

## Briefing November 2016

# FinTech – Proposed Regulation to Lower Market Entry Barriers

On 2 November 2016, the Swiss Federal Council proposed to ease the Swiss regulatory framework for providers of innovative financial technologies (FinTech). The proposed amendments provide for the following new exemptions and reliefs aiming to enable FinTech in Switzerland:

- (i) Extension of the maximum holding period of third party monies in settlement accounts from 7 to 60 days (without qualifying as client deposits);
- (ii) Introduction of an innovation sandbox allowing the acceptance of client deposits in an amount up to CHF 1 million without triggering a license requirement; and
- (iii) Creation of a new license type for FinTech innovators allowing the acceptance of client deposits in an amount of up to CHF 100 million (banking license 'light').

These exemptions and reliefs do not extend to anti-money laundering regulations, which will continue to apply to FinTech firms if they act as financial intermediaries. The Federal Council's proposal must now be fleshed out in further detail by the Federal Department of Finance by the beginning of 2017. Overall, the amendments are likely to enter into force at the earliest in the second half of 2017 and may be implemented by 2018, assuming the proposal is received positively by all stakeholders.

## Background and Objective

This proposal marks the first concrete step to facilitate FinTech at a governmental level. Indeed, until as early as 2015, the Federal Council took the stance that there was no specific need to address digital innovations in the financial industry. This approach imposed substantial hurdles for FinTech business models, since they often imply handling client funds, thus possibly triggering the requirement for an onerous banking license.

In a speech in September 2015, Mark Branson, the Chief Executive Officer of the Swiss Financial Market Supervisory Authority FINMA (FINMA), took a more open stance. He stated that, while regulation should be neutral as to technology, there was a legitimate need to create a less onerous license for start-ups in the financial industry as long as they do not engage in the traditional banking business of using public deposits to fund their lending business. This proposal was picked up by the Federal Council in April 2016, which initiated the process leading to the policy statement of 2 November 2016.

## Exemptions and Reliefs for FinTech

The proposal of the Federal Council aims, in particular, at facilitating crowd-funding services and other business models that require the acceptance of funds from the public by extending the maximum holding period of funds on settlement accounts and by creating an innovation sandbox allowing to develop a business model without being subject to a prudential license requirement. Furthermore, the Federal Council proposes to introduce a new license subject to less stringent requirements than a banking license. Keeping with the technology neutrality, these new rules would be available to FinTech and to traditional businesses alike, although they were drafted with the former in mind.

### Extension of the Maximum Holding Period of Monies on Settlement Accounts

Swiss banking regulation provides that third-party monies accepted on interest-free accounts for the purpose of settlement of client transactions do not qualify as deposits from the public (article 5 para. 3 lit. c Banking Ordinance; BO). This exemption allows a financial intermediary to hold client monies on settlement accounts in its books.

Currently, FINMA considers that monies can be held on a settlement account for at most seven days. This limits the practical role of this exemption for crowd-funding platforms, where funds may need to be collected for a longer period before being passed on.

The Federal Council proposes to extend the maximum holding period from seven to 60 days. This proposal aims to allow crowd-funding platforms to collect monies from the crowd on accounts in its own name and to hold on to such monies for a collection period of up to 60 days without requiring a banking license, as long as no interest is paid. However, it could also apply to other business models, including traditional ones.

### Innovation Sandbox

Generally speaking, Swiss banking regulation applies to persons that accept, on a commercial basis, or hold themselves out as accepting, deposits from the

public. This condition is deemed satisfied as soon as a person accepts on an ongoing basis more than twenty deposits, regardless of the individual or total amounts, or publicly solicits deposits (article 6 BO). If this threshold is reached, a banking license is required.

This restriction can be limiting to FinTech or other business models in the early stages of development because they have more than twenty clients or hold themselves out as accepting deposits from the public.

Following the proposal of Mark Branson, the Federal Council proposes to introduce an innovation 'sandbox' allowing start-ups to develop their projects without a license as long as the total volume of deposits does not exceed CHF 1 million. If accepted, this proposal would allow FinTech or other start-ups (and, in principle, even established companies) to accept deposits from an unlimited number of clients as long as the total volume does not exceed CHF 1 million. As a safeguard, however, firms using this sandbox exemption would be required to inform their customers that they are not supervised by FINMA.

From a practical perspective, the interest for this exemption as a long-term solution should be limited. However, it offers an interesting room for innovators to develop and test their business model during the 'proof of concept' phase without incurring the full burden of complying with prudential requirements.

### New License for FinTech Innovators

The regulatory requirements for obtaining and maintaining a banking license are very stringent. This creates a significant entrance barrier for most FinTech firms. This issue is a source of concern, since this regulatory regime seeks to address the risks associated with a traditional banking model based on accepting deposits from the public to funds loans, while FinTech business models often do not run the gamut of active and passive banking business.

The Federal Council proposes to solve this problem by introducing a new type of license for FinTech firms and other entities that accept public deposits but do not engage in commercial banking. This regime will, subject to additional safeguards, be open to entities

accepting less than CHF 100 million in deposits provided that they (a) do not pay any interest to depositors and (b) do not invest the deposits (a term that calls for further clarification).

In turn, the regulatory regime is envisaged to be substantially less burdensome than the one applicable to banks. In particular, license holders will be subject to a simpler capital adequacy framework requiring them to hold 5% of the assets on deposit but in no event less than CHF 300,000 in capital. Moreover, deposits with FinTech innovators will not be covered by the Swiss depositor protection system (*Einlegerschutz*).

This regime should be of interest for e-money issuers and crowd-funding platforms who would intend to hold client funds for a period exceeding the 60-day limit available for settlement accounts described above, but will also be available to other business models.

## **Application of Anti-Money Laundering Regulations**

The exemptions and reliefs proposed by the Federal Council do not extend to anti-money laundering regulations. FinTech firms that act as financial intermediaries will therefore continue, as a matter of principle, to be subject to the duty to join a self-regulatory organization or be directly supervised by FINMA for anti-money laundering purposes and comply with regulatory requirements regarding know-your-customer and anti-money laundering.

Although this will continue to create a burdensome requirement, FINMA already addressed earlier this year the major technological impediments in this area in connection with the identification of clients by recognizing various new forms of identification (e.g. video-based) that are better suited for FinTech business models.

## **Next Steps**

The Federal Council instructed the Federal Department of Finance to prepare a draft bill for consultation by the beginning of 2017 based on the proposals outlined above.

Some of these proposals, such as the extension of the maximum holding period for settlement accounts and, possibly, the license sandbox, could be implemented by amending the Banking Ordinance. The Federal Council could therefore implement them relatively quickly in the course of 2017 after a hearing process.

By contrast, where the proposal requires an amendment of a federal act such as the Banking Act, for instance to introduce a new regulatory license regime, it will need to follow the ordinary legislative procedure and will have to go through parliament after a consultation phase. However, this process could be accelerated to the extent the Economic Affairs and Taxation Committee of the Council of States, one of the chambers of Swiss Parliament (*Kommission für Wirtschaft und Abgaben des Ständerates, WAK-S*), already proposed in October 2016 in the context of the legislative project for a Financial Services Act (FinSA) and a Financial Institutions Act (FinIA) to amend articles 1a and 1a<sup>bis</sup> of the Banking Act to create the basis for the FinTech license. In any event, it is uncertain when these changes will be implemented, although realistically we would not expect them to enter into force before 2018.

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