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# THE BANKING REGULATION REVIEW

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EDITOR  
JAN PUTNIS

LAW BUSINESS RESEARCH

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This article was first published in The Banking Regulation Review,  
1st edition (published in June 2010 – editor Jan Putnis).

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Published in the United Kingdom  
by Law Business Research Ltd, London  
87 Lancaster Road, London, W11 1QQ, UK  
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ISBN 978-1-907606-02-1

Printed in Great Britain by  
Encompass Print Solutions, Derbyshire  
Tel: +44 870 897 3239

# ACKNOWLEDGEMENTS

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The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

AFRIDI & ANGELL

ANDERSON MÖRI & TOMOTSUNE

BONELLI EREDE PAPPALARDO

BREDIN PRAT

BUGGE, ARENTZ-HANSEN & RASMUSSEN

CLAYTON UTZ

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VIEIRA DE ALMEIDA & ASSOCIADOS.

WEBBER WENTZEL

WONGPARTNERSHIP LLP

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## EDITOR'S PREFACE

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Legal and regulatory areas of concern come and go in their perceived importance. It is, however, very difficult to recall any other occasion when a subject regarded by many lawyers as so obscure and arcane as international banking regulation has come to such prominence in such a short period of time.

Before the onset of the financial crisis in western economies in 2007, banking regulation was regarded by many as a discipline practised by technocrats who were, to put it politely, best left to themselves. The subject has risen up the agenda so quickly since then that few lawyers who advise financial institutions have had time to draw breath and assess the position now reached. The reality, of course, is that no final position has been reached and none is ever likely to be reached: banking regulation will continue to evolve, punctuated by bursts of activity every time there is a serious crisis to manage. What has happened is that the importance of this subject, and its rightful place amongst legal disciplines, has finally been recognised. This means that there is now great demand, from the banks themselves, but also from governments and regulators, for accessible and user-friendly explanations of the applicable rules.

The continual evolution of the rules makes any survey of banking regulation very difficult to write without risking almost immediate obsolescence. This book is an attempt to rise to that challenge and it is hoped that future editions will address the many further developments in this area that are expected to take place in the coming months and years. The book is aimed principally at lawyers and others who need access to an overview of the applicable rules in the important areas that the book covers and a commentary on recent developments. It also includes commentary on many of the areas of banking regulation that are of critical importance to the major cross-border transactions in which banks become involved.

The book illustrates the many and differing approaches that governments and banking regulators have taken to addressing what they perceive to be the problems affecting the banks that they regulate. To that extent, the lack of international coordination is a potential source of dismay amongst politicians and others who have spent so much time over the past three years trying to develop common approaches to the international challenges highlighted by the financial crisis.

It is, however, to be hoped that surveys of the kind in this book also inform the continuing debate about how to minimise the risk of a further crisis on anything like the scale that we have just seen. It will, quite literally, pay for governments to appreciate that further significant financial crises are inevitable in the future, and that the principal aim of reform should, therefore, be to minimise their likely impact, both on the lives of the millions of people who rely on banks and on local and regional economies.

It is a tribute both to the contributors and the publishers that so many leading banking and regulatory lawyers have made themselves available to write chapters for this book. I would like to thank them all for the support and encouragement that they have provided at a time when many of them have been almost overwhelmed with work on other projects emerging from the financial crisis. Many of the contributors have also been involved in initiatives designed to stabilise and reform the banking sectors in their countries. I would also like to thank Gideon Robertson and his colleagues at the publishers for their efforts in coordinating the project that this book has become, and in bringing it to fruition.

**Jan Putnis**

Slaughter and May

London

June 2010

## Chapter 30

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# SWITZERLAND

*Shelby R du Pasquier, Patrick Hünerwadel, Marcel Tranchet and Valérie Menoud\**

### I INTRODUCTION

The Swiss banking industry has a long tradition. It has been internationally focused from the outset. Services offered by Swiss banks comprise all banking services.

There are today some 265 licensed banks in Switzerland, of which two are so-called ‘big banks’ (UBS AG and Credit Suisse AG), which are active globally and subject to a special supervisory regime. Twenty-four are (partly) state-owned cantonal banks and 59 are regional banks and savings banks, and 113 are ‘foreign’ banks (i.e., banks controlled by significant foreign shareholders).

Present challenges to the Swiss banking industry include, among other issues, the continued and intense international debate on the future of the Swiss banking secrecy, perceived as a cornerstone of Swiss banking, albeit often misunderstood or reduced to its potential for abuse. Other challenges are shared with the global banking industry, namely a potentially massive wave of new regulatory activity spurred by the recent financial crisis. The main focus being enhancing the international regulatory framework and cooperation, as well as the stability of the financial industry and its systems generally by reinforcing capital adequacy and solvency requirements, cutting back on incentivising short-term risk taking, and – as a particular topic for big banks – addressing the ‘too big to fail’ issue. With Credit Suisse AG and UBS AG, Switzerland has two such global banks. In terms of their balance sheet as a percentage of Switzerland’s GDP, a measure frequently used in this context, both are not only big in absolute but also in relative terms with roughly 600 per cent as at the end of 2008. The Swiss National Bank and the Swiss Financial Market Supervisory Authority (‘FINMA’) have joined efforts to look into adequate approaches and measures compatible with international initiatives to address this issue, as the case may be with legislative action.

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\* Shelby R du Pasquier and Patrick Hünerwadel are partners, Marcel Tranchet an associate and Valérie Menoud a junior associate at Lenz & Staehelin.

## II THE REGULATORY REGIME APPLICABLE TO BANKS

### *i Main statutes*

The main statutes governing the Swiss financial markets are:

- a* the Federal Banking Act of 1934 ('BA');
- b* the Federal Stock Exchanges and Securities Trading Act of 1995 ('SESTA');
- c* the Federal Collective Investment Schemes Act of 2006 ('CISA'); and
- d* the Federal Act on Combating Money Laundering and Terrorist Financing in the Financial Sector of 1997 ('AMLA').

These statutes are supplemented by a number of ordinances enacted either by the Swiss government (i.e., the Federal Council) or, as regards more technical aspects, by FINMA and their practical application is further regulated by FINMA circulars.

Since January 2009, these regulations are complemented by the Federal Act on the Swiss Financial Market Supervisory Authority ('FINMASA'), which can be considered as a framework law governing the supervisory activities and instruments of the FINMA.

### *ii Banking and securities dealing activities*

From a Swiss perspective, a business entity that solicits or takes deposits from the public (or refinances itself with substantial amounts from other unrelated banks) in order to provide financing to a large number of persons or entities is considered a bank. The conduct of banking activities in or from Switzerland is subject to a licensing requirement and to ongoing FINMA supervision.

Swiss financial law makes no distinction between commercial and investment banks and banks are not limited in the scope of their activities. As a result, banks may act as broker-dealers in securities, in addition to pursuing deposit-taking and lending activities (i.e., interest operations). In order, however, to conduct securities trading activities, banks need to apply for an additional authorisation as a 'securities dealer'. The main statute governing the securities business of both banking and non-banking intermediaries in Switzerland is the SESTA.

Under Swiss law, securities dealing activities are broadly defined. They encompass the activities of securities dealers, issuing houses, market makers, derivative houses and brokers maintaining accounts in their books or holding securities deposits for more than 20 clients.

Although banking and securities dealing licences are two separate authorisations, most requirements in terms of minimum substance and documentation overlap. From a practical perspective, both banking and securities dealing licensing requirements are thus usually assessed within the same FINMA process. In a nutshell, the conditions for the granting of a licence to conduct banking and/or securities dealing activities encompass financial and organisational requirements (see Section III and Section IV, *infra*), as well as 'fit and proper' tests imposed on managers and qualified shareholders (see Section III, Section IV and Section VI, *i, infra*). FINMA grants a licence to the legal entity pursuing the banking activities, not to its managers or shareholders. It then monitors compliance with licensing criteria (and other regulatory obligations) on an ongoing basis. If, at a later stage, any of the licence requirements cease to be fulfilled, FINMA may take administrative measures, including, in extreme cases, the withdrawal of the licence.

The Swiss regime for cross-border banking and securities activities is rather liberal: foreign regulated entities that operate on a strict cross-border basis, i.e. by offering banking or securities services to Swiss investors without having a business presence in Switzerland, do not need to be authorised by the FINMA. If, however, the activities of a foreign bank or securities dealer involve a physical presence in Switzerland on a permanent basis, this cross-border exemption is not available. In practice, the FINMA considers a foreign entity to have such Swiss presence as soon as employees are hired in Switzerland.

The granting of a licence to a foreign bank to establish a Swiss branch, representative office or agency is conditional upon the principle of reciprocity being satisfied in the country in which the foreign bank has its registered office. In other words, if a Swiss bank or securities dealer is permitted to establish a representative branch, office or agency in the relevant foreign country without being subject to substantially more restrictive provisions than those imposed in Switzerland, FINMA will deem the reciprocity test to be met.

The granting of a licence to a Swiss bank or securities dealer controlled by foreign shareholders is also made dependent upon the reciprocity requirement by the relevant foreign country of domicile or incorporation of the foreign shareholders (see Section VI, *i*, *infra*).

*iii Other regulated activities*

A Swiss bank may also serve as a custodian for collective investment schemes. This type of activity is subject to the CISA and its implementing ordinances.

Financial intermediaries are supervised for the purpose of combating money laundering and the financing of terrorism according to the Anti-Money Laundering Act and its various implementing ordinances.

*iv FINMA*

Before the entry into force of the FINMASA in January 2009, the supervision of Swiss financial markets was mainly carried out by three authorities: the Swiss Federal Banking Commission, the Federal Office of Private Insurance and the Anti-Money Laundering Control Authority. Since January 2009, Switzerland has a single integrated financial market supervisory authority, FINMA, which is responsible for the supervision of banks, securities dealers, stock exchanges and collective investment schemes, as well as the private insurance sector. FINMA also monitors financial intermediaries with a view to preventing money laundering and the financing of terrorism.

FINMA is set up as a public institution with separate legal personality. Although it carries out its supervisory activity independently and autonomously, it has links to the government; FINMA has a reporting duty towards the Federal Council, which approves its strategic objectives, as well as its annual report prior to publication, and appoints FINMA's chief executive officer. The parliament is responsible for overseeing FINMA's activities.

FINMA currently employs approximately 360 people. Its operating expenses are estimated at around 95 million Swiss francs and are covered by fees and duties levied from the supervised entities. It is able to carry out its tasks with a relatively modest

organisation mainly as a result of the Swiss financial markets supervision system's strong reliance on external auditors and self-regulatory organisations. Indeed, external auditors carry out direct supervision and on-site audits, whereas the FINMA retains responsibility for the overall supervision and enforcement measures (see Section III, *i, infra*).

Self-regulatory organisations are being delegated certain regulatory duties: the Swiss Bankers Association and the Swiss Funds Association, for instance, issue self-regulatory guidelines to their members, which FINMA recognises as minimum standards that need to be complied with by all Swiss banks. In particular, the Swiss Bankers Association's guidelines governing the banks' duty of due diligence in identifying the contracting party and the beneficial owner of accounts,<sup>1</sup> the rules of conduct in securities dealing<sup>2</sup> and portfolio management<sup>3</sup> play an important role in practice.

### III PRUDENTIAL REGULATION

#### Relationship with the prudential regulator

As indicated above, the Swiss banking supervision system is based on an 'indirect' (or dual) supervision model. Banks, foreign banks' branches and financial groups (or conglomerates) subject to Swiss supervision have to appoint an external audit company licensed by FINMA. The auditor assists FINMA in its supervisory functions: it examines the annual financial statements and reviews whether the regulated entity complies with its by-laws and with Swiss financial markets regulation and self-regulatory provisions. The results of its audit are detailed in an annual audit report (so-called 'long-form report'), which is to be handed over to the supervised entity and to FINMA. FINMA exercises its oversight and ascertains whether the various regulatory requirements are complied with largely based on these reports.

In addition, auditors are obliged to inform FINMA if they suspect any breach of law or uncover other serious irregularities. Supervised entities further have a general duty to inform FINMA of any event or incident, which may be of relevance from a supervisory perspective. Furthermore, banks have special reporting duties, for instance, in case of changes in the foreign controlling persons (or entities), changes in the qualified shareholders, on the status of statutory equity capital, liquidity ratios or risk concentrations. Based on such informational tools, FINMA initiates investigations (if necessary through an appointed investigator) and, in case a breach is ascertained, takes administrative measures aimed at restoring compliance. In case of serious breach, FINMA can ultimately decide to withdraw the licence. In practice, the most common sanctions that the FINMA takes relate to the forced liquidations of unauthorised securities dealers, insolvency procedures, and sanctions following non-compliance with Swiss know-your-customer rules.

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1 Agreement on the Swiss Banks' Code of Conduct with regard to the Exercise of Due Diligence of April 2008.

2 Code of Conduct for Securities Dealers governing Securities Transactions of May 2009.

3 Portfolio Management Guidelines of January 2009.

Following the recent crisis, a more rigorous supervisory regime has been put in place for UBS AG and Credit Suisse AG, as the size and complexity of these institutions raise significant systemic risks. Accordingly, FINMA does not rely exclusively on the reports of the banks' auditors, but carries out its own investigations and maintains close contacts with the two banks. In addition, UBS AG and Credit Suisse AG are required to comply with new capital adequacy ratios in a range between 50 per cent and 100 per cent above Basel II minimum requirements by 2013. They will also have to comply with a maximum leverage ratio (i.e., a nominal cap on debts levels, regardless of the risks involved) defining the proportion of core capital to total assets set at a minimum of 3 per cent at group level and 4 per cent for the individual institution.

FINMA has generally been more active and interventionist than was previously the case with the two large Swiss banks. Since 2009, the supervisor has started carrying out extensive stress tests at Credit Suisse AG and UBS AG aiming at periodically and systematically assessing the resilience of the two banks to sharp deteriorations in economic conditions. The FINMA is further expected to intensify its analysis of the systemic risks raised by these large financial institutions and to examine adequate measures that could be taken in terms of capital adequacy, minimum liquidity levels and organisational requirements. Following the recent crisis and the ensuing international discussions on the matter, an expert group has been appointed in late 2009 to further address systemic risk issues linked to 'too-big-to-fail' institutions. The expert group is expected to report its findings by the end of 2010. In parallel, FINMA is working on proposals to amend the current legal framework, which aim at improving and facilitating the ongoing supervision of large institutions.

### **Management of banks**

The granting of a banking or securities dealer license is conditional upon the fulfilment of certain organisational requirements. In particular, the articles of incorporation and internal regulations of the bank must define the exact scope of business and the internal organisation, which must be adequate to the activities of the bank. As a general rule, two separate corporate bodies must be in place:

- a* Board of directors: The board of directors is primarily in charge of the strategic management of the bank and the establishment, maintenance, monitoring and control of the bank's internal organisation. The board has to comprise at least three members, who meet professional qualifications, enjoy a good reputation and offer every guarantee of proper business conduct. In practice, FINMA expects that the chairman or vice-chairman of the board be domiciled in Switzerland. As a matter of principle, the board of directors must be free of any conflicts of interests with the management or with the bank itself. Swiss banking law further strictly prohibits the exercise of a double mandate as a director and manager.
- b* Executive management: The bank's management carries out the executive management of the bank and implements the instructions of the board of directors. Its members must meet the various professional qualifications and 'fit and proper' tests. As a rule, the FINMA requires that a Swiss bank be managed from Switzerland and senior management is typically expected to be domiciled in Switzerland.

Under FINMA practice, the strategic management, supervision and control by the board of directors, the central management tasks of the management, as well as decisions concerning the establishment or discontinuation of business relationships, may not be delegated to another affiliated or non-affiliated entity. As a result, a Swiss bank that is a subsidiary of a foreign group must be granted a certain degree of independence in its decision-making process; general instructions and decisions from a foreign parent entity are, however, permitted. For the rest, as a general rule, outsourcing of other functions within a Swiss bank to affiliated or non-affiliated service providers both in Switzerland and abroad is generally permitted, subject to the satisfaction of certain requirements, in particular in relation to Swiss banking secrecy and data protection rules.<sup>4</sup>

Specific constraints and requirements regarding the organisation of a Swiss bank (e.g., with respect to internal audit, controls, compliance and reporting, segregation between trading, asset management and execution function, etc.) vary depending on the actual business and size of the bank.

In January 2010, the FINMA Circular on remuneration schemes entered into force. This document states 10 principles, which are largely based on the standards and recommendations issued by the Financial Stability Board on Sound Compensation Practices in September 2009. It aims at increasing the transparency and risk orientation of compensation schemes in the financial sector. The new rules do not impose any absolute or relative cap on remunerations. FINMA mainly requires that variable compensations (i.e., any part of the remuneration, which is at the discretion of the employer or contingent upon performance criteria) be dependent on long-term sustainable business performance, taking into account assumed risks and costs of capital. FINMA thus expects a significant portion of such remuneration to be payable under deferral arrangements. Furthermore, the compensation policy is to be disclosed annually to FINMA. The new rules are mandatory for banks, securities dealers, financial groups (or conglomerates), insurance companies, insurance groups and conglomerates, with capital or solvency requirements in excess of 2 billion Swiss francs. As a result, the seven largest Swiss banks and the five largest insurance companies currently fall under the scope of the Circular. For other financial institutions, the FINMA Circular represents guidelines for adequate remuneration policies.

### **Regulatory capital**

The recommendations and the three-pillar approach of the Basel II framework (i.e., minimum capital requirements, prudential supervision and disclosure and transparency) have been implemented in the Swiss regulatory capital regime. Capital adequacy and measurement rules are embedded in a separate implementing ordinance to the BA, the Capital Adequacy Ordinance ('CAO').

Having said this, while the approach is harmonised, Swiss minimum capital requirements are set significantly above the minimum capital requirements in international comparison.

---

4 See FINMA Circular 2008/7 on outsourcing.

*i Calculation of capital requirements*

As regards credit risks, Swiss banks can choose between a standard approach (Swiss or international standard) and an internal ratings-based approach (IRB in its two variations, foundation IRB or advanced IRB).

As regards operational risks, Swiss banks can choose between the basic indicator ('BIA') or the standard approach as simple methods. A Swiss bank having the necessary resources may also choose the advanced measurement approach ('AMA') and thereby use a tailor-made proprietary risk model approved by FINMA.

As regards market risks, the CAO implements the respective Basel II rules, developed by the Basel Committee in cooperation with the International Organization of Securities Commissions ('IOSCO').

In offering all these options, the legislator aimed at allowing domestic and regional banks to continue using relatively simple methods following the implementation of Basel II (Swiss standard). The more sophisticated approaches (advanced IRB for credit risks and AMA for operational risks) are intended for, and used by, the large banks and one cantonal bank. Previously, international banks calculated capital requirements both under applicable Swiss law and under Basel rules for international comparison purposes, whereas now, they only need to measure capital requirements according to internationally comparable standards (international standard).

*Swiss standard ('SA-CH')*

The Swiss standard implements all changes of Basel II, but maintains certain well established Swiss rules, which either take into account specifics of the Swiss market or are viewed as being more adequate to address particular risks. As a result, Swiss capital adequacy rules provide for more differentiated risk-weighting factors, different weighting of interbank receivables for three time bands, a flat factor for lombard credits, or lower risk weighting factor for assets secured on real estate.

*International standard ('SA-BIS')*

The aim of the international standard is to show as few discrepancies as possible compared to international regulation, bearing in mind, though, that Basel II leaves quite some freedom to the regulator whether or not to implement certain rules.

*Internal ratings-based approach ('IRB')*

The determination of risk weightings under both IRB (F-IRB and A-IRB) approaches pursuant to the CAO follows the formula established under Basel II and thereby corresponds to the Basel II credit-risk model.

As provided for under Basel II, the use of an IRB model is subject to FINMA approval in accordance with the detailed criteria established under Basel II. Switzerland has thereby opted for a risk weighting of certain assets based on their remaining term.

In three instances, though, the CAO deviates from the Basel II minimum standards. The capital requirements for participations and retail assets secured on real estate are based on the respective EU regulation. More importantly, the CAO provides for a bank specific multiple. This multiple can be applied should the IRB result in a capital ratio that is viewed as being too low compared to the targeted Swiss minimum capital

requirements. This compensation allows for a pragmatic approval of a bank specific IRB model, including an IRB of a foreign bank parent for its Swiss subsidiary.

Capital requirements must be met both at the level of the individual institution and at the level of the financial group or conglomerate. Stand-alone reporting is required on a quarterly basis and consolidated reporting on a semiannual basis.

*ii Minimum capital requirements*

The minimum capital requirements are calculated as the sum of and on the basis of the following:<sup>5</sup>

- a* 8 per cent of credit-risk weighted assets adjusted for open positions;
- b* 8 per cent of weighted non-counterparty-related risks;
- c* capital requirements for market risks, which correspond to different percentages per class of assets applied to the net positions in such assets, in accordance with the *de minimis* standard; under a model approach (subject to approval by FINMA) the requirements are based on the higher of the value-at-risk of the preceding trading day or the average value at risk over a 60-trading-day period as adjusted by a bank specific multiple (with a minimum multiple of three); and
- d* capital requirements for operational risks, which are set at 15 per cent of the relevant (positive) earning indicators over a three-year period, in accordance with the base indicator approach; under the standard approach, the percentages vary, depending on the eight particular banking segments tested, between 12 per cent, 15 per cent or 18 per cent on a weighted basis over a three-year period; subject to FINMA approval, capital requirements may also be determined under a bank specific model approach (AMA).

The capital requirements determined under the above first-pillar rules are minimum requirements. Each bank is expected to have qualifying capital in excess of these requirements in order to cope with risks that are not captured by the aforesaid rules or with adverse conditions.<sup>6</sup>

### **The qualifying capital**

The qualifying capital consists of tier 1 capital, tier 2 capital (subdivided in upper and lower tier 2 capital) and tier 3 capital.

Tier 1 capital consists of the paid-in capital, disclosed reserves, profit carried forward and, with certain limitations, profits for the current business year as shown on audited interim financial statements, and innovative capital with certain restrictions.

Tier 1 capital must be adjusted by deducting:

- a* losses carried forward and losses for the current financial year;
- b* any unfunded valuation adjustments or provisions required for the current financial year;
- c* goodwill and intangible assets (excluding software);

---

5 These requirements form the first pillar of the bank's regulatory capital base.

6 This requirement forms the second pillar.

- d* deductions envisaged in connection with securitisation transactions according to the Basel II minimum standards;
- e* net long positions of equity securities not held in the trading book; and
- f* innovative capital instruments directly or indirectly held by the bank.

Tier 2 capital is subdivided in upper tier 2 capital and lower tier 2 capital. The upper tier 2 capital consists of (1) hybrid instruments, with restrictions, (2) certain undisclosed reserves, subject to certain limitations and confirmation by the bank's auditors, and (3) innovative capital exceeding the maximum allocable to the tier 1 capital. Lower tier 2 capital consists of debt instruments issued by and loans made to the bank that comply with the requirements of Article 16 of the CAO and have a term of at least five years.

Tier 3 capital consists of the bank's liabilities that (1) comply with the requirements of Article 16 of the CAO, (2) have a term of at least two years and may not be repaid prior to their stated term without FINMA's consent and (3) preclude payments of interest and principal even on maturity, if such payments would otherwise cause the eligible capital to fall below the minimum required capital or to remain below that limit.

Tier 2 and tier 3 capital are limited to 100 per cent of the adjusted tier 1 capital. Lower tier 2 capital is limited to 50 per cent of the adjusted tier 1 capital, whereas tier 3 capital is only eligible to cover market risks and is limited to 250 per cent of the tier 1 capital used to cover market risks. Lower tier 2 capital in excess of the above limit or that becomes ineligible due to the theoretical amortisation previously discussed qualifies as tier 3 capital.

As a consequence of the financial crisis, FINMA has ordered enhanced capital requirements for Credit Suisse AG and UBS AG that in effect have doubled the capital requirements relating to risk-weighted assets. In addition, FINMA has introduced a leverage ratio for these two banks and expects them to have a capital asset ratio considerably above 3 per cent on a consolidated and 4 per cent on a stand-alone basis by 2013.

#### **IV CONDUCT OF BUSINESS**

The obligations imposed by anti-money-laundering regulation have a material impact on how banks conduct their activities. In a nutshell, financial intermediaries are obliged to verify the identity of their contracting partners as well as the beneficial owner of accounts. Furthermore, if reasons for suspicion of money laundering exist, banks must notify the Money Laundering Reporting Office ('MRO') of the Swiss Federal Office of Police and freeze the concerned assets for five days. The MRO examines the case and, as the case may be, communicates the matter to the competent criminal prosecution authorities. The rules of conduct of Swiss banks in relation to the prevention of money laundering and terrorism financing are further detailed by the Swiss Bankers Association's Agreement on the Swiss Banks' Code of Conduct with regard to the Exercise of Due Diligence of April 2008, which represent minimum standards. A breach by a bank of its duty to communicate is subject to a fine of up to 200,000 Swiss francs. In addition, certain behaviours may constitute a criminal offence of money laundering, as the case may be, by negligence.

With respect to its customer relationship, a bank is primarily bound by the duties and obligations stated in the relevant contractual documentation. In addition, banks licensed as securities dealers are bound by qualified duties of information, diligence, and loyalty towards their clients under Article 11 of SESTA. Among other things, a bank must draw the client's attention to the risks involved in the relevant securities transactions, ensure that its client is granted the best possible terms of execution for its transactions and that it is not disadvantaged by any conflicts of interests. These rules of conduct have been further defined by case law and supervisory practice and are detailed by a number of self-regulation guidelines (see Section II, *in, supra*). A breach of the duties of information, diligence and loyalty may give rise to civil liability as well as regulatory consequences, to the extent that FINMA is of the view that a bank no longer meets the requirements of good reputation and proper business conduct.

One of the most highly publicised aspects of banking regulation in Switzerland is the Swiss banking secrecy. A Swiss bank is bound by a statutory duty of confidentiality towards its clients. A breach of the bank's duty of confidentiality is considered a breach of the client–bank contractual relationship and may give rise to civil and criminal liability. As a general rule, any disclosure of client data to a third party, including the parent company, its supervisory authority or an affiliated entity, is prohibited. Exceptions apply under certain circumstances, such as in the context of consolidated supervision, following a request of international judicial or administrative assistance issued by a public authority, or if the client has given its consent to a disclosure. During the last couple of years, the importance and scope of Swiss banking secrecy has been subject to intense legal discussion in Switzerland, as the pressure of foreign countries in the field of administrative tax assistance grew stronger and the UBS case in the United States took unexpected turns (see Section VII, *infra*).

## V FUNDING

Swiss banks' main funding sources are money market instruments (65 billion Swiss francs), inter-bank funding (554 billion Swiss francs), customer savings accounts (431 billion Swiss francs), other customers' deposits (1,020 billion Swiss francs) and cash bonds (44 billion Swiss francs).

## VI CONTROL OF BANKS AND TRANSFERS OF BANKING BUSINESS

### *i Control regime*

For purposes of the BA, a participation is deemed to be qualified if it amounts to at least 10 per cent of the capital or voting rights of the bank or if the holder of the participation is otherwise in a position to significantly influence the business activities of the bank (a 'qualified participation'). It should be noted that, in practice, the FINMA often requires disclosure of participations of 5 per cent and more for its assessment whether the requirements of a banking licence are continuously met.

The BA does not set any restrictions on the type of entities or individuals holding a controlling interest in a bank. However, one of the general licensing conditions is that individuals or legal entities that directly or indirectly hold a qualified participation in a

bank must ensure that their influence will not have a negative impact on the prudent and reliable business activities of the bank. Thus, the bank's shareholders and their activities may be of relevance for the granting and the maintenance of a banking licence. Shareholders with a qualified participation may be deemed to have a negative influence on the bank; for instance, in case of lack of transparency, unclear organisation or financial difficulties of financial groups or conglomerates, as well as influence of a criminal organisation on the shareholders. Should FINMA take the view that the conditions for the banking licence are no longer met because of a shareholder with a qualified participation, it may suspend the voting rights in relation to such qualified participation or, if appropriate and as a last measure, withdraw the licence.

If foreigners with qualified participations directly or indirectly hold more than half of the voting rights of, or otherwise have a controlling influence on, a bank incorporated under the laws of Switzerland, the granting of the banking licence is subject to additional requirements. In particular, the corporate name of a foreign-controlled Swiss bank must not indicate or suggest that the bank is controlled by Swiss individuals or entities and the countries where the owners of a qualified participation in a bank have their registered office or their domicile must grant 'reciprocity', that is Swiss residents and Swiss entities must have the possibility to operate a bank in the respective country and such banks operated by Swiss residents are not subject to more restrictive provisions compared to foreign banks in Switzerland. In practice, the reciprocity requirement no longer applies as regards foreign holders of 'qualified participations' domiciled or incorporated in member states of the World Trade Organization, signatories of the General Agreement on Trade and Services ('GATS').

Furthermore, FINMA may request that the bank is subject to adequate consolidated supervision by a foreign supervisory authority, if the bank forms part of a financial group or conglomerate.

If a Swiss bank falls under foreign control, as described above, or if a foreign controlled bank experiences changes in its foreign shareholders holding directly or indirectly a qualified participation, a new special licence for foreign controlled banks must be obtained prior to such events. Under the BA, a 'foreigner' is (1) an individual who is not a Swiss citizen and has no permanent residence permit for Switzerland, or (2) a legal entity or partnership that has its registered office outside Switzerland or, if it has its registered office within Switzerland, is controlled by individuals as defined in (1).

As a matter of Swiss law, there are no restrictions as to the business activities of the entities holding qualified participations in a bank, as long as the conditions for the granting and maintenance of the licence are complied with. Generally, transactions between the (controlling) shareholders of a bank and the bank itself may be subject to specific requirements (e.g., the granting of loans to significant shareholders must be in compliance with generally recognised banking principles).

Each controlling shareholder has the duty to notify of the acquisition or disposal of a qualified participation, as well as the fact that its participation reaches, exceeds or falls below certain thresholds. Further, as mentioned above, the holder of a qualified participation is required not to negatively influence the prudent and reliable business activities of the bank.

Even though the acquisition of a qualified participation in a bank by a Swiss individual or a Swiss entity in theory only triggers notification obligations, it is necessary

to seek a letter of no objection from FINMA for the account of the bank prior to an envisaged transfer of controlling stake in a Swiss bank, since FINMA controls the continuing compliance with the conditions of a banking licence. FINMA will examine whether the influence of the new shareholder with a qualified participation would be detrimental to the prudent and reliable business activities of the bank.

*ii Transfers of banking business*

The vast majority of acquisition transactions in the Swiss banking industry are structured as share deals. There are very few examples only of transactions structured as asset deals and such transactions require the consent of the customers concerned. 'No consent' structures are not viewed as feasible from a Swiss law perspective, in particular due to Swiss banking secrecy restrictions.

Also, while it is being discussed as a possible future element of Swiss financial market laws, current laws do not provide the regulator with a right to transfer the business of a bank to another bank.

## VII THE YEAR IN REVIEW

2009 has been an eventful year for Swiss financial regulation. Both FINMA and the Swiss government have enacted several regulatory amendments and have examined potential revisions concerning key aspects of banking regulation and supervision.

### Regulatory developments

In addition to the issues addressed in the above sections (see in particular on compensation schemes and on the supervision of large banks in Section III, *supra*), the following regulatory developments can be outlined.

*i Deposits protection scheme*

Following the recent crisis and political discussion launched at European level, the Swiss government has revised the privileged deposit scheme provided for under the BA in December 2008. As a matter of Swiss law, following a bankruptcy of a Swiss bank, the FINMA will determine on a case-by-case basis the amount of small cash deposits, which are to be paid out as soon as possible to each depositor. These repayments are set aside and will not be taken into account during the bank's liquidation procedure. Within the liquidation procedure, cash deposits of up to 100,000 Swiss francs (30,000 Swiss francs before December 2008) per depositor are ranked in a privileged class in the bankruptcy estate. The payment of these so-called 'preferential deposits' is secured by a deposit protection system, which is, however, limited to an aggregate amount of 6 billion Swiss francs (4 billion Swiss francs before December 2008). All banks are obliged to participate in the deposit protection system and will be called upon to contribute up to 6 billion Swiss francs, in case the relevant bankruptcy estate does not have sufficient assets to repay preferential deposits. In addition, since December 2008, Swiss banks have been required to secure collateral for a total amount corresponding to at least 125 per cent of the preferential deposits they hold. As a general rule, only claims against third parties secured in Switzerland or assets in Switzerland are eligible as collateral

for the purpose of the deposit protection system. FINMA may grant derogations or increase the amount of the collateral.

The December 2008 revision of the Swiss deposit protection system has been enacted as a reaction to the crisis in the form of an urgent law, whose validity is limited to the end of 2010. In the meantime, the Swiss government has prepared a draft law on depositor protection, which provides, *inter alia*, for the streamlining of reorganisation procedures, prompter repayment of preferential deposits and the continuation of basic banking services during insolvency proceedings. For the rest, the draft law would pass the 2008 transitional amendments as permanent law.

### *ii Securities lending*

On 30 June 2010, a new FINMA Circular governing securities lending and borrowing and repurchase and reverse repurchase practices will enter into force. The new rules will, among others, significantly increase banks' information obligations in relation to the characteristics and risks of securities lending activities. Furthermore, the circular will prohibit uncollateralised securities lending and borrowing transactions with retail clients. The new provisions will also specify how transferred securities are to be accounted for liquidity requirement purposes.

### *iii Banking secrecy*

With respect to international administrative assistance in tax matters, 2009 has led to the abolition of the historical distinction made by Switzerland between tax fraud and tax evasion. In March 2009, Switzerland announced that it would adopt the standard set by Article 26 of the OECD Model Tax Convention. As a result, amendments to a number of double-taxation treaties reflecting this change have been signed in 2009 by the Swiss government and await ratification by the parliament. With the entry into force of these revised double-taxation treaties, the banking secrecy will be lifted and the transfer of bank account data will be allowed in situations where suspicions of tax offences exist. While a few of these revised treaties are expected to be approved by the Parliament during 2010, the renegotiation of Switzerland's entire network of treaties is expected to take several years.

## **Future changes**

Following the recommendations of an expert committee on market abuses, as well as the latest recommendations of the Financial Action Task Force ('FATF'), the Swiss government decided to revise the rules on insider trading and market manipulation behaviours and launched a consultation procedure in January 2010. The proposed amendments would, among others, aim at including 'aggravated insider trading' on the list of relevant crimes for money laundering purposes. Furthermore, the scope of prohibited insider trading and market manipulation behaviours would be extended to cover all markets participants instead of specific types of investors only. Depending on the results of the consultation procedure, it is likely that a final draft will be prepared for adoption by the end of 2010.

Among FINMA's priorities for 2010, the improvement of the protection of investment advisory and wealth management clients is at the top of the agenda. The

supervisor has conducted extensive investigations on the impact of the Madoff and Lehman cases and published its findings in February 2010. The report stresses that the current investor protection appears insufficient and that, in particular, the level of information given to clients as regards potential returns and risks is seen as inadequate. Also, the risk diversification practices of the industry are seen as inappropriate. The supervisor is currently carrying out an in-depth analysis of potential regulatory remedies and proposals are expected to come out by the end of 2010.

### **The UBS case**

In August 2009, the Swiss Confederation sold its stake in UBS AG. The stake resulted from the conversion of mandatory convertible notes subscribed in the fall of 2008 for an amount of 6 billion Swiss francs.

The difficulties experienced in the context of US Internal Revenue Service ('IRS') legal assistance requests concerning UBS accounts have led to intense legal discussions in Switzerland.

First, in a ruling dated 5 January 2010, the Federal Administrative Court declared the order given by FINMA to UBS in February 2009 to transfer data to the US authorities unlawful. FINMA, which had reacted in order to avoid the systemic risk that would have been caused by US sanctions on UBS, has appealed against this ruling. This case will give the Swiss Supreme Court, the court of appeal, the opportunity to bindingly determine the extent of the supervisor's legal latitude in crisis situations.

Second, the Federal Administrative Court has considered the agreement concluded on 19 August 2009 between the Swiss Confederation and the United States on the processing of the legal assistance request of the IRS concerning UBS accounts ('the UBS Agreement') in violation of the double-taxation treaty between Switzerland and the United States of 1996. The UBS Agreement specified categories of situations, in which bank account information was to be transmitted, and described behaviours that, according to the Federal Administrative Court, could not qualify as 'tax fraud or the like' cases, for which legal assistance could be granted pursuant to the double taxation treaty. As the parliament does not seem to be inclined to approve the UBS Agreement, the Swiss government is currently examining how to deal with this issue.

## **VIII OUTLOOK AND CONCLUSIONS**

The recent crisis brought up many regulatory topics, which have been examined by the supervisory authority and extensively discussed in the banking industry, such as the effects of a high density of regulations for certain sectors or the governmental influence on and support of financial institutions. In general, the FINMA has been more active and interventionist in the past couple of years, in particular with the two largest Swiss banks, Credit Suisse AG and UBS AG. In line with international developments and discussions, it continues to work on a refinement and strengthening of capital adequacy and liquidity requirements and gives closer attention to systemic risk issues.

The FINMA has recently published its strategic goals and priorities for the years 2010–12. These reflect likely future developments in financial regulation and supervisory trends and consist of reducing systemic risks and complexities, improving

client protection, streamlining and optimising regulation, increasing the effectiveness and efficiency of supervision, implementing sustainable market supervision and effective enforcement, positioning for international stability and close integration of markets, and strengthening FINMA as an authority.

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