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Switzerland

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Introduction

In the aftermath of the financial crisis of 2008/2009, Switzerland launched a massive overhaul of its financial regulations. These reforms followed several objectives. First, banking regulations were revised to ensure the stability of the financial system, in line with the recommendations of the Financial Stability Board ("**FSB**") and other international standard-setters. Second, Switzerland reacted to EU law in order to ensure equivalence, to be able to continue to access the European market as a third party state. Therefore, the reforms also aimed to align Swiss law with EU regulations 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. Finally, the reforms also tried to revise the regulations from a patchwork of sectorial regulations to a consistent regulatory framework.

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 in 2019 at the earliest.

Furthermore, the current environment has been characterised by a variety of legal developments, particularly in international tax matters. Switzerland has implemented the automatic exchange of information. In this context, the Federal Act on the International Automatic Exchange of Information in Tax Matters ("**AEOI-Act**") entered into force on 1 January 2017, and data on foreign customers of Swiss financial institutions has started to flow. In addition, in the course of the implementation of the revised recommendations of the Financial Action Task Force ("**FATF**") and the Global Forum on Transparency and Exchange of Information for Tax Purposes ("**Global Forum**"), several laws have been amended and further reforms are under way. Since 2016, serious instances of tax fraud constitute a predicate offence for money laundering. Furthermore, the anti-money laundering and anti-terrorism financing ("**AML**") framework has also become yet stricter. Out of the banking world, 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 any person beneficially owning 25% of the share capital or voting rights through registered or bearer shares. Correspondingly, the issuing companies have to keep a register of bearer shareholders and of beneficial owners. On 17 January 2018, the Swiss Federal Council launched a consultation on the recommendations of the Global Forum on Transparency and Exchange of Information for Tax Purposes ("**Global**

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Forum"). The bill proposes, among others, a mandatory conversion of bearer shares into registered shares for non-listed companies, as well as a system of criminal sanctions for breaches of the duty to report and record beneficial owners of shares in non-listed companies.

Banks in Switzerland are facing pressure due to these regulatory and legal developments. They have 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, have 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, including from new entrants coming from the technology sector. These challenges are aggravated by the continued low (including negative) interest rates and the strong Swiss currency, which together have resulted in declining profitability.

The accumulation of these factors has 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 Swiss subsidiaries of foreign banking groups, while the latter in particular either close down their operations in Switzerland by liquidation or sale, or 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 accumulated 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 outside the owner's home country with a global market share of 24% (see *Swiss Banking, Banking Barometer 2017: Economic trends in the Swiss banking industry*, August 2017, 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 flexible 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.

Looking forward, Switzerland has positioned itself to become a hub for innovative financial technologies ("**Fintech**"). As part of this effort, the Swiss regulatory framework was adjusted to create an appropriate environment for Fintech providers. As a first measure, the Swiss Federal Council adopted amendments to the Federal Ordinance on Banks and Savings Banks of 30 April 2014 ("**BankO**") that entered into force on 1 August 2017 (see below). In addition, the Swiss Parliament is currently preparing changes to the BankA with the aim to introduce a new regulatory licence category with less stringent requirements as compared to the fully fledged banking licence. The Swiss Financial Market Supervisory Authority FINMA ("**FINMA**") has, furthermore, revised several of its circulars that specify the practice of the regulator under the current legislation, to render them technology-neutral.

Regulatory architecture: Overview of banking regulators and key regulations

Responsible bodies for banking regulation

FINMA is the supervisory authority for banks, securities dealers and other financial institutions such as collective investment schemes and insurance undertakings. FINMA's

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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 is responsible for licensing, prudential supervision, enforcement and regulation.

In parallel, the Swiss National Bank ("**SNB**"), the Swiss central bank, is 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, in consultation with FINMA.

Under the so-called dual supervisory system, FINMA largely relies on the work of recognised audit firms. As the extended arm of FINMA, these audit firms exercise direct supervision over financial institutions. They conduct regulatory audits of the banks on behalf of FINMA. In addition, FINMA may undertake targeted on-site supervisory reviews with the aim of achieving timely and comprehensive supervision. As an exception to the dual supervisory system, FINMA has a dedicated supervisory team, which is responsible for monitoring directly UBS Inc./UBS Switzerland Ltd and Credit Suisse Group Ltd/Credit Suisse (Switzerland) Ltd., the two large Swiss banking groups.

Key legislation or regulations applicable to banks

The key legislation for Swiss banks includes:

- FINMASA defines the role and powers of FINMA;
- the BankA and the BankO provide for the general regulatory framework governing banks, including the banking licence requirements and accounting rules for banks;
- 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 and the rules of conduct for securities dealers; and
- 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.

Further important regulations are:

- the Ordinance of FINMA on Foreign Banks in Switzerland of 21 October 1996 (FBO-FINMA), which provides for additional requirements for banks controlled by foreign persons as well as branches and representative offices of banks incorporated abroad;
- 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**"), governing capital adequacy and liquidity requirements applicable to banks and securities dealers;
- the Ordinance of FINMA on the Insolvency of Banks and Securities Dealers of 30 August 2012 (BIO-FINMA) governing the resolution and recovery as well as insolvency proceedings applicable to banks and securities dealers;
- the Federal Act on Collective Investment Schemes of 23 June 2006 ("**CISA**") and the Ordinance on Collective Investment Schemes of 22 November 2006 ("**CISO**") on investment funds and companies as well as rules on distribution; and
- the Federal Act on Combating Money Laundering and Terrorist Financing in the Financial Sector of 10 October 1997 ("**AMLA**") and its implementing ordinances.

In addition, FINMA further specifies financial regulation in numerous circulars. FINMA

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circulars as such are, in principle, not binding for Swiss courts but constitute a mere codification of how FINMA interprets and applies applicable law. However, the guidance of 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 has 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 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 organisations and regulatory regimes or regulatory bodies

Switzerland is enrolled 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 which sets out international standards in the area of AML and the Global Forum. Finally, although Switzerland is not a member of the G20, it has regularly been invited to participate in this international forum, which plays a leader role in defining international initiatives.

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 its capital market regulation with MiFID II and MiFIR. Consequently, the Swiss legislator is following up and voluntarily harmonising certain aspects of Switzerland's legislation with MiFID II provisions in the the FMIA and 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). 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 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 implements the commitments assumed at the G20 summit in Pittsburgh in 2009 and adapts the Swiss regulation of the financial market infrastructures and derivatives trading to international requirements.

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. Switzerland follows a model of universal banking. Therefore, a bank,

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with few exceptions, e.g. to act as a depository of collective investment schemes, in addition to its deposit-taking business, and is allowed 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. Moreover, a bank is allowed to act as a securities dealer, but not as a fund management company or an insurance company.

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). 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.

In practice, 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**"). Furthermore, many larger financial groups have separate entities involved in fund management. By contrast, financial conglomerates, involving both banks and insurances, are a relatively rare occurrence in Switzerland.

Recent regulatory themes and key regulatory developments in Switzerland

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 the BankA (and BankO), securities dealers to the SESTA (and SESTO), and fund management companies and asset managers of collective investment schemes are subject to the CISA (and CISO). Similarly, the FMIA and FMIO, which entered into force on 1 January 2016, regulate the effectiveness of the financial market with respect to financial infrastructures.

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) the 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) the 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).

The Swiss Federal Council approved the dispatch on the FinSA and FinIA on 4 November 2015. The drafts of the FinSA and FinIA are now being debated in the Swiss Parliament. It is currently expected that the FinSA and FinIA will enter into force in July 2019 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 24

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January 2018, 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.

Administrative assistance

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 to be jeopardised by the prior notification (art. 42*a* (4) of the revised FINMASA, entered into force on 1 January 2016).

Fintech

On 1 August 2017, amendments to the BankO seeking 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, entered into force. Under the amended BankO, third-party monies accepted on interest-free accounts for the purpose of settlement of customer transactions do not qualify as deposits from the public (and therefore do not count towards a potential banking licence requirement) if the monies are held for a maximum of 60 days (instead of only seven days, as was the case before the amendment). The BankO, furthermore, exempts firms accepting deposits from the public or publicly offering them acceptance of deposits from the banking licence requirement as long as the deposits accepted do not exceed CHF 1 million. This exemption is available to Fintech as well as any other type of business.

In addition, the Swiss Parliament is currently preparing amendments to the BankA introducing a new type of licence, which will be subject to less stringent requirements, for financial innovators and other interested parties (sometimes referred to as banking licence 'light'). The planned new licence would enable its holder to accept deposits from the public up to a total value of CHF 100 million, but the holder would not be allowed to invest the deposits or pay interest on them. If the customers are protected through additional safeguards, FINMA can approve a higher threshold on a case-by-case basis. This project is being discussed in the Swiss Parliament in the context of the deliberations on the FinSA and FinIA.

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 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 the context of the liquidity standards of Basel III, the Net Stable Funding Ratio ("**NSFR**") will be implemented as second minimal standard for the liquidity of banks. The NSFR will make a revision of LiqO and FINMA Circular 2015/2 "Liquidity Risks – Banks" necessary. However, the decision on the revision was postponed until the end of 2018, because of substantial delays in the international timetable.

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

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provisions in a new Circular 2017/7 "Credit risks – banks" ("**Circular 2017/7**") that entered into force on 1 January 2017.

Furthermore, the BCBS issued new standards regarding leverage ratio which establish that the leverage ratio must amount to at least 3% as a mandatory key regulatory figure, starting in 2018. The necessary amendments of the CAO entered into force on 1 January 2018 and entail an amendment of FINMA Circular 2015/3 "Leverage ratio – banks".

In addition, the BCBS issued detailed standards for the diversification of risks which will be implemented by 1 January 2019 and require an amendment of the CAO and a total revision of FINMA Circular 2008/23 "Risk distribution – banks".

The revised Basel III standards also entail new rules to determine the capital adequacy for market risks. In Switzerland, the new market risk rules are expected to enter into force on 31 December 2020 at the earliest.

Automatic exchange of information and tax compliance

In response to the criticism of the Swiss financial centre, Switzerland adopted a "White Money Strategy" which led to the adoption of the automatic exchange of information in tax matters and extended the AML framework to taxation fraud. This strategy was heavily influenced by the recommendations of the FATF and the Global Forum in connection with international AML standards as well as the pressure of the OECD to adopt the OECD automatic exchange of information in tax matters with countries abroad ("**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 which, in turn, exchanges the data with the tax authorities of the partner states for the first time in autumn 2018. In view of the AEOI's activation with 38 states on 1 January 2017, Swiss financial institutions started to collect relevant data. Switzerland will start the exchange of data with 38 partner states (including all EU Member States) for the first time no later than September 2018. In December 2017, the Swiss Parliament adopted the AEOI with a further 40 partner states. As a result, Swiss financial institutions have been collecting account information referring to a further 40 partner states since 1 January 2018, and will exchange it for the first time no later than September 2019. Furthermore, the recommendations of FATF also influenced the revision of AMLA that came into effect on 1 January 2016, implementing, e.g., new regulations in connection with business relationships and transactions with politically exposed persons.

The Swiss Federal Council launched the consultation on the implementation of the recommendations of the Global Forum in the CO on 17 January 2018. The proposed text is expected to be discussed in the Parliament in winter 2018. The draft bill e.g. proposes a mandatory conversion of bearer shares of non-listed companies into registered shares, and a system of sanctions for shareholders who do not comply with their duty to report beneficial owners, and for companies breaching their obligation to keep a register of shareholders and beneficial owners. Furthermore, the draft bill grants authorities and financial intermediaries a right to examine the registers, if it is necessary for them to perform their statutory tasks.

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

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the US tax authority with the consent of the US clients concerned. However, in October 2014, the Swiss 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. It is still unknown at the present time when there will be a corresponding agreement between Switzerland and the United States.

Bank governance and internal controls

Key requirements for governance of banks

In order to obtain and maintain a banking licence, Swiss banks must, *inter alia*, comply with specific governance requirements as outlined in particular in the BankA and BankO, and further specified in guidelines and publications of FINMA, in particular the new Circular 2017/1, "Corporate governance – banks" ("**Circular 2017/1**") which entered into force on 1 July 2017. It remains to a large extent in line with the former FINMA guidance, except for a number of changes in specific areas. A significant change introduced by Circular 2017/1 is a shift from a "comply or explain" approach to a more differentiated approach, allowing FINMA to apply the requirements of Circular 2017/1 to the extent they are proportionate. 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 (2)(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 (2)(c*bis* BankA).

Separation of board of directors and executive management

The governance of Swiss banks is characterised by a strict separation between the board of directors, which is responsible for oversight, and the executive management.

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 be relevant in financial groups, in particular.
- The board of directors in its totality must have adequate management expertise and the required specialist knowledge of, and experience in, 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 comprise at least three members. However, the actual number of directors required depends on the size, complexity and risk profile of the bank (art. 11 (1) BankO and FINMA explanatory notes to the draft Circular 2017/1 N 3.2.2).

Committees of the board of directors

The larger and more complex banks, which belong to the supervisory categories 1 to 3 (out of 5) are required to establish an audit and a risk committee, irrespective of the total number

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of members of the board of directors. However, banks in the supervisory category 3 may combine the two committees (Circular 2017/1 N 31).

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 to 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 the 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 transactions.

The FINMA Circular 2010/1 on remuneration schemes ("**Circular 2010/1**") outlines minimum standards for remuneration schemes of banks and other financial institutions. In particular, it includes the requirement of a remuneration scheme to be simple, transparent, implementable, and oriented towards the long term. The Circular 2010/1 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, it 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 Swiss 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

The FINMA-Circular 2008/7 "Outsourcing – banks" ("**Circular 2008/7**") has been replaced by the new FINMA-Circular 2018/3 "Outsourcing – banks and insurers" ("**Circular 2018/3**") which will enter into force on 1 April 2018. Circular 2018/3 also applies to insurance companies. Under Circular 2018/3, in principle, all significant functions may be outsourced, except for the direction, supervision and control by the supreme governing body, central executive management functions and functions that involve strategic decision-making. In addition, decisions on entering or terminating a business relationship may not be outsourced.

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Furthermore, banks of the supervisory categories 1 to 3 are required to have an autonomous control body in the form of a separate risk control and compliance function. Operational risk management and compliance tasks may be outsourced by banks of all supervisory categories. The Circular 2008/7, *inter alia*, provides that the company must keep an inventory of the outsourced functions. Furthermore, the company, its audit firm and FINMA must have the contractual right to verify the service providers' compliance by inspecting and auditing all information relating to the outsourced function any time, unrestrictedly. Outsourcing to another country is admissible if the implementation and control rights and the possibility of restructuring or resolving the company in Switzerland, including the required information, are assured.

Accounting rules

Value adjustments for default risks in banking are to be calculated in future on the basis of expected losses. For this change, FINMA will draft a new ordinance on accounting which will also incorporate parts of the FINMA Circular 2015/1 "Accounting – Banks". The entry into force of this new ordinance is expected on 1 January 2019 (with a transitional period of one year).

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 (1) BankO). However, FINMA, in principle, requires a bank to have additional capital of at least CHF 10 million but usually more (which might be contributed in the form of a subordinated loan as well), depending on the intended scope of the bank's business activities.

In addition to the statutory capital requirements, banks are also subject to regulatory capital requirements based on the Basel III Framework. 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 (CET 1) capital (CET 1 ratio), and ii) 6% must be held in the form of Tier 1 capital (Tier 1 capital ratio) (art. 42 (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 CET 1 capital, depending on the supervisory category of the bank (art. 43 (1) and appendix 8 CAO; art. 2 (2) and appendix 3 BankO).
- *Counter-cyclical buffer*: Upon request of the SNB, 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 CET 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 Swiss 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

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foreign commitment of at least CHF 25 billion, have to hold an extended counter-cyclical buffer in the form of CET 1 capital. This 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 originate, but in no case more than 2.5% of the risk-weighted positions (art. 44*a* 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).
- *Leverage ratio:* A bank must also maintain a 3% minimum leverage ratio based on the un-risk-weighted assets and Tier 1 capital (art. 46 CAO and FINMA Circular 15/3 "Leverage Ratio").
- *Additional requirements for 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). The Swiss Federal Council sees a need for action in the area of gone concern capital requirements (for a potential resolution, as opposed to going-concern). Thus, it has instructed the Federal Department of Finance to prepare a draft for consultation of the revision of the Capital Adequacy Ordinance by 28 February 2018.

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

<u>Regulations applying to the bank's dealing with third parties</u>

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 (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 ("**SRO**") 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.

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. These rules are also implemented through the self-regulatory standards set forth in the Code of Conduct of the Swiss Funds &. Asset Management Association SFAMA, which is also recognised by FINMA as a minimum standard requirement.

<u>Rules applying to the general terms and conditions of banks</u>

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

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not regulate the GTC of banks specifically. Accordingly, the question whether GTC are valid must be established on the basis of the Swiss private civil law, particularly the general contract law provisions of the CO and art. 8 of the Federal Act against Unfair Competition of 19 December 1986 ("**AUC**") which 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. Furthermore, specific regulations prohibit banks from including certain terms in their GTC with customers. For example, a right to use client securities may not be included in GTC. Against this background, the use of GTC might, in a typical business-to-customer relationship, be more limited in the banking industry.

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 understood collectively and therefore FINMA does not adjudicate or even intervene in a dispute between a client and a bank. Disputes between a client and a bank are thus the remit of the Swiss Banking Ombudsman as a mediator (see more information below) and ordinary courts.

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. 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 to the enforcement of Swiss banking customers' rights; among others, a right of a customer to request the delivery of copies of documents concerning the customer from the financial service provider. The FinSA draft does, however, not implement the exemption of the customer from the requirement to pay court fees in advance in a lawsuit against a financial service provider, reversal of the burden of proof and arbitration court, which were highly controversial during the consultation.

Swiss depositor protection scheme

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 (4)(f) 2nd class of the Swiss Federal Act on Debt Collection and Bankruptcy of 11 April 1884 (DEBA) in conjunction with art. 37*a* (1) and art. 37b (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 (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*.

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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. 37*d* BankA in connection with art. 36*a* SESTA).

Furthermore, the Swiss Federal Council decided in February 2017 to strengthen the Swiss Deposit Protection Scheme. The consultation process with respect to the amendment of the BankA starts in 2018. The Swiss Federal Council also plans to close a loophole regarding the regulations on investor protection: the obligation to segregate client holdings booked to client accounts from proprietary holdings shall be extended over the entire custody value chain in Switzerland.

Restrictions on inbound cross-border banking activities

The Swiss approach to inbound cross-border banking services is rather liberal. Banking activities on a pure cross-border basis only (*i.e.* without any actual or deemed local physical presence) 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 (1) of the Ordinance of the Swiss Financial Market Supervisory Authority on Foreign Banks in Switzerland of 21 October 1996 in Switzerland (i.e. a representative office or a branch) and does not inaccurately represent that it is based or regulated in Switzerland.

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).

Regulatory framework on AML

Money laundering is subject to criminal sanctions under art. 305bis SCC. Money laundering in the meaning of the SCC includes any act suitable to conceal or disguise the identification of the origin or impede the tracing or the forfeiture of assets that have been obtained through serious crimes and certain tax offences.

Prudentially supervised financial institutions, such as banks and securities dealers, as well as other persons or entities who, on a professional basis, accept or hold third-party assets or who 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., are subject to additional regulatory requirements (art. 2 (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 SRO which will review their compliance with Swiss AML rules on a regular basis or, alternatively, submit themselves to direct AML supervision by FINMA for AML purposes (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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