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Brexit and Swiss Financial Markets: Switzerland Takes Steps to Soften a Hard Brexit

In less than a month, the deadline set out under Article 50 of the Lisbon Treaty on the European Union for the United Kingdom (UK) to achieve an agreement on the terms of its withdrawal from the European Union (EU) will lapse and the UK could then leave the EU without any sort of transitional regime under a 'hard Brexit' scenario.

While the relationship between the UK and the EU is at the forefront of discussion and comment, Brexit is also likely to affect relations with third countries such as Switzerland. As part of its 'Mind the Gap' strategy, Switzerland took various steps in connection with the insurance sector and derivatives markets to soften the regulatory blow of a hard Brexit on Swiss financial markets; this briefing describes these in further detail.

Banks, Securities Dealers and Financial Market Infrastructures: Keep Calm and Carry On

Switzerland is neither a Member State of the EU nor the European Economic Area and its sectorial bilateral agreements with the EU do not extend to banking, financial markets or capital markets, with the exception of non-life insurances (see below). This now presents something of a blessing in disguise with Switzerland and the UK needing to scramble to ensure continuity in areas where sectorial agreements with the EU defined trade.

Therefore, from the outset, Brexit will have limited direct consequences for the financial industry from a regulatory perspective, even under a hard Brexit scenario. This applies all the more since, to a large extent, the co-operation between Swiss and UK regulators was conducted at a national level, rather

than through the European institutions, and therefore will also remain strong after Brexit.

More specifically, UK financial institutions and financial market infrastructures will fundamentally continue to be able to serve clients, access Swiss financial markets and deal with counterparties in Switzerland as they have been doing up until now. In particular, Swiss subsidiaries, branches and representatives of UK financial institutions with a licence from FINMA as banks or securities dealers will continue to be able to carry on their activities and will not need to apply for a new licence. Similarly, financial market infrastructures, including trading venues and central-counterparties, which FINMA has already recognised will not need to apply for any new recognition following Brexit. Conversely, this also means that Swiss financial institutions, institutional investors as well as corporate and private clients will continue to be able to enjoy their existing access to the City of London.

Insurance: Insurance Treaty

One important exception to the above relates to non-life direct insurance: under an Agreement between the European Economic Community and the Swiss Confederation concerning direct insurance other than life insurance dating back to 10 October 1989, which was amended several times in the meantime, the Swiss and EU insurance sector was granted mutual and equal freedom to establish companies and branches in the field of direct insurance for damage, which facilitates the operation of international insurance groups.

To ensure continuity for insurance companies, the Swiss and UK governments entered into a new treaty to take effect when the UK leaves the EU: the Swiss-British Treaty on Direct Insurance Other than Life Insurance of 24 January 2019, which in essence replicates the terms of the existing agreement between the EU and Switzerland, thus ensuring continuity for Swiss and UK insurance companies when accessing the Swiss or UK market.

Therefore, continuity and legal certainty should also be guaranteed in this area.

Derivatives: Provisional Recognition of UK Regulations as Equivalent

While, outside of the insurance industry, access to financial institutions did not require any particular steps from the Swiss regulators, the same cannot be said for rules on derivatives trading. The Swiss Federal Act on Financial Markets Infrastructures of 19 June 2015 (FMIA SR958.1), the Swiss counterpart to Regulation (EU) n° 648/2012 (EMIR) or the Dodd-Frank Act in the US, provides for obligations for Swiss counterparties to report trades in derivatives to a trade repository. They also have to clear certain OTC-derivatives through a central counterparty, and mitigate risks related to OTC derivatives that are not centrally cleared by regularly valuing their positions, exchanging initial and variation margin, having

processes to confirm transaction in a timely manner, to reconcile portfolios, to identify and resolve disputes, as well as to engage in portfolio compression exercises.

While these rules are similar to those provided under EMIR or the Dodd-Frank Act, they are not identical. This can therefore lead to conflicting rules, where a Swiss counterparty would need to apply Swiss law even when it deals with a foreign counterparty. To avoid this issue, Swiss law provides two sets of exemptions: on the one hand, Swiss counterparties applying Swiss law may in certain circumstances be relieved from their obligations if their counterparty is subject to conflicting rules (see, e.g., article 102 and 114 FMIA). More importantly, Swiss counterparties are entitled, under article 95 FMIA, to carry out their duties under Swiss law by applying foreign laws, provided that FINMA recognises their equivalence and that, where applicable, the duties are carried out through a financial market infrastructure that is deemed equivalent.

In 2016, FINMA issued its FINMA Guidance 01/2016 provisionally recognising the EU rules on clearing OTC derivative transactions through a central counterparty, reporting of derivative transactions and risk mitigation duties as being equivalent. This determination is, however, specific to the EU regulations and, consequently, would not extend to UK regulations in the event of Brexit.

To overcome this gap, FINMA issued new guidance 01/2019 on 21 February 2019 provisionally recognising the UK regulations that will apply upon Brexit, namely the Over the Counter Derivatives, Central Counterparties and Trade Repositories Regulations 2018 (the EMIR Transposition Act) which transpose EMIR into domestic UK law with a number of minor formal changes as being equivalent to Swiss legislation, when the EMIR Transposition Act is passed by the UK parliament.

As a practical matter, however, the possibility of relying on substitute compliance under the FMIA will

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only apply to central clearing and risk mitigation obligations. Indeed, to this date, FINMA has not recognised any trade repository as being able to accept trade reports under EMIR (or under the EMIR Transposition Act).

Big Gap: Recognition and Enforcement of Judgments under the Lugano Convention

From a legal standpoint, the biggest gap following Brexit will come from the fact that the UK will cease to be bound by the Lugano Convention on the Recognition and Enforcement of Judgments in Civil and Commercial Matters of 30 October 2007 (Lugano Convention).

The Lugano Convention was signed by the EU, Denmark, Iceland, Norway and Switzerland. Upon a hard Brexit, the UK will cease being a State bound by the Lugano Convention and, consequently, judgments issued in the UK will neither receive automatic recognition nor be subject to the enforcement procedure provided by the Lugano Convention, but will need to be recognized and enforced under the Federal Act on Private International Law of 18 December 1987 (PILA; SR 291). This is a much more lengthy and cumbersome process, making the choice of English courts potentially less attractive for contracts with Swiss or European counterparties.

Initiatives are underway to extend the Lugano Convention to the UK after Brexit. However, it is unlikely that they will reach a conclusion in the event of a hard Brexit. Therefore, litigants should expect delays and complications in this area.

Outlook

Overall, while Brexit will yield its share of uncertainty and changes, the impact of it on Swiss-UK relationships across the financial industry is largely manageable from a regulatory perspective and with the Swiss-British Treaty on Direct Insurance Other than Life Insurance of 24 January 2019 and FINMA Guidance 01/2019 the main gaps have already been filled. From a practical perspective, the main concern will be the recognition and enforcement of judgments following a hard Brexit, which will be more cumbersome from a Swiss point of view.

Beyond the regulatory impact, however, as financial institutions reconsider their business model to offer services within the EU and shift teams from the UK to other countries in the EU, it may be necessary to review the set-up used to offer services in Switzerland to ensure that branches and representative offices continue to be linked to the correct entities and if needed apply for new licences in Switzerland if teams there are no longer integrated in the current legal entity but shifted to another entity within the EU.

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