

Trends and developments in Swiss financial market regulation

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Introduction

Growing retail markets and financial instrument variety, together with the need to keep up with international standards and reach regulatory equivalence with the European Union, have resulted in substantial changes to Switzerland's regulatory framework. Besides securing Switzerland's access to EU financial markets, new objectives have emerged from advancing digitalisation and technological progress in the banking sector. One objective is undoubtedly Switzerland's goal of retaining its status as a leading country in the booming fintech and blockchain industry, which has led to significant developments towards a more flexible, technology-friendly legislative framework.

Business conduct rules

In 2012 Switzerland initiated a substantial reform of its financial legislation following developments in EU market regulation, which will be completed through the introduction of the Swiss Financial Services Act (FinSA) and the Swiss Financial Institutions Act (FinIA) on 1 January 2020. One of the main objectives of the new acts is greater investor protection. In line with the EU Directive on Markets in Financial Instruments (2014/65/EU) (MiFID II), FinSA will introduce a code of conduct for financial service providers regarding their relationship to clients. The so-called 'business conduct rules' include:

- detailed information requirements;
- the obligation to conduct appropriateness and suitability checks;
- documentation requirements;
- best-execution duties;
- rules for handling conflicts of interest; and
- a regime on inducements and similar benefits received by financial service providers.

The extent of the rules' application in concrete cases will vary depending on client categories.

The business conduct rules are expected to have a positive impact on investor protection levels in Switzerland, thereby supporting the development of a Europe-wide level playing field for investment firms. Nevertheless, their implementation will have significant implications for financial service providers, especially in terms of costs. Moreover, despite its strong move towards compliance with MiFID II, the new Swiss conduct code contains a number of differences from the relevant EU provisions, some of which are more detailed than their Swiss equivalent (eg, information duties). Therefore, before offering cross-border services, investment firms must carefully assess the applicable requirements.

Financial services and lending activities

The current Swiss regime for the cross-border provision of financial services, including lending services, to Swiss-based customers is quite liberal. Foreign-regulated entities need not be authorised by FINMA as long as they operate without a business presence in Switzerland (ie, on a strict cross-border basis). Conversely, if these activities involve a permanent physical presence in Switzerland, the cross-border exemption is not applicable. Normally, FINMA retains that a foreign entity has a business presence in Switzerland if it hires employees in Switzerland. Additional criteria that may be relevant to determine whether there is a Swiss presence include the firm's business volume in

AUTHORS

[Alexander Vogel](#)



[Reto Luthiger](#)



[Valérie Bayard](#)



Switzerland or the existence of local agents or teams engaged on a regular basis and that specifically target the Swiss market.

This rather relaxed approach will change follows the introduction of FinSA and FinIA. These acts will introduce, among other things, a registration requirement for foreign financial service providers that intend to address Swiss-based customers. However, client advisers of prudentially supervised foreign financial institutions will not require such registration.

Swiss law currently imposes no general regulatory requirements on lending activities. However, if a lending entity also accepts deposits from the public or refinances itself through different banks, it would generally qualify as a bank and require a banking licence from FINMA. In addition, the granting of loans to individuals for non-commercial purposes (so-called 'consumer credit') is regulated by the Swiss Consumer Credit Act (SCCA). Its provisions also apply to non-professional lenders that offer consumer credit through crowd lending platforms. Lenders that fall under the SCCA must obtain authorisation from the canton in which they are established, with the exception of:

- Swiss banks licensed by FINMA; and
- credit granted to finance the acquisition of goods or services provided by the lender itself.

Reform of deposit insurance system

The Swiss Banking Act provides that, in the event of the bankruptcy of a bank or securities dealer, deposits of up to Sfr100,000 per customer are privileged and will be paid back to depositors within 20 days. If the bankrupt institution has no sufficient liquid funds to pay out such privileged deposits, the deposit insurance system kicks in: the self-regulation body Esisuisse levies special contributions from other banks, which are transferred to the liquidator and, in a second step, to the depositors. This process has generally proved its worth; however, the following aspects are being revised:

- In order to speed up the process and strengthen customers' confidence in the system, a shorter pay-out deadline of seven days will be introduced.
- The deposit guarantee is currently financed *ex post* (ie, the other banks must provide liquidity to the affected bank only once the bank failure actually occurs). Given the dangers related to *ex post* financed systems, especially in the event of a systemic crisis, there is an evident international trend towards the creation of *ex ante* funds. As an alternative, the Federal Council plans to replace the current system, requiring banks to keep additional liquidity, through an obligation to deposit readily realisable securities in hard currencies or Swiss francs in cash at a suitable, independent custodian. If the deposit insurance system needs to intervene, the deposited securities can be easily realised.
- Since the total amount of secured deposits has been growing in recent years, while banks' contribution obligations have remained constant, the deposit guarantee scheme's current limit will be increased accordingly.

Unlike cash deposits, securities deposited in a securities account such as stocks, shares and fund units are considered the property of their customers (ie, not the banks). Consequently, customers of an affected bank retain the right to request the segregation and delivery of such assets in bankruptcy proceedings. To this end, customers' holdings must be separated from banks' holdings. In order to facilitate this procedure, the rules on segregation (in particular, for book-entry securities) will be improved throughout the domestic custody chain and the first foreign depository (if any).

Regulatory framework for fintech firms

Over the past two years, the Federal Council has been working on legislative measures to promote innovation in the financial sector and remove market entry barriers for fintech firms. These measures include the introduction of a new category of authorisation through the amendment of the Swiss Banking Act and its ordinance: since 1 January 2019, fintech firms can apply for a so-called 'fintech authorisation' (or 'banking licence light'), which is special authorisation with simplified requirements. Fintech authorisation holders may accept public funds up to Sfr100 million, provided that they neither invest nor pay interest on these funds. Previously, such activity would have required a traditional banking licence, which was a deal breaker for most fintech companies since, notwithstanding the provision of bank-like services, they typically do not engage in core banking activities. In addition to the fintech authorisation, the new legislative measures extend the exception for the receipt of funds for settlement purposes to settlements within 60 days and exempt the receipt of deposits from the public of up to Sfr1 million from the licence requirement.

FINMA grants fintech licences and supervises those fintech companies that will obtain the authorisation. To simplify the application process, FINMA has published specific guidelines. Any changes to the business model for which the fintech licence was granted as well as other relevant facts (eg, changes in key personnel) must be reported to FINMA. Further, the licence holder must

obtain prior approval from FINMA before implementing substantial changes to the business model.

This new regulatory framework will be completed by the adaptation of a number of other statutory provisions to the developments in distributed ledger technology (DLT). The adapted norms are expected to enter into force on 1 January 2020 and include adjustments to:

- the Federal Law on Debt Collection, to ensure the segregation of crypto-based assets in the event of bankruptcy; and
- the Financial Market Infrastructure Act, to create a new authorisation category for DLT-trading facilities.

The changes to existing acts are not only expected to provide a more flexible and technology-friendly legislative framework, but also grant a higher degree of legal certainty for market participants and authorities.

The development of Swiss legislation in the fintech and DLT sectors has probably been the ultimate push behind establishing what could be called a new category of financial institution. On 26 August 2019, for the first time, FINMA issued banking and securities dealers' licences to two DLT and blockchain service providers registered in Zug and Zurich. These first 'crypto banks' will offer DLT and blockchain-related financial services for institutional and professional customers.

For further information on this topic please contact [Alexander Vogel](#), [Reto Luthiger](#) or [Valérie Bayard](#) at Meyerlustenberger Lachenal by telephone (+41 44 396 91 91) or email (alexander.vogel@mll-legal.com, reto.luthiger@mll-legal.com or valerie.bayard@mll-legal.com). The Meyerlustenberger Lachenal website can be accessed at www.mll-legal.com.

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