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The Swiss Act on Book-Entry Securities (Intermediated Securities) – What Issuers should take into Consideration

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The Swiss Act on Book-Entry Securities (BESA) became effective as of 1 January 2010. This article, which continues the series of articles on the BESA, focuses on the issuer, outlining a few things to take into consideration to ensure efficient transition to the new regime of book entry securities.

By Stefan Sulzer

1) Securities Regime Prior to the BESA

Swiss law provides that a security is a physical certificate and the rights evidenced by such security can only be exercised or transferred together with the physical certificate (article 965 of the Swiss Code of Obligations).

What once was intended to facilitate the transfer and trade of the rights evidenced by such physical certificates became increasingly a burden and a costly factor for the transfer and trade of fungible securities traded on exchanges.

In addition, unlike bearer shares, registered shares *(Namenaktien)* are individual securities bearing the name of the investor, that is, they are not fungible certificates, and therefore do not, in principle, allow for collective custody, which is a prerequisite to transfer in uncertificated securities *(Wertrechte).*

In practice, legal work-around solutions were based on endorsement in blank *(Blankoindossament)* for physical certificates representing securities held in safe custody by financial intermediaries (*e.g.,* bank, securities dealer) and transferred via securities settlement systems without physical delivery *(Immobilisierung)* or on the notion of a deferred or rescinded printing of share certificates *(Aktien mit aufgeschobenem oder aufgehobenem Titeldruck)* in case physical certificates have been entirely eliminated *(Entmaterialisierung).* In the case of deferred printing, certificates are not created at the time of issuance, and investors have the right to receive certificates free of charge at any time. Rescinded printing means that shares are not certificated, and shareholders have no right to receive share certificates.

These solutions to enhance transferability evolved without act of law and were burdened with significant limitations: (i) the transfer of uncertificated securities legally requires written assignment, and (ii) a good faith purchaser of uncertificated securities is not protected against competing ownership claims of third parties.

Uncertificated securities do not qualify as rights *in rem (Sachen)* but as claims *(Forderungen).* Companies implementing a regime of deferred or rescinded printing of share certificates thus introduced lengthy provisions in the articles of incorporation to

characterize uncertificated securities. For instance, article 7 of Novartis' articles of incorporation, under a regime of deferred printing of share certificates, currently reads as follows:

> (1) The Company may renounce the printing and delivery of certificates and may, with the consent of the owner of issued shares, cancel issued certificates for registered shares that are returned to the Company. It may renounce the issuance of new certificates for registered shares if the owner of the shares does not demand the issuance of certificates for its shares with the co-operation of the bank which handles the book entries.
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> (2) Registered shares not represented by a certificate may only be transferred by way of assignment, which assignment must encompass all rights connected with the transferred shares. To be valid, the assignment must be notified to the Company. Registered shares not represented by a certificate which a bank has been instructed by the shareholder to administer may only be transferred with the co-operation of that bank.
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> (3) Registered shares not represented by a certificate may only be pledged to the bank which handles the book entries of such shares for the shareholder, and only based on a written pledge agreement. A notification of the Company is not necessary. The right to require delivery of a certificate may be transferred to the bank accepting the pledge. In all other cases, the pledge of registered shares requires the transfer of the certificates to be valid.

2) Securities Regime Under the BESA

The Swiss Act on Book-Entry Securities (BESA) is an up-to-date regulation of intermediate custody of securities (for an overview of the BESA, see Renato Costantini, CapLaw-2009-55). It introduces the new legal concept of book entry securities *(Bucheffekten).*

A book entry security, a right *sui generis,* has all functional features of a security in paper form without, however, being a right *in rem* in the meaning of Swiss law. Book entry securities are subject to the uniform rules of the BESA, irrespective of whether they are created through (i) the deposit of individual certificates for collective custody *(Sammelverwahrung),* (ii) the deposit of global certificates *(Globalurkunden)* for collective custody or (iii) the entry of uncertificated securities in the master register of a custodian and the credit to securities accounts.

Simultaneously with the enactment of the BESA, the Swiss Code of Obligations has been amended with provisions concerning the collective custody of securities and uncertificated securities, codifying concepts already common in legal practice (article 973a–c of the Swiss Code of Obligations).

The BESA only governs ownership rights for book entry securities (rights *to* book entry securities) but not the relationship between investors and issuers (rights *out* of book entry securities), including dividend payments or rights of membership. Registration of registered shares in a company's share register are also not the subject matter of the BESA (accordingly, the enactment of the BESA does not affect registration restrictions (article 685d of the Swiss Code of Obligations) in any way).

Compared to uncertificated securities, book entry securities have the following advantages:

Disposition. A disposition of book entry securities does not require a written assignment *(Zession).* The holder merely directs the depositary institution to make the disposition and it then credits the book entry securities to the recipient's account. The disposition is perfected with the completion of the respective credit. At the same time, the account owner disposing of the book entry securities loses its right to them.

Bona fide acquisition. A purchaser of book entry securities is protected in the acquisition, even though the seller was not entitled to dispose of the book entry securities.

Security interest. Pledging book entry securities does not require a written pledge agreement as required for pledging uncertificated securities. Instead, granting of security interests over book entry securities may be effected by an irrevocable agreement between the account holder (security provider) and the depositary institution. In such an agreement, the depositary institution agrees to execute orders received from the secured party (security taker) without the co-operation of the account holder.

3) Actions Required from Issuers to Create Book Entry Securities

Issuers with share certificates or global certificates. If a company's shares (bearer shares or registered shares) are represented by share certificates held in collective custody by, or global certificates deposited with SIX SIS AG (SIS), the Swiss central securities depositary, or another intermediary *(Verwahrungsstelle),* no action by the company is required to convert such shares into book entry securities under the BESA. According to the BESA, any share certificates issued prior to 1 January 2010 that are *de facto* traded by crediting and debiting the securities accounts of the investors, automatically qualify as book entry securities.

Issuers with uncertificated securities. The BESA does not provide for an automatic conversion of uncertificated securities (deferred or rescinded printing of share certificates) into book entry securities. Rather, uncertificated securities must be registered by the issuer in the main register *(Hauptregister)* maintained by SIS or another intermediary to create book entry securities. This register is public, and makes it possible to monitor the number of book entry securities on an on-going basis. Under the transitional provisions of the BESA, such registration must be made by 1 July 2010. If the

relevant company fails to cause its uncertificated securities to be registered in the main register, any transfer of such shares must continue to be effected by way of written assignment, and the BESA will not apply.

Under the new article 973c paragraph 2 of the Swiss Code of Obligations, issuers of uncertificated securities must maintain a non-public register of uncertificated securities *(Wertrechtebuch)* which contains the number and denomination of the uncertificated securities as well as the names of the shareholders. For registered shares, the register of uncertificated securities will include the names of shareholders at the time of the register's creation and not the names of the first shareholders of the original issuance. The register of uncertificated securities may, therefore, show a holding of unregistered shares *(Dispoaktien)* without the names of the shareholders. While bearer shares typically have been issued as global certificates or share certificates kept in collective custody, they may, under the new article 973c of the Swiss Code of Obligations, also be issued as uncertificated securities. If a company with bearer shares is going to issue uncertificated securities, the register of uncertificated securities would contain the names of the persons submitting the subscription forms.

The issuer may delegate the administration of the register of uncertificated securities to a third party. However, particularly in cases of issuers having both uncertificated securities and physical certificates, it may be advisable to keep the register of uncertificated securities with the issuer. An issuer may satisfy the requirement of creating and maintaining such register by either keeping a separate register for all its uncertificated securities, or adapting its existing book-keeping system or its share register *(Aktienbuch)* to the new provisions of the Swiss Code of Obligations. Conceptionally, adapting the share register to the requirements of a register of uncertificated securities is necessary for the following reasons: Whereas the share register is merely declarative in nature, creating and maintaining a register of uncertificated securities is a necessary condition for the issuance and existence of uncertificated securities. Also, unlike the share register, the register of uncertificated securities is "frozen" with the names of the first shareholders and share transfers will not be updated. The register of uncertificated securities will only be updated to reflect share capital increases or decreases as well as new issuances.

4) Actions Required from Issuers to Adjust the Articles of Incorporation

In general. Based on the individual situation, each issuer has to consider whether and how to adapt the articles of incorporation to reflect the new provisions of the BESA and the amended Swiss Code of Obligations. The SIS gives no guidance on how to adapt the articles of incorporation. There are two principal ways to address these issues: (i) amending the existing provisions, or (ii) replacing the existing provisions on deferred or rescinded printing of share certificates.

Companies should make sure that their articles of incorporation fully comply with the requirements of the BESA and the new provisions of the Swiss Code of Obligations. In particular, it is recommended that the articles of incorporation provide either (i) that registered shares will be issued in uncertificated form, while giving the issuer the ability to issue individual or global certificates without shareholder approval, or (ii) that the company will issue global certificates or uncertificated securities, and may convert each form into the other. In addition, the articles of incorporation should state whether or not the shareholders are entitled to demand the issuance of share certificates in place of uncertificated securities or global certificates. The articles of incorporation may also need to be amended to comply with the provisions of the BESA regarding the transfer of, and granting of security interest in, book entry securities. Provisions providing that shares can only be pledged in favor of the bank where the securities are deposited are no longer required.

Amending **the existing provisions in the articles of incorporation.** Given the fact that the BESA does not change the regime of the underlying securities (deposit of securities for collective custody, the deposit of global certificates or uncertificated securities), issuers may just want to amend their articles of incorporation to comply with the requirements of the BESA and the amended Swiss Code of Obligations. For instance, an amendment of the articles of incorporation may, based on the aforementioned Novartis example, read as follows (changes are marked in *italics*):

> (1) The Company may renounce the printing and delivery or certificates and may, with the consent of the owner of issued shares, cancel issued certificates for registered shares that are returned to the Company. It may renounce the issuance of new certificates for registered shares if the owner of the shares does not demand the issuance of certificates for its shares with the co-operation of the bank which handles the book entries. *Registered shares may be issued as uncertificated securities (in terms of the Swiss Code of Obligations) or as book entry securities (in terms of the Swiss Book-Entry Securities Act).*
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> (2) Registered shares not represented by a certificate may only be transferred by way of assignment, (which assignment must encompass all rights connected with the transferred shares) *or, as the case may be, according to the provisions of the Swiss Book-Entry Securities Act.* To be valid, the assignment must be notified to the Company. Registered shares not represented by a certificate which a bank has been instructed by the shareholder to administer may only be transferred with the co-operation of that bank.
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> (3) Registered shares not represented by a certificate may only be pledged to the bank which handles the book entries of such shares for the shareholder, and only based on a written pledge agreement, *unless the Swiss Book Entry Securities Act is applicable, and in this case only in accordance with the provisions of this law.* A no-

tification of the Company is not necessary. The right to require delivery of a certificate may be transferred to the bank person accepting the pledge. In all other cases, the pledge of registered shares requires the transfer of the certificates to be valid.

***Replacing* the existing provisions in the articles of incorporation.** If an issuer recognizes that the BESA together with the amended Swiss Code of Obligations codify concepts already common in legal practice, it may choose to replace its respective provisions in the articles of incorporation with provisions in compliance with the BESA and the amended Swiss Code of Obligations. Novartis' provisions of uncertificated securities may, for instance, be replaced by the following provisions (keeping the regime of deferred printing of share certificates):

(1) Subject to paragraph 2, the registered shares of the Company are issued as uncertificated securities (in terms of the Swiss Code of Obligations) and as book entry securities (in terms of the Book-Entry Securities Act).

(2) The Company may withdraw shares issued as book entry securities from the custodian system *(Verwahrungssystem).*

(3) The shareholder has the right to the printing and delivery of certificates. The Company may, with the consent of the shareholder, cancel issued certificates that are returned to the Company.

Paragraph 3 of the above example reflects article 7 paragraph 2 of the BESA, providing that an account holder may request the issuance of share certificates only if the articles of incorporation provide so.

Issuers with a regime of deferred printing of share certificates may want to take the opportunity of the revision of their articles of incorporation to switch to a regime of rescinded printing of share certificates. This is recommended because the BESA extends various legal advantages to book entry securities (see 2. above), such advantages having in exceptional cases triggered a desire to hold a certificated security. Accordingly, paragraph 3 of the above mentioned example could be replaced with the following:

(3) The shareholder has no right to the printing and delivery of certificates. Provided that the shareholder is registered in the shareholder register, the shareholder may request from the Company a statement of his or her registered shares at any time. The Company may, however, print and deliver certificates (individual share certificates, certificates or global certificates) for shares at any time. The Company may, with the consent of the shareholder, cancel issued certificates that are returned to the Company.

For identification purposes, a shareholder may ask his or her bank to issue an account statement reflecting the book entry securities credited to such shareholder's securities account as of the relevant date. The second sentence of the above example gives the shareholders the additional right to request from the company a statement of his or her registered shares at any time. Although the BESA does not provide for such right, this clause acknowledges a shareholder's fundamental right to request from the company a mere certificate of proof of his or her shareholdings.

Uncertificated securities issued as book entry securities may still be transferred by assignment *(Zession).* However, article 30 paragraph 3 of the BESA provides that rights acquired in accordance with the BESA prevail over the rights of an assignee, irrespective of the time of the assignment. Although the BESA refers to the possibility of assigning book entry securities, no provision in the articles of incorporation excluding the transfer of book entry securities by assignment is required, given the clear statutory order of priority.

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The Impact of the New Intermediated Securities Regime on Capital Market Transactions

Reference: CapLaw-2010-2

Swiss issuers planning to conduct a rights offering, an initial public offering, a bond issuance or any other form of transaction involving fungible securities will have to consider the new regime on intermediated securities introduced by the Federal Act on Book-Entry Securities (Book-Entry Securities Act, BESA, also referred to as Federal Act on Intermediated Securities, FISA) on 1 January 2010. While the changes introduced by BESA do not fundamentally change the structure of such transactions, issuers and investment banks are well advised to carefully review their capital market documentation to make sure the securities issued are in proper form for intermediation. CapLaw has covered various aspects of this new legal regime in a series of articles. This article highlights key issues to be addressed in transactions involving newly issued securities to be listed on a Swiss stock exchange.

By Thomas Reutter

1) The "Sans-Papiers" Have Become Legal

The most common types of securities issued by listed Swiss companies are shares *(Aktien)* and Bonds *(Anleihen).* Both types of securities may either be issued in certificated (paper) or uncertificated (paperless) form. While the chosen form of a security does not impact the rights its holder has against the issuer, it is important in respect of

any legal transaction in such a security. In order to be fungible and amenable to trading on a stock exchange, securities must generally either be uncertificated or, if certificated, (i) in collective custody or (ii) issued as a global certificate encompassing all securities issued with the same features.

Registered shares, the most common form of equity securities of Swiss issuers, have been issued as uncertificated securities in order to allow trading on the SIX Swiss Exchange and settlement on SIX SIS AG. This was the case already before the entry into force of BESA despite the absence of an explicit legal basis. The articles of incorporation of such issuers usually specify either that the shareholder has no enforceable right to certification of securities ("suspended title printing", *aufgehobener Titeldruck*) or that the issuers foregoes certification pending an express demand for certification made by a shareholder ("deferred title printing", *aufgeschobener Titeldruck*). Uncertificated shares are governed by the rules relating to contractual rights (claims, *Forderungen*) for purposes of legal transfer and encumbrance, which in itself creates legal uncertainty given that a valid transfer of a claim mandates a written instrument, a requirement difficult to reconcile with stock exchange trading.

Since 1 January 2010, the concept of a dematerialized security is finally firmly enshrined in Swiss law (see Renato Costantini, Caplaw 2009-55 for a more comprehensive analysis). The new article 973c of the Swiss Code of Obligations (CO) has abolished the need to resort to the auxiliary concepts of *aufgehobener* or *aufgeschobener Titeldruck* used prior thereto. While many companies will continue to have a reference to such concepts in their articles, the new law gives issuers a firm legal basis to directly issue dematerialized securities *(Wertrechte).* It also stipulates that any uncertificated securities issued will qualify as dematerialized securities in the sense of article 973c CO *(Wertrechte),* if recorded in proper form in any ledger or "book" *(Wertrechtebuch).*

2) Creation of Shares as Intermediated Securities

Intermediated securities (book entry securities, *Bucheffekten*) provide a new and uniform legal framework for transactions in securities irrespective of the form of the underlying security. Thus, securities may be transferred or encumbered in the same way irrespective of whether the underlying security is in certificated form or in dematerialized form. Transfers of intermediated securities may simply be made by book entry form which facilitates fungibility and mass trading of securities. Thus, shares traded on the SIX Swiss Exchange should be in the form of intermediated securities.

As has been explained above, registered shares of listed Swiss companies are usually issued in dematerialized form as *Wertrechte*. For such dematerialized underlying securities intermediated securities are created by registering dematerialized securities *(Wertrechte)* with the public main register maintained for such purpose by SIX SIS AG and by crediting such securities to (one or several) securities accounts of financial in-

termediaries (usually banks). The rights conferred by the intermediated security to its holder are those conferred by the underlying share, i.e intermediated securities are not depository receipts or other rights against an intermediary, but do directly confer membership rights and claims against the issuer of the underlying share. In other words, holders of intermediated securities constituted in the way described above, will be considered as shareholders.

In light of the above, the process of issuing shares in the context of a rights issue or IPO of a Swiss listed company (stock corporation) involves several "registers" and several steps:

1. Step 1: Creation of shares by way of registration in the competent commercial register after completion of the necessary corporate steps (shareholder or board resolution, public deed etc.). This step has not been affected by BESA and is independent of the form the shares as either certificated or dematerialized security.

2. Step 2: Creation of the shares as dematerialized securities *(Wertrechte)* by recording the issue of such securities in any records *(Wertrechtebuch)* held by or on behalf of the issuer. In practice, the share registrar (*e.g.* SAG SIX AG) will usually also maintain these (non-public) records. Given that the recording of the first holder of such dematerialized securities *(Wertrechte)* in those records is, in theory, required by law (but see "Practical issues and outlook" below) and the ultimate holders of shares are unknown to the issuer and its advisers, the lead managing bank (or the Swiss bank involved in the transaction for technical reasons) can and will usually be registered as holder on behalf of the beneficial owners of the securities.

3. Step 3: Creation of the shares as intermediated securities by registering dematerialized securities *(Wertrechte)* with the public main register maintained for such purpose by SIX SIS AG and by crediting such securities to (one or several) securities accounts of a financial intermediary, usually of the lead managing bank in the transaction.

Since the completion of each step is a prerequisite for the existence in the proper form of the securities intended to be created by it, the parties involved in capital market transactions are well advised to properly monitor the above three step process. In particular, the execution of the above process should be carefully described in the underwriting agreement and the managing banks should require sufficient evidence that all three steps have been properly implemented prior to closing.

Even after completion of the above steps the shares created as intermediated securities are still not registered as shares with voting rights in the Company's share register. Thus, in order to be eligible to vote at the Company's shareholder meeting, a shareholder holding shares as intermediated securities will have to file an application to be

registered as shareholder with voting rights. This fourth step will, however, only occur after closing of the capital market transaction. Nevertheless, the fact that yet another register needs to be involved shows how technical and cumbersome the share creation and registration process has become.

3) Creation of Bonds as Intermediated Securities

Although bonds could in principle also be issued as dematerialized securities, most bond issues in the Swiss market are still documented by way of a permanent global certificate for the entire class of securities issued. Thus, bonds can be issued as intermediated securities by depositing the permanent global certificate with an intermediary, usually SIX SIS AG, and crediting the bonds incorporated therein to one or more securities accounts of a financial intermediary. Thus, the process is much simpler compared to the creation of intermediated securities for shares. In the absence of a requirement to register bonds in the commercial register or to establish a bond register, only a two step process is required:

1. Creation of bonds by establishing a permanent global certificate after completion of the required corporate actions (board resolution etc.).

2. Delivery of the permanent global certificate with SIX SIS AG and crediting the bonds incorporated therein to a securities account of the lead managing bank (or any Swiss bank involved in the transaction).

Obviously, the lead managing bank should be comfortable that the above process has been properly implemented prior to closing. In the case of convertible bonds, it will have to ensure that both the bonds and the shares into which the bonds may be converted are correctly established as intermediated securities. Given that shares underlying convertible bonds are usually sourced from a company's conditional capital, the process of establishing intermediated shares slightly differs from the standard approach described above. This is because shares from conditional capital can be created without prior registration in the commercial register. However, steps 2 and 3 will be substantially the same for shares established as intermediated securities as a result of conversions.

4) Practical Issues and Outlook

Intermediated securities are fungible claims or membership rights against the issuer, credited to a securities account of an intermediary (see article 3 BESA). Given that transactions in intermediated securities such as a transfer or an encumbrance are perfected differently from transactions in their respective underlying, it should be crystal clear in every instance whether a certain security qualifies as intermediated security. It appears that the one element that may be controversial in this respect is the fungibility requirement. How many securities of a same class have to be issued in order to make

a security fungible? The legislative materials indicate that "fungible" is not tantamount to "suitable for mass trading", the notion used in the Swiss Stock Exchange and Securities Trading Act (SESTA) to define "securities" *(Effekten).* Hence, the fungibility requirement should not be viewed as unduly restrictive. Against this background and for the benefit of legal certainty, it seems even justified to consider a class of securities as fungible if as little as two securities of the same class are issued. Of course, such securities will still have to be credited to an account of an intermediary, which in turn means that the securities are registered in the main register of SIX SIS AG as central depository (either as dematerialized securities or based on deposited certificates) and have been assigned a Swiss security number *(Valorennummer).* Provided these requirements are met and at least two securities of the same class have been issued, such securities can be considered, in our view, as intermediated securities or book entry securities in the sense of BESA, provided they are freely transferable.

Another problem could arise from the mere fact that intermediation of registered shares under Swiss law requires a plethora of registers or records to be completed, maintained and updated. This could turn out to be a costly and burdensome undertaking and particular issues could arise if there are discrepancies between the different registers. Thus, it does not seem unrealistic that there will be a convergence of the several registers in practice.

Such convergence is already considered acceptable for a listed company's share register, which may also serve as a record for dematerialized securities *(Wertrechtebuch),* provided that the number of dematerialized securities *(Wertrechte)* issued is recorded properly. Although the law also requires registration of a (first) "creditor" in such records, this requirement should not be applied strictly to equity securities such as shares for obvious reasons. Moreover, it cannot be fully adhered to in any event because, under Swiss law, there is no obligation by shareholders to disclose their identity to the company in the absence of a significant holding.

A further step towards convergence could involve a combination of the public main register as a record of intermediated securities based on dematerialized shares (see step 3 above) with the share register. Although the share register of a Swiss company is not available to the public, the information required for a "main register" *(Hauptregister)* can be retrieved from the share register and displayed electronically and the non-public information of the share register can be omitted. Hence, it can be expected that the Swiss market practitioners will find ways to reduce the complexity imposed by their lawmakers.

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The Swiss Federal Administrative Court holds that FINMA acted Without Legal Basis when ordering UBS to disclose Customer Data to the US Government

Reference: CapLaw-2010-3

By René Bösch

Following weeks and months of disputes and debates between the US Department of Justice (DoJ), the Internal Revenue Service (IRS) and UBS AG (UBS) with respect to certain of UBS' business practices in relation to US clients, UBS agreed to enter into a Deferred Prosecution Agreement (DPA) with the United States of America on 18 February 2009 in relation to certain criminal charges. Concurrently, bowing to pressure from US authorities exerted on UBS through various governmental investigations, including a John Doe Summons issued by the IRS in the summer of 2008 and in particular a threatened criminal action against UBS as well as senior representatives of the bank, FINMA decreed on 18 February 2009 that UBS shall provide or shall cause to provide to the US Government the identities and account information of approximately 300 UBS customers in accordance with paragraph 9 of the DPA. Immediately following the issuance of that decree, the relevant customer data was handed over to the US Government. When the news of the entering into the DPA and the FINMA decree broke the same night, some of the affected UBS customers tried immediately to obtain injunctive relief against the FINMA decree and to stop the handing over of the data to the US Government, but without success. Although an injunction had been issued by the Federal Administrative Court as early as 20 February 2009, it had no direct effect because the data had already been transferred to the US Government. But in the following, a legal battle between some of the affected customers and FINMA as well as UBS ensued which finally resulted in the decision by the Federal Administrative Court handed down on 5 January 2010 and published on 8 January 2010.

The Federal Administrative Court held that FINMA acted without legal basis in ordering the transfer of the customer data to the US Government. This ruling was received with surprise by some and with disbelief by others; quite a number of Swiss politicians even expressed publicly their dismay that—according to the Federal Administrative Court—FINMA acted without sufficient authority. Since Friday, 8 January 2010, a vivid debate is under way whether or not the Federal Administrative Court was right in holding that FINMA did not have any legal basis for its order, and even more importantly why the Swiss Federal Council did not act itself in February 2009 and did not invoke emergency law powers. This article describes the Federal Administrative Court's reasoning and seeks to explain what is currently at stake with respect to FINMA's powers under current banking laws.

As it is generally known and has been covered by the media quite intensively over the last two years, following the disclosure by a whistle-blower in the United States, UBS since September 2007 was involved in several investigations in the United Stated with the DoJ about its business practices in relation to US clients. These investigations by the DoJ as well as the IRS increased the pressure on UBS to cooperate with the US authorities and to accommodate the request of the US authorities to give them access to the relevant customer files. While a request for mutual assistance in administrative matters by the Internal Revenue Service of 16 July 2008 was processed by the Swiss Federal Tax Administration throughout the year of 2008, resulting in several decrees granting such mutual assistance in October 2008, these decrees were challenged by the affected customers in the Federal Administrative Court.

Presumably in partial response to such challenges and the resulting delays in getting access to customer data, the US authorities mounted additional pressure on UBS to agree to certain assistance in exchange to the offer to agree to a DPA. Towards the end of 2008 and in particular in the first few weeks of 2009, this pressure on UBS became so intense that UBS, together with FINMA, sought ways and means of how to accommodate the request to grant US authorities access to customer files in order to avoid the worst, namely an indictment in criminal matters in the United States against the bank and its senior executives (the dispute with the IRS about the John Doe Summons was resolved only in August 2009). FINMA discussed this situation several times with the Swiss Federal Council, but it became very clear in early February that the pressure on UBS reached such intensity that in FINMA's and UBS' assessment an immediate solution to the dispute needed to be found, in particular to prevent the US Government from rushing to such an indictment. Under such pressure in mid February 2009, FINMA consulted again with the Swiss Federal Council and informed it of its plan to issue the decree. On 18 February 2009, the Swiss Federal Council once again reiterated its position not to invoke emergency law powers but took affirmatively note of FINMA's plan to issue the decree; only a few moments later, FINMA issued the decree and started with the effectuation of the transfer of the pertinent data to the US authorities. FINMA justified its decree by reference to articles 25 and 26 of the Banking Act (BA) which vest FINMA with significant powers in case a Swiss bank finds itself or faces significant liquidity problems. FINMA argued that if an indictment would be issued against the bank or its senior executives, this may likely result in an immediate and extreme loss of confidence in the bank—similarly as happened in the case of the indictment against Arthur Andersen—which would or could eventually result in a run on the bank.

The Federal Administrative Court first reflected on the legal status of the bank secrecy in Swiss law. Considering that bank secrecy protection is part of the protection of personality, the Federal Administrative Court confirmed that this protection of personality finds its foundation both in civil law as well as in the constitution, more specifically

in the constitutional protection of the privacy (which is also reflected in the European Convention of Human Rights). However, the Federal Administrative Court confirmed the prevailing view that the protection of bank customer data does not belong to the core sphere of the protection of privacy as reflected in the constitution, and that it therefore is subject to restrictions and limitations. Furthermore, the Federal Administrative Court gave regard to the fact that the bank secrecy protection is reflected in several provisions of Swiss civil law as well as in article 47 BA which makes it a criminal sanction for employees, mandatees and liquidators of a bank if they divulge customer data to third persons without the consent of the bank customers or without a legal basis therefor.

The Federal Administrative Court then went on to consider whether there was a sufficient legal basis for FINMA to restrict or interfere with the bank secrecy protection of the UBS customers concerned. Its analysis started with the reference to the requirement under the Swiss constitution that an interference with or a restriction of constitutional rights must be based on a formal statute if such interference or restriction is significant. Furthermore, any such interference or restriction must be justified by public interest and must be in proportion to the aim pursued. The Federal Administrative Court then went on to elaborate on the specific formal and substantive requirements that a statute must fulfill in order to form a sufficient basis for a restriction of constitutional rights. In particular, the Federal Administrative Court did point out that aside from requiring that the limitation is allowed by a statute in the formal sense (*i.e.,* a statute or act rather than an implementing ordinance), the provision in such statute must be sufficiently clear that it would allow a person to realize and predict that the administration could rely on that particular clause in order interfere with or restrict the constitutional rights of people. In particular, the Federal Administrative Court put quite some emphasis on the specifity of the provision in the statute and the predictability of the addressee of such provision so that it may provide a sufficient basis for the restriction of the addressees own constitutional rights.

Because FINMA had based its decree primarily on articles 25 and 26 BA, the Federal Administrative Court then went on to analyze whether or not those provisions would meet the standards of specifity and predictability outlined by it. These two provisions were introduced into Swiss law in 2004 to specifically address measures in case of the danger of insolvency of banks. They vest FINMA with a range of powers in case that "there is a sufficient fear that a bank is illiquid or faces significant liquidity problems". The list of powers set forth in article 26 BA is not comprehensive and leaves room for further powers or measures that FINMA may take. The Federal Administrative Court then went on to consider whether FINMA could actually claim that there was a "sufficient fear" that UBS may encounter "significant liquidity problems" in case of an indictment by the DoJ.

The Federal Administrative Court then analyzed the specifity and predictability of those two norms in view of the claim by FINMA that there was an imminent danger that UBS would face "significant liquidity problems", and it arrived at the conclusion that these two provisions of the Banking Act would not provide a sufficient basis for interference or the restriction of constitutional rights and the bank secrecy protection of UBS' customers. The Federal Administrative Court found that these two provisions are not sufficiently specific in that respect and that a bank customer did not have to expect that FINMA could base a decree thereon to the effect that a Swiss bank had to hand over bank customer data to foreign authorities without the consent of the affected customers. Moreover, the Federal Administrative Court briefly discussed whether there would be any other basis in the Banking Act or in the Financial Market Supervisory Authority Act that would vest FINMA with relevant powers, but it did not find any.

The Federal Administrative Court then went on to analyze whether FINMA could have relied on emergency powers to claim extraordinary circumstances which would have justified the decree. After having given regard to the provisions of the constitution which specifically vest exclusively the Parliament and the Federal Council with such emergency powers, the Federal Administrative Court arrived at the further important conclusion that in this instance only the Federal Council would have had the right to claim a state of emergency and to issue such a decree which interferes with the constitutional rights of customers of UBS. However, the Federal Administrative Court also noted that the Federal Council did not exercise such powers and further confirmed that the Federal Council would not have been entitled to delegate these powers to FINMA. Concluding, the Federal Administrative Court also found that FINMA would not have been entitled, in the alternative, to rely on a basis of emergency situation powers to base its decree.

As a result of its deliberations and analysis, the Federal Administrative Court found that the two provisions in the Banking Act on which FINMA primarily relied in order to justify its decree did not provide a sufficient legal basis for FINMA to issue its decree, in particular for the ordering of the disregard of the bank secrecy protection of the UBS customers concerned. And the Federal Administrative Court found that if FINMA, in the alternative, would have claimed to base its decree on emergency law powers, FINMA would not have been entitled to this either because it did not have any such emergency law powers.

On 21 January 2010, FINMA announced that it will challenge this decision in the Swiss Federal Supreme Court, the highest Court of Switzerland. The outcome of that challenge is unpredictable, not least also because there is doubt as to whether the decision is actually subject to challenge. Aside from these procedural uncertainties, the decision of the Federal Administrative Court addresses a very important issue that goes far beyond the individual case here: how specific do statutory laws and powers

need to be for an administrative agency such as FINMA to be entitled to issue measures affecting banks or their customers, or more specifically, how specific must such a statutory provision be that a bank or a bank customer could or should predict that FINMA could use such a statutory provision for ordering specific measures against it? Moreover, it raises the question of whether a stricter standard applies when customers and their constitutional rights are concerned or whether banks could also rely on their constitutional rights (*e.g.,* economic freedom) in assessing the justification of future decrees issued by FINMA. This overall issue is of significant importance for the shaping of future bank regulations in Switzerland and will have a great significance on FINMA's future role and its enforcement powers.

On the same day, the Federal Administrative Court dealt another blow to the Swiss government in its cooperation with the US government in connection with the "UBS matter": it held that the Federal Council was not authorized to concede to the US authorities that the non-delivery of a W-9 form by Swiss bank customers for more than 3 years constituted "tax fraud and the like" in the meaning of the Swiss-US double taxation treaty if such customer had assets in excess of CHF 1 mio with the Swiss bank and realized profits of more than CHF 100 000 *p.a.* in average on such assets during such 3 year period. Therefore, in the case at hand—which is a "pilot case" for numerous other cases to come—Swiss authorities are not entitled to hand over to the IRS information about the UBS customer and his or her accounts. While this case addresses an entirely different legal issue, it may add to the general uncertainty whether Switzerland may be able to meet the US government's expectations as to the level of required or desired cooperation in the "UBS matter" and issues of similar importance.

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Proposed Swiss Bank Deposits Protection Law

Reference: CapLaw-2010-4

In response to the financial crisis and the insolvency of numerous banks worldwide, the Swiss Parliament passed an emergency law in December 2008 to enhance protection for Swiss bank depositors. The Parliament has, *inter alia,* increased the depositors' bankruptcy privilege to CHF 100 000 per depositor and bank and has raised the maximum amount covered by the Swiss Banks' and Securities Dealers' Deposit Protection (DPA) from CHF 4 to 6 billion. The *ex post* financed system of self-regulation by the DPA has not been amended, however. On 11 September 2009, the Federal Department of Finance opened public consultation on a Bank Deposits Protection Law (the Deposits Protection Law or DPL). Whereas the proposed Deposit Protection Law would make the emergency law permanent, it would also introduce a pre-financed deposit protection fund. The public consultation proceedings ended on 31 December

2009. Most respondents participating in the consultation proceedings seem not to support the draft DPL and challenge its envisaged effectiveness.

By Markus Pfenninger / Thomas S. Müller

1) Background

Deposit protection in Switzerland is currently based on a two pillar system as established in the Banking Act (BA). The first pillar is a bankruptcy privilege that gives depositors a preferred claim in the bankruptcy of a Swiss bank, now a maximum of CHF 100 000 per depositor, which must be paid from the assets of the bank in priority to its other unsecured creditors (see also CapLaw-2009-8). The second pillar consists of a guarantee for certain deposits issued by the DPA, a banking industry self-regulatory organisation. Swiss banks that accept deposits are required to become members of the DPA. If a bank fails, the DPA solicits contributions from its members, based on the relative size of the member's deposit base, to cover the guaranteed amount of deposits. These contributions are then transferred by the DPA to the administrator of the failed bank for payout to depositors. Although these two pillars are interrelated, their scope is somehow different. For example, a depositor with a non-Swiss branch of a Swiss bank would be protected by the bankruptcy privilege, but not by the DPA's deposit guarantee.

The DPA guarantee has also been criticised as a potentially weak, even an accelerant means because member banks might be further impaired by the payment of DPA guarantee contributions during a wide-spread banking solvency crises.

2) Emergency Legislation of 19 December 2008

Towards the end of 2008, the Federal Department of Finance (FDF), the Swiss National Bank (SNB) and the Swiss Financial Market Supervisory Authority FINMA (FINMA) agreed on several measures in order to stabilize and strengthen the Swiss financial system. In connection with these measures, the Swiss Parliament has passed an emergency law amending the BA which, among other things:

(i) increases the depositors' bankruptcy privilege to CHF 100 000 from CHF 30 000 per depositor and bank (article 37b (1) BA);

(ii) provides for a separate and privileged treatment of claims to bank foundations *(Vorsorgestiftungen)* and vested benefits foundations *(Freizügigkeitsstiftungen)* being considered as deposits from the pension plan holder or the insured person (article 37b (3) BA). This separate privilege may actually lead to a total privilege of CHF 200 000 for some bank customers;

(iii) increases the maximum amount covered by the DPA from CHF 4 billion to CHF 6 billion (article 37h (3b^{bis}) BA);

(iv) provides for an accelerated disbursement to depositors in the event of a bank failure out of the liquidity available at the failing bank and outside of the schedule of claims of the bankruptcy proceedings (article 37a^{bis} BA);

(v) requires banks to hold assets in Switzerland (for details see CapLaw-2009-43) in an amount equal to 125% of the amount of the deposits protected by the bankruptcy privilege (article 37b (5) BA);

These changes of the BA resulting from the implementation of the emergency law will remain in force until the end of 2010.

3) Proposed Deposits Protection Law

a) Establishment of a Pre-Funded Deposit Protection Fund

The now proposed DPL would make the 2008 emergency amendments to the BA permanent and replace the DPA's deposit protection with a pre-funded deposit protection fund (DPF).

The DPL would require banks to contribute cash and to pledge assets to the DPF in a total amount equal to 3% of the protected deposits of all Swiss banks (article 13 (1) DPL). The DPF would be established as an independent fund under public law. Banks would need to fund two-thirds of this amount by annual contributions and one-third by pledging assets to the DPF. The latter would constitute eligible collateral if it were acceptable to the SNB in securities repurchase (repo) transactions. Swiss banks currently hold approximately CHF 325 billion in deposits that would be protected by the DPF, so the target amount for the DPF would be about CHF 9.75 billion.

Presumably, full funding of the DPF would be achieved over a period of more than 20 years. Each bank would make an annual contribution in an amount equal to 4% of its share in the target amount for the cash portion of the DPF (article 14 (2) DPL), subject to an adjustment for a bank's risk profile. Such funding of the cash portion would lead to an industry-wide contribution of approximately CHF 260 million per year, accordingly eight basis points (bp)—8/100s of a percent. It is yet unclear how the proposed individual bank's risk adjusted contribution would be calculated. The DPL is rather vague and provides for some generic guidelines only: the risk profile would be based on the equity capital, the leverage ratio, and the growth of the guaranteed deposits. Further, banks that enjoy state guarantees would probably benefit from relaxed standards while banks that have been granted an exemption to the cover duty under article 37b (5) BA would perhaps become subject to stricter standards. It is interesting to note that the DPL does neither take into account any duration gap calculation (difference between the lifespan of the bank's assets, and the lifespan of its liabilities), refinance capacity nor any cash ratio, as poor figures of these ratios would be likely to cause liquidity problems for a bank that could ultimately lead to its failure.

If the DPF sustains a loss before it is fully funded, banks would be required to contribute an amount equal to a maximum of 2% of protected deposits to the extent needed to cover the DPF's shortfall incurred by payments made for deposit protection purposes (article 27 DPL). The DPL would also require each bank to hold additional reserve to cushion this contribution obligation for DPF shortfalls. As these measures may still be inadequate to cover a protected loss, the DPL would further allow the DPF to either request a loan (at market-based interest rates) or a guarantee from the Swiss Federal Government to finance or secure unfunded deposit protection payments (article 24 et seq. DPL). In each case, the DPF would be required to pay an annual commitment fee to the Federal Government, and the DPF would charge each bank its proportional share of this fee.

b) Costs Resulting from the DPL

The FDF projects the recurring annual costs associated with the proposed scheme at 9 to 33 bp of the privileged deposits on a single bank level (depending on the risk profile of an individual bank) and at 12 bp on an average industry-wide level. We believe that the yearly costs would be significantly higher as it would appear that the FDF has included neither refinancing costs of the annual contributions (including loss of interest) nor probable lost profits resulting from business activity limitations under article 37b (5) BA in its projection. It also seems that administrative costs of both the DPF and the banks have not been considered. It is fair to say that all of these costs would be (P&L) relevant for every bank subject to the DPL. Moreover, anticipated total costs of several billion CHF would prove to be overly burdensome for banks if they had to be entered into the profit and loss account for present value under International Finance Reporting Standard on the date the DPL would be enacted.

4) Effects on Insolvency Proceedings Applicable to Banks

In the annex to the DPL, the FDF proposes several material amendments to the insolvency proceedings applicable to banks under the BA that was last revised in July 2004.

Pursuant to the current provisions of the BA, FINMA may commission a person with the restructuring of a bank (restructuring commissioner, Sanierungsbeauftragter), if a well-founded prospect exists with respect thereto. The FDF takes the view that the appointment of a restructuring commissioner should no longer be mandatory as required restructuring measures would usually be known already at the time when restructuring proceedings are initiated. Accordingly, FINMA should receive broader authority to order and decide on any measures necessary or appropriate for the restructuring proceeding (which would include the right to appoint a restructuring commissioner [article 28 draft BA]).

Perhaps the most important amendment to the insolvency proceedings would be FINMA's authority to have certain bank services of a failing bank continued (for the benefit of the depositors) as one of the options available under the restructuring proceedings. Therefore, restructuring proceedings would not only be initiated with a view to carry on the bank's business under the current structure but to limit business continuity to certain business units of the bank while winding-up others or restructuring them separately. Continuing businesses may either be transferred to a bridge bank that may be established for restructuring purposes, or may be merged into an existing bank (article 30 (2) draft BA). Consistent with the current BA, the plan of restructuring would have to be approved by FINMA. In case the restructuring plan would affect creditors' rights, FINMA would submit the plan to the creditors that may reject it within the deadline set by FINMA. The proposed respective proceedings are very similar to those currently enacted (article 29–31 BA and article 31 and 31a draft BA). Assets and liabilities (including real estate and existing contracts) of the failing bank would be transferred to a bridge bank or an existing third party bank by operation of FINMA's approving the restructuring plan. No other measures, approvals, consents and formalities would be necessary for the transfer to be valid. In particular, the provisions of the Swiss Merger Act would not apply.

In addition, neither any change of control nor any assignment of contract resulting from such transfer may be considered as events of default allowing any third party to terminate the agreement concluded with the failing bank or for any close-out netting to apply. A respective contractual clause would be void and incompatible with ordre public (article 31 (3) draft BA). It goes without saying that these provisions are aimed to facilitate an expeditious transfer of bank assets (and liabilities) in times of distress. However, they would also substantially infringe freedom of contract and the rule of law that contractual agreements concluded prior to the insolvency of one party would be valid and enforceable (also against any restructuring commissioner or liquidator) in the insolvency of such party. The potential impact of this provision on close-out netting arrangements under market standard master agreements is yet uncertain. Moreover, such a provision would not be in line with respective international developments (see CapLaw-2009-31). We would, therefore, encourage the lawmaker to reconsider the proposed provision.

In order to enable or facilitate restructurings or business transfers, FINMA may request the DPF to allocate certain fund assets for these tasks. The DPF would have an obligation to approve such request if (i) the restructuring limited its own the risk of loss, (ii) the protected deposits were covered by assets (of the failing bank), and (iii) the allocated fund assets were not used for the expansion of existing or the development of new banking businesses (article 5 DPL). In any event, the DPF would be restricted to provide fund assets that exceed the greater of 25 percent of the protected deposits of the failing bank or 10 percent of the DPF's target amount (article 6 (1) DPL).

5) Appraisal of the Proposed Deposits Protection Law

According to the International Association of Deposit Insurers, explicit bank deposit protection measures have been adopted in more than 100 countries, and many countries have recently increased their deposit protection schemes. Although many of these schemes are said to reinforce investors' confidence or strengthen the resilience of the banking sector, doctrine continues to question their viability and effectiveness. Critics contend that deposit protection:

(vi) increases moral hazard, the risk that bankers will not act prudently;

(vii) cannot cope with systemic financial crises because the failure of a single large bank or a few medium-sized banks would result in losses far greater than the deposit protection fund;

(viii) imposes undue costs on banks, resulting in lower interest rates on deposits or higher interest rates on loans, or both, and hinders a bank's accumulation of additional capital;

(ix) results in the unproductive hoarding of funds by governmental agencies.

It is at least doubtful whether deposit protection significantly increases moral hazard in the banking sector. The financial crisis has shown that governments are reluctant to allow banks to fail. Such implicit governmental guarantee would appear to be a greater contributor to moral hazard theory than the existence of deposit protection or its subsequent increase in a crisis. Many economic arguments against deposit protection—*e.g.* penalty on profits, hindering of capital accumulation and misallocation of funds—are directed at the scope of an existing scheme, how and when it should be funded, and by whom, rather than at the core issue, *i.e.* should there be deposit protection at all.

Deposit protection seems marginally relevant for *too big to fail or too interconnected to fail* banks as they are perceived to have an implicit governmental guarantee, and—in the event such bank will nevertheless be wound up—a deposit protection fund is unlikely to be large enough to protect all of its depositors. In light of this, deposit protection would rather be an instrument to protect depositors in banks that are small enough to fail, and the size of a deposit protection fund could be scaled-down, accordingly.

It is perhaps fair to say that the draft DPL has gone beyond what could have been achieved by balancing the various political, economic and legal considerations. By making an effort to include the risk of systemic banks and, eventually, to mitigate systemic crisis, the FDF presented a very cost-intensive scheme which overruns the current needs but is yet too weak to achieve the new goals. This may explain why the DPL did not get much credit by contributors during the public consultation which ended on

31 December 2009. Nevertheless, the concept of a pre-funded scheme seems to be a prudent proposal because it spreads the cost of losses over a longer period of time.

6) Alternatives to the Proposed Law

The considerations above and the fact that bank failures in Switzerland have been relatively rare and small would bespeak for a deposit fund of roughly two-thirds of the size contemplated by the DPL—perhaps CHF 1 to 1.5 billion pre-funded together with a post-funded component of CHF 4.5 to 5 billion in maximum collected from the industry after a bank failure. It should be noted that a deposit protection scheme having access to such an amount would cover more than 90 percent of all banks holding protected deposits and could therefore be deemed as appropriate.

Also, more expensive pre-funded components could be replaced by the proposed and presumably less expensive security concept pursuant to which banks would provide eligible collateral to the fund without affecting the level of protection afforded to depositors.

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US Bankruptcy Court finds that Payment Conditionality is unenforceable under Section 2(a)(iii) of the ISDA Master Agreement

Reference: CapLaw-2010-5

In September 2009, the US Bankruptcy Court for the Southern District of New York (S.D.N.Y.) held in a Lehman bankruptcy case that a non-defaulting counterparty acted improperly by suspending payments under Section 2(a)(iii) of the ISDA Master Agreement. The Court determined that the US Bankruptcy Code required the counterparty to either terminate the agreement or continue making payments, and prohibited the counterparty from suspending performance based on the Lehman bankruptcy filings.

By Thomas Werlen / Stefan Sulzer

1) The Case

In 2007, Metavante Corporation (Metavante) entered into an amortizing interest rate swap transaction with Lehman Brothers Special Financing (Lehman) with a notional amount of USD 600 million under which Lehman, as floating amount payer, agreed to make quarterly payments based on a floating interest rate. Metavante, as the fixed amount payer, agreed to make payments based on a fixed interest rate. The transac-

tion was documented in a 1992 ISDA Master Agreement and customary trade confirmation.

The parent company of Lehman, Lehman Brothers Holdings, Inc., filed for bankruptcy protection under the US Bankruptcy Code in 2008. The bankruptcy filing constituted an event of default under the ISDA Master Agreement, which permitted (but did not require) Lehman's counterparty, as the non-defaulting party, to designate an early termination date for the transaction.

Metavante did not terminate the transaction given the interest rate environment during the period following Lehman's bankruptcy filing (the Metavante swap was significantly in the money in favor of Lehman). In reliance on Section 2(a)(iii) of the ISDA Master Agreement, which provides that "[e]ach obligation of each party under Section 2(a)(i) [to make a scheduled payment or delivery] is subject to […] the condition precedent that no event of default or potential event of default with respect to the other party has occurred and is continuing […]", Metavante also chose not to perform its obligations to pay quarterly fixed amounts. Lehman asserted that as of May 2009, Metavante owed USD 6.6 million in quarterly payments and filed a motion pursuant to the US Bankruptcy Code to compel Metavante to fulfill its scheduled payment obligations under the ISDA Master Agreement.

2) The Decision

On 17 September 2009, the judge responsible for the Lehman bankruptcy proceedings in the United States granted Lehman's motion (In re Lehman Brothers Holding Inc., No. 08-13555 [S.D.N.Y., Docket No. 5209]). The Court held that the swap agreement is an executory contract and that Metavante acted improperly by suspending performance under the agreement because case law makes clear that until a debtor determines whether to assume or reject an executory contract, the counterparty to such contract must continue to perform.

Relying on the New York contract law principle that the failure of a condition precedent excuses the counterparty's obligation to perform, Metavante argued that it had the right to suspend payments pending termination of the swap because Section 2(a)(iii) of the ISDA Master Agreement conditioned its payment obligations on there being no event of default.

The Court rejected this argument, determining that the US Bankruptcy Code trumps a state law excuse of nonperformance and that the bankruptcy laws compelled a different result. Therefore, the Court held that Section 2(a)(iii) of the ISDA Master Agreement, as an *ipso facto* provision triggered by Lehman's bankruptcy, was unenforceable. The Court observed that the special protections for swaps in the US Bankruptcy Code

are available for liquidation, termination, acceleration and netting but that other uses of *ipso facto* provisions are unenforceable.

The Court also found that Metavante's reliance on the standard condition precedent provision of Section 2(a)(iii) of the ISDA Master Agreement to excuse its payment indefinitely due to Lehman's bankruptcy was counter to the ISDA Master Agreement's intent to allow for prompt closing out and immediate termination upon default.

Although the safe harbor provisions of the US Bankruptcy Code otherwise would have permitted Metavante to terminate the swap agreement on account of Lehman's bankruptcy (see Sections 560 and 561 of the US Bankruptcy Code), the Court held that Metavante had waived its right to terminate the swap by waiting for more than a year after the filing of bankruptcy. Under this interpretation, counterparties risk waiving their rights to terminate their contracts if they fail to exercise their rights "fairly contemporaneously with the bankruptcy filing".

3) Comment

The Metavante case raises the critical issue of whether there exists a window of time after a bankruptcy filing during which a non-defaulting party may withhold payments. The import of the Metavante decision is that a swap counterparty may not reasonably anticipate a grace period from its performance in accordance with its obligations under the ISDA Master Agreement. Like any other executory contract, performance is required by all parties notwithstanding the pendency of a given party's bankruptcy proceeding, until such time, if ever, as the contract has been terminated or otherwise disaffirmed by the debtor party in accordance with the terms of such contract, and subject to the US Bankruptcy Code. The precedent established by the Metavante decision effectively negates the ability of any counterparty to rely on Section 2(a)(iii) of the ISDA Master Agreement as a walkaway clause.

Given the absence of a window of time during which a non-defaulting party may withhold payments, such party would need to decide by its next scheduled payment date whether it wants to terminate or pay.

There had been a similar case in Australia in 2003. In *Enron Australia v. TXU Electricity,* a case in which the liquidator of *Enron Australia* sought to disclaim transactions under an ISDA Master Agreement based on a provision of the Australian Corporations Act, the court, however, upheld the right to suspend payments.

In both the Metavante case and the Enron case, the question was not over the validity of Section 2(a)(iii) of the ISDA Master Agreement as a contractual provision, but whether or not that provision was affected by national bankruptcy laws. In the Enron case the judge held that Australia's bankruptcy laws did not permit the court to deprive the counterparty of its contractual rights. The court specifically upheld the contractual

right not to designate an early termination date and the right under Section 2(a)(iii) of the ISDA Master Agreement to suspend performance *indefinitely,* and thereby effectively upheld the English common law position accepting the right to terminate a contract after the occurrence of a designated event by giving express notice. In the Metavante case, the Court held that the ISDA Master Agreement with Lehman is valid and enforceable in all respects, and available to the parties' continuing right in it, but is subject to the US Bankruptcy Code (see ISDA Memorandum re Metavante Ruling in United States Bankruptcy Court, dated 30 September 2009).

Although the Metavante case is based on policies that underlie the US Bankruptcy Code, rather than on general contract law principles, it may also influence other court's analysis of the enforceability of Section 2(a)(iii) of the ISDA Master Agreement in proceedings where the US Bankruptcy Code is not applicable. Therefore, the Court's ruling should now be taken into account by any party to an ISDA Master Agreement when it decides whether or not to declare an early termination event upon the insolvency of its counterparty. It also remains to be seen how courts in other jurisdictions will rule on this issue.

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Successful Secondary Placement of 10% Stake in SGS SA

Reference: CapLaw-2010-6

In November 2009, in one of the largest secondary share placements in Switzerland in the year 2009, the von Finck family sold shares in SGS SA worth approx. CHF 1bn (approx. a 10% stake) after a one-day accelerated bookbuild and thereby reduced its stake to approx. 15%.

EUR 1 bn Issuance under the UBS Covered Bond Programme

Reference: CapLaw-2010-7

On 30 November 2009, UBS AG (UBS) closed its second issuance under its Covered Bond Programme established in September 2009. EUR 1 bn of Covered Bonds with a 10 years maturity were issued by UBS AG, London Branch and are guaranteed by

UBS Hypotheken AG. The Covered Bonds issued under the Programme are indirectly backed by a portfolio of mortgages from UBS's domestic mortgage pool.

Swiss Prime Site closes CHF 300 Million 1.875% Convertible Bond Issue

Reference: CapLaw-2010-8

On 20 January 2010, Swiss Prime Site AG successfully raised financing through a placement of CHF 300 Million 1.875% Convertible Bonds (Bonds). The Bonds were priced with a coupon of 1.875% and a conversion premium of 22.5% to the volume weighted average price on the day of launch. Credit Suisse and UBS Investment Bank who acted as joint bookrunners in this transaction have exercised their overallotment option in full, increasing the total issue size of the Bonds to CHF 300 Million.

Kickbacks and Conflicts of Interests – from Advisor to Seller (Retrozessionen und Interessenkonflikte – wenn der Berater zum Verkäufer wird)

Berne, 22 February 2010, 13.30–17.50 h
Bernischer Juristenverein, Restaurant zum Äusseren Stand, Zeughausgasse 17

http://www.bernischerjuristenverein.ch

Financial Crisis and Regulation – Overview on Implications for the Regulation of Banks and the Financial Market (Finanzkrise und Regulierung – Überblick über Implikationen für die Banken- und Finanzmarktregulierung)

Zurich, 2 March 2010, 09.00–16.30 h
Conference Center Grünenhof

Swiss Conference on Banking Law 2010: Credit Law
Schweizerische Bankrechtstagung 2010: Kreditrecht

Berne, 5 March 2010, 08.30–16.10 h
Institute of Banking Law, Hotel Bellevue Palace

http://www.ibr.unibe.ch/lenya/ibr/live/tagung.html