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News | Deals & Cases

Events

New Transparency Rules in Respect of Holders of Bearer Shares and Qualified Beneficial Owners of Unlisted Shares of Swiss Companies

Reference: CapLaw-2015-55

On 12 December 2014, the Swiss Parliament adopted the Federal Act Implementing the Revised Financial Action Task Force (FATF) Recommendations of 2012. The Act provides new and revised provisions in the field of anti-money laundering and criminal law which were discussed in CapLaw No. 3/2015 (p. 6 et seqq.). The Act also introduced new reporting obligations of acquirers of bearer shares and in respect of beneficial owners of 25% or more of the share capital or voting rights of unlisted Swiss companies. These changes, which entered into effect on 1 July 2015 and affect shareholders and companies alike, are discussed in this article.

By Hans-Jakob Diem / Tino Gaberthüel

1) General Description of the New Rules

a) Reporting Duty of Acquirers of Bearer Shares of Unlisted Companies Limited by Shares

According to the new provision in article 697*i* of the Code of Obligations (CO), an acquirer of bearer shares, including bearer participation certificates, of a company limited by shares (*Aktiengesellschaft*), whose shares are not listed on a stock exchange, has to notify the company of the acquisition within one month, by reporting to the company his/her first name and name or its corporate name (in case of a corporate acquirer) and the address. This notification duty is not subject to a minimum threshold, which means that the acquisition of a single bearer share has to be reported (which also means that unlisted bearer shares are subject to stricter notification rules than listed shares for which a notification duty is only triggered if the threshold of 3% of the voting rights is reached or crossed). Any subsequent change in the reported information (e.g. name or address change) has to be notified to the company as well. The one-month notification period is triggered with the completion of the acquisition, i.e. the transfer of legal title. While not explicitly stated in the law, the creation of a usufruct on bearer shares will likely also trigger a reporting duty as the concerned shares are transferred to the usufructuary (article 746 of the Civil Code (CC)). A mere pledge of shares does, however, not trigger the reporting duty.

An acquirer of bearer share(s) will have to provide evidence to the company that it actually possesses the bearer share(s), and must identify itself by submitting the original or a copy of an official identification document containing a photograph (such as passport, identity card or driver's license) or an up-to-date extract from the commercial register or an equivalent foreign document (in case of a corporate acquirer). To evidence possession of the bearer share(s) the submission of a copy of the share certificate(s)

should in our view be sufficient. The law does not require that the notification be made in a specific form. However, the shareholder and the company will usually prefer a notification in writing, by e-mail or telefax.

The above-described notification duty does not apply where bearer shares have been issued as intermediated securities (*Bucheffekten*) and are deposited with, or registered in the main register of, a depositary (*Verwahrungsstelle*) in Switzerland.

b) Reporting Duty in Respect of Beneficial Owners of Shares of Companies Limited by Shares and Limited Liability Companies

In addition to the reporting obligation of holders of bearer shares, article 697*j* CO requires the acquirer of any shares, including bearer shares or registered shares of a company limited by shares and shares of a limited liability company (*GmbH*, LLC), who, acting alone or in concert with third parties, reaches or exceeds the threshold of 25% of the share capital or voting rights of the company, to report to the company within one month the first name, name and address of the beneficial owner of such shares. Any subsequent changes in such information (e.g. name or address change of the beneficial owner) have to be notified to the company as well. The law provides that the beneficial owner to be reported is the "individual person for whom the shareholder ultimately acts". Accordingly, a legal entity may, at least in principle, not be reported as the beneficial owner. From the wording of article 697*j* CO it seems clear that intermediate companies do not have to be reported.

It is open whether a notification is required under article 697*j* CO under circumstances where the beneficial owner changes but no shares of the company transfer. The wording of article 697*j* CO seems to indicate that no notification is required under such circumstances. However, the purpose of the provision, which is to create transparency about the beneficial owners of significant interests in unlisted companies, suggests that a change of the beneficial owner has to be reported even absent a transfer of shares of the company, although, in practice, compliance with this notification duty may prove difficult since a shareholder may not know and may not have the means to ensure timely knowledge of all changes of the beneficial owner.

No reporting duty exists if the shares are in the form of intermediated securities deposited or registered with a depositary in Switzerland.

c) Duty of the Company to Keep a List of Bearer Shareholders and of Beneficial Owners; Retention Duty

Besides the reporting duties of acquirers of bearer shares and regarding beneficial owners of 25% or more of the share capital or voting rights of a company, the new law (article 697*l* CO) requires the company to keep a record of the bearer shareholders

and beneficial owners reported to it. The list of bearer shareholders has to include for each individual person his/her first name, name, address, nationality and date of birth and for each corporate shareholder its corporate name, address and date of incorporation. The list of beneficial owners has to contain the first name, name and address of the individuals who have been reported to the company as beneficial owners.

These lists must be accessible at any time in Switzerland to at least one board member or officer domiciled in Switzerland. Any documents based on which a bearer shareholder or a beneficial owner has been registered on the list have to be retained for a period of ten years following the deletion of such shareholder or beneficial owner from the list. Following the dissolution and deletion of a company from the commercial register, the share register (*Aktienbuch*) as well as the list of bearer shareholders and of beneficial owners have to be retained for ten years and must be accessible in Switzerland during that period (article 747 para. 1 CO).

These obligations relating to the keeping of a list of beneficial owners and the retention of documents apply by analogy also to LLCs.

According to article 697*k* CO, in case of bearer shares, the general meeting of shareholders of a company may resolve that the reporting by holders of bearer shares shall not be made to the company itself but to a financial intermediary as defined by the Federal Act on Combating Money Laundering and Terrorist Financing (AMLA; such as banks, securities dealers, SIX SIS). If such resolution is passed, the board of directors of the company has to appoint the financial intermediary and inform the shareholders accordingly. The financial intermediary is responsible for keeping and updating the list of holders of, and beneficial owners in, bearer shares as well as retaining the corresponding documents.

d) Consequences in Case of a Breach of the Notification Duties

If an acquirer of bearer shares does not comply with its reporting duties or if a shareholder does not comply with its obligation to report the beneficial owner of 25% or more of the share capital or voting rights of a company, any membership rights attached to the shares (in particular voting rights) are suspended for as long as the shareholder has not made the required notifications. In addition to the suspension of the membership rights, any financial rights attached to the shares (in particular the right to receive dividends) may only be claimed by a shareholder if and when such shareholder has made the required notifications. The right to receive dividends will be forfeited if the shareholder does not comply with its notification duties within one month from the acquisition. If the shareholder subsequently makes the required notifications, the entitlement to future dividends will resurge as soon as, and for the period after, the notifications have been made. It is, however, unclear whether these severe consequences also apply if a shareholder does not notify changes in the name or address of

the holder of bearer shares or of the beneficial owner. In our view, this should at least not be the case in respect of the forfeiture of financial rights, in particular considering that the law only provides for this consequence if a shareholder does not make the required notification within one month after the *acquisition* of the shares. The described consequences apply by analogy also to LLCs.

The new law also provides that the board of directors of a company (or the managers of an LLC) is responsible for ensuring that no shareholder exercises voting rights or receives any dividends if and for so long as such shareholder has not made the required notifications. The law does not set out whether the board of directors has any specific duties in relation to outstanding or incorrect notifications. It is recommended that the board of directors proactively informs any acquirer of shares of its notification duty and the potential consequences in case of non-compliance. However, the board of directors does in our view not have a duty to examine or verify the correctness and completeness of the notifications received from its shareholders, unless the board has a reasonable suspicion that a notification is incorrect or incomplete.

e) Further Amendments of the CO

To support the new transparency requirements, additional provisions of the CO have been amended with effect as of 1 July 2015:

- *Share register*. Any documents based on which a shareholder or usufructuary of registered shares has been registered in the share register have to be preserved for a period of ten years following the deletion of such shareholder or usufructuary from the share register. These documents must be accessible in Switzerland during that period.

- *Conversion of bearer shares into registered shares*. The possibility to convert bearer shares into registered shares is now explicitly provided for in the CO. The conversion of bearer into registered shares requires only the majority of votes cast (and not represented) in the general meeting of shareholders. The articles of incorporation may not provide for any higher quorum.

- *Cooperatives (Genossenschaften)*. The revised law states that cooperatives have to keep a member register containing the first name, name (or corporate name) and address of each of their members. The member register must be accessible at any time in Switzerland to at least one board member or officer domiciled in Switzerland. Any documents based on which a member has been registered in the register have to be preserved for a period of ten years following the deletion of such member from the register.

f) Transitional Regime

The new rules have entered into force on, and have been applicable since, 1 July 2015. Holders of bearer shares who already owned bearer shares on 1 July 2015 have to comply with their reporting obligations by 31 December 2015; otherwise their *financial rights* accrued since 1 July 2015 will be forfeited. The question whether the same six-month transition period also applies in relation to *membership rights* (in particular voting rights) is unclear. Accordingly, it is recommended that holders of bearer shares who wish to exercise any membership rights by 31 December 2015 make a notification prior to such exercise. By contrast, the holders of registered shares of a company or shares of an LLC are not required to report the beneficial owner if the 25% threshold had already been reached or exceeded prior to 1 July 2015. The notification duty only arises if such shares are acquired and the threshold was reached or exceeded on or after 1 July 2015. Finally, the new law provides that any necessary amendments of the articles of incorproation or organizational regulations will have to be implemented within two years from the entry into force of the new rules, i.e. by 30 June 2017.

2) Two Practical Questions

a) Indirect Participations and Group Relations

Various questions arise in connection with indirect participations and companies with a wide shareholder base. For illustrative purposes, we assume a holding company (HoldCo) whose shares are held by numerous family members. Some family members hold their HoldCo shares directly, others through individual (family) holding companies. The family members may or may not be organized in a shareholders' agreement. HoldCo plans to acquire a new subsidiary (TargetCo) which has issued bearer shares.

While the notification of HoldCo as the new bearer shareholder of TargetCo does not raise issues, the duty to report the beneficial owner is less straight forward where there is more than one shareholder in the acquirer. According to article 697*j* CO, the beneficial owner is the individual person for whom the acquirer ultimately acts. While unclear, this wording seems to imply that the beneficial owner somehow controls the acquirer. Further, article 697*j* CO (*"den Vor- und den Nachnamen und die Adresse der natürlichen Person melden, für die er letztendlich handelt (wirtschaftlich berechtigte Person)."*) seems to assume that only one individual (or a group of individuals acting in concert) is deemed the beneficial owner of the acquirer. Against this background, it can in our view be validly argued that the beneficial owner of HoldCo must be the individual (and only the individual) who ultimately controls HoldCo, either through the holding of more than 50% of the shares in HoldCo or by other means. The purpose of the new rules (prevention of money laundering and transparency), practicability considerations as well as legal certainty support this interpretation of the term "beneficial owner" in the CO as well. Thus, if each family member holds less than 50% of the HoldCo shares and does not otherwise control HoldCo, HoldCo does in our view not have a

beneficial owner in the sense of article 697*j* CO. In such a case, no beneficial owner has to be reported. From the board of directors' perspective it is recommended that a negative notification (in writing or even orally) be made, stating that there is no beneficial owner. If on the other hand 60% of the HoldCo shares were held by one family branch through a family holding company, such family holding would control HoldCo. However, whether or not a beneficial owner would have to be reported, would depend on whether any individual family member holds a controlling stake of more than 50% of the shares of the family holding.

The result of above analysis could be different if the Holdco shareholders (or a part thereof) are party to a shareholders' agreement or similar arrangement. Whether such a shareholders' or similar agreement will indeed alter the analysis will depend on the specific content of the agreement. Mutual rights of first refusal, purchase rights, drag-along and tag-along rights or typical minority rights should not change the analysis, i.e. the concerned individuals would not be deemed to jointly control HoldCo. The result may however be different if under the shareholders' agreement an individual shareholder could require other shareholders to sell their shares if such individual decided to sell his HoldCo shares, or if a shareholder were able to exercise (or to direct the exercise of) the voting rights of other shareholders and thereby control HoldCo. The same would hold true if a shareholder is granted the contractual right to designate the majority of the members of the board of directors of HoldCo. A mere informal and one-time coordination of voting rights prior to a general meeting of shareholders does, however, not lead to joint control. In any event, an assessment of the specific facts and circumstances of the individual case will be necessary.

b) Group Companies Ultimately Held by a Listed Company

The new law explicitly states that the notification duties pursuant to articles 697*i* and 697*j* CO do not apply to the acquisition of shares in companies whose shares are listed on a stock exchange. The reason for this exemption is that transparency is ensured through different notification obligations that are applicable to listed companies (article 20 of the Federal Act on Stock Exchanges and Securities Trading (SESTA), article 663*c* CO). These exemptions must in our view apply regardless of whether all or only a portion of the shares are listed, because the notification obligations under SESTA apply to listed as well as non-listed shares.

While the wording of article 697*j* CO implies that the exemption only applies to the acquisition of shares in the listed company itself, it seems in our view justified to extend the exemption to the acquisition by the listed company (or an unlisted subsidiary of the listed company) of a controlling stake in another unlisted company, as the acquired company will fall into the scope of consolidation of the listed company. This interpretation is also covered by article 4 AMLA which provides that the financial intermediary does not have to determine the beneficial owner of a listed company or of a subsidiary

that is majority-controlled by the listed company. If, however, a listed company acquires, directly or indirectly, a minority stake in another company, such purchase would not be exempted from the reporting duty pursuant to article 697*j* CO. The notification would in our view though not have to state the beneficial owner of the acquirer, but only the fact that the acquirer is a listed company or the subsidiary of a listed company.

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The European Capital Market Union

Reference: CapLaw-2015-56

Only two years ago the European Union adopted two regulations that serve as the pillars of the European Banking Union. In October 2015, the Commission launched an ambitious plan to establish a European Capital Market Union until 2019. Although both "unions" go in the same direction – an even more integrated and centralized European financial market – and use the same institutional instruments, they are based on a different motivation.

By Peter Sester

While the Banking Union and its two pillars, the Single Supervisory Mechanism Regulation and the Single Resolution Mechanism, are characterized by a highly risk-adverse, if not overshooting, post-crisis driven motivation, the European Commission finally seems to realize that competitive financial markets and a regulatory framework that is more friendly to risk taking is absolutely necessary to inject the desperately needed oxygen into the economy of the EU member states, particularly but not only in the Mediterranean.

For the first time since the Financial Service Action Plan of 1999 the European Commission addresses the task to build a fully integrated European capital market capable of competing with leading international financial markets, particularly the ones in the US. Therefore, re-calibration of over-risk-averse banking regulation is proposed with regard to specific sectors of the financial market: securitization and infrastructure finance in particular. Further objectives of the Action Plan on Building a Capital Market Union are:

– growth and attractiveness of the European capital market (and its corporate sector) for investors from third countries,

- coming closer to the depth and structure of the US capital market, which is considered as benchmark,
- facilitating larger volumes of direct financing through public markets (stocks and bonds), and
- enhancing the importance of investment capital and private placement.

The first steps in this direction are a regulation laying down common rules on securitization and creating a European framework for simple, transparent and standardized securitization and a revision of the Prospectus Directive. The (final) proposal of the Securitization Regulation was already published by the European Commission; the proposal of the Prospectus Directive is expected to be published in November or December. The latter will lead to a kind of de-regulation, or in the wording of the Action Plan on Building a Capital Markets Union: "This will update when a prospectus is needed, streamline the information required and the approval process, and create a genuinely proportionate regime for SMEs to draw up a prospectus and access capital markets."

However, at least from an institutional perspective (using the term in the sense of New Institutional Economics), these new legislative proposals do not mark the real start of the European Capital Market Union. In fact, the process already started in the aftermath of the financial crisis when the European legislator realized that the effectiveness of its traditional approach – building on (so-called full-harmonization) directives and a coordination of national supervisory bodies – to the task of creating a fully integrated market had come to its limits if not failed. Starting with the Regulation of Credit Rating Agencies in 2009, followed by EMIR in 2012 and MiFIR (plus MiFID II) as well as MAR in 2014 the European legislators clearly favors regulations over directives. Furthermore CESR was upgraded to a permanent "water and bricks" institution, which subsequently has been granted and will be granted more and more power vis-à-vis national securities and/or financial regulators.

This shift towards regulations and European authorities (ESMA, EBA and EIPO) is much more than a mere technical ("legalistic") and bureaucratic modification of the familiar path. In contrast, this paradigm change will among others lead (at least in the medium-run) to a significant change in the legal consulting industry, just like in the area of antitrust law where Brussels is THE center of European antitrust lawyers, a few clusters for banking and securities lawyers will emerge. From a Swiss perspective, this change offers opportunities and possesses challenges. Challenges emerge particularly for the traditional Swiss strategy to gain access to EU markets: the autonomous implementation (*autonomer Nachvollzug*), which is perfectly coherent with directives but not regulations. Opportunities arise for Swiss lawyers, because when facing EU regulations instead of transposed directives (consequently national law) there is no longer a substantial reason (missing bar admission/formal qualification and increased liability

risks) why Swiss finance lawyers should not offer legal advice on subjects falling within the scope of an EU regulation – provided that they invest in the building of the respective competence.

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Implementing Ordinance of the Federal Council on Swiss Derivatives Trading Rules Published

Reference: CapLaw-2015-57

On 25 November 2015 the Federal Council released the final version of its implementing ordinance ("FMIO") to the Swiss Financial Markets Infrastructure Act ("FMIA"). The FMIO provides for important clarifications and implementation provisions for, among other things, the new rules on derivatives trading provided for by the FMIA (including clearing, reporting and risk mitigation obligations). The FMIA and the implementing ordinances are expected to become effective on 1 January 2016, subject to a phase-in.

By Stefan Kramer

1) Introduction and Background

The FMIA aims to implement the G-20 reform agenda regarding over-the-counter (**OTC**) derivatives markets and to create a regulation equivalent to the European Union's European Market Infrastructure Regulation (**EMIR**). The FMIA requires counterparties to OTC derivatives transactions to comply with a variety of obligations (including clearing, reporting and risk mitigation obligations), which apply not only to so-called financial counterparties (such as banks and insurance companies), but also to non-financial counterparties (such as trading and industrial companies). Given the technical nature of most of its provisions and the desire to create a flexible set of rules that can be quickly amended to reflect changes to international market standards, the FMIA takes the form of a framework legislation. Accordingly, the FMIA provides for a wide delegation of powers to the Federal Council and FINMA to enact implementing ordinances.

2) Certain Key Aspects of the FMIO

a) Thresholds for Counterparty Categorization

In terms of an overview, the obligations under the FMIA apply to the following categories of counterparties:

	FC+	FC-	NFC+	NFC-
Clearing	yes	no	yes	no
Reporting	yes	yes	yes	(see section 2.b) below)
Trade Confirmation, Dispute Resolution, Portfolio Compression	yes	yes	yes	yes
Portfolio Reconciliation	yes	yes	yes	no
Daily Valuation	yes	no	yes	no
Exchange of Collateral	yes	yes	yes	no
Platform Trading	yes	no	yes	no

A non-financial counterparty (**NFC**) is deemed to be a small non-financial counterparty (**NFC-**) if its average gross position of outstanding OTC derivative contracts calculated on a rolling basis over 30 working days is below the applicable threshold in each of the following categories (subject to certain exclusions, *e.g.*, in relation to hedging transactions):

Type of Contract	Threshold
Credit Derivative Contracts	CHF 1.1 billion in gross notional value
Equity Derivative Contracts	CHF 1.1 billion in gross notional value
Interest Rate Derivative Contracts	CHF 3.3 billion in gross notional value
FX Derivative Contracts	CHF 3.3 billion in gross notional value
Commodity Derivative Contracts and other OTC	CHF 3.3 billion in gross notional value

A financial counterparty (**FC**) is deemed to be a small financial counterparty (**FC-**) if its aggregate average gross position in all outstanding OTC derivative contracts calculated on a rolling basis over 30 working days is below the threshold of CHF 8 billion on a financial group level. Counterparties that are not small are hereinafter referred to as **FC+** or **NFC+**, respectively.

The FMIO further provides that thresholds are generally to be calculated by taking into account derivative contracts entered into by fully consolidated group companies. However, with a view to avoid any unnecessary deviations from the calculation of thresholds under EMIR, we believe that the Swiss rules should be interpreted to only require non-financial counterparties to include contracts entered into by other non-financial entities within the same group, and financial counterparties to include contracts entered into by other financial entities within the same group.

b) Allocation of Reporting Obligation

The FMIA introduces an obligation to report all new, modified or terminated derivative contracts to an authorized or recognized trade repository. The duty to report is gener-

ally allocated to one party to the transaction (one-sided reporting). Transactions between two small non-financial counterparties are exempt from the reporting obligation (but an NFC- may still be required to report trades with a non-Swiss counterparty if the non-Swiss counterparty does not itself report the trade). The reporting obligation is generally allocated as follows:

	FC+	**FC–**	**NFC+**	**NFC–**
FC+	Seller			
FC–	FC+	Seller		
NFC+	FC+	FC–	Seller	
NFC–	FC+	FC–	NFC+	N/A

If the transaction is cleared centrally, the report shall be submitted by the central counterparty. If a recognized foreign central counterparty does not submit a report, the reporting duty shall remain with counterparties. Subject to the CCP's duty to report, centrally cleared exchange traded derivatives have to be reported by the counterparty whose position is closer to the central counterparty in the transaction chain.

c) Thresholds for Portfolio Reconciliation | Portfolio Compression

As a general rule (with the exception of OTC derivative contracts with an NFC–), counterparties must have in place procedures for periodic **portfolio reconciliation**. The periodicity of the periodicity of the portfolio reconciliation depends on the number of OTC Derivative contracts outstanding (not including FX swaps and forwards):

Number of Contracts	**Reconciliation Date**
≥500	once every business day
<500 but >50	once every week
≤50 contracts	once every quarter

In addition, counterparties must regularly, but at least twice per year, perform **portfolio compression** if they have 500 or more non-centrally cleared OTC derivative contracts outstanding, except if (i) this is not expected to lead to a limitation of counterparty risk (e.g., because the portfolio contains no or only a small number of offsetable transactions), and|or (ii) the effort would be disproportionate to the expected reduction of the counterparty credit risk.

d) Cross-border Transactions | Availability of "Substituted Compliance"

As a general rule, transactions between a Swiss counterparty and a counterparty domiciled abroad are subject to the provisions of the FMIA regarding clearing, reporting and risk mitigation obligations. However, the Swiss rules provide for a substituted compli-

ance regime and certain exemptions with a view to avoid duplicative or conflicting rules in case of cross-border transactions:

The Swiss rules provide for **substituted compliance regime** in that a counterparty may satisfy its obligations under the FMIA by complying with foreign regulations, if (i) the relevant foreign law is recognized as being equivalent (FINMA will recognize foreign law as being equivalent if the obligations regarding derivative transactions as well as the provisions regarding supervision are in their material effects comparable to the corresponding Swiss provisions), and (ii) with respect to clearing and reporting obligations, if the relevant foreign central counterparty (**CCP**) or trade repository has been recognized by FINMA (or has been exempted from the recognition requirement by FINMA) (*c.f.*, section 2.e) below).

In addition, the FMIO provides for an **exemption from the clearing obligation and the obligation to exchange collateral**, as applicable, **for cross-border transactions** with a third country entity which (i) has its registered office in a third country whose law is recognized as being equivalent by FINMA, and (ii) is not subject to a clearing obligation or the obligation to exchange collateral, as applicable, pursuant to the laws of the relevant country.

e) Recognition of Foreign CCPs and Trade Repositories

The clearing obligation and reporting requirements under the FMIA may be satisfied by Swiss market participants using a foreign CCP or trade repository, as applicable, which has been recognized by FINMA (*c.f.*, section 2.f) above). FINMA shall grant recognition for a foreign CCP or trade repository if:

- the foreign CCP | trade repository is subject to appropriate regulation and supervision; and
- the competent foreign supervisory authorities:
  - do not have any objections to the cross-border activity of the foreign CCP | trade repository,
  - confirm that they will inform FINMA if they detect violations of the law or other irregularities on the part of Swiss participants, and
  - provide FINMA with administrative assistance (in case of CCPs) or certain guarantees in relation to the access to, and the use of, data collected (in case of trade repositories).

FINMA may refuse recognition if the state in which the foreign CCP | trade repository has its registered office does not grant Swiss CCPs or trade repositories, as applicable,

actual access to its markets or does not offer them the same competitive opportunities as are granted to domestic central counterparties | trade repositories. Any international commitments to the contrary (*e.g.*, GATS) are reserved.

FINMA may exempt a foreign CCP from the obligation to obtain recognition, provided this does not interfere with the protective purpose of the FMIA.

Recognition of a trade repository may be based on a general determination by FINMA in relation to a particular jurisdiction confirming that the relevant foreign regulation and authorities satisfy the requirements of the FMIA.

f) Timing of Application | Phase-in Periods

The FMIO provides for the following phase-in periods (which may be extended by FINMA under certain circumstances):

Obligation	Phase-in
Clearing	Phase-in over a period of 6 to 18 months (depending on the type of counterparty) from the date FINMA has announced the application of the clearing obligation for the relevant classes of OTC derivatives (which may only occur once a CCP has been authorized or recognized to clear the relevant classes of OTC derivatives by FINMA)
Reporting	Phase-in over a period of 6 to 12 months (depending on the type of counterparties) from the date of the first authorization or recognition of a trade repository by FINMA (which is expected to occur in the course of 2016)
Trade Confirmation, Portfolio Reconciliation, Dispute Resolution, Portfolio Compression	Phase-in over a period of 12 to 18 months (depending on the type of counterparty) starting on 1 January 2016
Daily Valuation	Phase-in over a period of 12 starting on 1 January 2016
Exchange of Collateral	Phase-in over a period of up to one year (for variation margin) and up to four years (for initial margin), in each case starting on 1 September 2016
Platform Trading	Will only become applicable once the Federal Council has put into effect the relevant provisions in accordance with international developments

3) Outlook

According to a press release of the Federal Council of 25 November 2015, the FMIA and the FMIO will become effective on 1 January 2016, subject to the aforementioned phase-in periods.

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TLAC – The FSB Issues the Final Principles and Final Term Sheet

Reference: CapLaw-2015-58

On 9 November 2015, the Financial Stability Board finalized its Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution, including the Total Loss-absorbing Capacity (TLAC) Term Sheet. It introduces a new international standard for quantitative and qualitative requirements for external and internal TLAC as well as new disclosure requirements.

By René Bösch / Benjamin Leisinger

1) Introduction

On 9 November 2015, the Financial Stability Board (FSB) finalized its *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution*, including the *Total Loss-absorbing Capacity (TLAC) Term Sheet* (the Term Sheet).

These principles go back to the G20 Leaders' assignment in 2013 to the FSB to assess and develop proposals on the adequacy of global systemically important financial institutions' (G-SIBs) loss-absorbing capacity when they fail.

The draft principles and proposals for a common international standard for TLAC by G-SIBs had been prepared in consultation with the Basel Committee on Banking Supervision (BCBS) and have been subject to consultation between 10 November 2014 and 2 February 2015 (also see CapLaw-2015-15). The final principles issued on 9 November 2015 (the TLAC Principles) reflect changes made following the public consultation and comprehensive impact assessment studies.

The TLAC Principles will form a new international standard for G-SIBs.

2) Quantitative Requirements

According to the TLAC Principles, the G-SIBs must have sufficient loss-absorbing and recapitalization capacity available in resolution for authorities to implement an orderly resolution that minimizes impacts on financial stability, maintains the continuity of critical functions, and avoids exposing public funds (*i.e.*, funds other than those of creditors of the respective G-SIB) to loss.

G-SIBs will be required to meet the TLAC requirement alongside (and in addition to) the minimum regulatory requirements set out in the Basel III framework and implemented by national regulation. Specifically, G-SIBs will be required to meet a *Minimum TLAC Requirement* of at least 16% of the resolution group's risk-weighted assets (TLAC RWA Minimum) as from 1 January 2019. As from 1 January 2022, the

TLAC RWA Minimum amounts to at least 18%. Minimum TLAC must also be at least 6% of the Basel III leverage ratio denominator (TLAC Leverage Ratio Exposure Minimum) as from 1 January 2019, and at least 6.75% as from 1 January 2022. G-SIBs headquartered in emerging market economies are subject to a different – more generous – phase-in.

In order to reduce the risk of contagion, G-SIBs must deduct exposures to eligible external TLAC instruments and liabilities issued by other G-SIBs from their own TLAC position their own or regulatory capital in a manner generally parallel to the existing provisions in the Basel III framework. On 9 November 2015, the BCBS released a consultative document on TLAC holdings in this respect; the consultation period runs until 12 February 2016.

Home authorities of resolution entities are requested to apply additional firm-specific requirements above these minimum standards if they, in consultation with the Crisis Management Groups (CMG) and subject to review in the Resolvability Assessment Process, determine that this is necessary and appropriate in the specific case to meet the intended goals of the TLAC Principles.

The FSB will monitor the implementation within the stated periods.

3) Consequences of a Breach

According to the TLAC Principles, the Minimum TLAC Requirements should be treated the same as regulatory capital requirements. Accordingly, a breach or likely breach should be treated as severely as a breach or likely breach of regulatory capital requirements.

4) Core Features of External TLAC

The Term Sheet lists the core features for TLAC-eligible external instruments (External TLAC) in Sections 7 to 14. As expressly stated in the TLAC Principles, the Term Sheet and the core features should be read in conjunction with the TLAC Principles.

In order to qualify, External TLAC must fulfill the following:

(1) It must generally be issued and maintained directly by resolution entities. There are, however, important exemptions from this rule. For example, debt liabilities issued indirectly by a wholly and directly owned funding entity of the resolution entity prior to 1 January 2022 are also recognized if certain additional requirements are met. These additional requirements, for example, refer to the Basel III framework and the requirement for special purpose vehicles, including the requirement of a downstreaming of the proceeds in a form that meets or exceeds the TLAC requirements.

(2) It must be fully paid-in.

(3) It must be unsecured. The Term Sheet still does not specify what type of security would make the instrument ineligible. In light of the TLAC Principles, any security that would either prevent that these instruments absorb losses when needed or that enhances the instrument's ranking in the relevant situation should not be permissible. In contrast, in our understanding, guarantees by the resolution entity in situations where the External TLAC is issued by the funding entity (see at (1) above) should be permissible.

(4) It must not be subject to set off or netting rights that would undermine their loss-absorbing capacity in resolution.

(5) It must not be redeemable by the holder (*i.e.*, no holder put option) prior to maturity. Where such a put option exists, the date for this must be specified in the terms of the instrument and the minimum maturity (see at (7) below) is calculated based on the earliest possible date on which the holder can exercise the redemption/put option.

(6) Redemption by the issuer is not possible without supervisory approval if the redemption would lead to a breach of the G-SIB's Minimum TLAC Requirements.

(7) It must be perpetual or, if dated, must have a minimum remaining maturity of at least one year. Further, according to the Term Sheet, the appropriate authority should ensure that the maturity profile of a G-SIB's External TLAC is adequate to ensure that its TLAC position can be maintained in times where access to capital markets is temporarily impaired. This requirement and the minimum maturity requirement effectively increase the TLAC position a G-SIB must hold.

(8) It must not be funded directly or indirectly by the resolution entity. However, an exemption is available for G-SIBs applying a multiple point of entry resolution strategy if the relevant home and host authorities in the CMG agree.

(9) It must not qualify as an *excluded liability*. This means that it must (i) not be an insured deposit, (ii) not be a sight or short term deposit, (iii) not qualify as a liability arising from derivatives, (iv) not be a debt instrument with derivative-linked features (such as structured notes), (v) not arise otherwise than trough a contract, (vi) not be preferred to senior unsecured creditors under the relevant insolvency law, (vii) not be excluded from bail-in, and (viii) not be subject to a material risk of successfully legal challenge or valid compensation claims in the case of a bail-in.

(10) It must be able to absorb losses prior to excluded liabilities (see above at (9)) in insolvency or in resolution by way of contractual, statutory, or structural subordination without giving rise to material risk of successful legal challenge or compensation claims. As clarified in a footnote in the Term Sheet, External TLAC may be senior to regulatory capital instruments, including tier 2 instruments. The Term Sheet introduces a new limited exemption from the requirement that External TLAC must be junior to all excluded liabilities (see above at (9)): Subordination of eligible external TLAC to excluded liabilities is not required if (i) the amount of excluded liabilities on the balance sheet of the resolution entity that rank *pari passu* or junior to the TLAC eligible liabilities does not exceed 5% of the resolution entity's eligible External TLAC; (ii) the resolution authority of the G-SIB has the authority to differentiate among *pari passu* creditors in resolution (*i.e.*, order a bail-in with respect to the External TLAC but not with respect to the excluded liabilities raking *pari passu*); (iii) differentiation in resolution in favor of such excluded liabilities would not give rise to material risk of successful legal challenge or valid compensation claims; and (iv) this does not have a material adverse impact on resolvability.

The entire subordination requirement does not apply in those jurisdictions in which all excluded liabilities are statutorily excluded from the scope of the bail-in tool. Where such exclusion may only be ordered by the resolution authority in exceptional circumstances, the relevant authorities may permit liabilities that would otherwise be eligible to count as External TLAC but which rank alongside excluded liabilities to contribute up to 2.5% (when the TLAC RWA Minimum is 16%) or up to 3.5% (when the TLAC RWA Minimum is 18%) of the resolution entity's Minimum TLAC Requirement.

(11) It must either be governed by the laws of the jurisdiction in which the relevant resolution entity is incorporated, or, if subject to the law of another jurisdiction, include legally enforceable contractual provisions recognizing the application of resolution tools by the relevant resolution authority if the resolution entity enters resolution, unless there is equivalent binding statutory provision for cross-border recognition of resolution actions.

(12) It must either contain a contractual trigger or be subject to a statutory mechanism which permits the relevant resolution authority to expose the instrument to loss or convert it to equity in resolution.

5) Core Features of Internal TLAC

In addition to the requirements for External TLAC, the Term Sheet also specifies the quantitative and qualitative requirements for internal TLAC (Internal TLAC). Internal TLAC is defined as loss-absorbing capacity that resolution entities have committed to

material sub-groups. Its primary objective is to facilitate co-operation between home and host authorities and the implementation of effective cross-border resolution strategies by ensuring the appropriate distribution of loss-absorbing and recapitalization capacity within resolution groups outside of their resolution entity's home jurisdiction. The core features of eligible Internal TLAC are the same as those for External TLAC (except with regard to the issuing entity and permitted holders).

However, additional requirements are also set forth in the Term Sheet. For example, the Term Sheet clarifies (i) who has to hold Internal TLAC (*i.e.*, who must be an issuer), (ii) which additional criteria Internal TLAC must comply with if such instruments qualify as regulatory capital (*e.g.*, regarding the write-down or conversion by the relevant *host authority* at the point of non-viability, subject to consent by the relevant home authority), or (iii) which criteria collateralized guarantees have to meet in order to substitute on-balance sheet Internal TLAC.

6) Increased Transparency via New Disclosure Rules

In order to increase transparency as to the TLAC positions and ranking of External TLAC in resolution, the Term Sheet introduces new disclosure standards, to be further specified by the BCBS:

- G-SIBs must disclose the amount, maturity, and composition of external and internal TLAC that is maintained, respectively, by each resolution entity and at each legal entity that forms part of a material sub-group and issues internal TLAC to a resolution entity.

- Moreover, resolution entities must disclose, at a minimum, the amount, nature, and maturity of any liabilities which in the relevant insolvency creditor hierarchy rank *pari passu* or junior to External TLAC.

- Entities that are part of a material sub-group and issue internal TLAC to a resolution entity must disclose any liabilities which rank pari passu with or junior to internal TLAC issued to a resolution entity.

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Extraterritorial Application of CISA based on Doctrine of Effects (*Auswirkungsprinzip*)?

Reference: CapLaw-2015-59

By Jürg Frick / Tobias Aggteleky

1) Investor Protection as Key Objective of Swiss Collective Investment Schemes Regulation

Investor protection is one of the key objectives of Swiss financial market regulation, including the regulation of collective investment schemes (article 5 Financial Market Supervisory Act; article 1 Collective Investment Schemes Act (CISA)). The goal is not to protect Swiss investors against losses as such, but to protect them against risks inherent in the fact that funds from unrelated investors are pooled and managed by a third-party for the account of such investors (*Fremdverwaltung*). Such management of assets by a third-party results in a principal-agent relationship including its inherent information asymmetries and the risk of opportunistic behavior by the agent or, for that purpose, the fund management company or the asset managers of the respective collective investment scheme.

2) Limitations on Scope of Application of CISA

Even though the Swiss legislator may be tempted to protect Swiss investors against any and all kinds of improper fund activities, including risks associated with investments in foreign collective investment schemes, CISA and its investor protection regulations may only be invoked within the boundaries of its scope of application. In general, the scope of application of administrative laws, including financial market regulation, is subject to the following limitations: (i) subject matter of the law: the respective regulation shall only govern certain facts, situations or activities, *e.g.* the distribution of foreign collective investment schemes (*Sachlicher Anwendungsbereich*); (ii) addressees of the law: the regulation shall only apply to certain persons, be it natural persons or legal entities, *e.g.* financial intermediaries distributing foreign collective investment schemes in Switzerland (*Persönlicher Anwendungsbereich*); (iii) time limitations on applicability of the law: new regulation shall only be applicable as of its enactment, taking into account transitional periods set forth in the respective laws (*Zeitlicher Anwendungsbereich*); and (iv) territorial limitations on applicability of the law: the regulator shall only impose regulations on persons being resident or domiciled within the frontiers of its jurisdiction (*Territorialer Anwendungsbereich*).

The subject matter of this article shall be the territorial scope of application of CISA. In accordance with the so-called principle of territoriality (*Territorialitätsprinzip*), CISA shall only apply to persons being resident or domiciled or acts taking place within the frontiers of Switzerland. For instance, Swiss collective investment schemes subject to

CISA regulations shall only be collective investment schemes having their registered office or their main administration office in Switzerland (article 2 (1)(a) in conjunction with article 119 (1)(a) CISA). Furthermore, foreign collective investment schemes shall only become subject to Swiss regulation if they have a relevant connection to Switzerland, which may be that they are distributed in Switzerland (article 2 (1)(b) CISA).

As a consequence, CISA only protects investors investing in foreign collective investment schemes if the distribution of the shares or units in the respective collective investment scheme took place in Switzerland. As a consequence, provided distribution of a foreign fund occurred in Switzerland, CISA applies irrespective of whether the investor investing in such fund is a Swiss investor or a foreign investor.

This rule can be illustrated by the following examples: In the case of a foreign investor passing through Zurich Airport and receiving a call from a distributor, the offered foreign collective investment scheme falls within the scope of CISA even if the foreign investor picked up the phone in Switzerland by mere coincidence. Equally, the fact that a Swiss investor – regardless of how this term is defined – receives a call or an e-mail while being on holiday outside Switzerland renders the CISA inapplicable. Finally, where the asset manager of a Swiss investor travels abroad to purchase shares of a foreign collective investment scheme on behalf of his or her client, the latter does not enjoy protection by CISA – even if the asset manager went abroad for the sole purpose of evading Swiss regulations.

3) The Doctrine of Effects and its Recognition in Switzerland

The randomness by which the applicability of CISA is determined at times as well as the ease by which it can be circumvented raise questions regarding the principle of territoriality as sole and decisive criterion defining CISA's scope of application. In particular, if Swiss interests are at stake it is questionable whether CISA protection should in fact be confined to the frontiers of Switzerland.

The aforementioned unwelcome consequence of the principle of territoriality, or an overly strict application thereof, has long been recognized (DFC 133 II 341 et seq.). As a result, the doctrine of effects (*Auswirkungsprinzip*), complementing the principle of territoriality, has been acknowledged.

Pursuant to the doctrine of effects, a particular provision or an entire act may apply to facts occurring abroad where these facts have an effect on interests within the legislating state's domain. Most prominently, the doctrine of effects is applied in antitrust legislation. Article 2 (2) of the Cartel Act stipulates that "[it] applies to practices that have an effect in Switzerland, even if they originate in another country."

However, the application of the doctrine of effects is not limited to antitrust legislation; several financial market laws and regulations around the globe determine their territorial scope of application, at least partly, in accordance with the doctrine of effects. As for derivatives regulation, article 28 (2) of the Markets in Financial Instruments Regulation (MiFIR), concerning the obligation to trade on regulated markets, sets forth that "[t]he trading obligation shall also apply to third-country entities […] provided that the contract has a direct, substantial and foreseeable effect within the Union […]." Equally, article 4 (1) (a) (v) of the Derivatives, Central Counterparties and Trade Repositories Regulation (EMIR) asserts that clearing obligations as set out in this act apply to all OTC derivative contracts "between two entities established in one or more third countries […] provided that the contract has a direct, substantial and foreseeable effect within the Union[…]." Similar language may be found in article 4 (12) EMIR. The same applies in the United States: According to § 722(d) of the Dodd-Frank Act, "Provisions relating to swaps do not apply to activities outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce in the United States; […]". Finally, in Germany the doctrine of effects is generally recognized as the primary rule to determine the territorial scope of financial market laws (see Eva-Maria Köpfer, Anwendung und Auswirkungen des Europäischen Kapitalmarktrechts auf Akteure aus Drittstaaten – Eine Analyse auf Basis der Umsetzung ins Deutsche Recht und der Auswirkungen auf die Schweiz, Diss., St. Gallen 2015, p. 116).

Even though Swiss financial market laws do not expressly stipulate the doctrine of effects, it may still be relied upon: pursuant to the Swiss Federal Supreme Court, Swiss public law may be applicable to facts occurring abroad but having a sufficient effect on Swiss territory, even in the absence of a provision expressly providing for such extraterritorial application (*cf.* DFC 133 II 331, 342 C. 6.1). In order for such extraterritorial application to be justified, it has to ensure the protection of legitimate Swiss interests. In line with this finding, the Swiss Federal Administration Court recently found in its decision B-5281/2012 of 24 September 2014 that the doctrine of effects is applicable in the context of Swiss financial market legislation. Therefore, Swiss financial market laws may have an extraterritorial application based in the doctrine of effects, provided that legitimate Swiss interests are protected (FAC Decision 5281/2012 C. 4.3.5).

4) Investor Protection as Legitimate Swiss Interest

So far, no general rule has been developed as to what qualifies as legitimate Swiss interests that merit the application of Swiss regulations to facts which occurred outside Switzerland, but had an effect on Switzerland. The applicability of the doctrine of effects can only be determined on a case-by-case basis, the purpose of the respective law being the critical criterion. In the context of financial market legislation, the

Swiss Federal Administration Court held that protection of the creditors, protection of the investors and protection of the functioning of the financial market as such are legitimate Swiss interests (*ibid.*). In other words, investor protection may qualify as legitimate Swiss interest justifying the extraterritorial application of Swiss financial market regulation.

This finding holds particularly true for the CISA as it expressly recognizes investor protection as a primary objective. Moreover, the Federal Supreme Court held that investor protection is to be taken into consideration when determining the scope of application of the Investment Fund Act, CISA's predecessor (DFC 110 II 74, 81 C. I.3; *cf.* also Verfügung der Übernahmekammer der Eidg. Bankenkommission vom 30. September 1999 i.S. LVMH Moët Hennessy Louis Vuitton, Paris und TAG Heuer International SA, Luxemburg regarding the scope of the Stock Exchange Act).

The fact that only the protection of legitimate Swiss interests warrants an extraterritorial application of a particular law, leads to the question under what circumstances the protection of investors qualifies as Swiss interest. It seems likely that the respective investors must have a genuine connection to Switzerland in order to justify such extraterritorial application of Swiss law (*cf.* Erläuterungsbericht zum Bundesgesetz über die Finanzdinestleistungen und Bundesgesetz über die Finanzinstitute of 25 June 2014, p. 164; seemingly dissenting: FAC Decision B-5281/2012 C. 4.4.3). Nationality as connecting factor being out of the question, the domicile of an investor remains the only option. Given that the domicile of the person is generally recognized as connecting factor in private international law, it also seems to be a reasonable option.

With regard to the distribution of foreign collective investment schemes, this finding is further corroborated by the fact that the Directive on Alternative Investment Fund Managers (AIFMD) governs marketing to investors domiciled or with a registered office in the European Union irrespective of where the distribution takes place (article 4 (1)(x) AIFMD). Germany, for instance, has implemented this provision in § 293 (1) of its Investment Code defining the term distribution in an equal manner.

The consequence of the definition of legitimate Swiss interests would be that investors domiciled in Switzerland were generally protected by the CISA, irrespective of the origin of the collective investment scheme and of where the distribution takes place.

5) Desirability of an Extraterritorial Application of the CISA

a) General Pros and Cons of the Doctrine of Effects

At times, Swiss case law referred to investor protection in order to justify the extraterritorial application of Swiss financial market law (*cf. supra* 3.). But Swiss courts have done so in specific cases only and never suggested a general application of the doc-

trine of effects in financial market law. Similarly, only few Swiss authors expressly spoke out in favor of it (*cf.* Pascal Rüedi, Der örtliche und sachliche Anwendungsbereich des Schweizer Übernahmerechts, Diss., Bern 2011, Rz. 141). Given that the majority of German authors recognizes the doctrine of effects as prime criterion to determine the territorial scope of financial market legislation, this reluctance is rather surprising.

The main advantage of the doctrine of effects is that it harmonizes the application of a law with its objectives. CISA would be applicable to all circumstances warranting such application in order to protect Swiss investors – or the stability of the Swiss financial market as the second key objective of the CISA. As a consequence, investor protection could be ensured in a comprehensive manner. In addition, extraterritorial application of investor protection provisions impedes regulatory arbitrage.

On the other hand, the doctrine of effects may lead to a lack of predictability and, consequently, a lack of legal certainty. Depending on the definition of "effect", the doctrine may lead to all but unlimited applicability of some financial market provisions: The global financial market is not separated by borders and there is a frequent interaction between actors from different jurisdictions. Therefore, an average transaction will often have an effect on several jurisdictions. An overly broad definition of "effect" would result in the applicability of several different laws which, in turn, would lead to undesirable conflict of laws issues.

However, two aspects have to be clarified with respect to this argument: First, the doctrine of effects comes into play only if, from a Swiss law point of view, the applicable foreign law does not sufficiently protect Swiss investors. In case that the applicable foreign law, however, provides for an equivalent standard in terms of investor protection, no legitimate Swiss interests will warrant an extraterritorial application of CISA in the first place. The potential circumstances under which the doctrine of effects may have an impact are thus limited. Second, irrespective of the doctrine of effects, Swiss financial market law, and anti-money laundering law as well as bank insolvency law in particular, contains provisions that apply globally (*cf.* article 5 and 6 of the Anti-Money Laundering Ordinance and article 3 of the Bank Insolvency Ordinance both issued by the Swiss Financial Market Supervisory Authority, FINMA). These provisions have not lead to unsolvable problems in the past.

b) The Consequences of an Extraterritorial Application of the CISA

Since Swiss collective investment schemes are mandatorily governed by the CISA (*cf. supra* 1.), an extraterritorial application would exclusively affect foreign collective investment schemes. Particularly, the distribution of foreign collective investment schemes to Swiss investors outside Switzerland could regularly trigger the extraterri-

torial application of CISA. In such a case, provisions of CISA concerning the distribution of foreign investment schemes in Switzerland should be applied *per analogiam*.

Coming back to the example of the asset manager travelling abroad, the consequence of an extraterritorial application of CISA would be that even though not being distributed in Switzerland, the acquired foreign collective investment scheme would have to appoint a Swiss representative and paying agent as well as to ensure that the designation of the collective investment scheme does not provide grounds for confusion or deception (article 120 in conjunction with article 120 (2)(c) and (d) in conjunction with article 10 (3ter) CISA *per analogiam*). Where the investor on whose behalf the asset manager is acting has opted-out within the meaning of article 10 (3ter) CISA, the distributed foreign collective investment scheme would additionally require an approval by FINMA (article 120 (1) CISA *per analogiam*).

As for the Swiss investor being distributed a foreign collective investment scheme while on holiday outside Switzerland, he or she would be equally protected by article 120 CISA. In contrast, a foreign investor passing through Switzerland would not enjoy protection under the doctrine of effects – unless other legitimate Swiss interests, such as market integrity, would be affected.

The downside of such application of article 120 CISA would be that investor protection rules generally act as a market entrance barrier for foreign collective investment schemes. Particularly the requirement to appoint a Swiss representative and a Swiss paying agent is sometimes conceived by foreign collective investment schemes as being overly burdensome. The extraterritorial application of CISA could, therefore, have a repelling effect on distributors of foreign collective investment schemes in the sense that they would be more reluctant to distribute their funds to Swiss investors. The result would be a limitation of the investment universe available to Swiss investors.

6) Conlcusion

In sum, we conclude that CISA's scope of application is not strictly limited by the principle of territoriality and confined to the frontiers of Switzerland, but that the doctrine of effects may warrant the application of CISA investor protection also, for instance, to the distribution of foreign collective investment schemes to Swiss investors even though distribution took place outside of Switzerland. Such extraterritorial application may be justified if Swiss interests were negatively affected, should CISA investor protection regulations not be applied. However, Swiss interests should never be affected in case Swiss investors would equally be protected by the relevant foreign law applicable to the distribution of foreign collective investment schemes.

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New Release of the Swiss Banker's Code of Conduct – CDB 16

Reference: CapLaw-2015-60

On 1 January 2016, the revised Agreement on the Swiss banks' code of conduct with regard to the exercise of due diligence (CDB 16) will come into effect. A revision of the former agreement from 2008 has become necessary due to the recently introduced broad revisions to anti-money laundering regulations (see CapLaw-2015-31). The CDB 16 provides new and revised due diligence obligations for Swiss banks with regard to anti-money laundering and counter-terrorist financing. The revisions mainly focus on (1) the introduction of the concept of controlling persons for operating legal entities and partnerships, (2) new or revised template declaration forms as appendices to the CDB 16, and (3) a fundamentally revised framework and formal structure of the CDB 16.

By Robin Hauser

1) Introduction

The "Agreement on the Swiss banks' code of conduct with regard to the exercise of due diligence" (CDB), established in 1977 and extended ever since, is a key part of the Swiss banking supervision system which allows for the delegation of certain duties to self-regulating organizations. The Swiss Bankers Association regularly issues these self-regulation guidelines, which FINMA recognizes as minimum standards that need to be complied with by all Swiss banks and securities dealers. The guidelines specify the duty of due diligence in identifying the contracting party, the beneficial owner and other relevant persons, while prohibiting active assistance in the flight of capital and tax evasion. The statutory bank auditors, FINMA, and the CDB Supervisory Board verify compliance with these guidelines. In the event of a failure to comply with the CDB, a fine of up to CHF 10 million may be imposed on the bank in question by the Swiss Bankers Association and FINMA may take appropriate supervisory measures. The CDB is generally revised on a five-year cycle. However, due to the enactment of the Federal Act for implementing the Revised Financial Action Task Force (FATF) Recommendations of 2012 and the consequent changes concerning the AMLA and the MLO-FINMA, a new release for the CDB from 2008 (CDB 08) has been postponed from 2013 to 2016.

On 24 November 2015, the Swiss Bankers Association has again published a written commentary to the CDB 16 (Commentary), which is intended to clarify the code in order to contribute to uniform implementation of the CDB 16 and the new or revised forms.

2) The Concept of the "Controlling Person"

The due diligence obligations under the CDB 08 were focused on establishing the identity of the beneficial owner of assets deposited with the bank while operating com-

panies in particular were considered to be the beneficial owners of their assets. The revised AMLA, however, provides for a duty of financial intermediaries to identify the beneficial owner of a legal entity in all cases with effect as of 1 January 2016. In this context, the concept that an operating company is considered the beneficial owner of its assets is dropped and, with limited exceptions, only individuals can be beneficial owners of assets held with a Swiss bank. Against this background, the CDB 16 introduces the concept of the controlling person together with a distinction between (i) establishing the identity of the beneficial owner/controlling person of operation legal entities and partnerships, and (ii) establishing the identity of the beneficial owner of assets deposited with the bank. It is important to note that the newly introduced duty to establish the identity of the beneficial owner of operation legal entities and partnerships focuses on the entity/partnership itself, whereas the already existing duty to identify the beneficial owner relates to the assets held in the account with the Bank. In contrast to the approach under the FATF guidelines, the concept of the controlling person, and the obligation to identify such controlling person, only applies with regard to operating entities or partnerships. For domiciliary companies, defined by the CDB 16 as companies that are not operating, the rules regarding controlling persons do not apply, and the contracting party of the bank has to establish the beneficial owner of the assets deposited with the bank instead. In case of an operating company, the contracting party has to disclose any fiduciary holding of assets, *i.e.* whether a third person is the beneficial owner of the assets held in the account. The bank would then have to obtain the relevant information regarding such beneficial owner on a separate form A. This concept is reflected in the new Form K in the appendix to the CBD 16.

A controlling person of a legal entity or partnership is defined as individual who either (i) directly or indirectly owns at least 25% of the capital rights or voting rights in the contracting party, (ii) controls the contracting party in any other way, or (iii), as a substitute, if no controlling person can be determined, holds the position of the highest managing director (e.g. the chairman of the board of directors or the CEO). The contracting partner must confirm the name, first name and actual domicile address of the controlling person by using Form K. There are different concepts that can be applied when performing the above analysis and the Commentary published by the Swiss Bankers Association provides further guidance in this respect.

The CDB 16 also provides for a number of exceptions regarding the obligation to identify the controlling person behind the contracting party, including companies listed on a stock exchange (including subsidiaries of such companies), public authorities, banks and other financial intermediaries, certain non-profit organizations, simple partnerships, condominium owners and common ownership collectives.

3) Further Key Points of the New Release

Further key points of the reform can be summarized as follows:

- **Presumption of Beneficial Ownership**: Under the CDB 08, the bank was generally entitled to assume that the contracting partner is also the beneficial owner of the assets. Only if the contracting partner was not the same as the beneficial owner, or if his identity was in doubt, the banks and securities dealers had to require the contracting partner to provide a written declaration of the identity of the beneficial owner. Under the CDB 16, this assumption is limited to natural persons only, and even then the bank is required to make an appropriate written note to file of the fact that the bank has no doubts that the contracting partner is identical to the beneficial owner. For legal entities the bank always has to request a declaration on the identity of the controlling person/beneficial owner.

- **Exceptions for Fund Managers, CISA Investment Companies and Others**: The rule that banks and securities dealers as contracting partners are not required to provide a declaration of beneficial ownership was extended. It now also includes fund managers, life insurance companies (with certain exceptions), CISA investment companies and CISA wealth management companies, as well as tax-exempted pension schemes with registered office in Switzerland or in a foreign country, provided that they are subject to appropriate supervision and regulation with respect to combating money laundering and terrorist financing or do not manage secondary accounts for unnamed clients.

- **Identification of Ordinary Partnerships**: As a new general rule, the identity of at least one of the partners has to be verified in addition to any authorized signatories vis-à-vis the bank.

- **Swiss Attorneys Authorized to Provide Authentication**: A copy of an identification document may now be authenticated by an attorney accredited in Switzerland recognized for this purpose by the bank establishing the business relationship.

- **Certification of Electronic Signatures**: Identification provided from the data base of a provider recognized according to the Federal Law on the Certification of Electronic Signatures (CertES) together with electronic authentication of the customer is now considered a valid authentication.

- **Exemption from the Execution of Commercial Transactions**: The bank does not have to obtain a statement concerning the beneficial ownership of the assets for the execution of commercial transactions regarding parties for whom the bank does not act as a depositary bank from its contracting partner, as long as payment and delivery are carried out via a different bank.

- **New Restrictions for Collective Investments or Investment Companies**: The rule that if the contracting partner is a collective investment or an investment company with more than 20 investors, the bank does not have to obtain a statement

concerning the beneficial owners, was restricted to cases in which the collective investment or investment company is subject to an appropriate supervision or regulation with respect to combating money laundering and terrorist financing. In this context, collective investment forms and investment companies with a domicile in high-risk countries and non-cooperative jurisdictions according to FATF do not qualify for this exemption.

– **Delegation of Identification to Financial Intermediaries**: The bank may delegate the identification of the contracting partner and the establishment of the controlling person and the beneficial owner to a different financial intermediary as far as this intermediary is subject to any prudential supervision or regulation with respect to combating money laundering and terrorist financing. It was further clarified that the establishment of a business relationship by correspondence by the mandatory is prohibited.

4) New or Revised Forms as Appendices to the CDB 16

In the context of the above revisions, new or revised template declaration forms as appendices to the CDB 16 were introduced:

– **New Form K for Controlling Persons**: As described above, this new form is to be used to establish information on the controlling person of operating legal entities and partnerships that are not quoted on the stock exchange.

– **Revised Form T for Trusts**: The information required for trusts is to be provided by the contracting partner using the revised Form T. Under the CDB 08 this form was used broadly as declaration for any organized association of individuals, assets or patrimony without specific beneficial owners. Under CDB 16 it can only be used as declaration for trusts. Whereas the information requested by the former Form T mainly related to the actual settlor, the (class of) beneficiaries, and the protector, the revised Form T further requires (i) a declaration on the type of trust (discretionary or non-discretionary) and its revocability (revocable or irrevocable), (ii) information on the ultimate economic (not fiduciary) settlor of a pre-existing trust if the trust results from a restructuring of a pre-existing trust (re-settlement) or a merger of pre-existing trusts, and (iii) information on protectors, if any.

– **New Form S for Foundations and Similar Constructs**: The information required for foundations and similar constructs is to be declared by the contracting partner using the new Form S. Associations of individuals or asset-holding entities where no specific individuals are the beneficial owners are to be treated similarly to foundations, while for operating foundations the controlling persons are to be declared on a Form K. In addition to the declarations required previously, the new Form S also requires (i) a declaration on the type of foundation (discretionary or non-discretion-

ary) and its revocability (revocable or irrevocable), (ii) information on the ultimate economic (not fiduciary) founder of a pre-existing foundation if the foundation results from a restructuring of a pre-existing foundation (re-settlement) or a merger of pre-existing foundations, and (iii) additional information on persons having to determine or nominate representatives of the foundation, if any.

– **Form I for Insurance Wrappers**: The obligations of financial intermediaries under the AMLA when dealing with life insurance policies with separately managed accounts/securities accounts (insurance wrappers) are set out in the FINMA newsletter 18 (2010). These obligations of the newsletter to identify the insured person, and if different, the actual premium payer are now reflected in the CBD 16.

5) New Formal Structure of the CDB 16

For the CDB 16 a new formal structure with rearranged chapters and articles is introduced. In order to enhance comprehensibleness, general provisions have been condensed and simplified. In particular the provisions relating to the identification of the controlling person are combined in a separate chapter to make the difference to the determination of the beneficial owner visible.

6) Practical Relevance for Financial Intermediaries

The new rules governing the identification of contracting partner and the establishment of the controlling person and the beneficial owner must be applied with respect to any new business relationship established after 1 January 2016 (when the CDB 16 comes into force) or where the procedure for the identification of the contracting partner or the establishment of the beneficial owner needs to be repeated after that date.

The practical relevance of the CDB 16 must not be underestimated. The identification of the controlling persons of legal entities that are not listed on a stock exchange, including holding or real estate companies, will be challenging for banks and securities dealers, in particular with regard to multilevel and/or split ownership structures and legal entities domiciled outside FATF countries. In addition, banks and securities dealers will have to address any potential risks represented by these newly identified persons (e.g. U.S. persons). To ensure compliance with the new guidelines, banks and securities dealers will have to review internal directives, adapt the client onboarding processes and IT systems, and train their employees. Further, considering the commitment of Switzerland to participate in the automatic exchange of information within the OECD as of 2018, banks and other financial intermediaries might be well advised to systematically process the information provided on the controlling persons and beneficial owners as it might be subject to reporting duties to other countries under the Common Reporting Standard.

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Retrocessions – Struggle Without End?

Reference: CapLaw-2015-61

The topic of retrocessions has been in the focus of banks, asset managers, clients, pension funds, lawyers and the media ever since a verdict was given by the Federal Supreme Court in March 2006 (BGE 132 II 460). In their decision, the Federal Supreme Court decided that the retrocessions received by asset managers from banks belong to the clients of the respective asset management mandates. The topic was further intensified by another judgment of the Federal Supreme Court of October 2012 (BGE 138 III 755) which extended the duty of restitution; not only asset managers are bound to restitute the retrocessions received from banks, but also the banks have to pass on hidden commissions they receive from product providers to clients with discretionary mandates.

By Thomas Müller

1) Open Questions

What has started with the Federal Supreme Court's fundamental decisions regarding the duty of independent asset managers and banks to restitute retrocessions has had broader implications. On the one hand, the legal combat zone has been extended to the question of whether clients who have taken the decision to buy products or fund units independently may also claim the restitution of retrocessions and provisions. On the other hand, the applicable statute of limitation period remains a point of controversy (see NZZ, 16 April 2014: Pensionskassen verklagen Banken).

This article deals with the statute of limitation period applicable to the duty to restitute retrocessions. In this context, two questions arise. On the one hand, whether the five- or the ten-year statute of limitation period applies and, on the other hand, at what point in time does the statute of limitation period start to run. These two questions have been discussed in a judgment rendered by the Regional Court of Bern-Mittelland on 15 September 2014 which has since become final.

2) Controversial Views on the Statute of Limitation Period

According to Art. 127 of the Swiss Code of Obligations (CO), as a general rule, claims become time-barred after ten years. However, certain claims, including those in connection with periodic payments, are subject to the shorter statute of limitation period of five years (Art. 128 number 1 CO). It is controversial whether retrocessions constitute periodic payments. If so, the five-year statute of limitation period applies, otherwise the ten-year period. In legal literature, differing positions are being taken on this issue. The positions follow the opposing interest of banks and clients, respectively. While clients' lawyers argue for a ten-year statute of limitation period, those on the banks' side argue for a five-year period.

Another focus is the point in time when the statute of limitation period begins to run. While clients' lawyers take the view that the statute of limitation period begins only with the termination of the asset management agreement, the banks and their representatives, on the other hand, argue that the statute of limitation period already commences upon receipt of the compensation by the asset manager or the bank.

3) Considerable Relevance of the Statute of Limitation

The question of the statute of limitation applicable to claims for restitution of retrocessions is crucial. The later the statute of limitation period begins and the longer it runs, the larger are the clients' potential claims. If a ten-year statute of limitation period applies, starting to run from the termination of the business relationship, banks and asset managers might see themselves confronted with very high claims of long-term clients. The bank or the asset manager concerned might learn about the assertion of a claim only ten years after termination of the asset management mandate. In some cases, the respective business documents may no longer be available as the legal retention period expires after ten years.

The institution of limitations recognizes the healing power of time. If a claim is not asserted within a specified period, it can no longer be enforced against the will of the debtor. In regard to the question of when such legal relief occurs for banks and asset managers, two contradictory decisions are currently available. Indeed, client's lawyers base their argumentation on a decision handed down by the Supreme Court of the Canton of Zurich on 13 January 2012 whereas the supporters of the bank-friendly argumentation refer to a decision handed down by the Regional Court of Bern-Mittelland on 15 September 2014. Unlike the mentioned decision of the Supreme Court of the Canton of Zurich, which discusses the limitation issue only in passing, the Bernese decision exclusively deals with limitation.

An external asset manager, who had received retrocessions from the custodian bank, was sued by one of his clients for restitution of those retrocessions. In its decision, the Regional Court of Bern-Mittelland solely discussed the duration and the starting point of the statute of limitation period. It essentially held the following:

Banks pay retrocessions to asset managers periodically, usually on a quarterly basis. As a consequence, such retrocessions constitute periodic payments, which in general is undisputed. Accordingly, the asset manager's claim against the bank becomes time-barred after five years. In contrast, there is disagreement on whether the asset manager's duty to restitute retrocessions to clients is periodic as well. In other words, it needs to be assessed whether a payment that arises periodically and must be passed on constitutes a periodic payment, too. If so, the claim for restitution also becomes time-barred after five years. The Bernese court followed the argument that the periodically

flowing retrocessions have to be forwarded periodically after receipt and that, therefore, the five-year statute of limitation period applies.

The starting point of the statute of limitation period is closely linked to the question of when the retrocessions received by the asset manager must be passed on to the client. According to Art. 130 (1) CO, the statute of limitation period commences when a claim falls due. Art. 75 CO stipulates that obligations fall due immediately. The fact that the asset manager is obliged to restitute the retrocessions without delay suggests that the statute of limitation period commences immediately, i.e. upon receipt of the retrocessions by the asset manager. Some legal scholars, however, take the view that the statute of limitation period begins to run only when the asset management agreement is terminated. The authors draw a parallel with the restitution duty regarding assets handed over to the asset manager. Such assets, according to the unanimous opinion of both legal doctrine and the courts, have to be restituted only upon termination of the asset management agreement and, accordingly, the statute of limitation period only commences upon termination of the latter. The argument concludes that the same shall now also apply to retrocessions, as they are used to fulfil the contract. However, this is logically incorrect as retrocessions are asset inflows occurring from time to time which are not part of what an asset manager needs to fulfil the contract. The Bernese court followed this reasoning. Accordingly, the five-year statute of limitation period starts upon receipt of the retrocessions.

4) Conclusion

The decision of the Regional Court of Bern-Mittelland has not been appealed and hence has become final. However, until now, no Federal Supreme Court decision on the statute of limitation period applicable to claims for restitution of retrocessions exists. Hence, it remains to be seen when the struggle for retrocessions will come to an end. At least, the judiciary of the Canton of Bern has sent out an important sign. Namely, that the asset manager's duty to restitute retrocessions becomes time-barred after five years and the statute of limitation period starts to run upon receipt of the retrocessions by the asset manager.

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AFG Arbonia-Forster-Holding AG Successfully Completes Rights Offering

Reference: CapLaw-2015-62

AFG Arbonia-Forster-Holding AG successfully completed its rights offering which was resolved at the extraordinary shareholders' meeting held on 11 September 2015. In the rights offering, existing shareholders were offered 25,515,845 new registered shares with a par value of CHF 4.20 each at an offer price of CHF 8.10 per new share. The rights offering resulted in gross proceeds of approximately CHF 207 million.

RAG Invests Into Perpetual Hybrid Convertible Bonds Issued by Siegfried

Reference: CapLaw-2015-63

RAG-Stiftung Beteiligungsgesellschaft mbH based in Germany subscribed the CHF 60,000,000 2.5% Hybrid Convertible Bonds issued by Siegfried Holding AG in order to finance Siegfried's acquisition of significant elements of BASF's pharmaceutical supply business. The bond was issued on 29 September 2015, and entitles RAG-Stiftung Beteiligungsgesellschaft mbH to convert the amount within five years into Siegfried Holding AG shares, corresponding to a stake in Siegfried of about 7%.

UBS Issues USD 4.3 bn Senior Debt Instruments in Support of its Single-Point-of-Entry Bail-in Strategy

Reference: CapLaw-2015-64

On 24 September 2015, UBS launched its inaugural issuance of "Bail-inable Bonds", a class of newly designed senior debt instruments. The USD 1.5 bn 2.95% Senior Notes due 2020, the USD 2.5 bn 4.125% Senior Notes due 2025 and the USD 300 mio Floating Rate Senior Notes have been issued by UBS Group Funding (Jersey) Limited on 24 September 2015 on a Rule 144A/RegS basis and are guaranteed by UBS Group AG. The Notes will be listed on the SIX Swiss Exchange Ltd.

Credit Suisse Announces CHF 6 bn Share Capital Increase to Further Strengthen the Group's Capital Base

Reference: CapLaw-2015-65

On 21 October 2015, Credit Suisse Group AG (SIX: CSGN) announced that it plans to issue new shares in a total amount of CHF 6 bn (EUR 5.55 bn). A first tranche of this capital increase shall result in the issuance of registered shares to certain qualified investors. The second tranche shall be executed by way of a rights offering to existing shareholders, underwritten by a banking syndicate. Both tranches were approved by the shareholders in an extraordinary general meeting on 19 November 2015. The closing is expected to occur on 4 December 2015. Through this capital increase, Credit Suisse Group intends to strengthen its Common Equity Tier 1 capital.

Julius Baer Group Ltd. Successfully Places SGD-Denominated Perpetual Tier 1 Subordinated Bonds

Reference: CapLaw-2015-66

In November 2015, Julius Baer Group Ltd. successfully placed SGD 450,000,000 perpetual tier 1 subordinated bonds in the Asian markets. The bonds are listed at the Singapore Exchange.

21. Forum Financial Market Regulation – Asset Deal and Bank Bankruptcy (21. Forum Finanzmarktregulierung – Asset Deal und Bankenkonkurs)

Thursday, 3 December 2015, University Zurich, Zurich

http://www.finreg.uzh.ch/events/FFVrbaski_Einladung.pdf

5. Convention on Private Equity Fundraising, Investment, Realization and Reinvestment – Current Trends and Challenges (5. Tagung zu Private Equity: Fundraising, Investition, Realisation, Reinvestition – Aktuelle Entwicklungen und Herausforderungen)

Thursday, 28 January 2016, Metropol, Fraumünsterstrasse 12, 8001 Zürich, Schweiz

http://www.eiz.uzh.ch/uploads/tx_seminars/Programm_Private_Equity_28.01.2016_01.pdf