifying that only information essential for the execution or approval of transactions may be transmitted. In accordance with article 42c(3) FINMASA, the transmission of information of substantial importance must be reported to FINMA beforehand. The circular closes with listing examples of information for transmission which a) must be reported to FINMA and b) do not require any prior reporting. The circular requires (re-)insurers to issue until 30 June 2017 an internal guideline that governs the process required for compliance with article 42c FINMASA which is subject to regulatory auditing.

c) Revision of Outsourcing Practice (Not Yet in Force)

In view of the growing importance of outsourcing in the banking and insurance sector, FINMA put the new version of its Circular 2008/7 "Outsourcing - banks" out for consultation which ended on 31 January 2017. The draft circular now also covers (re-)insurance companies. Where appropriate, the requirements for banks, securities dealers and (re-)insurance companies have been harmonized. Despite FINMA's announcement that the circular eases the requirements for (re-)insurance companies, the new requirements are far reaching and *e.g.* go beyond Solvency II.

In general, FINMA expects intra-group outsourcing to be treated with the same caution and subject to the same level of monitoring as external outsourcing. The key implication is that all requirements defined in the circular will now apply equally to intra-group outsourcing. The circular only covers outsourcing of "significant" outsourcing which needs to be determined independently for banks and insurers. For (re-)insurers significant means the functions that are inherent / mandatory for the (re-)insurance company. In principle, all significant functions can be outsourced. However, the Risk Management and Compliance function, which are newly deemed as significant functions, can only be outsourced in specific areas. The (re-)insurer has to define and document the requirements for service providers before the conclusion of an outsourcing contract which includes a risk analysis. For cross-border outsourcing the auditor and FINMA must have audit rights.

4) Conclusion

A majority of the FINMA proposals outlined above were well received by the industry. However, the industry also suggested material changes through specific submissions some of which were not taken up by FINMA in the final regulations. Recognition of the principle of proportionality in applying the circulars is explicitly stated and clarified. FINMA has also simplified the wording of its circulars wherever possible which clearly can be seen as a positive development. Unfortunately, FINMA has also missed some opportunities for clarifications, such as *e.g.* the rules on derivatives in the FINMA Circular "Investment guidelines – insurers" (that apply to insurance and reinsurance companies) which have not been substantially revised and continue to be unclear. The same applies to the implementing rules in the FINMA Circular "Direct transmission" which did not provide for the clear conditions according to which the supervised institutions can directly transmit non-public information without risking to trap into any criminal behaviour. The change of the valuation approach for assets and liabilities at t=1 under the new FINMA Circular "SST" could lead to substantial changes to the calculation process and potentially higher / lower SST capital requirements and thus was criticised by the industry without success. Finally, the draft FINMA Circular "Outsourcing" which has not yet entered into force is expected to introduce significant operational burden to (re-)insurers, with some of them going beyond the requirements of Solvency II. Hopefully these rules will be reconsidered in due time.

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New Regulatory Guidelines on Operational Risks and Remuneration Schemes for Banks, Securities Dealers and Financial Groups/Conglomerates

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On 1 November 2016, FINMA published the revised circulars 2008/21 on "Operational risks - banks" and 2010/1 on "Remuneration schemes" which both have been revised in the context of the new FINMA circular 2017/1 "Corporate governance – banks". The most significant changes pertain to i) the adoption of minimum requirements for the regulation of IT and cyber risks in the revised circular 2008/21 as well as ii) a narrowed scope of application and the prohibition of hedge transactions in the revised circular 2010/1. Both revised circulars will enter into force on 1 July 2017.

By Peter Ch. Hsu / Sandro Fehlmann

On 1 November 2016, FINMA published the revised circulars 2008/21 on "Operational risks – banks" (*Revised Circular 08/21*) and 2010/1 on "Remuneration schemes" (*Revised Circular 10/1*). Both apply to banks, securities dealers, financial groups and (bank or securities dealer dominated) conglomerates (collectively referred to as *Banks*). They have been revised in the context of the new FINMA circular 2017/1 "Corporate governance – banks" (see our article in the 2/2017 edition of CapLaw) and will enter into force on 1 July 2017.

The two revised circulars remain to a large extent in line with the currently applicable FINMA guidance (and the draft circulars published on 1 March 2016), except for a number of important changes in specific areas, which will be the focus of this article.

1) The Partially Revised Circular 2008/21 on "Operational risks – banks"

a) Introduction

FINMA considered a partial revision of the circular 2008/21 on "Operational risks – banks" to be required because supervisory practice has shown that operational risks have become more diverse in banking. *E.g.*, the risk management principles regarding technological infrastructure in the Revised Circular 08/21 now specifically regulate the management of IT and cyber risks. In addition, it incorporates the principles set out in the FINMA position paper "Legal and reputational risks in cross-border financial services". Furthermore, several provisions on corporate governance were transferred from the current version of the circular 2008/21 to circular 2017/1.

b) Further Implementation of the Principle of Proportionality

The partial revision of the Revised Circular 08/21 mainly relates to chapter IV referring to the qualitative requirements on the handling of operational risks. The principle of proportionality already applies to this chapter under the current regime, but the definition of small banks which are exempt from certain duties has been revised: Under the Revised Circular 08/21, banks of the supervisory categories 4 and 5 are deemed to be small banks (note 118 of the Revised Circular 08/21). In contrast, under the current regime, small banks are defined as banks of the supervisory category 5 and securities dealers of the supervisory categories 4 and 5. However, to decide whether certain requirements must be fulfilled by a specific institution, FINMA may still apply an institution-specific assessment of a Bank on the basis of its type, scope, complexity and risks associated with its business activities, as already implemented under the current regime for a Bank in the supervisory category 4.

c) Introduction of New Guidelines on Managing IT and Cyber Risks

Principle no. 5 of the current circular 2008/21 contains basic requirements on the technology infrastructure. As a result of the increasing awareness on IT and cyber risks, FINMA decided to devote particular attention on a broader regulation of such risks. Under the Revised Circular 08/21, Banks will be required to implement a concept of minimum requirements addressing IT and cyber risks (note 135 of the Revised Circular 08/21). However, if compared to its draft version the requirements on the IT and cyber risk concepts in the Revised Circular 08/21 have been softened.

In this context, the Revised Circular 08/21, in principle, requires the management body to develop a concept addressing IT risks that fulfils certain minimum standards such as the outline of an overview on the IT network environment, systemic processes for the identification and assessment of IT risks and appropriate monitoring and risk mitigation measures (notes 135.1-135.5 of the Revised Circular 08/21). However, FINMA explicitly acknowledges that the concrete implementation will be determined on an institution-specific basis on the grounds of the specific technology infrastructure.

The Revised Circular 08/21 further requires Banks to implement a concept addressing cyber risks that particularly ensures the identification of potential risks of cyber-attacks, the protection of its operating processes and technology infrastructure, the prompt reaction to cyber-attacks and the continuation of the Bank's ordinary business operations in the event of a cyber-attack (notes 135.6-135.12 of the Revised Circular 08/21).

d) Provisions on Recovery and Resolution Planning

For systemically relevant banks, the Revised Circular 08/21 provides for a requirement to (i) identify the bank's systemically important functions and (ii) design its contingency planning in a way that it can be implemented immediately and ensures the continuation of the bank's systemically important functions in the event of impending insolvency (note 136.1 of the Revised Circular 08/21). This duty for systemically relevant banks specifies the general requirements for such banks set forth in article 9 (2) (d) Banking Act.

FINMA has not adopted general provisions on the recovery and resolution planning for banks in all supervisory category (*e.g.*, an inventory list for most critical services and operations) in the Revised Circular 08/21 as initially suggested in the draft of the revised circular 2008/21 but criticized with regard to the legal basis for such provisions for smaller banks and cost-benefit considerations in the consultation procedure.

e) Incorporation of Principles relating to Risks arising from Cross-border Financial Services

The Revised Circular 08/21 adopts the principles relating to FINMA's expectation on the management of risks arising from the provision of cross-border financial services as currently set out in the FINMA position paper "Legal and reputational risks in cross-border financial services" (notes 136.2-136.5 of the Revised Circular 08/21). FINMA points out that the new rules in the revised circular are principle-based and reflect the current FINMA practice without material amendments.

External asset manager are considered as "partners" in the Revised Circular 08/21 and Banks are required to "consider the risks generated by external asset managers and adopt a careful approach in the selection and instruction of such partners" (note 136.4 of the Revised Circular 08/21). In the draft of the Revised Circular 2008/21, external asset managers have been referred to as "agents" of the Banks which has been criticized by several participants in the consultation procedure (*e.g.* by Swiss Banking).

2) The Partially Revised Circular 2010/1 on "Remuneration schemes"

a) Modification of the Scope of Application

The revised Circular 2010/1 on "Remuneration schemes" mandatorily applies to Banks of the supervisory category 1 (*i.e.* to the financial groups of UBS and Credit Suisse) and the two largest insurance groups, being Zurich und Swiss Re (notes 6 and 7 of the Revised Circular 10/1; *explanatory report* dated 1 March 2016, p. 21). In contrast, the circular does not apply to financial groups or conglomerates that are not subject to consolidated supervision by FINMA but e.g. subject to the supervision of a foreign regulatory authority. Under the current regime, the provisions mandatorily apply to all Banks of the supervisory categories 1 and 2 as well as the two largest insurance groups. This narrowed scope of application aims to relieve smaller institutions from the more stringent requirements that are appropriate for larger institutions.

However, the circular remains a key guideline for best practice in relation to remuneration schemes for all financial institutions and groups or conglomerates supervised by FINMA.

In addition, FINMA may still require financial institutions other than UBS, Credit Suisse and the two largest insurance groups to mandatorily implement the provisions set out in the circular in full or in part if appropriate in the light of the circumstances (note 9 of the Revised Circular 10/1).

Under the Revised Circular 10/1, a financial institution that is part of a financial group or conglomerate is on the entity level not required to i) adopt remuneration regulations, ii) appoint a remuneration committee or iii) prepare a remuneration report if the financial group/conglomerate as a whole is within the scope of the circular (note 4 of the Revised Circular 10/1). The current circular 2010/1 requires Banks of a group/conglomerate also to implement the provisions on a single entity level if such Bank falls within the circulars' scope of application. Accordingly, this is a sensible limitation and clarification of the scope of application of the circular for subsidiaries of financial groups.

b) Minor Modifications on Organizational Requirements

The Revised Circular 10/1 contains a few minor, but still interesting modifications on the organizational requirements: Newly, the board of directors has to approve the remuneration of the senior management, of the heads of the control functions and of the total pool of the firm on a yearly basis (note 20 of the Revised Circular 10/1). Under the current regime, the board of directors does not need to approve the remuneration of the heads of the control functions. Interestingly, the term "board of directors" is still being used in the Revised Circular 10/1. In contrast to other new circulars such as the circular 2017/1 on Corporate Governance that introduced the more general term "governing body".

Furthermore, the board shall establish a remuneration committee irrespective of the size and structure of the financial institution or the complexity of the remuneration system (note 21 of the Revised Circular 10/1). Currently, the establishment of a remuneration committee is dependent on the size and structure of the financial institution or the complexity of its remuneration system.

c) Further Modifications

Content-wise, the Revised Circular 10/1 now explicitly prohibits hedge transactions that run counter to the effectiveness of the elements of the remuneration system (note 24 of the Revised Circular 10/1). This new provision shall further improve the effectiveness of remuneration systems in the financial industry.

In the Revised Circular 10/1, FINMA has not introduced a requirement of a clawback clause to ensure that remunerations paid may be reclaimed from an employee in case of a retrospective discovery of severe misconduct (*e.g.* by agreement on respective provisions in employment contracts). The draft of the Revised Circular 2010/1 initially suggested such clawback requirement for variable remunerations. However, FINMA abstained from such a clawback clause requirement as a response to the issues of potential legal unenforceability and unclear tax treatment as expressed by the industry in the consultation procedure (see *consultation report* dated 22 September 2016, p. 30).

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PRIIPs: Potential Impact on Plain Vanilla Bond Market

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Most Swiss financial service providers have been aware of, and have been preparing for, the effect the new EU regulation on key information documents for packaged retail and insurance-based investment products or "PRIIPs" will have on the offering of structured products and other complex financial products. However, recent attention in connection with the medium term note program update season in Europe has been paid to potential effects that the regulation may have on the offering of plain vanilla bonds and the corporate bond market generally. This article discusses these potential effects, including those that may be of particular importance to the Swiss financial market.

By Lee Saladino / Andreas Josuran

In December 2014, Regulation (EU) No. 1286/2014 of the European Parliament and of the Council of 26 November on key information documents for packaged retail and insurance-based investment products (the PRIIPs Regulation) came into effect and will directly apply in all Member States of the European Union and the European Economic Area (the EEA) commencing on 1 January 2018. The PRIIPs Regulation requires persons who manufacture, advise on or sell packaged retail and insurance-based investment products (PRIIPs) to provide retail investors with, and sets out uniform rules on the form and content of, a key information document (KID). The stated purpose of requiring the provision of a KID is to help investors to understand and compare the key features and risks of the PRIIP.

While one of the key objectives of the PRIIPs Regulation is clearly the harmonization and improvement of disclosures relating to more complex financial products such as investment funds, life insurance policies with an investment element, structured products and structured deposits, it lacks a clear-cut definition of exactly what financial products are in scope. The PRIIPs Regulation defines PRIIPs generally as "products […] where the amount repayable to the retail investor is subject to fluctuation because of exposure to reference values, or subject to the performance of one or more assets which are not directly purchased by the retail investor". Furthermore, while the PRIIPs Regulation includes examples of certain products that do not fall within the scope of this definition, it does not set forth an exhaustive list. Despite the PRIIPs definition referring to the amount "repayable" being subject to fluctuation (which on its face would not pick up interest payments linked to a floating rate) and such fluctuation being specifically linked to exposure to reference values or the performance of assets, a certain amount of uncertainty has developed as to whether even certain types of "plain vanilla" bonds (*i.e.*, fixed rate, floating rate and zero coupon) will qualify as PRIIPs. There seems at least to be a consensus that a fixed rate bond that redeems at par with no other special features (including no early redemption feature) would clearly fall out of scope since no amount repayable (or payable) to investors would be subject to fluctuation. However, due to the broad nature of the PRIIPs definition and certain confusing messaging from the European Commission and the European supervisory authorities (ESAs), many UK law firms have taken the position that there is a not negligible amount of uncertainty as to whether other plain vanilla bonds, such as those with a floating rate of interest and/or a make-whole or other early redemption feature, would be categorized as PRIIPs.

While there is hope that a sufficient amount of clarity will be obtained regarding the treatment of plain vanilla bonds under the PRIIPs Regulation before 1 January 2018, there has been some debate as to how issuers, underwriters and other primary market participants should proceed in the event that this does not happen. If a plain vanilla bond were considered to be a PRIIP and sales to retail investors were not to be excluded, the manufacturer (which in the plain vanilla bond context will almost always be the issuer) would not only be required to prepare a KID prior to the bond being made available to retail investors, but would have to regularly review and (as may be required under the PRIIPs Regulation) revise and republish the KID during the entire life of the bond. In addition to the cost associated with this obligation, the issuer would be exposed to civil liability under the laws of the relevant Member State of the EEA for a KID that is misleading, inaccurate, inconsistent with the legally binding pre-contractual and contractual documents, or inconsistent with the form and content requirements set forth under the PRIIPs Regulation. Furthermore, any person advising a retail investor on or selling the bond to a retail investor would be obligated to provide such investor with the KID "in good time" before such investor is bound by any contract or offer relating to the bond. Finally, both the issuer (as manufacturer) and any person advising on or selling the bond would be required to establish appropriate complaint and redress procedures for retail investors. Understandably, both corporate bond issuers and underwriters have generally indicated a desire to avoid falling into this regime in the case of plain vanilla bond issuances, particularly in the case of bonds that have been traditionally targeted at wholesale investors within the meaning of the Prospectus Directive (*i.e.*, bonds with a denomination of EUR100,000 (or equivalent) or more). Against this backdrop, many UK law firms appear to have taken a conservative view and are advising clients that, to be on the safe side, they should approach future issuances of plain vanilla bonds as if the bonds are PRIIPs.

In order to assist primary market participants in addressing the above-described uncertainty, in February 2017, the International Capital Market Association (ICMA) developed suggested selling restrictions and legends for plain vanilla bonds that may or may not constitute PRIIPs and where the issuer will not publish a KID. ICMA has included suggested language for debt programs under which bonds may be offered, and for standalone bond issuances that will be offered, on or after 1 January 2018. Although the PRIIPs Regulation does not contain any grandfathering provisions, it is hard to see what obligations would be placed on primary market participants thereunder in the case of plain vanilla bonds for which the primary distribution has been completed prior to 1 January 2018 (however, a separate analysis of obligations that may be placed on secondary market participants is required). Consequently, there is arguably a six-month period during which primary market participants can debate and analyze the best way to handle standalone bond issuances, whereas inclusion of PRIIPs-driven selling restrictions and legends was very much a hot topic during this year's medium term note program update season in Europe. ICMA has presented two different options for debt programs: a blanket prohibition on offers to retail investors in the EEA on and after 1 January 2018 ("Option 1"), and a default prohibition on offers to retail investors in the EEA on and after 1 January 2018, that may be "turned off" for a particular drawdown under the program ("Option 2"). Notwithstanding these two options, ICMA has also indicated that since a full understanding of the implications of the PRIIPs Regulation for the plain vanilla bond market is still evolving, an issuer may choose, in the program context, to wait to amend its program documentation to address the PRIIPs Regulation until such understanding develops and, in any event, prior to commencing an offer on or after 1 January 2018 ("Option 0").

In connection with this year's medium term note program update season in Europe, which typically involves documentation governed by English law, it has been our experience that UK law firms – irrespective of whether they are representing the issuer or the program dealers – are suggesting that the ICMA-developed selling restrictions and legends be included in the documentation (*i.e.*, either Option 1 or Option 2, but not Option 0). In addition, we have observed a strong push by certain of those firms to select Option 1 on the basis that it is the "safer" choice for market participants, even in cases in which the issuer uses the program exclusively for plain vanilla bond issuances. If most primary market participants elect to exclude the possibility of offers and sales of plain vanilla bonds to EEA retail investors out of an abundance of caution and irrespective of whether plain vanilla bonds (or particular subsets of plain vanilla bonds) would be categorized as PRIIPs under the PRIIPs Regulation, they run the risk of significantly shrinking and otherwise damaging the European retail corporate bond market.

For the Swiss financial market, which is one of the world's leading (if not the leading) international wealth management centers, and has traditionally focused on Swiss and international retail clients (many of whom are domiciled in the EEA), the impact of excluding retail investors in the EEA could be particularly severe. In Switzerland, where a large number of corporate bonds (both those that are classified as wholesale and those that are classified as retail under the Prospectus Directive) are placed with retail clients booked in Switzerland. Consequently, exclusion of sales to retail investors in the EEA could mean not only that there may be a more limited supply of European retail corporate bonds, but that European corporate bonds subject to such a prohibition may not be placed (or may not easily be placed) with retail clients booked in Switzerland. There is the practical concern about "flowback" of any such bonds to retail investors in the EEA, as well as the inability of Swiss banks to place such bonds with their large number of retail clients (which include, for example, family offices) that are booked in Switzerland, but domiciled in the EEA. In addition, in the case of plain vanilla bonds, the PRIIPs Regulation defines "retail investor" as any person classified as a "retail client" under Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (MiFID II) (*i.e.*, a client who is not a professional client), and does not (either directly or indirectly via MiFID II) appear to explicitly state that in order for a person to be considered to be a "retail client" thereunder, such person must be domiciled or otherwise located in the EEA. Consequently, banks in Switzerland potentially also need to consider whether a client domiciled and booked in Switzerland could still be considered to be a retail investor in the EEA (*e.g.*, through citizenship).

It is worth noting that the Swiss Federal Financial Services Act (*Finanzdienstleistungsgesetz*) (FIDLEG), which was approved by the Swiss Federal Council of States on 14 December 2016, and is currently before the other chamber of the Swiss parliament (the Swiss National Council), contemplates a concept that is similar to the PRIIPs Regulation's KID. The FIDLEG will require a basic information document (*Basisinformationsblatt*) (BIB) to be prepared in cases in which certain types of financial instruments are offered to private clients. It is expected that FIDLEG's implementing ordinance will ensure that the requirements for BIBs are aligned with those applicable to KIDs under the PRIIPs Regulation. Notwithstanding this expected alignment, following widespread criticism regarding the suitability of a BIB beyond short-term financial investment products (particularly, structured products) that was raised during the FIDLEG public hearing process, the Swiss Federal Council of States broadened the types of financial products exempted from the requirement to provide a BIB and specifically exempted all debt instruments without "derivative elements". While at first glance this appears to be helpful in the case of plain vanilla bonds placed in the Swiss market (in particular with respect to the domestic Swiss franc bond market where the bonds are primarily intended to be booked in Swiss accounts and typically trade in minimum denominations of CHF5,000), it is unlikely to mitigate the effect of the treatment of some or all types of plain vanilla bonds offered in the EEA as PRIIPs or provide any relief in the case of retail clients that are booked in Switzerland but may still be considered to be retail investors under the PRIIPs Regulation (whether through domicile, citizenship or otherwise).

ICMA is continuing to work with industry participants to find a solution for plain vanilla bonds that will address the concerns described above, as well as take into account the product governance rules set out in MiFID II, which will also affect plain vanilla bond issuances and apply in all Member States of the EEA as of 3 January 2018. In the meantime, we believe that market participants appear to be well advised not to limit their flexibility (*i.e.*, use Option 2 or Option 0 in medium term note program documentation and take a wait and see approach to standalone plain vanilla bond issuances) until more clarity is reached, and Swiss market participants in particular should watch this space.

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SIX Swiss Exchange adapts new Regulations regarding Sustainability Reporting and further Disclosure Obligations

Reference: CapLaw-2017-28

In response to the growing trend of sustainability reporting as an additional component of annual reporting, the Regulatory Board of the SIX Swiss Exchange has decided to issue new regulations regarding sustainability reporting. In addition, new disclosure rules have been adapted for publicly disclosed buyback programmes, redemption of own units by real estate funds and net asset value disclosure by collective investment schemes. The changes will enter into force on 1 July 2017.

By Adam El-Hakim

1) Adaption of the Directive on Information relating to Corporate Governance (DCG)

By way of ***opting in***, issuers now have the opportunity (but not the obligation) to inform SIX Exchange Regulation (SIX) that they issue a ***sustainability report*** in accordance with internationally recognized standards (article 9 DCG in conjunction with article 9 item 2.03 DRRO) (Opting In). Such standards are updated periodically by SIX to take account of international developments. The fact that an issuer is Opting In will get published by SIX on the SIX website for the purpose of informing market participants. This can be viewed as a "quality label". Issuers choosing an Opting In are required to publish the sustainability report on their website within eight months of the balance sheet date for the annual financial statements. Further, the report must remain available in electronic form on the issuer's website for five years from the date of publication.

However companies remain free not to choose an Opting In and to (i) issue and publish a sustainability report in line with an internationally recognized standard without reporting this to SIX or (ii) include certain sustainability topics in their annual report.

2) Adaption of the Directive on Regular Reporting Obligations for Issuers of Equity Securities, Bonds, Conversion Rights, Derivatives and Collective Investment Schemes (DRRO)

Once the above mentioned ***Opting In*** regarding ***sustainability reporting*** is adopted, it takes the form of a new regular reporting obligation (article 9 item 2.03 DRRO), whereas the Opting In as such remains, as mentioned above, entirely voluntary for issuers.

Provisions within the Financial Market Infrastructure Act (FMIA) as well as in the Financial Market Infrastructure Ordinance (FMIO) restrict the permissibility of ***buybacks*** insofar as such buybacks may generally not be carried out during black-out periods.

However, exceptions in the form of safe-harbour rules exist. For example in case of a postponement of disclosure (pursuant to article 54 SIX Listing Rules), buybacks made at market price are permissible as long as they are (i) undertaken by a securities dealer commissioned for this purpose prior to the start of the buyback programme and (ii) carried out by the securities dealer within the parameters originally prescribed by the issuer without the issuer having any further influence (article 124 (2) (a) FMIO). The buyback is also permitted during a black-out period if it is undertaken by a trading unit segregated with information barriers, insofar the issuer itself is a securities dealer (article 124 (2) (b) FMIO).

The Swiss Financial Market Supervisory Authority wants SIX to strengthen the monitoring of compliance regarding such regulations on ***publicly disclosed buyback programmes***. Therefore, SIX will foster increased contact with issuers publicly disclosing aforesaid buyback programmes. A new regular reporting obligation has therefore been introduced to reduce unnecessary requests. It obliges issuers with publicly disclosed buyback programmes to inform SIX about the buyback programme undertaken during a black-out period by an independent securities dealer or a trading unit (in the meaning of article 124 (2) (a) and (b) FMIO (article 9 item 1.11 DRRO)). Further, SIX must be informed if the requirements set out in article 124 (2) (a) and (b) FMIO are no longer met.

In the cases where a ***real estate fund*** (open-ended collective investment scheme) ***redeems its own units***, the issuer is obliged to report this to SIX so that the corresponding changes – in particular in the relevant index – can be made (article 12 item 2.06 and article 13 item 2.05 DRRO).

The current regulations require issuers with ***collective investment schemes*** to report the ***official net asset value*** (NAV; article 83 of the Collective Investment Schemes Act) and, where applicable, the indicative NAV of ***exchange-traded funds*** to SIX. As SIX does not publish these key figures on its website, the decision has been taken to waive henceforth this reporting obligation. The corresponding provisions of the DRRO (article 12 item 2.01 et seq. and article 13 item 2.01 et seq. DRRO) are therefore ***repealed***.

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FINMA recognizes REGIS-TR as the first foreign trade repository

Reference: CapLaw-2017-29

On 3 April 2017, FINMA officially announced the recognition of REGIS-TR as the first foreign trade repository for the purpose of derivatives trading under the Swiss Federal Markets Infrastructure Act in Switzerland.

IPO of Galenica Santé

Reference: CapLaw-2017-30

Galenica (expected to be renamed Vifor Pharma) has sold its shares in Galenica Santé by way of an initial public offering (IPO) on the SIX Swiss Exchange. The IPO volume was CHF 1.9 bn making it the largest IPO announced in Europe so far this year. The shares of Galenica Santé (ticker symbol: GALE) were priced at CHF 39.00.

Capital Increase of Credit Suisse Group

Reference: CapLaw-2017-31

On 25 April 2017, Credit Suisse Group AG announced that it plans to issue new shares in a total amount of approximately CHF 4 bn (excluding the issuance of any new shares from the exercise of rights allotted on shares received as scrip dividend) by way of a rights offering to existing shareholders underwritten by a banking syndicate. The capital increase was subject to shareholder approval in an extraordinary general meeting held on 18 May 2017. Closing has occurred on 8 June 2017.

Helvetia issues EUR 500 m hybrid bonds via a repack structure

Reference: CapLaw-2017-32

On 11 April 2017, Helvetia Schweizerische Versicherungsgesellschaft AG (Helvetia) successfully issued EUR 500 m hybrid bonds. Helvetia made use of a repack structure whereby issuers domiciled in Switzerland may access international debt capital markets free of withholding tax. Helvetia placed loan notes (the Loan Notes) governed by Swiss law and guaranteed on a subordinated basis by Helvetia Holding AG to a multi-issuance vehicle domiciled in The Netherlands, which in turn issued secured notes (the Secured Notes) governed by English law and secured by the claims under the Loan Notes. The Secured Notes were placed with investors in the international debt capital markets and will be listed on the Irish Stock Exchange.

Rights Offering of Lonza

Reference: CapLaw-2017-33

On 12 May 2017, Lonza Group completed a capital increase by way of a rights offering raising gross proceeds of approximately CHF 2.25 bn. The proceeds will be used to partially finance the acquisition of Capsugel. The rights offering has been fully underwritten by a banking syndicate.

Merger between Clariant and Huntsman

Reference: CapLaw-2017-34

On 22 May 2017, Clariant AG and Huntsman Corporation announced that the companies have entered into a definitive agreement to combine in an all-stock cross-border "merger of equals". The combination of both companies will create a leading global specialty chemicals company with a combined enterprise value of approximately USD 20 bn.

The transaction shall be structured as a cross-border reverse triangular merger with Clariant remaining as the parent company, which shall be renamed HuntsmanClariant Ltd. As a result of the transaction, the current Clariant and Huntsman shareholders would be expected to own approximately 52% and 48% of HuntsmanClariant. The shares of the new company will have a dual direct listing on the SIX Swiss Exchange and on the New York Stock Exchange.

Fibi Bank (Switzerland) completes the sale of its banking relationships and clients' assets to CBH Compagnie Bancaire Helvétique

Reference: CapLaw-2017-35

On 2 June 2017, Fibi Bank (Switzerland) Ltd (Fibi), a subsidiary of The First International Bank of Israel Ltd, and CBH Compagnie Bancaire Helvétique SA (CBH) completed the sale and transfer of Fibi's banking relationships and clients' assets to CBH.

Groupe Acrotec places CHF 70 m 3.75% Bonds

Reference: CapLaw-2017-36

Groupe Acrotec SA, a high precision manufacturer of small components and specialised service provider for the watchmaking and industrial sectors, has completed the placement of CHF 70 m 3.75% bonds due 2023. The bonds were issued at 100% of their principal amount and, unless previously redeemed or repurchased and cancelled, will mature on 14 June 2023 at 100% of their principal amount.

Listing of Idorsia

Reference: CapLaw-2017-37

On 16 June 2017, Idorsia Ltd (SIX: IDIA) announced its debut as an independent company newly listed on SIX Swiss Exchange.

Following the transfer of Actelion's drug discovery and early stage clinical pipeline business to Idorsia, registered Idorsia shares held by Actelion have been distributed to Actelion shareholders by way of a dividend in kind. The distribution of Idorsia shares to Actelion shareholders completes the demerger from Actelion in connection with the all-cash tender offer for all publicly held shares of Actelion Ltd by Janssen Holding GmbH, a Swiss subsidiary of Johnson & Johnson (J&J) for 280 US Dollars in cash per share that will also settle on 16 June 2017.

20th Zurich Conference on Mergers & Acquisition (20. Zürcher Konferenz Mergers & Acquisitions)

Tuesday, 5 September 2017, Lake Side, Zurich

http://www.eiz.uzh.ch/uploads/tx_seminars/Programm_M_A_05.09.2017_01.pdf

Quo Vadis – Financial Center Switzerland? (Quo Vadis – Finanzplatz Schweiz?)

Thursday, 24 August 2017, University Zurich

http://www.eiz.uzh.ch/uploads/tx_seminars/Programm_Quo_Vadis_24.08.2017.pdf

Financial Markets Regulation – Current Legal Topics (Finanzmarktregulierung – aktuelle Rechtsprobleme)

Tuesday, 21 November 2017, Hotel Marriott, Zurich

http://www.lam.unisg.ch/de/lam-tagungen/finanzmarktregulierung/finanzmarktregulierung_uebersicht.php

4th Conference on Compliance in the Financial Services Industry (4. Tagung zur Compliance im Finanzdienstleistungsbereich)

Wednesday, 22 November 2017, Lake Side, Zurich

http://www.eiz.uzh.ch/uploads/tx_seminars/Programm_Compliance_22.11.2017_01.pdf

Capital Markets and Transactions XIII (Kapitalmarkt – Recht und Transaktionen XIII)

Tuesday, 28 November 2017, Metropol, Zurich

http://www.eiz.uzh.ch/uploads/tx_seminars/Programm_Kapitalmarkt_28.11.2017.pdf