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New Rules on the Disclosure of Beneficial Owners and the Death Knell for Bearer Shares


On 21 June 2019, the Swiss Federal Assembly passed the Federal Act on the Implementation of the Recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes (the Act) into law. The Act sounds the death knell of bearer shares for non-listed companies. It also introduces criminal law sanctions for breaches of the obligation to disclose beneficial ownership of shares and several corporate housekeeping duties regarding the share register and the register of beneficial owners. Finally, it provides for draconian sanctions for holders of bearer shares who would fail to comply with their disclosure duties and for companies who would fail to maintain the requisite corporate registries or issue bearer shares in breach of the new provisions. At the same time, the Act also introduces some clarifications around the disclosure of beneficial owners and several issues that were subject to controversy.

By Rashid Bahar

1) International Context

As a member of the Financial Action Task Force (FATF/GAFI) and the OECD Global Forum on Transparency, Switzerland has committed to enact legislation to improve the transparency of legal entities to support the global effort to combat money-laundering and the financing of terrorism as well as the international processes for the automatic exchange of information among tax authorities. A key element of this legislation is increased transparency in relation to the legal and beneficial owners of legal entities.

On 14 December 2014, Switzerland passed legislation to address these concerns, which entered into force in July 2015. The Swiss approach consisted mainly of relying on corporate law to create the requisite framework to ensure sufficient transparency. Furthermore, following some opposition from small and medium enterprises, the Swiss parliament decided at the time to retain bearer shares albeit with an obligation for the holders of bearer shares to disclose their identity and address to the company and provide a copy of identification documents within a month of the acquisition of the shares (article 697i (1) and (2) CO). However, following peer reviews that were carried out in 2016, the system was criticized because it lacked a mean to ensure an effective compliance. In particular, the lack of sanctions – other than the corporate law mechanism provided for by article 697m CO – was deemed to be insufficient. At the same time, the amendments of 2014 raised a number of questions for practitioners which remained unsolved.

In response to these findings the Federal Council presented a bill to amend the code of obligations in parliament last year and the Act was adopted on 20 June 2019. The main goal of the Act is to overcome the shortcoming identified by peer reviews
conducted by the FATF and the Global Forum in time for the next peer review scheduled for November 2019.

2) Abolition of Bearer Shares

A central aspect of the Act will be the abolition of bearer shares for joint stock companies (article 622 (1bis) CO as amended). Swiss companies will no longer be allowed to issue bearer shares with two exceptions: first, companies with equity securities listed on a stock exchange will continue to be able to issue bearer shares (article 622 (1bis) CO as amended). This exception will, however, only be available to a limited number of companies. Second, other companies will be able to issue bearer shares only if the shares are issued as intermediated securities held by a Swiss custodian designated by the company (article 622 (1bis) CO as amended). Such intermediated securities must then be held on custody accounts with a financial institution, typically a bank or a securities dealer. In both cases, this fact will need to be registered with the commercial register (article 622 (2bis) CO as amended). Therefore, all companies which issued bearer shares will need to react: either by converting their bearer shares into registered shares or by registering the fact that they benefit from one of the two exemptions.

3) Transitional Regime for Outstanding Bearer Shares and their Holders

Notwithstanding several motions to allow companies which had complied with the previous regime to be grandfathered, parliament decided to vote in favor of the proposition of the Federal Council and also bar companies which already issued bearer shares from maintaining their bearer shares. As a result, existing bearer shares will need to be converted into registered shares, subject to the two limited exceptions mentioned above (for listed companies and certain intermediated securities).

To soften the blow, the Act provides for a transitional regime: the abolition will not be effective immediately when the Act comes in force. Instead, companies will have a period of 18 months to amend their articles of association and convert their existing bearer shares into registered shares unless the shares are already issued as intermediated securities or the company has listed equity securities on a stock exchange or issued as intermediated securities held by a Swiss custodian. Even if one of the exemptions applies, the company will need to record this fact with the commercial register within the same deadline (article 2 of the Transitional Rules of the Amendment of 21 June 2019).

a) Automatic Conversion of Outstanding Bearer Shares

If bearer shares are still outstanding by the end of the transitional period of 18 months, they will be converted by law into registered shares (article 4 (1) Transitional Rules). The commercial registrar will be responsible for recording this change in the
commercial register (article 4 (2) Transitional Rules). The change will also be effective against third parties (article 4 (1) Transitional Rules). The shares will retain their existing nominal value, voting rights and financial rights (article 4 (3) Transitional Rules). However, the shares will need to be endorsed to be transferred and the new acquirer will have to request the registration of their details in the share register, even if, on the face of the share certificate, they are bearer shares. However, transfer restrictions will not apply to the transfer of such shares (article 4 (3) Transitional Rules).

To enforce a swift adjustment of the articles of incorporation after the 18 months interim period, the commercial register will not be allowed to complete any change to the articles of association until the company has implemented the changes to its articles of incorporation (article 5 (1) Transitional Rules).

b) Reinstatement of Former Shareholders

Following the conversion, the Company will need to register the holders of bearer shares who complied with their disclosure duties in its share register (article 6 (1) Transitional Rules). If shareholders fail to comply with their disclosure duties, they will see their voting rights suspended and lose their financial rights (article 6 (2) Transitional Rules). If shareholders want to be reinstated, they will need to a claim in court within five years of the entry into force of the Act (article 7 (1) Transitional Rules). However, to do so, they will need to secure the prior consent of the company to register them as shareholders. The Transitional Rules do not define under what conditions the company must consent and the court must approve the petition. Nevertheless, we would believe that the review should be limited to ensure that the shareholder is indeed entitled to the shares and has in the meanwhile complied with its disclosure duties.

c) Cancellation of Bearer Shares

If shareholders fail to be reinstated within this five year deadline, their shares will become null and void by law and the holders will lose any rights they have to the shares. Instead, their shares will be replaced by treasury shares held by the company (article 8 (1) Transitional Rules).

This sanction is irremediable. If the shareholders prove that they were not a fault, they will only have the right to apply to the court to be paid out the fair value of their shares, provided, however, the company has sufficient freely disposable equity to make this payment (article 8 (2) Transitional Rules). In all other cases, the law does not provide for a compensation of expropriated shareholders. However, it needs to be seen whether courts will leave shareholders disenfranchised, e.g., if the company does not consent to the reinstatement of rights without any valid grounds.
4) Changes to the Obligation to Disclose the Beneficial Owner

In addition to the abolition of bearer shares, the Act also amends the regime for the disclosure of the beneficial owner of shareholders acquiring, alone or in concert with third parties, more than 25% of the shares in a company. This regime continues to apply to all joint stock companies, regardless of whether they have issued bearer or registered shares and also to limited liability companies.

a) Control as the Determinant of Beneficial Ownership

The amendments clarify several controversial points. In particular, they define the beneficial owner of a legal entity as the physical person exercising control by analogy with the consolidation rules of Swiss accounting law (article 697j (2) CO as amended). Therefore, a physical person controls a legal person (i) if it holds, directly or indirectly, a majority of votes in the highest management body, (ii) if it directly or indirectly has the right to appoint or remove a majority of the members of the supreme management or administrative body or (iii) if it is able to exercise a controlling influence based on the articles of association, the foundation deed, a contract or comparable instrument (article 963 (2) CO). This clarification solves numerous controversies concerning the definition of the beneficial owner in corporate structures and should therefore contribute to greater legal certainty.

Furthermore, the new rules clarify that if no physical person controls a legal entity holding, alone or in concert with third parties, more than 25%, the legal entity is required to make a negative declaration to the company (article 697j (2) CO as amended): so, where the shareholder is a state-owned entity, has dispersed ownership, or is set up structurally so that it cannot be controlled by natural persons, e.g. with certain charitable foundations, the shareholder must make a negative declaration. This process will add an additional burden of compliance for shareholders, but will make it easier for the board of directors to ensure that the beneficial owners of shareholdings in excess of 25% have been effectively disclosed.

b) New Regime for Listed Companies and their Affiliates

A further clarification concerns listed companies and their affiliates: when the shareholder (i) is a listed company, (ii) is controlled by a listed company or (iii) controls a listed company, it will not need to make a full declaration regarding its beneficial owners. It will only need to disclose this fact as well as the name and seat of the listed company (article 697j (3) CO as amended).

This substantially simplifies the ongoing compliance burden for affiliates of listed companies, since they will not need to report any change within the shareholders of their listed parent, without decreasing the level of transparency, since the rules on the disclosure of substantial shareholding under the Financial Market Infrastructure Act (or similar foreign laws) ensure an appropriate level of disclosure for listed companies.
c) Deadline to Give Notice of Changes

One important amendment concerns alterations made due to changes of name, surname or address of the beneficial owner: currently, article 697j (3) CO does not specify the deadline to give notice of such changes to the company, which led certain commentators to take the stance that the notice is not subject to any timing constraints. To solve the controversy, the Act specifies that shareholders have three months to disclose the change to the company (article 697j (4) CO as amended).

This deadline provides some more leeway for shareholders to report these minor changes and should avoid sanctioning shareholders for failing to update the formalities of their report.

5) Sanctions for Non-Compliance

To ensure effective compliance with the transparency obligations and the record keeping duties and respond to the concern of the global standard setters, the Act introduces new criminal offences in the Swiss criminal code: pursuant to article 327 of the Swiss Criminal Code, the failure to comply with the obligations to disclose the beneficial owners of large shareholdings (including any changes) will be subject to a fine.

Similarly, intentional breaches of the corporate law obligations relating to the maintenance of the share register and the register of beneficial owners and other similar registers will also be subject to a fine (article 327a of the Swiss Criminal Code).

These sanctions will apply in addition to the corporate law effects of failing to comply with disclosure duties: namely the suspension of voting rights (article 697m(2) CO) and the loss of property rights until a proper notice is given to the company (article 697m (3) CO).

Furthermore, the failure to duly maintain the required registers or unlawfully issuing bearer shares will constitute a violation of organizational duties which can, at the request of a shareholder, a creditor or the commercial register, lead the court to summon the company to comply with its duties or take steps to dissolve the company and liquidate it in accordance with bankruptcy law (article 731a CO as amended).

6) Outlook

The Act has now been approved by the Swiss parliament and will become law if no referendum is petitioned for by 10 October 2019. The Federal Counsel has already announced that the Act would enter into force on 1 November 2019 to remedy all outstanding issues prior to the next peer review.

Companies and shareholders should carefully assess whether there is a need to act. All companies which have issued bearer shares should act. They should therefore assess whether they are allowed to continue to have bearer shares, i.e. whether they
have listed equity securities or have issued their shares as intermediated securities held by a Swiss custodian. If they are or ensure that they meet the requirements within the 18 months interim period, they must register in the commercial register the fact of their exemption to avoid a mandatory conversion.

For the other companies with bearer shares, it may be advisable to prospectively convert bearer shares into registered shares, or at least to ensure that the conversion of bearer shares by law is properly reflected in the articles of association and the commercial register after the interim period of 18 months.

Furthermore, all companies, including those who have only issued registered shares, should assess whether they have an effective and compliant corporate housekeeping in view of the new criminal sanctions in case of non-compliance.

Similarly, shareholders of non-listed joint stock companies and partners of limited liability companies should analyze whether they hold bearer shares or more than 25% of the share capital in any company, whether through bearer or registered shares. If so, they should carefully review their existing filings (and whether they made filings so far). Any deficiencies should be cured promptly and, if possible, before the new law enters into force to avoid the new criminal sanctions.

Additionally, holders of non-listed bearer shares must be particularly cautious, since they may, if they do not comply with the transparency requirements, need to go through a cumbersome court procedure to have their rights re-instated, and in some cases entirely lose their rights without compensation.

Nevertheless, these amendments should be welcomed as an effort to improve transparency of shareholders and beneficial owners of Swiss legal entities. While the manner in which these reforms have been brought about may seem haphazard, they should be understood as part of an ongoing effort to find a balance between the goals of international standard setters and the legitimate concern not to place an excessive burden of compliance on companies and their shareholders, who in their very large majority are not remotely connected to money laundering and financing of terrorism or more mundane tax fraud.

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New Delegation Rules under FinSA/FinIA as well as CISA: Impact on supervised and non-supervised entities

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The purpose of this article is to provide a first analysis of the key features and challenges, which will result from the shift from the current delegation rules under CISA to the new regulations on “delegation” pursuant to FinSA, FinIA and CISA. The new regulatory framework concerning the transfer of tasks to third parties covers a variety of factual and operational circumstances and set-ups. One of the main particularities of the new framework is that it is untested for the newly prudentially supervised entities under FinIA (i.e. trustees and asset managers) and that it will, at least in part, wherever financial services are provided, also impact non-supervised entities. The new rules may have consequences for both Swiss institutions delegating financial services and other tasks and international service providers with whom Swiss financial institutions will conclude delegation schemes.

By François Rayroux

1) Introduction

a) Importance and plurality of delegation schemes in practice

In practice, delegation schemes are characterised by a multitude of configurations and structures. In particular, they have rapidly evolve to become a common set up in financial groups since the financial crisis. Delegation arrangements, however, are also increasingly concluded with third parties. From an operational perspective, the reason for a delegation is, in most cases, the will to reduce costs and inefficiencies in the context of the value chain of the asset management industry taken as a whole.

On the other hand, supervisory authorities, both in the European Union and in Switzerland, have since the financial crisis increasingly focused on delegation arrangements. In many cases, regulations are driven not only by investor’s protection concerns, but also by the stated objective of regulators that companies keep at least a minimal substance in the home jurisdictions. In this context, an obvious example is the concept of the “letter box entity” rules, which have been developed after the financial crisis in the European Union (see e.g. Commission Delegated Regulation 231/2013, article 82, implementing AIFMD) and have impacted the rules of the CISA on delegation, in particular since the revision of the CISA which came into effect on 1 March 2013. In that regard, FINMA has repeatedly focused its supervisory and audit activities on delegation schemes (see FINMA Annual Report 2014, p. 70). FINMA has notably noted an increasing use of (the) delegation to third parties, including regarding key functions of the asset management business, such as risk management or other material tasks (see FINMA Annual Report 2016, p. 66). The Swiss supervisory authority also noted
a growing trend towards delegation to non-supervised institutions (see FINMA Annual Report 2017, p. 74).

It is therefore a natural evolution that, in the context of the implementation of FinSA, FinIA and the revised CISA, the new rules applying to the recourse to third parties, in particular the delegation of tasks, would confirm or adjust the evolutions initiated after the financial crisis. A detailed analysis of the new legal framework shows, however, that the impact of the new delegation rules may be material and raise new questions, depending on whether “financial services” are provided and on the level of supervision of the financial institutions.

b) Legal framework

i. Current legal framework

The former FINMA Circular 2008/37 on the “Delegation by Management Companies/ SICAVs” provided for a detailed set of rules as well as a list of tasks which could be delegated in full, or only subject to certain conditions, as opposed to the key tasks which fund management companies (Fondsleitungen/directions de fonds) within the meaning of articles 28 et seq. CISA (“Management Companies”) or SICAVs were not allowed to delegate. These principles were incorporated into the rules currently in force, which derive from articles 18(b) and (31) CISA as well as article 66 CISO-FINMA. The current framework however takes a principle based approach, without the detailed regulations and the catalogue of tasks which could be delegated contained in the former FINMA Circular 2008/37. The legislator had indeed realised that a detailed catalogue may also raise difficulties and therefore chose to opt for a principle based delegation regulation (see FINMA Explanatory Report to the Revision of the CISO-FINMA of 3 April 2014, p. 41-42). Simultaneously, the scope of the rules on delegation derived from article 66 CISO-FINMA were expanded to also apply to asset managers of collective investment schemes, as well as to representatives of foreign funds.

The current framework based on article (66) CISO-FINMA, while principle based, has raised several questions in practice. In particular, the general reference to “material tasks”, to which the delegation rules are to apply pursuant to article 66(1) CISO-FINMA, which is not further defined or explained, has led to discussions among market participants, legal practitioners and auditors as to the scope of application of the new delegation rules. Furthermore, the potential sub-delegation of tasks involving asset management decisions to which article 3 (1) CISA refers was restricted by FINMA practice, causing an increasing number of practical issues in the context of the sub-delegation of asset management functions to foreign asset managers (see FINMA Communication 39 (2012), 24 July, 2012, p. 5-6). Finally, the obligations imposed on supervised entities in the case of a delegation abroad pursuant to article 66 (5) CISO-FINMA to provide evidence that the entity itself, the audit firm and FINMA may
perform their inspection rights is more cumbersome compared to the rules applicable to outsourcing arrangements pursuant to the FINMA Outsourcing Circular 2018/3.

In this respect, there is in practice also a lack of clear delimitation between a "delegation" pursuant to articles 18(b) and (31) CISA as well as article (66) CISO–FINMA and an "outsourcing" according to the FINMA Outsourcing Circular 2018/3, with a number of practical instances where both concepts overlap. One of the key distinctions between both sets of rules is that, whereas certain material tasks cannot be delegated under the CISA delegation rules, there is no similar restriction in the FINMA outsourcing Circular (See for the delimitation Fabio Pelli, Die Delegation von Aufgaben bei offenen kollektiven Kapitalanlagen nach KAG, Diss. St. Gallen, 2010, p. 21-27). It is finally to be noted that article 11 FMIA, as specified by article 11 FMIO, contains similar rules for financial markets infrastructures, but dealing, as a matter of terminology, more generally with “externalisations” (Auszlagerung/externalisation).

2) Overview of the new delegation legal framework pursuant to FinSA, FinIA and CISA

There is a need to clarify the concept and the terminology of the delegation rules under FinSA and FinIA. From the outset, it must however be noted that different rules on “delegation” apply at different levels of the new legislation depending on the nature of the tasks delegated and the supervisory status of the delegating entity. It is therefore important to provide for a first overview of these different sources for the new “delegation” rules, which, in essence, all aim at avoiding “letter box entities”:

- For both supervised and non-supervised financial services providers: specific rules apply in the context of financial services, as defined under article 3 let. c cipher 1–5 FinSA. On one side, article 23 FinSA imposes specific obligations in case of recourse to third parties. On the other hand, specific obligations are imposed on members of a chain of financial service providers pursuant to article 24 FinSA. Article 23 and article 24 FinSA are part of the third Chapter of FinSA relating to organizational rules. They apply both to FINMA supervised entities, as well as to non-supervised providers of financial services in Switzerland. Article 23 FinSA and article 24 FinSA are not further defined in the Draft-FinSO.

- In the case of a delegation for the preparation of the base information sheet: specific rules apply to the delegation to third parties in the context of the “offer” of financial instruments to private investors. In these particular instances, article (58) (3) FinSA imposes enhanced delegation rules when the duty to prepare the base information sheet is delegated. Indeed, this delegation can only be implemented if this task is entrusted to qualified third parties, which are persons or entities which, in the opinion of the issuer of the base information sheet, have the necessary qualifications (article 84 Draft-FinSO).
In the context of prudentially supervised institutions across the “authorization cascade”: In the case of financial institutions which are supervised under the FinIA, prudential rules apply to the delegation of tasks, whether the delegated task relates to financial services or not, which vary depending on the nature of the supervision (see articles 14, 27, 35 FinIA as well as articles (9), (17), (32) and (48) Draft-FinIO). It is important to note that, in our view, the rules of the FinIA on Securities Houses (Wertpapierhäuser/Maisons d’émission) pursuant to article (41) et seq. FinIA must be clearly distinguished from those applying to asset managers, trustees, managers of collective assets and Management Companies pursuant to articles (14), (27) and (35) FinIA. Indeed, even though article 9 Draft-FinIO generally refers to Securities Houses when laying down the principles of a delegation for FinIA supervised entities, we expect that Securities Houses will be subject to the specific delegation rules which, as of now, are applied under the SESTA and closely follow the rules on outsourcing which apply to banks subject to the Swiss Banking Act under the FINMA Circular 2018/3 on Outsourcing.

In the field of CISA institutions: specific rules apply, as under the current CISA, in case of a delegation between a Management Company and the Custodian (see article 33 (3) and article (35) FinIA). Additional specific rules also apply, in the limited context of the CISA, to delegation schemes implemented by SICAVs or representatives of foreign funds (see article 14(1) CISA and article 12(b) DRAFT-CISO). By contrast, it is important to note that, under the CISA, no additional delegation rules based on article 20 CISA will apply. Article 20 CISA imposed until now funds specific rules of conduct, in particular in the context of the “delegation” of the distribution of investment funds. As a matter of principle, the delegation rules derived from the current article 20 CISA will be replaced by the rules of conduct and organization introduced by FinSA. Finally, the stricter liability of Management Companies in case of a delegation is limited to tasks linked to its “ManCo function”, at the exclusion of any other tasks (article 68(3) FinIA; article 48 Draft-FinIO). Incidentally, we note that additional and more stringent delegation rules will apply to CISA institutions with the proposed amendments to the CISA resulting from the implementation of the so-called Limited Qualified Investors Funds (See Explanatory Report of the Federal Finance Department to the Consultation Procedure for the Amendment of the CISA, dated 26 June 2019, p. 13).

3) “Delegation” pursuant to FinSA in the field of financial services
The “recourse to third parties” pursuant to article 23 FinSA imposes specific obligations as to the selection, instruction and supervision of said third parties. This provision aims at imposing a uniform standard of care, as applicable to the supervision of employees (see Dispatch of the Federal Council p. 8963-8964). This will imply the obligation to lay down organizational rules and processes for the verification of their
capacities, knowledge and experience for the specifically delegated tasks. More precisely, the existence of the authorized entity requires that regulatory authorizations, whether in Switzerland or abroad, as well as the necessary registrations, for instance in the client advisors register pursuant to article (28) FinSA, will have to be verified at the occasion of the conclusion of the delegation arrangements. The supervisory obligations will then extend not only to the third party financial provider itself, but also to the latters employees (see Dispatch of the Federal Council, p. 8963). These obligations will be imposed irrespectively of whether the delegated task is a financial service pursuant to article (3) let. c cipher 1-5 FinSA or not. Furthermore, the nature of the contractual relationship, namely whether the delegation is based on a mandate or not, will not be relevant. The broad scope of application of article (23) FinSA shall ensure that it also covers any cooperation with intermediaries or distributors. These obligations pursuant to article (23) FinSA are expressly meant to be additional to the specific delegation rules which are imposed to financial services provider, e.g. as a result of the Swiss Banking Act, the FinIA or CISA (see Dispatch of the Federal Council p. 8964).

In addition, wherever a chain of financial service providers exists, article 24 FinSA will impose specific obligations on the delegating financial services provider, which will have to make sure that the information required in the context of financial services is complete and correct, in line with the new obligations imposed by FinSA. The delegating financial service provider will be responsible for the compliance with the obligation pursuant to articles 8-16 FinSA (see article 24(1) FinSA). On the other hand, the party to which the performance of financial services has been delegated has the obligation to “supervise” the delegating financial service provider, as a specific obligation is imposed on him to cease to perform the delegated financial services in case of clear evidences that there is a violation of the information obligation pursuant to articles 8-16 FinSA.

In other words, the implementation of article 24 FinSA will, in practice, impose a supervisory mechanism in the context of so-called “chains of financial service providers”, the modalities of which are at this stage difficult to define. This will in particular apply wherever a financial service pursuant to article 3 let. (c) cipher 1 and 2 FinSA is delegated, such as, as the case may be, asset management or “distribution” activities. In many cases, the requirements of articles (23) and (24) FinSA will apply cumulatively and in addition to the specific prudential delegation rules already imposed to supervised entities under the Swiss Banking Act, FinIA or CISA. The combination of the “delegation rules” contained in articles (23) and (24) FinSA, which will apply to financial service providers (but, in respect of article 23 FinSA, also for tasks which do not constitute “financial services”) in conjunction with the prudential delegation rules is expected to trigger complexities for the internal organisation.
4) Delegation rules in the context of supervised entities under the FinIA

a) Concept of the new delegation rules

The new delegation rules are principle based and cover any transfer of performance of all or part of a material task to a third party on an independent and durable basis (article 9(1) Draft-FinIO). They are governed by the fundamental aim to prevent letter box entities. Where an assessment must be made as to the existence or absence of an “empty shell” or “letter box entity”, all the circumstances must be considered. In case of financial groups, this includes the analysis of the substance not only on the level of the Swiss delegating entity, but also on the level of its affiliates, branches or representative offices in Switzerland or abroad (see Explanatory Report of the FDF, p. 85).

The new rules are essentially based on the current regulations of article 66 CISO-FINMA and are intended to apply at the delegation of material tasks only. However, the Explanatory Report of the FDF, when citing examples for tasks which are covered by the delegation rules, expressly refers to matters which, in practice, are in most cases not “material tasks”, such as financial analysis, tax reporting, accounting, investment advice (as opposed to investment management based on discretionary powers), elaboration of model portfolios, etc. (Explanatory Report of the FDF, p. 89). Yet, it appears that the explicit intent of the legislator was to aim only at important tasks, meaning those covered by the core business activities, as well as the key elements of the initial FINMA authorisation (see article 19, 26 and 34 FinIA and article 6 Draft-FinIO), such as tasks linked to asset management, risk management, internal controls and compliance, as well as data processing including client names. It would be essential to limit in the final text of the Draft-FinSO the tasks which may be defined as material or at least to provide an indicative guidance as to the meaning of what constitutes such “material tasks”.

General requirements are defined which apply to all supervised entities (article 9 Draft-FinIO), including to asset managers and trustees which is a novelty for those institutions. The general conditions that must be fulfilled by supervised institutions are based on article 66 CISO-FINMA as well as article 11 FMIO and relate to the organisation (article 9 FinIA and article 6 Draft-FinIO). These provide in essence that core competencies (such as the key elements for the risk management of asset managers) pursuant to both Swiss company law and supervisory regulations, as well as the place where management of supervised entities is located (article 10 FinIA), cannot be delegated. The delegation of tasks is subject to the same restrictions currently imposed under the CISA, including the obligation to verify the capacity, knowledge and experience, as well as to supervise and instruct the appointed service providers (article 14(1) FinIA; article 9(3) Draft-FinIO). This also includes the obligation to provide for an adequate organisational structure in terms of substance and process, including
human resources and know-how, for the performance of the instruction and control functions. The current obligation to enter into written delegation arrangements and to plan for adequate provisions and processes, including as to the protection of data and any permitted sub-delegation, in the organisational charts, is maintained. The new delegation rules are more flexible than the current ones provided for under article 66(5) CISO-FINMA as to evidence to be provided regarding the possibility of on-site access of FINMA or the auditors in case of a delegation to a foreign jurisdiction.

It is noteworthy to emphasise that the prudential responsibility always remains with the delegating entity and that the delegation of tasks always has to be implemented, bearing in mind the interests of the customers (article 9(2) Draft-FinIO). In other words, the legislator seems to consider that delegation arrangements cannot be contracted in the exclusive interest of the contracting parties, but must be structured in such a manner that the investors’ interests are adequately protected.

b) Specific rules depending on the type of FinIA supervised entities

In line with the concept of the “authorization cascade” introduced by the FinIA, increasing prudential obligations apply to a delegation depending on the regulatory status of the FinIA supervised entity in question. The paradigm-shift in the context of the delegation rules is the most flagrant one for asset managers and trustees, to the extent that they are under the current framework not subject to prudential restrictions as to the delegation of tasks. The applicable delegation rules are in practice those imposed by the self-regulation provisions of the SROs, but without any express legal basis in Swiss law and, in particular, no ultimate FINMA sanction pursuant to the FINMASA as a result of the new prudential supervision introduced by the FinIA.

The new rules are intended to keep allowing asset managers and trustee a significant freedom to define and implement delegation rules depending on their specific business model and appropriate to the risk model and size of their operations. Delegation arrangements, which relate to the typical tasks of an asset manager or trustee pursuant to article 19 FinIA, will be subject to the new rules provided as a matter of principle in article 14 FinIA and article 9 Draft-FinIO, which include the obligation to provide for the possibility that they can be verified by FINMA, their supervisory organisations or the auditors.

The rules for the delegation by managers of collective assets (article 27 FinIA/Art. 32 Draft-FinIO) are in essence those already provided for in the CISA, in particular under article 66 FINMA-CISO. The delegation must be based on legitimate interests for the purposes of the performance of the asset management function (article 27(1) FinIA). The responsibility for the compliance with applicable investment restrictions for collective investment schemes or pension funds expressly remains with the delegating entity (article 27(2) FinIA). A delegation is only permitted to other asset managers, which are
subject to “recognised supervision” (article 32(2) Draft-FinIO). There is however, at this stage no further explanation in the Draft-FinIO or in the explanatory report of the FDF as to what is covered under the concept of such a “recognised supervision” (article 24 FinIA). In our view, it should include Swiss de minimis asset managers who do not reach the threshold specified in article 24(2)(a) FinIA, but most likely not foreign asset managers which are not subject to a foreign asset manager license and are therefore not subject to a “recognised supervision”, as provided for in article 32(2) Draft-FinIO.

For Management Companies, the current restrictions provided for in the CISA are widely implemented in the FinIA (see in particular article 48 Draft-FinIO). This holds true for the delegation of investment decisions as well as other tasks, which must be justified by a legitimate interest (article 35(1) FinIA). A delegation of the asset management function to the custodian or its affiliates is not permitted in case an agreement exists for the “distribution” of the funds within the European Union (article 35(2) FinIA). The current separation rules between a custodian and a management company are integrated into the FinIA (article 33(3)/ article 35 FinIA). As is the case under the current rules (article 18b(4) and article 31(4) CISA), Management Companies and managers of collective asset may only delegate the asset management function to an entity located in a jurisdiction which provides for the obligation to conclude a cooperation agreement, if such a cooperation agreement between FINMA and the competent foreign supervisory authority exists. This provision was historically based in particular on the aim to force EU jurisdictions, which had previously introduced a similar requirement in AIFMD in 2013, to conclude such cooperation agreements with FINMA (failing which delegation by Swiss Management Companies to EU based asset managers would not have been possible). In this respect, article 14(2) FinIA only provides for FINMA’s right to request such cooperation agreements, as opposed to the current legal obligation stated under article 18b(4) and article 31(4) CISA. This seems to be an error, as the legislator’s intent does not seem to have been to include at this stage more flexible rules towards foreign jurisdictions given the absence of reciprocal arrangements, in particular with the EU. Therefore, article 48(3) Draft-FinIO expressly imposes the current stricter obligation, which is similar to the one of current article 18b(4) and article 31(4) CISA. As a matter of consequence and parallelism, an analogous restriction for managers of collective assets should be included in the final text of article 32 Draft-FinIO.

5) Conclusions
The new delegation rules contained in the FinSA, FinIA and CISA are in line with international trends, aiming in essence at avoiding “letter box entities”. On the other hand, they are clearly structured in such a manner as to contribute, in particular in the case of independent asset managers and trustees, to allow for a “risk based” application of these new delegation rules, and to adapt the new system to the business models of
these independent asset managers and trustees. More flexibility is introduced in case of a delegation outside of Switzerland as well, to the extent that the current strict requirements laid out in article 66(5) CISO-FINMA regarding the possibility for FINMA and the auditors to inspect and audit the delegated tasks, will be eased. Indeed, the requirement of the proof that such an onsite audit is possible, as currently required by article 66(5) CISO-FINMA, will be waived.

In essence, the impact of the prudential delegation rules provided for in the Draft-FinIO will have no material consequences for managers of collective assets and Management Companies. By contrast, to the extent that independent asset managers and trustees are currently not supervised, these new rules, while they impose less stringent requirements as opposed to those applicable to managers of collective assets and Management Companies, will be a novelty for those institutions.

The practical difficulties will arise from the need to coordinate the multiplicity of “delegation rules” pursuant to FinSA, FinIA and, as far as applicable, CISA. In this context, the interpretation of the concept of financial service, pursuant to article 3(2)(c) cipher 1-5 FinSA, will be of essence, to the extent that the delimitation of its precise scope of application will also trigger the specific rules derived from the new obligations linked to the existence of a “chain of service providers” within the meaning of article 24 FinSA. In this context, it is noteworthy that the tax rules linked to delegation arrangements, and in particular possible exemptions in the field of VAT, will continue to follow separate conditions and criteria. This holds true in particular for the delegation of asset management and distribution tasks pursuant to article 21(2), cipher 19 of the Swiss Federal VAT Act, which is likely to increase the complexity of dealing with VAT arrangements in practice (see MWST-Branchen-Info 14(5)(2); “Decision of the Federal administrative Court A-5044/2017 of 23 November 2018”).

By François Rayroux (francois.rayroux@lenzstaehelin.com)
New Limited Qualified Investor Fund (L-QIF) – Innovation and Deregulation as Growth Catalyst for the Fund and Asset Management Industry in Switzerland

Reference: CapLaw-2019-41

The Federal Council aims to boost the attractiveness of Switzerland as a domicile for fund production with the proposed introduction of the Limited Qualified Investor Fund (L-QIF). The ongoing consultation period for the L-QIF was initiated on 26 June 2019 and will end on 17 October 2019. The L-QIF is an innovative financial product that may invest in all thinkable investments and will benefit from very flexible investment restrictions. To speed up time-to-market and reduce costs, the L-QIF will neither require a regulatory authorization or product approval nor will it be subject to ongoing supervision by the Swiss Financial Market Supervisory Authority FINMA.

By Sandro Abegglen / Luca Bianchi

1) Introduction

Good news for the Swiss funds and asset management industry: the Federal Council intends to increase the attractiveness of Switzerland as a fund production location by introducing the new Limited Qualified Investor Fund (L-QIF) in the Collective Investment Schemes Act (CISA). The L-QIF is a collective investment scheme which is accessible exclusively for qualified investors. It must be administrated in accordance with the requirements of the CISA. However, the L-QIF shall – most importantly – not require an authorization or an approval by the Swiss Financial Market Supervisory Authority FINMA.

The development of the L-QIF has been shaped and pushed forward by the Swiss Funds & Asset Management Association SFAMA as well as the Federal Council, respectively, the Federal Department of Finance (FDF). As a result, the FDF has published a Preliminary Draft of the new CISA-provisions regarding the L-QIF (the Preliminary Draft or PD) as well as an Explanatory Report to the Preliminary Draft concerning Amendments to the Collective Investment Schemes Act (the Explanatory Report) on 26 June 2019. The consultation period will end on 17 October 2019.
2) Overview
The following chart shows the structuring options for an L-QIF:

![Diagram showing structuring options for an L-QIF]

The above graph indicates that the L-QIF can be set-up in the form of open-end structures such as the contractual Investment Fund or the Investment Company with Variable Capital (SICAV) or closed-end structures such as the Limited Partnership for Collective Investment (LP, respectively, KmGK), or the Investment Company with Fixed Capital (SICAF). Thus, it must be launched in one of the existing legal forms of the CISA (but does not require a FINMA-approval).

3) Key Points
The L-QIF features the following key points:

- Only for qualified investors: The L-QIF will be accessible exclusively for qualified investors (article 118a(1) lit. a PD-CISA in connection with article 10(3) CISA and article 4(3-5) FinSA) such as:
  - Financial intermediaries as defined in the BA, the FinIA and the CISA;
  - insurance companies;
  - foreign clients subject to prudential supervision (like the Swiss financial intermediaries listed above);
  - central banks;
  - public entities with professional treasury operations;
- occupational pension schemes and entities which serve the aim of occupational pension schemes with professional treasury operations;

- companies with professional treasury operations;

- large companies (i.e., companies that exceed two of the following thresholds: (i) balance sheet total of CHF 20 million, (ii) sales revenue of CHF 40 million, or (iii) equity of CHF 2 million); and

- investment structures with professional treasury established for high-net-worth (HNWI) private clients.

Furthermore, HNWI (and private investment structures without professional treasury established for them) which declare that they wish to be treated as professional clients (opting-out) according to article 5(1) FinSA are deemed to be qualified investors (article 10(3) CISA). In addition, investors with a permanent written asset management or investment advisory agreement which are considered qualified investors in terms of the CISA are admitted to invest in an L-QIF, unless they declared in writing that they want to be treated as retail clients (article 10(3) CISA). Non-qualified investors are not allowed to invest in an L-QIF.

Attractively, as any other Swiss fund, an L-QIF can be set-up as a single investor fund for insurance companies, public entities with professional treasury operations, occupational pension schemes, or entities which serve the aim of occupational pension schemes with professional treasury operations (article 7(3) CISA; article 5(4) D-CISO; Explanatory Report, p. 33).

- Investment restrictions: Special and very liberal investment restrictions apply for the L-QIF (article 118n et seq. PD-CISA). The investment restrictions of the supervised fund structures listed in the overview in section 2 are, in principle, not applicable for the L-QIF (Explanatory Report, p. 16). Generally speaking, all thinkable investments are permitted for an L-QIF (within the legal system) (Explanatory Report, p. 27). In particular, the Explanatory Report expressly mentions securities (Effekten), units of collective investment schemes, money market instruments, real estate, derivatives, structured products, commodities, infrastructure projects, crypto currencies, wine, art, or old-timers as examples of feasible investments of an L-QIF. Furthermore, the PD-CISA does not contain regulatory diversification requirements (article 118o PD-CISA; Explanatory Report, p. 16).

However, the applicable contractual or statutory investment restrictions (which can be very flexible) must be specified in the fund agreement of a contractual Investment Fund, the investment guidelines of a SICAV/SICAF, or the partnership agreement of an LP (article 118n et seq. PD-CISA). An L-QIF may apply the investment
restrictions of supervised fund structures on an optional basis. Further specifications concerning investment restrictions could, potentially, be included in the CISO. It is strongly hoped that “hybrid” L-QIFs which invest in more than one asset class (e.g., equity and real estate) will be permitted under the CISO.

- **Fund administration:** The Preliminary Draft proposes – as a general rule – that an L-QIF must delegate its fund administration to a FINMA-authorized fund management company (Fondsleitung) (article 118g et seq. PD-CISA). An exception from this general requirement shall apply in case of an L-QIF in the legal form of an LP if the general partner is a bank or insurance company (article 118h(3) PD-CISA). The insertion of further exceptions from the general rule would be a desirable change from an industry perspective (e.g., in case of a self-managed SICAV or SICAF).

- **Asset management:** The fund administration company (or general partner in case of an LP) of an L-QIF may – but is not obliged to – delegate the asset management to (i) an asset manager of collective investments according to article 2(1) lit. c FinIA, or (ii) a foreign asset manager of collective investments if it is subject to an equivalent regulation and supervision in its domicile country and a cooperation agreement exists between FINMA and the responsible foreign authority (article 118g et seq. PD-CISA). In addition, the rules of the regulatory authorization cascade apply, i.e., the asset management may be delegated not only to asset managers of collective investments but also to financial institutions with a higher regulatory standard such as a bank, a securities house, a fund management company, or an insurance company (article 6 FinIA; Explanatory Report, p. 23). Therefore, all these types of financial institutions could benefit from launching an L-QIF (and conducting its asset management).

- **Custodian bank:** L-QIFs in the legal form of a contractual Investment Fund, a SICAV and a SICAF must appoint a custodian bank (Explanatory Report, p. 15). The custodian bank is authorized and supervised by FINMA and has an important (indirect) control function by way of a self-reliant review of the fund documentation (Explanatory Report, p. 15 and p. 31). More specifically, in case of a contractual Investment Fund the approval of the fund agreement (and amendments thereto) by the custodian bank are a regulatory requirement (article 118j(1) und 2 PD-CISA).

- **Audit company:** An L-QIF must nominate a regulatory auditor (the same as the statutory audit company; see below) (article 118i PD-CISA). By way of a regulatory audit, the audit company must determine whether the regulatory requirements of the CISA are fulfilled and will continue to be fulfilled in the foreseeable future (Explanatory Report, p. 24). In addition, the audit company must conduct an accounting audit (Explanatory Report, p. 24).
No FINMA-approval or supervision: Similar to the Reserved Alternative Investment Fund (RAIF) in Luxembourg the L-QIF does not require an authorization or a product approval by FINMA (article 13(2) and 15(3) PD-CISA). A mere notification of the FDF by the administrator is sufficient. Thus, if the requirements of the CISA for an L-QIF are fulfilled it can be launched very quickly. Also, the L-QIF is not subject to an ongoing regulatory supervision and the related authorization and approval of ongoing changes by FINMA (Explanatory Report, p. 31).

Investor information: The legal name (Firma) of the L-QIF must always include the designation “L-QIF” as well as the selected legal form (see section 2; article 118e(1) PD-CISA). On the first page of the fund documents as well as in advertisements, this designation must be stated (article 118e(2) lit. a PD-CISA). In addition, a disclaimer must be included that the L-QIF does not have an authorization or approval from, and is not supervised by, FINMA (article 118e(2) lit. b PD-CISA). Furthermore, special risks of alternative investments must be pointed out in the designation, in the fund documents as well as in advertisements (if applicable) (article 118n(2) PD-CISA).

4) Conclusion and Outlook

Overall, the FDF has succeeded in preparing a new and very flexible fund product. The introduction of the L-QIF represents an impactful step to increase the attractiveness of Switzerland as a fund production location and creates a business opportunity for innovative fund providers (especially, for the Swiss market). After a decade of ever massively increasing regulation in the area of financial products, the Swiss funds and asset management industry will experience a regulatory product innovation with deregulation. Qualified investors will be able to invest in a professionally managed fund vehicle with a very short time-to-market. The L-QIF may even have the potential to be considered a growth catalyst (especially, for alternative investment or crypto fund providers) in the near future.

Meanwhile, the industry has the chance to respond to the proposed new rules during the consultation process, which will end on 17 October 2019. As a next (major) step after the completion of the consultation, the revised versions of the Draft-CISA are expected to be published (and, subsequently, dealt with in Parliament). It will be exciting to see how the industry provides feedback during the consultation and to what extent further changes will be made by the Parliament. The entering into force of the new L-QIF provisions in the CISA is expected in 2021.

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FINMA Grants Banking Licenses to New Swiss Crypto Banks, Introduces New Strict AML Rules regarding Payments on Blockchain

Reference: CapLaw-2019-42

On 26 August 2019, the Swiss financial regulator FINMA granted full banking and securities dealer licenses to two new financial institutions focusing on services in the area of crypto currencies and other digital assets. At the same time, FINMA issued new guidance on its interpretation of Swiss anti-money laundering regulation in respect of digital token transfers. The practice adopted by FINMA is very strict, especially in the light of international standards, and will challenge regulated financial services providers, new and old alike, intending to offer services regarding digital assets.

By Daniel Flühmann / Rashid Bahar

1) Licensed Swiss Crypto Banks Enter the Scene

On 26 August 2019, SEBA Crypto AG and Sygnum Bank AG, two Swiss start-ups, announced that they had been granted full banking and securities dealer licenses by the Swiss Financial Market Supervisory Authority FINMA, the Swiss financial regulator. Both entities were established with the goal of building a new generation of bank in the age of crypto currencies and other digital assets, the first such entities in the Swiss financial market. Both also focus on professional clients and intend to offer brokerage, asset management and custody services for digital assets as well as tokenization services. In both cases, FINMA conditioned the banking and securities dealer license decrees on the satisfaction of certain requirements prior to the actual launch of the regulated business. In addition to servicing professional clients directly, the two new players could also become cooperation partners for traditional banks looking to cover this emerging segment. It will be interesting to see the impact of these new digital asset service providers on the market.

2) Swiss AML Regulation Develops in Light of the Challenges of Digital Assets

On the same day as these announcements, FINMA published the FINMA Guidance 02/2019 – Payments on the blockchain (Guidance). The Guidance sets out FINMA’s interpretation of how Swiss anti-money laundering (AML) regulation applies in the context of blockchain payment services and, in particular, what measures financial services providers under FINMA supervision must take to comply with the obligation to provide information on the originator and beneficiary of payment orders pursuant to article 10 of the FINMA-Anti Money Laundering Ordinance (AMLO-FINMA).

As the date of the announcement shows, the Guidance is aimed squarely at SEBA and Sygnum. However, it will also impact existing Swiss banks and other financial services
providers subject to FINMA supervision that intend to offer blockchain-related services or have already started to do so.

The Guidance should not be viewed as a stand-alone effort by the Swiss regulator, but is part of a global effort to address the AML risks related to virtual assets. As such, the Guidance takes its cue from the recent FATF Guidance on the application of the risk-based approach to virtual assets and virtual asset service providers of June 2019 (FATF VASP Guidance), which, together with earlier interpretative notes, addresses how FATF Recommendation 16 on wire transfers applies to transfers of virtual assets.

3) Key Points of the Guidance

Article 10 AMLO-FINMA requires the financial intermediary of a payment originator to transmit the originator’s name, account number (or, alternatively, a transaction-based reference number) as well as its address (or, alternatively, the place and date of birth, client number or national identity number). Further, it must transmit the name and account number (or a transaction-based reference number) of the beneficiary of the payment.

In the Guidance, FINMA reaffirms its “technology neutral” approach to regulation and states, in particular, that operators of blockchain-based business models cannot be allowed to circumvent the existing regulatory framework. In the context of article 10 AMLO-FINMA, this means, as stated in the Guidance, that “token transfers” must be treated in the same way as traditional wire transfers and are not entitled to any relief. Against this backdrop, FINMA reaches the following conclusions:

- The transmission of the data required for compliance with article 10 AMLO-FINMA does not need to be performed using blockchain architecture, but may use other, separate communications channels.

- However, FINMA is currently not aware of any system at national or international level (such as the SWIFT messaging system) nor of any bilateral agreements between individual service providers that would enable the reliable and compliant transmission of originator and beneficiary identification data for payment transactions on blockchain. For such systems or agreements to meet Swiss regulatory requirements, eligible participants would need to be limited to service providers subject to appropriate AML supervision.

- In the absence of a suitable information transfer system or network of bilateral or multilateral agreements between regulated correspondent institutions, financial institutions subject to FINMA’s supervision are required to ensure that transfers of tokens to or from external wallets only involve their own clients who have been appropriately onboarded. This also means that the financial institutions must verify the
“ownership” of the external wallet using “suitable technical means”, which may prove challenging in practice. The same applies to exchange transactions involving an external wallet of a client.

Where a token transfer involves the external wallet of a third party, i.e. a person who is not a client of the FINMA supervised financial institution, the financial institution will need to complete a full onboarding of the third party, as if it were onboarding a new client. This will substantially burden the transfer process and will, in practice, limit the potential to use tokens as payment instrument.

At this point, the Guidance only provides a relatively high-level interpretation of Swiss AML regulation as applicable in the area of blockchain payments. A number of important points remain open, in particular the question as to the relevant universe of “tokens” (with FINMA in other communications distinguishing between payment tokens or “pure” crypto currencies, utility tokens and asset tokens). FINMA also provides no further guidance as to the specificities an information transfer system or bilateral agreement between regulated institutions would need to satisfy FINMA’s requirements.

FINMA’s interpretation of article 10 AMLO-FINMA with respect to blockchain payments forms a rather restrictive corset for supervised market participants. Indeed, the Guidance applies not only to payment services, which are perhaps not the key use case for crypto currencies for the time being, but can also be expected to impact brokerage and trading services in crypto currencies.

In the media release accompanying the Guidance, FINMA states that the Guidance is intended to set high standards that will be among the most stringent in the world. Because the Guidance does not refer to any de minimis thresholds, it is to some extent even more stringent than the requirements applicable to over-the-counter cash transactions. FINMA’s interpretation of article 10 AMLO-FINMA also goes beyond what is required by the FATF VASP Guidance, which allows member states to provide for certain exemptions in the context of payment transactions in virtual assets that are originated by or whose beneficiary is an individual that is not a client of an entity subject to AML supervision. FINMA declined to introduce such exemptions in its application of Swiss AML regulation because, in its view, this would create an imbalance between unregulated and regulated service providers and would ultimately defeat the purpose of article 10 AMLO-FINMA.

4) Outlook

In the recent past, it has become apparent that AML compliance is a priority for financial institutions and their regulators worldwide. FINMA in particular has sharpened its focus on AML regulation and enforcement in connection with blockchain technology, which approach has clearly found its way into the Guidance. The new crypto banks as
well as other FINMA supervised institutions will need to devise methods to structure their business set-up, internal policies and procedures in line with FINMA’s stringent interpretation of the law.

While the Guidance applies only to service providers subject to FINMA supervision, we expect recognized Swiss AML self-regulatory organizations to follow suit with respect to their interpretation of analogous provisions in their regulations. These apply to a range of Swiss blockchain service providers such as certain custody wallet providers, trading or exchange platforms, meaning that these businesses can expect to be faced with similar challenges in this area as the prudentially regulated financial institutions.

Overall, this development is somewhat paradoxical in light of the original intention of developers of blockchain technology, who aimed at reducing or eliminating the need for (trusted) intermediaries. However, transactions between unregulated individuals or entities that do not avail themselves of the services of a financial intermediary subject to AML regulation will remain unaffected by the new practice.

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Swiss Financial Market Supervisory Authority Publishes New Guidelines for “Stable Coins”

Reference: CapLaw-2019-43

Against the backdrop of the growing number of projects for so-called “stable coins” since mid-2018, the Swiss Financial Market Supervisory Authority (FINMA) on 11 September 2019 published new guidelines explaining the regulatory qualification of tokens that are linked to underlying assets such as fiat currency, commodities or securities with the goal to minimise fluctuations in their market value. The new guidelines supplement FINMA’s ICO Guidelines of 16 February 2018, which continue to apply. While the stable coin guidelines are general in nature, their publication coincides with the recent announcement by the Swiss based Libra Association to launch a payment token that is backed by a basket of fiat currencies, a project that has attracted worldwide attention by governments and regulators.

By Martin Peyer / Gadi Winter

1) Background

On 11 September 2019, FINMA published guidelines with a focus on “stable coins” (Stable Coin Guidelines) as a supplement to its February 2018 guidelines for enquiries regarding the regulatory framework for initial coin offerings (ICO Guidelines). The
Stable Coin Guidelines confirm FINMA’s principle-based and technology-neutral approach to financial market regulation and provide a high-level overview of the regulatory qualification of stable coins under Swiss financial market laws, in particular with respect to the Swiss Banking Act, the Collective Investment Schemes Act (CISA), the Anti-Money Laundering Act and the Financial Market Infrastructure Act. Furthermore, FINMA distinguishes between four categories of stable coins by reference to the underlying assets.

2) Supplemental Rules for Stable Coins
Since the release of FINMA’s ICO Guidelines in February 2018, FINMA has observed an increasing number of projects for tokens that are linked to underlying assets such as e.g. a basket of currencies or commodities. For the purposes of the Stable Coin Guidelines, FINMA refers to such tokens as “stable coins”, although it considers that this is primarily a marketing term. The aim of linking tokens to underlying assets is to prevent speculative swings which are typical for “traditional” payment tokens such as Bitcoin or Ether and to help establish cryptocurrencies as a stable, low-volatility means of payment. Against this background and given that there are no specific rules for stable coins under Swiss law, the Stable Coin Guidelines outline FINMA’s approach for the application of the legal and regulatory framework to such coins.

That said, FINMA does not consider stable coins to be a new type of token. It emphasises that the categorisation set out in the ICO Guidelines remains applicable although it is rather unlikely that utility tokens will be backed by underlying assets. Since stable coins are in most cases intended to serve as a means of payment or value transfer, they often qualify as a form of payment token even if the holder may redeem the token for the underlying assets with the issuer. Stable coins which are used as a means of payment will therefore also fall within the scope of Swiss anti-money laundering (AML) regulation.

The Stable Coin Guidelines further focus on Swiss fund regulation, which was previously only addressed in a generic way in FINMA’s ICO Guidelines. In case a stable coin is deemed a unit in a collective investment scheme (see below for further details), it may also qualify as an asset token.

3) Same Risks, Same Rules
In the Stable Coin Guidelines, FINMA follows – similar to the ICO Guidelines – its well established approach of focusing on the economic function and the purpose of a token (“substance over form”) and applying the existing regulatory framework in a technology-neutral manner according to the principle “same risks, same rules” while continuing to evaluate projects on a case-by-case basis (even taking into account advertising claims relating to the respective coin). This means that a stable coin that exposes its
holders to risks similar to banking activities may require its issuer to apply for a banking licence under the Swiss Banking Act, whereas a stable coin which is similar to a fund may trigger licensing obligations under the CISA.

4) Categorisation of Stable Coins based on their Underlyings

Stable coins exist in many different forms depending on their legal, technical, functional and economic design. Nevertheless, the new Stable Coin Guidelines establish four main types of stable coins based on their underlyings:

- **Stable coins backed by currencies:** The issuer of a stable coin backed by currencies may require a license as a bank pursuant to the Swiss Banking Act, if the holder of the coin has a right of redemption at a fixed price (e.g. 1 coin equals 1 CHF) against the issuer. This is because in such a set-up, the issuer may be deemed to have accepted deposits from the public. By contrast, if the coin holder may redeem the stable coin only at the current value of an underlying currency basket (i.e. at net asset value), the coin may qualify as a unit in a collective investment scheme rather than as a deposit. To distinguish between a deposit and a unit in a collective investment scheme, FINMA looks at the question of who bears the risks related to the management of the underlying assets (such as profits or losses from interest, market fluctuations of the underlyings or counterparty and operational risks). If the coin holder bears the risks, the coin is likely to qualify as a unit in a collective investment scheme. If the issuer of the stable coin, however, bears all these risks, the coin does not constitute a unit in a collective investment scheme and will not trigger any licensing or approval requirements under the CISA.

- **Stable coins backed by commodities:** The licensing requirements for an issuer of stable coins backed by commodities depend on the type of underlying commodity and whether the coin holder has a contractual claim only or acquires a right in rem in the underlying commodity. Stable coins representing a right in rem are not subject to financial market regulations and do not qualify as securities if (i) the holder does not only have a contractual claim in the underlying commodity, (ii) the transfer of the coin results in a transfer of the ownership in the commodity, and (iii) the underlying commodities do not constitute a deposit of fungible goods according to article 481 of the Code of Obligations (i.e. the custodian will become the owner of the underlyings). By contrast, where a stable coin represents a contractual claim against the issuer, the qualification of the coin depends on the type of underlying. The issuer may require a banking license if the stable coin is backed by banking-grade precious metals (Bankedelmetalle) and, thus, is similar to a precious metal (bank) account. If other commodities are used as underlyings, the coin may constitute a security and potentially also qualify as a derivative resulting in a potential licensing obligation for the issuer as a securities dealer. Lastly, commodity-based stable coins may also qualify as units in a collective investment scheme if the
investors are exposed to the risks related to the management and custody of the underlying commodities.

- **Stable coins backed by real estate**: Redeemable stable coins which are backed by real estate (i.e. one or several real properties) will in most cases fall within the scope of the CISA and require a license thereunder (unless a statutory exemption applies) since the underlying real estate will usually be managed by the issuer on behalf of the coin holders and the latter do not have a right *in rem* in the real estate.

- **Stable coins backed by securities**: A stable coin that is backed by a *single* security and that provides for a (contractual) right of the coin holder in the underlying security likely qualifies as a security itself. By contrast, if the underlying assets are composed of several securities, the respective stable coin constitutes in most cases a unit in a collective investment scheme.

5) **New Prospectus Requirements under the Financial Services Act**

Although the prospectus requirement in respect of stable coins is not discussed in detail in the Stable Coin Guidelines, it is noteworthy that with the new Swiss Financial Services Act (FinSA) (expected to enter into force as of 1 January 2020), the prospectus requirements for all tokens (including stable coins) that qualify as securities will undergo substantial changes. Whereas under the current rules, the issuer would only be required to prepare a prospectus if the token represents shares, bonds or units of collective investment schemes, the rules under the new Swiss Financial Services Act require the preparation and approval by a Review Board (*Prüfstelle*) of a prospectus for the public offering of all tokens (including stable coins) qualifying as securities unless an exemption applies (see articles 35 ff. FinSA). Furthermore, for certain tokens qualifying as financial instruments which are offered to retail clients, a key information document must be prepared (articles 58 ff. FinSA).

6) **Conclusion**

The stabilization mechanism adds an additional layer of complexity to the regulatory treatment of stable coins vs. other types of tokens. While the Stable Coin Guidelines set out the framework based on which FINMA assesses stable coins, FINMA reiterates at the same time that a case-by-case analysis will be required depending on the specific features of a stable coin. Consequently, issuers of stable coins will have to carefully assess the impact of the stabilization mechanism on their regulatory status. Requesting a ruling from FINMA based on a detailed description of the stabilization mechanism and the underlying assets will in our view continue to be good practice for most projects.
Moreover, issuers of stable coins and other tokens in general have to assess the implications of the anticipated entry into force of the Financial Services Act on 1 January 2020 for their projects, in particular with respect to prospectus requirements and the requirement to prepare a key information document for certain tokens.

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Swiss Debt Capital Markets: More Flexibility under New Swiss Withholding Tax Rules

Reference: CapLaw-2019-44

A bond issued by a foreign resident issuer which is guaranteed by its Swiss resident parent company may be reclassified in a domestic issuance subject to 35 withholding tax if the proceeds raised under such bond are used in Switzerland. Under the rules which entered into force on 1 February 2017, it was possible to use the proceeds in Switzerland up to an amount equal to the equity of the foreign issuer. New rules which entered into force on 5 February 2019 added further flexibility with respect to the permissible use of proceeds in Switzerland.

By Stefan Oesterhelt

1) Introduction

Switzerland levies a 35 percent withholding tax (Verrechnungssteuer) on interest payments on bonds. International capital markets generally do not accept bond issuances with deduction of Swiss withholding tax. As a consequence, it is common for Swiss multinational groups to issue bonds through a foreign subsidiary. However, the Swiss Federal Tax Administration reclassifies such foreign issuance in a domestic issuance if the amount of proceeds used in Switzerland exceeds certain thresholds. While historically the proceeds had to be used outside of Switzerland completely, it was permissible to use the proceeds in Switzerland up to the equity of the foreign issuer since 1 April 2017 (see already Stefan Oesterhelt, Swiss Capital Markets: New Swiss Withholding Rules CapLaw 2017). A new guidance which has been published on 4 February 2019 by the Swiss Federal Tax Administration increases the amount which can be used in Switzerland considerably.

2) General Principles

A bond issued by an entity resident outside 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 case, the Swiss guarantor
will have to pay 35 percent Swiss withholding tax to the Swiss federal tax administra-
tion on any interest payments (53.8 percent in case of a gross-up).

Any direct or indirect on-lending to a Swiss group company is considered a (potentially
harmful) “use of proceeds in Switzerland”. If the “use of proceeds” in Switzerland ex-
ceeds the permissible threshold as described below, the bond will be reclassified in its
totality into a domestic issuance (see Figure 1).

A foreign bond may be 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 Swit-
zerland (see Figure 2).
However, 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).
A connex between the bond issuance and the on-lending to Switzerland is not necessary for a reclassification of the bond. Even pre-existing on-lending to Switzerland may be potentially harmful (see Figure 4).

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 and even if the total equity amount of foreign subsidiaries is below CHF 100 million at year end.

The bond may 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 the “use of proceeds” in Switzerland exceeds the permissible amount at year-end and consequently the bond has to be reclassified in a domestic issuance, the bond will keep this classification until maturity (see Figure 5). A repayment of the on-lending to Switzerland does not have any effect.

3) Safe-harbour-rule of 1 April 2017

The rules which entered into force on 1 April 2017 introduced a safe harbor rule for on-lending into Switzerland. Under this rule, it was permissible to on-lend to Switzerland up to the amount of the equity of the foreign issuer (i.e. IFRS equity at end of business year of the foreign issuer) (see Figure 6).

An on-lending to Switzerland results in a reclassification of the bond only if it exceeds the equity of the foreign issuer at the end of the business year of the foreign issuer. Consequently, any on-lending to Switzerland which is repaid before year-end is not harmful (see Figure 7). This rule is subject to the abuse of law principle, however. The Swiss Federal Tax Administration would still reclassify a bond in to a domestic issuance if the proceeds of the bond are used in Switzerland in an amount exceeding the total equity of foreign resident companies most of the time (but never over year-end date).

While this rule is in principle still valid, there has been an extension as per the guideline of 5, 2019 (see below under 4).
4) **New guideline of 5 February 2019**

The Federal Tax Administration published a new guideline on 5 February 2019, which increases the permissible amount of use of proceeds considerably. Under this new guideline, it is permissible to on-lend to Switzerland up to the amount of IFRS equity of all direct and indirect foreign subsidiaries of the Swiss guarantor. Consequently, any on-lending to Switzerland which is at year-end below the sum of IFRS equity of all direct or indirect foreign subsidiaries of the Swiss guarantor does not result in a reclassification of the bond (see Figure 7).

All foreign subsidiaries which have to be fully or partially consolidated can be taken into account. The equity of foreign subsidiaries which are not fully owned by the Swiss group will be taken into account proportionally.
Furthermore, the net amount used in Switzerland is relevant. Any proceeds on-lend to Switzerland which will be further on-lend by the Swiss company to a foreign company will reduce the net amount used in Switzerland.
The guideline of 5 February 2019 states that this new rules are subject to an advance private letter tax ruling obtained from the Swiss Federal Tax Administration. This statements needs to be clarified. While in practice the capital markets will always request an advance tax ruling for transaction security purposes, an advance private letter ruling is not a condition per se to be eligible for the application of the practice published in the guideline of 5 February 2019.

The new practice published by the FTA on 5 February 2019 increases the flexibility of on-lending to Switzerland for Swiss multinationals considerably and is therefore highly welcome.

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Legatics

Reference: CapLaw-2019-45

One of the editing law firms of CapLaw has gained first experience in the Swiss legal market with the legal tech software Legatics which was deployed in a complex acquisition financing involving multiple investors and borrowers. Legatics is an intelligent deal platform that allows to automatically generate conditions precedent (CP) checklists mirroring the required CPs or other deliverables under loan documents, SPAs or underwriting agreements and permits parties involved in a deal to upload documents besides specific CP-line items and to leave comments and update status with respect to such line items. Furthermore, it keeps all involved parties updated in real time on the current status of the deal as well as the current action requirements for each party. At the end of the deal, it automatically generates transaction bibles. Legatics has been deployed in large financing transactions in other jurisdictions and based on first experience in Switzerland also proves to provide a more efficient and transparent method of managing legal processes in Swiss lead financing transactions where numerous parties in several jurisdictions are involved. It reduces the administrative work load, the amount of email correspondence and the need for update/status calls and it can be expected that this legal tech solution will enhance law firms’ client services.

Credit Suisse successfully launched its inaugural SARON-based Additional Tier 1 Bonds in the Swiss market and SOFR-linked Bail-in Bonds in the U.S. market

Reference: CapLaw-2019-46

In September 2019, Credit Suisse issued its inaugural SARON-based Additional Tier 1 (AT1) Bonds in the Swiss market and SOFR-linked Bail-in Bonds in the U.S. market. These are the first benchmark deals of Credit Suisse Group AG using interest rates that are based on one of the new risk-free rates established as an alternative to LIBOR, and the AT1 issuance is the first public issuance in the Swiss market to reset over mid-swaps based on SARON.
KBL European Private Bankers S.A. to acquire Bank am Bellevue AG  
Reference: CapLaw-2019-47

In August 2019, KBL European Private Bankers S.A. (KBL epb), a pan-European private banking group headquartered in Luxembourg and operating in 50 cities across Europe, announced that it has entered into an agreement to acquire Bank am Bellevue AG (Bank), the wealth management business of the independent Swiss financial boutique Bellevue Group AG listed on the SIX Swiss Exchange. The acquisition of the Bank – which currently employs 22 staff and manages some CHF 1.7 bn in assets – marks KBL epb’s return to Switzerland.

Completion of the Public Exchange Offer for Panalpina  
Reference: CapLaw-2019-48

In August 2019, the public exchange offer by DSV A/S, Hedehusene, Denmark, for the publicly held shares of Panalpina Welttransport (Holding) AG, listed on SIX Swiss Exchange and headquartered in Basel, Switzerland, was successfully completed. A total of 23'379'700 Panalpina shares were tendered into the offer, corresponding to 98.44% of all shares issued by Panalpina. DSV consummated the offer on 19 August 2019. The total value of the transaction is approximately USD 5.5 billion.

Definitive Interim Results of CSA’s public tender offer for Alpiq shares  
Reference: CapLaw-2019-49

Following the expiry of the offer period of its public tender offer for all publicly held shares of Alpiq Holding AG, Schweizer Kraftwerksbeteiligungs-AG, a subsidiary of CSA Energy Infrastructure Switzerland, announced that it held 89.22 percent of all Alpiq shares as of the end of the offer period. The additional acceptance period will run from 16 to 27 September 2019. The offer is expected to settle on 9 October 2019.
In light of the new data protection laws, CapLaw has released a privacy statement. The privacy statement, as updated from time to time, is available on our website (see http://www.caplaw.ch/privacy-statement/). For any questions you may have in connection with our data processing, please feel free to contact us at privacy@caplaw.ch.