Redrawing the boundaries

Swiss financial regulation is set to change markedly in 2020 with the arrival of the Swiss Financial Services Act and Swiss Financial Institutions Act, write Alexander Vogel, Daniel Schoch and Reto Luthiger of Meyerlustenberger Lachenal

In the aftermath of the 2008 financial crisis, and along with the growth of the retail markets and proliferation of financial instruments, Switzerland's regulatory framework has been undergoing significant changes. These developments are driven, on one hand, by the need to keep up with international standards and attain regulatory equivalence with the EU, which will secure Switzerland's access to EU financial markets. On the other, they are driven by the wish to remain a leading jurisdiction for the booming fintech (including blockchain) sector, and this implies a flexible, technology-friendly legislative framework.

Lending business and financial services

Under Swiss law, there are currently no general regulatory requirements for lending activities. However, if the lending entity accepts deposits from the public or refinances itself through different banks, it would generally qualify as a bank, and therefore require a banking licence from the Swiss Financial Market Authority FINMA. Moreover, the granting of loans to individuals for non-commercial purposes (consumer credit) is regulated by the Swiss Consumer Credit Act (SCCA). This is also the case if a non-professional lender offers consumer credit through a crowd-lending platform. Lenders that fall under the SCCA need to obtain authorisation from the canton in which they are established. No authorisation is required for Swiss banks licensed by FINMA, and for credit granted to finance the acquisition of goods or services provided by the lender itself.

The Swiss regime for the cross-border provision of financial services, including lending services, to Swiss-based customers is quite liberal. Foreign regulated entities do not need to be authorised by FINMA, as long as they operate without a business presence in Switzerland: namely, on a strict cross-border basis. Conversely, if these activities involve a permanent physical presence in Switzerland, this cross-border exemption is not applicable. Normally, FINMA deems that a foreign entity has a business presence in Switzerland if it hires employees locally in Switzerland. Further criteria that may be relevant to determine whether there is a Swiss presence are, among others, the firm's business volume in Switzerland or the existence of local agents or teams regularly engaged in specifically targeting the Swiss market.

This rather relaxed approach is expected to change with the introduction of the Swiss Financial Services Act (FinSA) and the Swiss Financial Institutions Act (FinIA), on January 1 2020. These two acts will introduce a registration requirement for foreign financial service providers that intend to address Swiss-based customers. However, for client advisers of prudentially supervised foreign financial institutions, no registration will be required.

Prospectus requirement

Swiss law does not provide for a uniform and comprehensive set of rules on prospectuses. The relevant provisions are scattered over a number of different laws and self-regulations. Moreover, as long as the securities are not listed on a trading venue, approval of a prospectus is not required. The aforementioned FinSA will however change the documentation requirements that apply to the offering of securities (including their admission on a trading venue) and other financial instruments.

Under the new act, anyone who offers securities to the public or applies for their admission on a trading venue, in principle, will be obliged to produce a prospectus. Prospectuses will be subject to detailed content requirements and they will have to be approved by specific approval bodies.

Unlike the existing regime, FinSA does not distinguish between the financial products at issue, introducing instead a number of exemptions that are largely aligned to the EU Prospectus Regulation. Such exemptions can be divided in three categories, depending on whether they relate to the type of offer, to the type of securities, or to an admission to trading. In addition, FinSA will require any financial instrument available to non-professional clients to be accompanied by a key information document (KID); a short document, very similar to the one required in the EU for packaged retail and insurance-based investment products (Priips), displaying in understandable terms the key information concerning the relevant product: product type, risks, performance and costs. The KID will help investors with no or less knowledge and experience regarding financial instruments, to make informed investment decisions.

Most securities that are usually issued by (non-financial) corporate issuers, however, are exempt from this requirement. These include: shares and certain related equity securities (such as participation certificates; convertible bonds; tradable subscription rights; options granted to employees by the employer or a related group entity; and debt instruments (to the extent that they are not considered to be of a derivative nature). Furthermore, collective investment products that are already subject to the requirement to prepare a key investor information document (KIID) under the Ordinance on Collective Investment Schemes (CISO) will also be exempted from this requirement.

To avoid undue burden for distributors of financial products, FinSA expressly states that the Federal Council may recognise certain documents prepared in accordance with laws of other jurisdictions as being equivalent to the Swiss key information document; for instance, the key information documents for Priips pursuant to the relevant EU regulation.

The new regime will have a serious impact on issuers obliged to prepare a prospectus (and/or a KID). Entities looking to finance options will have to consider whether an issuance falls within the scope of the new documentation requirements and if it does, structure the offer in order to fall under one of the several exemptions.

Business conduct rules

Based on the legislative motifs of 'investor protection' and 'regulatory equivalence', FinSA will introduce, on the same lines of the EU Directive on Markets in Financial Instruments (Mifid II), business conduct rules for financial service providers. These new norms include detailed information requirements, the obligation to conduct appropriateness and suitability checks, documentation requirements, best-execution rules, provisions addressing conflicts of interests, and a regime on inducements and similar compensations.

Notwithstanding their expected positive impact for investor protection in Switzerland, and the progress towards a Europe-wide level playing field for investment firms, the conduct rules and their implementation will have significant implications for financial service providers, especially in terms of costs. In fact, despite its strong orientation to EU law, the Swiss conduct code contains a few divergences from Mifid II. Therefore, before offering cross-border services, investment firms should carefully assess the applicable requirements.

Strengthening the deposit insurance system

Under the Swiss Banking Act, in the event of the bankruptcy of a bank or securities dealer, deposits of up to CHF100,000 ($103,000) per customer are privileged and will be paid back to depositors within 20 days. If the institution in bankruptcy does not have sufficient liquid funds to pay out such privileged deposits, the deposit guarantee applies: 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 deposit insurance system has generally proved its worth, however, specific aspects are undergoing a reform.

First, in order to speed-up the process and bolster confidence in the system, a new pay-out deadline of seven days will be introduced. Second, the deposit guarantee is currently financed *ex-post*: the other banks are obliged to provide liquidity to the affected bank only once the bank failure actually occurs. Due the dangers related to *ex-post* financed systems, especially in the event of a systemic crisis, there is a clear international trend towards the creation of *ex-ante* funds. As an alternative, the Federal Council wants to replace the current system, which requires banks to keep additional liquidity, by the obligation to deposit readily realisable securities in hard currencies or CHF in cash at a suitable third-party custodian. In case the deposit insurance system needs to kick in, the deposited securities can be easily realised. Third, since the total amount of the secured deposits has increased in recent years, while the banks' contribution obligations have remained constant, the limit of the deposit guarantee scheme will be adjusted accordingly.

In contrast to cash deposits, securities that are deposited in a securities account such as stocks, shares and fund units are considered to be owned by customers even if they are in custody with the bank. Therefore, the customers of an affected bank have the right to request the segregation and delivery of these assets in the bankruptcy proceedings. To this end, the holdings of customers need to be separated from the bank's own holdings. In order to strengthen 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

Since 2017, the Federal Council has been working on legislative measures to promote innovation in the financial sector and remove market entry barriers for fintech firms. Among these measures, a new category of authorisation was introduced through the amendment of the Swiss Banking Act and its Ordinance. Accordingly, since January 1 2019, fintech firms can apply for 'fintech-authorisation' or a 'banking licence light': a special authorisation with simplified requirements, which allows its holders to accept public funds up to CHF100 million. Entities can do this provided that they neither invest nor pay interest on these funds.

Previously, such activity would have required a full banking licence, a deal-breaker for most fintech companies, since, notwithstanding the provision of bank-like services, they remain generally outside of core banking activities. Besides the fintech-authorisation, the new 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 CHF1 million from the licence requirement.

FINMA is responsible for granting the fintech licence. It will also supervise all licenced fintech companies. FINMA has also published guidelines to simplify the application process. Any changes to the business model on which the fintech licence was granted (or other relevant facts, such as changes in key personnel) must be reported to FINMA. In the event of material changes to the business model, prior approval must be obtained from FINMA before the changes can be implemented.

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). These are expected to enter into force on January 1 2020, and include amendments to the Federal Law on Debt Collection, to ensure the segregation of crypto-based assets in the event of bankruptcy, and to the Financial Market Infrastructure Act, to create a new authorisation category for DLT-trading facilities.