Global Legal Insights

Banking Regulation

2017

Fourth Edition

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global legal group

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Switzerland

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Introduction

The financial crisis of 2008/2009 triggered a wave of new regulations in Switzerland in recent years. Besides client protection and stability for the overall economic system, past and currently ongoing reform projects are a reaction to international regulations and particularly aim to harmonise Swiss regulations with existing and upcoming EU regulations, such as the EU Directive 2011/61/EU on Alternative Investment Fund Managers ("**AIFMD**"), Directive 2014/65/EU on Markets in Financial Instruments II ("**MiFID II**") and Regulation (EU) No 600/2014 on Markets in Financial Instruments ("**MiFIR**") to ensure Swiss financial institutions' access to the European financial markets. The core of the new Swiss banking regulation will consist of the existing Federal Act on Banks and Savings Banks of 8 November 1934 ("**BankA**"), the existing Federal Act on the Swiss Financial Market Supervisory Authority of 22 June 2007 ("**FINMASA**"), the Financial Market Infrastructure Act of 19 June 2015 (entered into force on 1 January 2016; "**FMIA**"), the planned Federal Financial Services Act ("**FinSA**") and the planned Financial Institutions Act ("**FinIA**"). It is currently expected that the FinSA and FinIA will enter into force on 1 January 2018 at the earliest.

Furthermore, the current environment has been characterised by a variety of legal developments, particularly in international tax matters: first, at the end of August 2013, the US Department of Justice ("**DoJ**") and the Swiss Federal Council announced a programme for the settlement of the tax dispute between the Swiss banks and the DoJ ("**US Program**"). The process of concluding Non-prosecution Agreements ("**NPA**") with the DoJ is already well advanced. As per 6 February 2017, 78 of approximately 100 banks participating in the US Program concluded a NPA with the DoJ (http://www.justice.gov/tax/swiss-bank-program). Furthermore, in the course of the implementation of the revised recommendations of the Financial Action Task Force ("**FATF**"), several laws have been amended. E.g., under the amended provisions of the Swiss Criminal Code ("**SCC**") (entered into force on 1 January 2016), certain types of tax fraud constitute a predicate offence for money laundering. Further, pursuant to new provisions in the Swiss Code of Obligations ("**CO**"), acquirers of non-listed shares (except for shares in the form of book-entry securities) have to report to the issuing company the acquirer of bearer shares and the beneficial owner of registered or bearer shares if the threshold of 25% of the share capital or votes has been reached or exceeded. Correspondingly, the issuing companies have to keep a register of bearer shareholders and of beneficial owners. In addition, the Federal Act on the International Automatic Exchange of Information in Tax Matters ("**AEOI-Act**") entered into force on 1 January 2017. It provides a legal foundation in Switzerland for the OECD automatic exchange of information in tax matters with countries abroad ("**AEOI**")

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(collection of data as of 2017 and exchange of data as of 2018 at the earliest), resulting in a direct notification of foreign tax authorities regarding financial information.

Banks in Switzerland are facing pressure due to these regulatory and legal developments. They led to heavily increased reporting burdens. In addition, the tougher international capital and liquidity standards such as Basel III issued by the Basel Committee on Banking Supervision ("**BCBS**") or the new standards set by the Financial Stability Board ("**FSB**") over the last few years led to increased costs of a bank's capital and long-term funding and other regulatory requirements including, e.g., new standards for resolution planning. Besides these increased burdens, the major challenges currently lie in responding to strong competitive pressure and the resulting declining profitability, further aggravated by the continued low (including negative) interest rates and the strong Swiss currency.

The accumulation of these factors forced many banks to scale back some of their activities in Switzerland and consequently led to a trend toward consolidation in the Swiss banking sector in recent years. These tendencies toward consolidation are primarily seen with small banks and foreign Swiss bank subsidiaries, while foreign banking groups in particular either close down their operations in Switzerland by liquidation or sale or try to seek a critical mass of assets under management through acquisition or merger.

Despite this currently challenging environment, Switzerland is still a very attractive financial centre, as it combines many years of practical knowledge with expertise, particularly in private banking and wealth management. In particular, the Swiss financial centre is the global market leader in the area of assets managed cross-border (i.e. assets managed offshore, outside the owner's home country) with a global market share of 25% (see Swiss Banking, Banking Barometer 2016: Swiss banks stable, but face significant challenges, 1 September 2016, available at www.swissbanking.org). Professional advice, top-quality services and sophisticated banking products are the traditional strengths of Swiss financial institutions. Furthermore, a good educational and training infrastructure guaranteeing a reliable stream of qualified staff, political and economic stability, a liberal labour market and good infrastructure are also convincing arguments to build up Swiss banking presences. Moreover, the global position of Switzerland for currency trading has been further strengthened, since the Peoples' Bank of China authorised the Zurich Branch of China Construction Bank to act as a clearing bank for the Chinese currency Renminbi in November 2015. This Renminbi hub substantially facilitates the use of Renminbi in cross-border transactions. In addition, Switzerland has become a hub for innovative financial technologies (FinTech). To ease the Swiss regulatory framework for FinTech providers with the aim to further strengthen the competitiveness of the Swiss financial centre, the Federal Council launched a public consultation on proposed amendments to the BankA and the Federal Ordinance on Banks and Savings Banks of 30 April 2014 ("**BankO**") from 1 February 2017 until 8 May 2017.

Regulatory architecture: overview of banking regulators and key regulations

Responsible bodies for banking regulation

The Swiss Financial Market Supervisory Authority ("**FINMA**") is the supervisory authority for banks, securities dealers and other financial institutions such as collective investment schemes and insurance undertakings. FINMA's primary tasks are to protect the interests of creditors, investors and policyholders and to ensure the proper functioning of financial markets. To perform its tasks, FINMA uses the instruments of licensing, supervision, enforcement and regulation.

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The Swiss National Bank ("**SNB**") is an independent central bank and responsible for monetary policy and the overall stability of the financial system. This includes the mandate to determine banks and bank functions as systemically important upon consultation with FINMA.

Under the so-called dual supervisory system, FINMA in its supervision largely relies on the work of recognised audit firms. These audit firms as an extended reach of FINMA provide a direct supervision by conducting regulatory audits of the banks that have to be submitted to FINMA. In addition, FINMA might undertake targeted on-site supervisory reviews with the aim to achieve a timely and comprehensive supervision. As an exception from the dual supervisory system, a dedicated supervisory team of FINMA directly monitors UBS Inc./ UBS Switzerland Ltd and Credit Suisse Ltd, the two large Swiss banking groups.

Key legislation or regulations applicable to banks

The key legislation for Swiss banks includes:

- the BankA and the BankO outlining, among others, the banking licence requirements and accounting rules for banks; and
- the Federal Act on Stock Exchanges and Securities Trading of 24 March 1995 ("**SESTA**"); the Ordinance on Stock Exchanges and Securities Trading of 2 December 1996 ("**SESTO**") containing, among others, rules on licence requirements for securities dealers, the FMIA and the Ordinance on Financial Markets Infrastructures ("**FMIO**"), containing, among others, i) licence requirements for stock exchanges, multilateral trading facilities, organised trading facilities, central depositories, central counterparties, payment systems and trade repositories, ii) takeover and disclosure rules referring to listed companies, and iii) regulations on market conduct in securities and derivatives trading.

The Swiss regulatory architecture is currently subject to a fundamental reform (see more information on the reform of the legislation below).

Further important regulations are:

- the Ordinance of FINMA on Foreign Banks in Switzerland of 21 October 1996 ("**FBO-FINMA**"); the Federal Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Dealers of 1 June 2012 ("**CAO**"); the Ordinance on Liquidity for Banks of 30 November 2012 ("**LiqO**") and the Ordinance of FINMA on the Insolvency of Banks and Securities Dealers of 30 August 2012 ("**BIO-FINMA**"); and
- the Federal Act on Combating Money Laundering and Terrorist Financing in the Financial Sector of 10 October 1997 ("**AMLA**"); the Federal Act on Collective Investment Schemes of 23 June 2006 ("**CISA**") and the Ordinance on Collective Investment Schemes of 22 November 2006 ("**CISO**"); and the FINMASA that provides a framework regulation for FINMA.

In addition, FINMA further specifies financial regulation in numerous circulars. FINMA circulars as such are in principle not binding for Swiss courts but constitute a mere interpretation by FINMA of the applicable law. However, FINMA circulars might *de facto* have a binding effect for banks since a violation may lead to regulatory sanctions.

Furthermore, the Swiss financial sector has a long tradition of industry-sponsored self-regulation initiatives. Against this background, FINMA acknowledged several self-regulatory guidelines and agreements as minimum standards, thus incorporating them within the regulatory framework and subjecting non-compliance to enforcement action (see FINMA-Circular 2008/10 on "Self-regulation as a minimum standard"). An important example of self-regulation is the agreement on the Swiss bank's code of conduct with regard to the exercise of

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due diligence of 2016 ("**CDB 16**") by the Swiss Bankers Association ("**SBA**"), which defines know-your-customer policies that banks and securities dealers must apply.

Influence of supra-national regulatory regimes or regulatory bodies

Switzerland is engaged in numerous international bodies, such as the FSB, the Bank of International Settlements ("**BIS**"), BCBS and the International Organization of Securities Commissions ("**IOSCO**"). Furthermore, Switzerland is a member of the FATF that sets out international standards in the area of anti-money laundering ("**AML**"). The standards established by supra-national organisations have a strong impact on Swiss regulation in the financial sector, including, e.g., FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions dated 15 October 2014 and Guidance on Arrangements to Support Operational Continuity in Resolution, dated 18 August 2016. As a case in point, Basel III had a significant influence on the Swiss regulatory framework, such as CAO or LiqO. Furthermore, international standards have an increasing importance for Switzerland as it has to ensure access for its financial institutions to foreign markets and to maintain a good reputation of the Swiss financial market overall.

The Swiss regulatory framework is particularly influenced by developments in the European Union. As an example, the European Union recently harmonised their capital market regulation with MiFID II and MiFIR. Consequently, the Swiss legislator is following up and is voluntarily harmonising certain aspects of Switzerland's legislation with MiFID II provisions in the draft FinSA. This is required to maintain access to the European financial markets (which requires, among others, a regulation that is equivalent to the EU regulation).

The same also applies in the context of derivatives trading: the provisions on derivatives trading of the FMIA are significantly influenced by the respective provisions in the European Market Infrastructure Regulation (EU) No 648/2012 ("**EMIR**") and by rules of other international regulatory bodies: for example, FMIA should implement the commitments assumed at the G20 summit in Pittsburgh in 2009 and adapt the Swiss regulation of the financial market infrastructures and derivatives trading to international requirements.

Furthermore, the current revision of the Federal Act on Data Protection ("**FADP**"), which is likely to have an impact in several sectors, including the banking sector, aims to harmonise certain aspects of the FADP to the recently revised data protection regime of the European Union, in particular the General Data Protection Regulation (EU) No 2016/679.

The so-called "White Money Strategy" which intends to combat abuses in the areas of money laundering and taxation in the Swiss financial market is a general response to the recent criticism of the Swiss financial centre and was heavily influenced by the recommendations of the FATF in connection with international AML standards as well as the pressure of the OECD to adopt the AEOI. Against this background, a legal foundation for introducing the AEOI in Switzerland was created with the AEOI-Act that entered into force on 1 January 2017. Under the AEOI-Act, financial institutions subject to the AEOI-Act must collect specific data from 2017 onwards and submit it to the Swiss Federal Tax Administration that in turn exchanges the data with the tax authorities of the partner states for the first time in 2018. Switzerland will start the exchange of data with 37 partner states (including all EU Member States) as of 1 January 2018. In addition, it is currently expected that Switzerland will start the exchange of data with 41 additional states as of 1 January 2019. Furthermore, the recommendations of FATF also influenced the revision of AMLA that was passed by Parliament in December 2014 and came into effect on 1 January 2016, implementing, e.g., new regulations in connection with business relationships and transactions with politically exposed persons.

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Restrictions on the activities of banks

A bank must obtain a licence from FINMA in order to operate in Switzerland or from Switzerland to abroad. Formally, Swiss law only provides for one type of banking licence. However, a bank is required to describe in detail the scope of business (including the subject matter and geographical scope) of its activities in the licence application (and in the article of association and the organisational rules). A broad scope of business in principle requires a more extensive organisation of the bank, in particular to mitigate the risks of potential conflicts of interests within the bank. Similarly, a securities dealer is required to describe in detail the scope of business activities in the licence application for a securities dealer (art. 10 SESTA). In case of any changes (in particular an expansion) of the scope of the business activities of a bank or securities dealer, the respective bank or securities dealer is required to inform and obtain prior approval of FINMA. Consequently, the scope of a banking and/or securities dealer licence is *de facto* individualised and, hence, varies from case to case.

This being said, Switzerland follows a model of universal banking. Therefore, a bank, with few exceptions, is allowed in addition to the deposit-taking business to engage in any other business in the financial industry provided it has an appropriate organisation to carry out such activity and manage the operational and reputational risks it entails. It is, thus, fairly common for banks to be also licensed as securities dealers, to provide a full range of portfolio management services to their clients or even to act as a family office for high-net-worth individuals. Similarly, the two large Swiss banking groups carried out their investment banking business out of the same legal entity that serviced retail clients until fairly recently, when they were pressured by the regulators to separate these businesses to facilitate their potential resolution as systemically important financial institutions ("**SIFIs**").

Recent regulatory themes and key regulatory developments in Switzerland

Contemplated new architecture of the Swiss regulatory framework

The current Swiss regulatory framework is based on the so called "silo-principle": the various financial institutions are, in principle, regulated in separate Swiss federal acts. For example, banks are primarily subject to BankA (and BankO), securities dealers to SESTA (and SESTO), and fund management companies and asset managers of collective investment schemes are subject to CISA (and CISO). Similarly, the FMIA and FMIO, which entered into force on 1 January 2016, regulate the effectiveness of the financial market with view to financial infrastructures. The implementation of the FMIA also entailed several changes in other areas, e.g. with regard to administrative assistance, where FINMA now may not be required to inform the relevant customer prior to transmitting the information to the requesting authority if the purpose of the administrative assistance were jeopardised by the prior notification (art. 42a para. 4 of the revised FINMASA, entered into force on 1 January 2016).

However, the Swiss regulatory architecture is currently subject to a fundamental reform. Under the currently planned new regulatory framework, as reflected in various stages of draft legislation, financial institutions will be subject to a "cross-sectorial regulation". In particular, the reform would introduce two new acts: i) FinSA regulating the relationship between the financial intermediary (of all sectors, including banks, securities dealers and insurance undertakings to the extent they provide financial services) and the customers; and ii) FinIA containing the licence requirements of financial institutions (whereby all institutions need to comply with certain fundamental requirements but additional requirements apply if a licence allows a broader range of activities) with the exception of banks which will remain subject to the regulatory requirements set out in the BankA (and BankO).

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The Federal Council approved the dispatch on the FinSA and FinIA on 4 November 2015. The drafts of FinSA and FinIA are now being debated in parliament. It is currently expected that the FinSA and FinIA will enter into force on 1 January 2018 at the earliest. Under the current draft version of the economic affairs and taxation committee of the council of states (*Kommission für Wirtschaft und Abgabgen des Ständerates, WAK-S*) of 3 November 2016, the insurance sector is out of the scope of FinSA. Furthermore, the competent supervisory body for asset managers under FinIA shall be one (or several) supervisory bodies authorised and supervised by FINMA.

The Federal Council launched a public consultation on proposed amendments to the BankA and the Federal Ordinance on Banks and Savings Banks of 30 April 2014 ("**BankO**") from 1 February 2017 until 8 May 2017. The amendments seek to ease the Swiss regulatory framework for providers of innovative financial technologies (FinTech), e.g. crowdfunding and crowd-lending, electronic payment services, robo-advice and crypto-currencies. The proposed amendments include two exemptions from the requirement to obtain a banking licence in connection with certain deposit-taking activities and introducing a new type of licence, which would be subject to less stringent requirements, for financial innovators and other interested parties (banking licence 'light'). The proposed amendments to the BankA and BankO are likely to enter into force at the earliest in 2018, assuming the proposal is received positively by all stakeholders.

Implementation of the Basel III requirements

Under LiqO (as in force since 2012), banks have to appropriately manage and monitor liquidity risks. It was thus possible to transpose part of the international liquidity standards of Basel III into Swiss law. In a further step, the revised LiqO (entered into force on 1 January 2015) has now also adopted the new quantitative liquidity requirements in accordance with the international liquidity standards. In particular, a Liquidity Coverage Ratio ("**LCR**") has been introduced for short-term liquidity, requiring banks to provide for sufficient high-quality liquid assets. A bank should, among others, be able to survive for at least 30 days in the event of a liquidity stress scenario with client deposits being withdrawn or difficulties with securing refinancing on the capital market.

In addition, the revised CAO that entered into force on 1 January 2017 implemented the adjusted regulations of Basel III on credit risk capital requirements for derivatives, fund investments and securitisations for banks. FINMA issued the associated implementing provisions in a new Circular 2017/7 "Credit risks – banks" that entered into force on 1 January 2017 with a transitional period of one year.

Furthermore, e.g. the new FINMA Circular 2015/3 "Leverage ratio – banks" implemented the required calculation rules for the leverage ratio in accordance with Basel III in Switzerland. The circular entered into force on 1 January 2015.

Implementation of the Foreign Account Tax Compliance Act (FATCA)

On 2 June 2014, the agreement between Switzerland and the United States on cooperation to simplify the implementation of the unilateral US regulation FATCA entered into force. Under this agreement, the implementation of FATCA in Switzerland was based on the so-called "Model 2", which means that Swiss financial institutions disclose account details directly to the US tax authority with the consent of the US clients concerned. However, in October 2014, the Federal Council approved a mandate for negotiations with the US on switching to "Model 1", which might lead to the application of the automatic exchange of information between Switzerland and the US.

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Bank governance and internal controls

Key requirements for governance of banks

In order to obtain a FINMA banking licence, Swiss banks must, *inter alia*, comply with specific governance requirements as outlined in particular in BankA and BankO, and further specified in guidelines and publication of FINMA, such as the FINMA Circular 2008/24 "Supervision and Internal Control – Banks" of 20 November 2008 ("**Circular 2008/24**") and the FAQs "board of directors of banks and securities dealers" of 28 August 2012 ("**FINMA FAQ**").

As of 1 July 2017, the new Circular 2017/1 "Corporate governance – banks" ("**Circular 2017/1**") will enter into force, streamlining the regulatory framework on corporate governance for banks and certain other financial institutions by i) consolidating the currently applicable guidelines outlined e.g. in the Circular 2008/24 and the FINMA FAQ, and ii) partially revising the minimum requirements as well as the underlying principles. Circular 2017/1 remains to a large extent in line with the currently applicable FINMA guidance, except for a number of changes in specific areas. A significant change in Circular 2017/1 *vs.* the current regulation is, e.g., the shift from a "comply or explain" approach as currently applied in several areas to a consistently applied principle of proportionality. This allows FINMA to consider on a case-by-case basis the characteristics of each bank in terms of size, complexity, structure and risk profile.

Good reputation and guarantee of a proper business conduct

Persons entrusted with the bank's administration and management must enjoy a good reputation and guarantee proper business conduct (art. 3 para. 2 *lit.* c BankA). Furthermore, qualified shareholders of a bank (i.e. persons holding at least 10% of the capital or voting rights or that otherwise have a significant influence on the bank) must guarantee that their influence will not have a negative impact on the bank's prudent and solid business activity (art. 3 para. 2 *lit.* c^{bis} BankA).

Composition of the board of directors

A bank's board of directors as a body and each board member must meet specific conditions, including the following:

- To comply with the independence requirement, the board members have to structure their personal and business relationships in a way to avoid possible conflicts of interest with the bank. In particular, at least a third of the board members must be independent (Circular 2017/1 N 17 *et seq.*). FINMA may in justified exceptional cases grant exceptions. This might in particular be relevant in financial groups.
- The board of directors in its totality must have adequate management expertise and the required specialist knowledge and experience of the banking and financial services sector. It is diversified to the extent that all key aspects of the business, including finance, accounting and risk management, are adequately represented (Circular 2017/1 N 16).
- The board of directors must be comprised of at least three members. However, the actual number of directors required depends on the size, complexity and risk profile of the bank (art. 11 para. 1 BankO and FINMA explanatory notes to the draft Circular 2017/1 N 3.2.2).

Committees of the board of directors

Banks in the supervisory categories 1–3 are required to establish an audit and a risk committee, irrespective of the total number of members of the board of directors. However, banks in the supervisory category 3 may combine the two committees (Circular 2017/1 N 31).

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Internal audit function

The board of directors in principle has to establish an internal audit function that directly reports to the board or one of its committees, typically to the audit committee. The internal audit function works independently from the daily business processes and in particular provides an important basis for the assessment of whether the bank has implemented an adequate and effective internal control system (Circular 2017/1 N 82 *et seq.*)

Mandatory management functions

Banks in the supervisory categories 1–3 have to implement the role of an independent chief risk officer ("**CRO**") who has to be a member of the management body if the bank is systemically relevant. Such CRO may be responsible also for other independent control functions (e.g. for the compliance function) even in case of systemically relevant banks (Circular 2017/1 N 67 *et seq*.).

Remuneration of a bank's employees

As a general rule, a bank's remuneration system must not offer any incentives for an employee to disregard the bank's internal control mechanisms. In particular, the remuneration system for employees of internal audit, the compliance function and the risk function may not contain incentives that could lead to a conflict of interests. Therefore, their remuneration (among others, through salaries and bonuses) may not depend on the performance of individual products and transaction.

The FINMA Circular 2010/1 on remuneration schemes ("**Circular 2010/1**") outlines minimum standards for remuneration schemes of banks and other financial institutions. It in particular includes the requirement of a remuneration scheme to be simple, transparent, implementable, and oriented towards the long term. The revised Circular 2010/1 that will enter into force on 1 July 2017 mandatorily only applies to banks of the supervisory category 1 (i.e. to UBS and Credit Suisse) and the two largest insurance groups, being Zurich and Swiss Re (see notes 6 and 7 of the Circular 2010/1). However, Circular 2010/1 applies as a non-binding code of best practice to all other institutions. In addition, FINMA may in justified cases require such other institutions to mandatorily implement the Circular 2010/01 in full or in part if appropriate in the light of the circumstances (Circular 2010/1 N 9).

On 1 January 2014, the ordinance against excessive compensation implementing the so-called "Say-on-Pay" Initiative entered into force, toughening the formal corporate governance regime for listed companies. Among others, it prohibits severance payments (golden parachutes), advance payments and similar extraordinary payments to directors or senior managers. Furthermore, the aggregate compensation of directors and the senior management is subject to the approval of the general meeting of shareholders. In the course of the ongoing revision of the company law, the Federal Council proposes to further implement the Minder Initiative by including provisions on "say-on-pay" in the CO.

Scope and requirements for outsourcing of functions

Under the FINMA-Circular 2008/7 "Outsourcing – banks" ("**Circular 2008/7**"), in principle, any type of service may be outsourced without the approval of FINMA if the bank complies with the data protection requirements and with the further requirements of Circular 2008/7. However, the following activities, among others, cannot be outsourced according to Circular 2008/7: direction, supervision and control by the board of directors; executive management tasks of the executive management; and decisions of the management on entering or terminating a business relationship with clients. Furthermore, certain functions

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such as risk management and other central control functions may not be entirely outsourced as a matter of FINMA practice. The Circular 2008/7 is currently being revised. FINMA issued the draft circular 2017/xx and ran a consultation phase that ended on 31 January 2017. Based on such draft, e.g. intra-group outsourcing shall be treated with the same caution and subjected to the same level of monitoring as external outsourcing. Furthermore, in particular, additional requirements for systemically important banks shall be implemented.

Bank capital requirements

In order to obtain a banking licence from FINMA, a bank must have a fully paid-in share capital of at least CHF 10 million (art. 15 para. 1 BankO). However, FINMA in principle requires a bank to have additional capital of at least CHF 10 million (that might be contributed e.g. as well in the form of a subordinated loan) taking into account the bank's contemplated business activities.

The CAO specifies in more detail the regulatory capital required by Swiss banks, particularly depending on the bank's size and scope of business. The required capital comprises, in principle, the following parts:

- *Minimum required capital*: A bank must hold at least 8% of the risk-weighted positions as minimum required capital, whereof at least i) 4.5% must be held in the form of common equity tier 1 capital ("CET1 ratio"), and ii) 6% must be held in the form of tier 1 capital ("T1 capital ratio") (art. 42 para. 1 CAO).
- *Capital buffer*: A bank must in principle hold a capital buffer between 2.5% and 4.8% of their risk-weighted positions in particular in the form of common equity tier 1 capital (CET1), depending on the supervisory category of the bank (art. 43 para. 1 and appendix 8 CAO; art. 2 para. 2 and appendix 3 BankO).
- *Counter-cyclical buffer*: Upon the Swiss National Bank's request, the Swiss Federal Council may, if necessary, require the banks to hold a counter-cyclical buffer of a maximum of 2.5% of their risk-weighted positions in Switzerland in the form of common equity tier 1 capital to i) enhance the banking sector's resilience against the risk of excessive credit growth, or ii) counteract excessive credit growth (art. 44 CAO). Currently, the Federal Council has activated the counter-cyclical buffer to counteract the risk of a real estate bubble fuelled by cheap mortgage loans and requires banks to hold a counter-cyclical buffer of 2% of their risk-weighted positions whereby a residential property in Switzerland acts as real security (in accordance with art. 72 CAO).
- *Extended counter-cyclical buffer*: Banks with a balance sheet of at least CHF 250 billion, of which the total foreign commitment amounts to at least CHF 10 billion, or with a total foreign commitment of at least CHF 25 billion have to hold an extended counter-cyclical buffer in the form of common equity tier 1 capital (CET1). Such buffer amounts to the weighted average of the counter-cyclical buffers that apply in the member states of the Basel Committee where the bank's relevant receivables from the private sector are located, but in no case more than 2.5% of the risk weighted positions (art. 44a CAO).
- *Additional capital*: FINMA may require a bank to hold additional capital if the *minimum required* capital and counter-cyclical buffer does not sufficiently cover the risks of a specific bank (art. 45 CAO).
- *Additional requirements for systemically important banks (SIFIs)*: In addition to the above-mentioned requirements that apply to all banks, SIFIs have to comply with additional requirements, for example the capital of each individual entity of the SIFI must amount to at least 14% of the risk-weighted positions (art. 124 *et seq*. CAO).

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Rules governing banks' relationships with their customers and other third parties

Regulations applying to the bank's dealing with third parties

Banking and securities dealer activities

In Switzerland, the primary law governing the relationship between banks or securities dealers and their clients is the private civil law laid down in the CO. In many instances, a banking relationship is subject to the principles of the law of mandate of the CO. Under such provisions, an agent has to act faithfully and diligently (art. 398 para. 2 CO). Furthermore, the nature of the legal duties owed by and customs of banks have been developed through court practice and by professional standards established by recognised self-regulation organisations.

Securities dealers must comply with the rules of business conduct outlined in art. 11 SESTA, including the duty to provide information, the duty of diligence and the duty of loyalty. Furthermore, rules of self-regulatory organisations recognised by FINMA as minimum standard requirements applicable to certain financial institutions specify these duties. These self-regulatory rules include among others the Code of Conduct for Securities Dealers, the Portfolio Management Guidelines of the SBA and CDB 16.

Activities referring to collective investment schemes

If a bank is responsible for the management of a collective investment scheme, the safekeeping of the assets held in it or the distribution of it to non-qualified investors in Switzerland, it has to comply with the code of conduct requirements outlined in art. 20 *et seq*. CISA, including the duty of loyalty, the duty of diligence and the duty of providing information.

Rules applying to the general terms and conditions of banks

The use of general terms and conditions ("**GTC**") to govern the relationship between the bank and its clients is widespread in the Swiss banking industry. However, Swiss law does not provide for any specific rules dealing particularly with GTC of banks. Accordingly, the question whether GTC have been validly implemented must be established on the basis of the Swiss private civil law, particularly the general contract law provisions of CO.

Furthermore, in view of protecting consumers against potential abuse, the use of GTC to govern the relationship between banks and consumers is subject to stricter regulation, going beyond the scope of general contract law. Against this background, art. 8 of the Swiss Act against Unfair Competition ("**AUC**") prohibits the use of GTC that, to the detriment of consumers and contrary to the requirement of good faith, provide for a significant and unjustified imbalance between contractual rights and contractual obligations.

Mechanisms for addressing customer complaints against banks

General remarks

Under supervisory law, FINMA's mandate includes the protection of creditors, investors and policyholders. However, client protection is to be understood collectively and therefore FINMA does not adjudicate on a dispute between a client and a bank. For any dispute between a client and a bank, either the Swiss Banking Ombudsman as a mediator or the courts are responsible.

Swiss Banking Ombudsman

The Swiss Banking Ombudsman is an independent and neutral mediator whose services are free of charge for the banking customer. He is competent to approach specific complaints raised by banking customers against banks based in Switzerland but has no power to decide.

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Consequently, he mainly acts as a mediator in disputes to avoid costly and lengthy legal proceedings. The parties are not bound by his proposal but may choose either to accept it or to take other steps, such as starting a lawsuit.

Proposed changes of the enforcement of client's rights according to the draft FinSA

In order to reduce the risk of high procedural costs associated with the enforcement of rights for banking clients, the draft FinSA proposes several changes of the enforcement of Swiss banking customers' rights, among others a right of a customer to request for the delivery of copies of documents concerning the customer from the financial service provider and the exemption under certain conditions of the customer from the requirement to pay court fees in advance in a lawsuit against a financial service provider. The latter is, however, controversial and in the debate in the Swiss Parliament, the Council of States voted to drop this proposal from the bill.

<u>Swiss depositor protection scheme</u>

Deposits of Swiss banks are, in particular, protected by the following measures:

a) Client deposits of Swiss banks are, in principle, privileged claims in case of bankruptcy of a bank up to CHF 100,000 (art. 219 para. 4 2^{nd} class *lit*. f of the Swiss Federal Law on Debt Collection and Bankruptcy ("**DEBA**") in conjunction with art. 37a para. 1 and art. 37b para. 1 BankA). However, the law further distinguishes between certain types of accounts. For example, deposits for vested benefit schemes are treated separately from other bank accounts and may benefit from the privileged status in an additional protected amount of up to CHF 100,000 (art. 37a para. 5 BankA).

b) Furthermore, client deposits of a bank or securities dealer located in Switzerland are protected to a maximal amount of CHF 100,000 per depositor. This depositor's guarantee in case of bankruptcy of a bank is ensured by the Swiss depositor protection scheme ("***esisuisse***") which requires that all Swiss banks and branches of foreign banks must have their preferential deposits protected by *esisuisse*.

c) Finally, client custody assets of Swiss banks and securities dealers are deemed by law, in principle, as segregated client assets. Consequently, they will be segregated in case of an insolvency of a bank or securities dealer (art. 37d BankA in connection with art. 36a SESTA).

<u>Restrictions on inbound cross-border banking activities</u>

The Swiss approach to inbound cross-border banking services is rather liberal. Banking activities on a pure cross-border basis from abroad into Switzerland are, in principle, not subject to a banking licence requirement. Consequently, a foreign banking institution may, in principle, freely offer banking services to Swiss-based customers if it does not establish a physical presence in the meaning of art. 2 para. 1 BankA in Switzerland (i.e. a representative office, a branch or a bank subsidiary).

In contrast, the distribution of shares or units of collective investment schemes or the placement of certain financial products in Switzerland are subject to restrictions and licence or prospectus requirements, including the restriction that only Swiss licensed representatives, holders of a FINMA distributor licence or entities adequately licensed in their country of domicile to distribute collective investment schemes may proceed with any form of distribution of collective investment schemes in Switzerland (art. 13 CISA).

<u>Regulatory framework on anti-money laundering</u>

Money laundering is subject to criminal sanctions under art. 305^{bis} SCC. Money laundering in the meaning of the SCC includes any act suitable to conceal or disguise the identification

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of the origin or impede the tracing or the forfeiture of assets that have been obtained through serious crime (including certain types of tax offences).

With regard to the prevention of money laundering, financial intermediaries are subject to licence requirements for AML purposes. In addition, prudentially supervised entities such as banks and securities dealers, as well as other persons or entities, may qualify as financial intermediaries in the meaning of AMLA if they, on a professional basis, accept or hold third-party assets or that assist in the investment or transfer of such assets, including activities such as (independent) asset management and certain types of credit/lending business, trade finance including factoring with right to recourse, payment services, trading activities, etc. (art. 2 para. 2 and 3 AMLA). Financial intermediaries which are not otherwise regulated (e.g. by FINMA through holding a banking or securities dealer licence) have to join a recognised self-regulatory organisation ("**SRO**") which will review their compliance with Swiss AML rules on a regular basis or, alternatively, submit themselves to direct AML supervision by FINMA (art. 14 AMLA).

A major part of the AMLA provisions deal with the due diligence duties in connection with a financial intermediary's handling of third-party assets including the due identification of the contractual party and the due determination of a potential beneficial owner, whereas, among others, these duties are further specified in the CDB 16.

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