

The New Financial Market Architecture in Switzerland Becomes Tangible

Thomas G. Albert, LL.M*
 Attorney at Law, Legal Counsel, BNP
 Paribas (Suisse) SA, Switzerland

☞ Financial regulation; Switzerland

Abstract

Three major legislative projects shall reshape the Swiss financial market architecture. The current sectorial legislation shall be replaced by a cross-sectional system. Some steps towards this new set-up have already been taken; some are currently subject to parliamentary deliberations. This article shall provide the readers with an overview in order to perceive the full impact of the reforms.

Introduction

The Swiss Government's regulatory enthusiasm over past years has not only been driven by globally changing political and economic views—which led to the adaptation of traditional Swiss pillars, such as the Swiss banking secrecy, by implementing international standards, e.g. in view of the Markets in Financial Instruments Directive II (MiFID II)¹—but also by the intention to safeguard the free access to the European financial market by the Swiss financial industry through equivalent legislation as foreseen in European Market Infrastructure Regulation (EMIR) art.13(2).²

Three major legislative projects shall reshape the Swiss financial market architecture: the current vertical, i.e. sectorial, financial market legislation shall be replaced by a horizontal, i.e. cross-sectional or transversal, system,

particularly through the implementation of the new Financial Market Infrastructure Act (FMIA), which already entered into force on 1 January 2016, and the pending Financial Services Act (FinSA) and Financial Institutions Act (FinIA), which are currently subject to parliamentary deliberations.³

While these three major proposals shall be at the heart of this article, a general overview on the reshaping of the financial market architecture and references to further amendments to other acts may prove helpful in order to perceive the full impact of the reforms.

General overview on the reshaping of the financial market architecture

Historically, the Swiss financial market regulation has been product- and sector-oriented. Ever since its early beginnings in 1885 with the adoption of a first supervision act on private insurance companies, replaced by the Insurance Supervision Act in 2004 and the significant Banking Act in 1934, the legislation evolved based on market reality and requirements and was particularly crisis-driven. The Insurance Contract Act 1908 still regulates the relationships between insurance companies and their clients, a first investment funds act in 1966 led to the Collective Investment Schemes Act 2006 (CISA) and the current Stock Exchange Act dates from 1995.⁴ Also, until 2009 the financial institutions, services and products were basically subject to different supervisory authorities or even remained unregulated.

Despite this fundamentally vertical character of the Swiss financial market regulation, horizontal and transversal legislation was gradually implemented, e.g. by the Anti-Money Laundering Act 1997, the National Bank Act 2003 and the Financial Market Supervision Act (FINMASA) 2009, which set the basis of the current single, integrated supervisory authority FINMA.

The new Swiss financial market architecture, with its horizontal and cross-sectional approach, shall now be based on the three major legislative projects: FMIA, FinSA and FinIA, together with the aforementioned FINMASA, as depicted by the following overview:

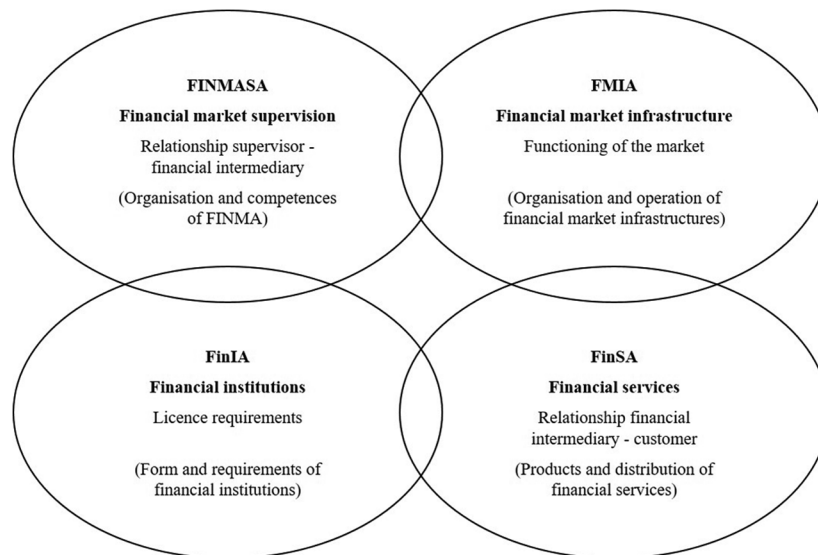
* Responsibility for the information and views set out in this article lies entirely with the author; they do not necessarily reflect the position of BNP Paribas (Suisse) SA and/or of the BNP Paribas Group.

¹ Directive 2014/65 on markets in financial instruments and amending Directive 2002/92 and Directive 2011/61 [2014] OJ L173/349.

² Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1. P. Nobel, "Entwicklungen im Bank- und Kapitalmarktrecht" in *Schweizerische Juristen-Zeitung* SJZ 112 (2016), p.10.

³ P. Nobel, "Entwicklungen im Bank- und Kapitalmarktrecht" in *Schweizerische Juristen-Zeitung* SJZ 111 (2015), p.11.

⁴ Based on the description in P. Nobel, *Swiss Finance Law and International Standards* (Bern: Stämpfli, 2002), pp.597 onwards.



Source: Federal Department of Finance (FDF).

Despite this new approach, the insurance sector will continue to be subject to the current specific regulation, even though it will, nevertheless, be affected by the new financial market architecture, such as FinSA. Further, the CISA shall not be abolished. Finally, the banks shall continue to be subject to the Banking Act, instead of being integrated into FinIA, based on the results of the consultation proceedings. However, the two acts will be reconciled instead.⁵

What has been implemented so far?

With the FMIA, a major piece of legislation has been implemented as part of reshaping the Swiss financial market architecture. Furthermore, other acts have been amended, be it as a consequence of FMIA or due to new international standards, which had to be implemented in Switzerland.

The Financial Market Infrastructure Act

The new FMIA has entered into force on 1 January 2016, after it had been adopted by the Swiss Parliament in 2015. This Act shall adjust the regulation of financial market infrastructures and derivatives trading with international standards as well as with the current market developments. FMIA includes supervisory law requirements for the operation of financial market infrastructures, including, as per the definition of the term in FMIA art.2 lit.a: (1) stock exchange; (2) multilateral trading facilities; (3) central counterparties; (4) central securities depositories; (5) trade repositories; and (6) payment systems.

In addition, it provides for the rules applying in connection with trading in securities and derivatives for all financial market participants (market rules of conduct), particularly the new derivatives trading rules, which are consistent with the international standards, and include provisions on the disclosure of shareholdings, public offers, insider trading and market manipulation, which were previously defined in the Stock Exchange Act.⁶

Since the majority of Swiss derivatives trading is cross-border and mainly takes place with the EU, the provisions regarding derivatives are predominantly based on EU law, including clearing via a central counterparty, reporting to a trade repository and risk mitigation, but excluding transactions among foreign entities, which are not in scope.⁷ Occupational pension schemes and investment foundations will generally not have to fulfil the clearing duties until August 2017 according to the current EU regulations.⁸

Contrary to EU law, however, but similar to the Dodd-Frank Act 2010, exceptions have been foreseen for both financial and non-financial counterparties according to FMIA arts 98 and 99.⁹ The threshold for non-financial counterparties has been set for each different class of derivatives and is basically based on the ones applicable under EMIR¹⁰; a threshold of CHF 8 billion in open derivative contracts has been set for financial counterparties, such as banks and insurers, each according to the respective Financial Market Infrastructure Ordinance (FMIO) art.88. Financial counterparties below this value are deemed to be small and have less extensive duties to fulfil.

⁵ FDF available at: <https://www.news.admin.ch/message/index.html?lang=en&msg-id=56559> [Accessed 12 April 2016].

⁶ State Secretariat for International Financial Matters (SIF) at <https://www.sif.admin.ch/sif/en/home/dokumentation/mediennmitteilungen/mediennmitteilungen.msg-id-59647.html> [Accessed 12 April 2016].

⁷ R. Bahar, "Derivative Trading under the Federal Act on Financial Markets Infrastructure" (2015) (4) *GesKR*, p.485.

⁸ SIF.

⁹ R. Bahar, "Derivative Trading" (2015) (4) *GesKR*, p.485.

¹⁰ R. Bahar, "Derivative Trading" (2015) (4) *GesKR*, p.485.

The FMIO, being the Swiss Government's implementing provision for the FMIA, is based on existing legislation, international requirements and EU law. In the area of the financial market infrastructures, a new set of rules, particularly for combatting the negative effects of high-frequency trading, is now defined. Moreover, the FMIO regulates the reporting duty of trading venue participants. It is now required to report not only securities transactions to the trading venue, but also transactions in derivatives derived from securities admitted to trading on a trading venue. Furthermore, details in order to identify the beneficial owner need to be provided. As regards the adjustment of the IT systems, a transitional period up to January 2017 is foreseen according to FMIO art.29 para.2, expecting that comparable duties shall also take effect in the EU by then. Otherwise, the Swiss Government would consider extending the envisaged transitional period. The FMIO is complemented by the National Bank Ordinance and the new FINMA FMIO, which include the respective implementing regulations for the FMIA under the Swiss National Bank's or FINMA's responsibility.¹¹

Further amendments to other acts

In addition to the FMIA, the following acts have also been amended in the context of reshaping the Swiss financial market architecture:

- **Financial Market Supervision Act**

The Financial Market Supervision Act (FINMASA) has existed since 2009, when a single, integrated and cross-sectional supervisory authority was created—today's FINMA. Hence, it is not a new act. The implementation of FMIA and the pending implementations of FinSA and FinIA, however, have had and will have an impact on the Act. The amendments required by the entering into force of FMIA are rather unrelated to the Swiss financial market architecture and are predominantly affecting the co-operation with foreign authorities, including the spontaneous exchange of information under certain conditions.

As regards FinSA, only minor and rather formal amendments will be required. The implementation of FinIA, however, is set to require various amendments to FINMASA, reflecting the provisions in the FinIA,¹² including provisions on data processing, new enforcement tools and a

semi-public supervisory authority, the details of which shall be discussed below together with FinIA.

- **FINMA Collective Investment Schemes Ordinance**

The FINMA Collective Investment Schemes Ordinance came into force on 1 January 2015, with a transition period until 1 January 2016, in some cases until 1 January 2017. The revision aimed to enhance investor protection, maintain market access, taking into account the changes to international standards, and to ensure that an appropriate and efficient risk management is in place. The ordinance particularly includes new rules on the delegation of fund managers' duties to third parties, on the risk assessment models for derivatives, on the requirements for the management and on the custody of securities, including OTC derivative investment techniques and business transactions.¹³

- **Implementation of FATF Recommendations and new predicate offence to money laundering**

Based on the revised recommendations of 2012 issued by the Financial Action Task Force (FATF), and in order to fix some overdue shortcomings as stated during the FATF's evaluation of Switzerland back in 2005, the Swiss Government proposed a new Federal Act for Implementing the Revised FATF Recommendations. The Act affected various laws and focussed mainly on three topics: transparency regarding bearer shares, the introduction of predicate offences in the tax area and the money laundering reporting system for suspicious activities. The provisions entered into force on 1 July 2015 and on 1 January 2016.

Furthermore, since 1 January 2016, qualified tax fraud is considered a predicate offence to money laundering, as long as the amount of tax evaded exceeds CHF 300,000 according to Swiss Criminal Code art.305bis. Previously, only felonies, i.e. offences that carry an imprisonment sentence of more than three years, qualified as predicate offences to money laundering, but not misdemeanours, such as tax evasion and tax fraud relating to direct taxes.

¹¹ SIF.

¹² FDF, *Explanatory Report* (2014), p.24.

¹³ FINMA, *Report on Consultation Procedure* (2014) available at: <https://www.admin.ch/ch/d/gg/pc/documents/2482/ergebnisbericht-kkv-finma-de.pdf> [Accessed 12 April 2016].

What shall be implemented in the near future?

FinSA and FinIA, being the other two remaining major legislative proposals responsible for reshaping the Swiss financial markets architecture, have been submitted to Parliament after the Swiss Government adopted the respective dispatches in November 2015.¹⁴ These new sets of guidelines should result in a strengthening of client protection, enhance the competitiveness of the financial centre and, by creating a level playing field, reduce competitive distortions between providers.¹⁵

The Economic Affairs and Taxation Committee of the Swiss Council of States decided on 17 February 2016 to enter into the debate and not to reject the dispatches of FinSA and FinIA. It asked the Federal Department of Finance (FDF), however, to submit proposals in order to heavily simplify the acts and reserved the right to change the provisions regarding the supervision of the insurers and of the independent asset managers.¹⁶ The comments made hereunder are based on the current dispatches published by the Swiss government in November 2015.

While FinSA and FinIA were initially anticipated to enter into effect as of 1 January 2017, the delay of MiFID II until 2018 and the intense parliamentary debates will most probably postpone the entering into effect of the two acts to 1 January 2018 as well.¹⁷

The Financial Services Act

FinSA shall govern the relationship between the financial intermediaries and their clients regarding all financial products, whereas, under the current regulations, only banks, securities dealers and collective investment schemes are subject to prudential regulation. FinSA shall also apply to all types of customers in line with the provisions of CISA, such as retail clients, institutional clients and professional clients, although with a different level of protection and with possibilities to opt out or into some levels.¹⁸ Particular focus shall be laid on FinSA's impact as regards: (a) the rules of conduct; and (b) the new prospectus regime.

- **Rules of conduct**

Besides the requirements for the provision of financial services, being a basic training and a continuing development duty according to FinSA art.6, the rules of conduct of financial service providers towards their clients are defined in FinSA arts 8 onwards. As a basic principle, financial services providers shall act in the best interest of their clients and with the

required level of skill, care and diligence, as also provided in Swiss Code of Obligations (CO) art.398. The duties to provide information aims to give investors a clear picture of the services and products they shall receive as regards their term, risks, returns and costs. In order to facilitate the information duties as regards clarifying the scope of the services, i.e. whether providers are acting independently or not, and whether they restrict their investment services to products issued by certain issuers or analyse the entire market, the information may be given to clients in a standardised form and be sent electronically according to FinSA art.9 para.3.

FinSA also codifies existing requirements under contract law and introduces as a regulatory requirement that financial services providers ensure the services and instruments they offer are suitable for their clients.¹⁹ The financial services providers are required to inquire about the financial situation and investment objectives of the clients, and also to take into account their expertise and experience regarding the offered financial instruments or services before making a recommendation. In case the results are unsatisfactory, no advisory or asset management services may be provided. Financial services providers delivering financial services other than advisory or asset management services will have to perform an appropriateness check according to FinSA art.12. The clients' expertise and experience with respect to the offered financial instrument or services shall be assessed. Professional clients are deemed to have the required level of knowledge and experience in order to financially bear the investment risks associated with the financial services (FinSA art.15). As regards institutional clients, neither suitability nor appropriateness checks are required.

Moreover, while FinSA provides for best execution obligations in line with MiFID II, it basically codifies the principles developed by the Swiss Supreme Court regarding inducements and distribution fees as a regulatory obligation applicable to all financial services providers, such as

¹⁴ FDF available at: https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msg-id-59331.html [Accessed 12 April 2016].

¹⁵ Swiss Federal Council available at: <https://www.news.admin.ch/message/index.html?lang=en&msg-id=56559> [Accessed 12 April 2016].

¹⁶ Economic Affairs and Taxation Committee (Council of States) available at: <https://www.parlament.ch/press-releases/Pages/mm-wak-s-2016-02-17.aspx?lang=1031> [Accessed 12 April 2016].

¹⁷ "EU overhaul of financial market rules to be delayed", Financial Times, 10 November 2015. Available at: <http://www.ft.com/cms/s/0/c851182c-8797-11e5-9f8c-a8d619fa707c.html#axzz42luNrmEG> [Accessed 12 April 2016].

¹⁸ R. Bahar and T. Reutter, "Reshaping the Future" (2014) 30(38) *International Financial Law Review* 65–67.

¹⁹ Bahar and Reutter, "Reshaping the future" (2014) 30(38) *International Financial Law Review* 65–67.

accounting and handing over to the client inducements received unless the latter waived such rights in advance.²⁰ Together with extensive documentation and reporting duties as well as the organisational obligations, also as regards the financial services providers' employees and any third party they may instruct, and the duty to register client advisors of Swiss and foreign financial services providers (unless they have obtained an appropriate license according to FINMASA art.3), FinSA provides for a comprehensive and, in view of the respective criminal provisions, also an enforceable set of rules of conduct.

- **New prospectus regime**

Under the current Swiss prospectus regime and regulations, the relevant rules applicable to debt securities offerings depend on whether the offering is private or public. While private offerings are not regulated, i.e. there is no obligation to publish or provide for a prospectus (even though a prospectus or an information memorandum are typically prepared on a voluntary basis), the prospectus requirements for public offerings, in principle, are defined in the CO, whereby the EU Prospectus Directive²¹ and other EU/EEA capital market regulations do not apply.²² In case debt securities shall be listed on a stock exchange in Switzerland, the respective listing requirements and rules apply. Since the prospectus requirements according to the CO are not extensive, a listing prospectus, which complies with the applicable listing rules, usually also covers the provisions of the CO. This is the reason why a Swiss prospectus may not just be referred to as a mere listing prospectus, but also as an issue prospectus.

The new prospectus regime, as provided by FinSA arts 37 onwards, will significantly differ from the current regime described above. Any person making a public offer for the acquisition of securities as defined in FinSA art.3 lit.c or any person who seeks the admission of securities to trading on a trading venue in Switzerland will first have to publish a respective prospectus. This obligation to prepare a prospectus will apply both to primary offerings in connection with issuances and secondary

offerings.²³ Similar to the exemptions provided in the EU Prospectus Directive, however, FinSA also provides for similar exemptions, for example, if the public offer is solely addressed at investors classified as professional clients or at fewer than 150 investors classified as retail clients or at investors acquiring securities for the value of at least CHF 100,000, respectively if the public offer has a minimum denomination per unit of CHF 100,000 and if it does not exceed a total value of CHF 100,000 over a 12-month period. Some types of securities are also exempted according to FinSA art.39. Also, FinSA provides for extensive content requirements, which are generally in line with standard market practice and international regulations. It is also foreseen that the Swiss Government may, according to FinSA art.49, grant a relaxation of the prospectus requirements for small- and mid-sized enterprises, which do not exceed two of the following volumes in the preceding financial year:

- a balance sheet total of CHF 20 million;
- a turnover of CHF 40 million; and/or
- 250 full-time equivalents (FTEs) on average for the year.

The Swiss Government shall also be entitled to grant a relaxation of the requirements, particularly for issuers with low market capitalisation on a trading venue, for issues of subscription rights or for issuers that regularly offer securities publicly or whose securities are admitted to trading on a foreign trading venue, whereby the regulation, supervision and transparency are acknowledged as being appropriate by a domestic trading venue.

While the new rules regarding issuing a prospectus are comparable to the current listing rules used in Switzerland, particularly the listing rules of SIX Swiss Exchange Ltd in Zurich, being the most relevant stock exchange in Switzerland, the prior examination of a prospectus by a reviewing authority constitutes a fundamental change. This new reviewing authority will be appointed by FINMA once FinSA has been implemented. Taking into account the requirements to be applied to

²⁰ S. Abegglen and L. Bianchi, "Regulation of the Point of Sale—An Update on the Rules of Conduct of Financial Services Providers under the Proposed FIDLEG" [2016] *CapLaw* 3.

²¹ Directive 2003/71 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34 [2003] OJ L345/64.

²² L. Wyss, M. Winzap and T. Müller, "Developments in Swiss debt capital markets—2015" in Lisa Paul (ed.), *The International Debt Capital Markets Handbook 2016*, (2015), Ch.XX pp.48–53.

²³ Bahar and Reutter, "Reshaping the future" (2014) 30(38) *International Financial Law Review* 65–67, 66.

said body, it is expected that a private organisation will be appointed.²⁴ The reviewing authority shall render its decision on a submitted prospectus within ten business days, or, in case of a first-time issuer, within 20 business days.

Finally, FinSA will introduce a general obligation to produce and publish a basic information sheet regarding any financial instrument offered to retail clients. All investment products except equities, but including packaged investment products and also straight bonds, will be subject to this new obligation.²⁵

The Financial Institutions Act

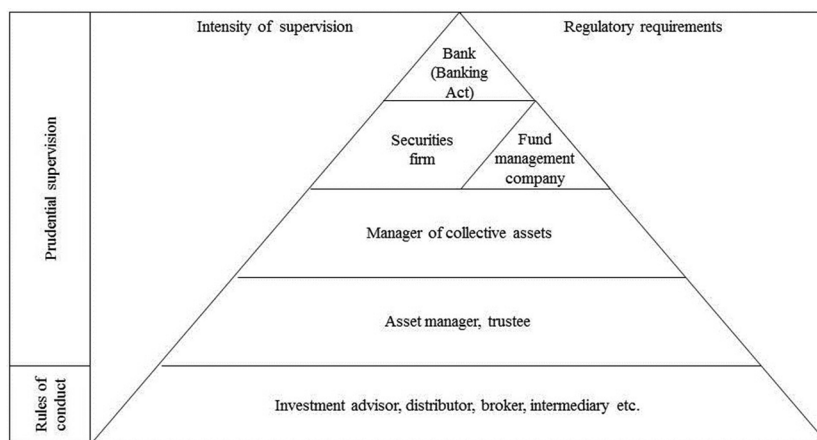
A new supervisory regime for financial institutions, i.e. asset managers, managers of collective assets, fund management companies and securities firms (formerly securities dealers), shall be introduced with FinIA. The basic idea was to draft a framework law, which would govern the licensing requirements and further organisational conditions for the aforementioned financial institutions. FinIA shall:

- enhance the protection of investors and clients of financial institutions;

- increase the functionality of the financial market; and
- increase the stability of the financial system according to FinIA art.1 para.2.

The main changes are related to the prudential supervision of managers of individual client assets, managers of assets of occupational benefits schemes and trustees. Nevertheless, it is not foreseen that all financial institutions will be supervised by FINMA. It is intended that the prudential supervision of managers of individual client assets and trustees shall be performed by a separate supervisory organisation, which is independent in its supervisory activities, based on the US Financial Industry Regulatory Authority (FINRA) model.²⁶ As regards the asset management, both supervisory authorities, i.e. FINMA and the new supervisory organisation, will be given the powers to make provision for an audit frequency of several years, depending on the risk and the activity of those supervised by them.

Furthermore, FinIA will introduce an authorisation chain or regulatory pyramid system. As a rule, the more complete form of authorisation will now also include the authorisation forms which are envisaged for less extensive activities, whereby banks will continue to be governed by the Banking Act,²⁷ as depicted by the following overview:



Source: FDF (adjusted translation).

The authorisation chain or regulatory pyramid system does not exempt entities from fulfilling the duties for their respective activity; it just exempts them from formally obtaining additional authorisation.²⁸

Outlook and concluding observations

Ever since the financial crisis of 2007, the Swiss financial industry has been under tremendous pressure to adapt to the existing political and legislative environment. Many

steps have already been taken, particularly in order to set boundaries to Swiss banking secrecy by signing double taxation treaties or by adopting the OECD standards.

As regards the new financial market architecture, the challenge has been to safeguard the free access to the European financial market by the Swiss financial industry through equivalent legislation. Particularly with the enacting of FMIA and the proposed FinSA and FinIA, the Swiss financial centre should be in a position to secure its international reach. In order to safeguard the financial

²⁴ FDF, *Explanatory Report* (2014), p.69.

²⁵ Bahar and Reutter, "Reshaping the future" (2014) 30(38) *International Financial Law Review* 65–67, 66.

²⁶ Federal Council, Basic information: Dispatch on Financial Services Act and Financial Institutions Act (November 2015), p.5.

²⁷ FDF available at: https://www.efd.admin.ch/efd/en/home/dokumentation/nsb-news_list.msg-id-59331.html [Accessed 12 April 2016].

²⁸ Federal Council, Basic information: Dispatch on Financial Services Act and Financial Institutions Act (November 2015), p.5.

centre's leading position, the Swiss Government and parliament have to ensure its international competitiveness and, thus, constantly adapt the new financial market

architecture to the rapidly changing market conditions, while continuing with the Swiss tradition of clear, understandable and limited legislation.