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# Update

## Newsflash October 2016

# FINMA launches public consultation on proposed amendments to the Bank Insolvency Ordinance-FINMA

**The Swiss Financial Market Supervisory Authority (FINMA) has launched a consultation on proposed amendments to the Bank Insolvency Ordinance-FINMA (BIO-FINMA) to clarify the scope and the transitional regime for the implementation of Art. 12 para. 2$^{bis}$ Banking Ordinance providing for an obligation for banks and securities dealers to have counterparties recognize a stay of termination rights pursuant to Art. 30a Banking Act. The consultation period ends on November 8, 2016. The revised BIO-FINMA is expected to come into force on March 1, 2017 with an implementation of the recognition obligations as from May 31, 2017 where the counterparty is a bank or a securities dealer or a foreign equivalent and August 31, 2017 for any other counterparties.**

### Power to stay termination of contracts under Art. 30a Banking Act

In line with international standards, the Swiss legislator introduced a new Art. 30a into the Banking Act providing for a power of the FINMA to stay the termination of contracts in support of protective or reorganization measures ordered by the FINMA against a Swiss bank, where such (automatic) termination or (optional) termination by an exercise of termination rights (both a termination) is as per the terms of the relevant contract predicated upon the order of such measures.

Art. 30a Banking Act entered into force on January 1, 2016 and replaced the former Art. 57 BIO-FINMA that provided for a similar power, albeit limited to financial contracts. This former provision had been criticized mainly for the lack of a sufficient legal basis in the Banking Act and an inconsistency with the safeguards of netting and private realization rights with respect to collateral as provided for in the former Art. 27 Banking Act.

With the new Art. 30a Banking Act, both issues were addressed. The power to order a stay of termination now has a clear legal basis and the revised Art. 27 para. 2 Banking Act specifically states that, as an exception to the otherwise overriding principle of the safeguard of netting, private realization of collateral and now also porting rights under Art. 27 para. 1 Banking Act, the order of a stay would take precedence and thereby not only preclude the termination of a contract as such, but also the exercise of any ensuing right of netting, private realization of collateral or porting of transactions.

At the same time, the scope of the power to stay a termination was extended beyond financial contracts to cover any contract that provides for, or allows, a termination based on the order of protective or reorganization measures against a bank.

The stay is now limited to 2 business days, but to the extent that FINMA confirms that the protective or reorganization measures that were coupled with such a stay of a termination were successful to reinstate compliance with the regulatory authorization and other legal requirements, such stay becomes permanent with respect to any termination that could otherwise have been based on the particular underlying order of such protective or reorganization measures.

This power of FINMA to stay termination of contracts applies to banks regulated under the Banking Act, but also to securities dealers regulated under the Stock Exchange Act (see Art. 36a Stock Exchange Act) and to financial market infrastructures regulated under the Financial Market Infrastructure Act (see Art. 88 Financial Market Infrastructure Act).

**Obligation to have such stay recognized in contracts pursuant to Art. 12 para. 2$^{bis}$ Banking Ordinance**

With the enactment of the new Art. 30a Banking Act, the Swiss Federal Council introduced a new Art. 12 para. 2$^{bis}$ into the Banking Ordinance, which also came into force on January 1, 2016, and that provides for an obligation for banks individually and on a group level in essence to have their counterparties contractually recognize in advance such potential stay of a termination under Art. 30a Banking Act as binding on it, where the underlying contract is governed by a law other than Swiss law or provides for jurisdiction by a court other than a Swiss court.

The rationale of this obligation, as for other jurisdictions that have adopted similar obligations, is to ascertain enforceability of such stay of a termination by having such recognition take the form of a conditional advance contractual consent of the recognizing party under a private law agreement and thereby overcome the underlying concern that such stay, which is governed by Swiss law and constitutes public regulatory law, may not be recognized where the underlying contract is not governed by Swiss law and where the very question of the effect of such stay is not to be decided by a Swiss court.

We note that contrary to other jurisdictions (see e.g. Art. 55 EU Bank Recovery and Resolution Directive BRRD) Art. 12 para. 2$^{bis}$ Banking Ordinance only addresses the order of the stay of a termination as such, i.e. this mere supportive and ancillary order, rather than the underlying substantive order (such as e.g. a bail-in right or order for a transfer of a banking business including the respective contracts) that have arguably much more significant ramifications for the counterparty concerned and in respect of which the same concern as to enforceability arises.

Still, against the background of the not insignificant burden of such obligation, it would have seemed preferable to have such obligation in the Banking Act itself and thereby in a formal law rather than in the Banking Ordinance. This would also have ascertained a uniform implementation of Art. 30a Banking Act and the recognition obligations (in this respect see Art. 75 Financial Infrastructure Market Ordinance, that deals with the implementation for financial market infrastructures in a slightly different manner, and the fact that, while the recognition obligations are certainly intended to apply to securities dealers as well, the Banking Ordinance does not on its face apply to securities dealers – contrary to the BIO-FINMA which specifically stipulates its applicability to securities dealers).

**Clarification of recognition obligations and transitional regime**

The applicability of Art. 30a Banking Act to any contracts had raised some criticism in the public consultation as being too wide and in particular beyond the rationale of such a power to stay a termination or the exercise of termination rights which under international standards is limited to financial contracts, as rightfully was the predecessor provision of the former Art. 57 BIO-FINMA.

The enactment of the recognition obligations under Art. 12 para. 2$^{bis}$ Banking Ordinance,

though, led to a more immediate problem, namely the impossibility or impracticability of implementing it for all new or amended contracts.

As the FINMA points out in its explanatory report accompanying the proposed amendment of the BIO-FINMA, Art. 12 para. 2$^{bis}$ Banking Ordinance must be seen as a principle based regulation that calls for further clarification by the implementing authority, namely the FINMA, in terms of its exact addressee and the type of contracts concerned.

Also, Art. 69 para. 5 Banking Ordinance granted the FINMA the power to allow adequate time to the addressees to implement such recognition obligations in line with international standards. While Art. 12 para. 2$^{bis}$ Banking Ordinance entered into force on January 1, 2016, and the FINMA did not issue any public statement to this effect prior to the launch of its consultation, it was implied by market participants, and tacitly shared by the FINMA, that indeed the FINMA would not expect and enforce implementation as from January 1, 2016 despite such regime not being implemented internationally by January 1, 2016, which is in line with the FINMA now proposing a clear transitional regime.

For the implementation of the principles laid down in Art. 12 para. 2$^{bis}$ Banking Ordinance, the FINMA has to clearly define an exhaustive catalogue of qualifying contracts, not least because a failure to comply with Art. 12 para. 2$^{bis}$ Banking Ordinance would attract supervisory action and sanctions.

The catalogue proposed by the FINMA as Art. 56 para. 1 of the revised BIO-FINMA now in essence comprises financial contracts in line with international standards which is certainly a welcome and justified approach. More specifically, it is proposed to have it apply to the following types of contracts:

- contracts governing the purchase, sale, lending and repurchase of certificated and uncertificated securities or intermediated securities and similar transactions referring to indices which contain such securities as well as options referring to such underlying instruments (lit. a);
- contracts governing the purchase and sale with future delivery, the lending or repurchase of goods and similar transactions referring to indices which contain such transactions as well as options referring to such underlying assets (lit. b);
- futures and forward contracts with respect to goods, services, rights or interest (lit c.);
- contracts in respect of swap transactions regarding inter alia interest, foreign exchange, currencies, goods as well as certificated and uncertificated securities or intermediated securities and similar contracts referring to indices which contain such underlyings, including credit derivates and interest options (lit. d);
- credit agreements in the interbank sector (lit. e);
- any other contracts with the same effect as the contracts listed in lit. a–e (lit. f); and
- the contracts listed in lit. a–f above in the form of master agreements (lit. g).

Art. 56 para. 3 in connection with the transitional regime discussed below of the revised BIO-FINMA also clarifies that the obligation only applies for contracts entered into or amended by the parties (as opposed to automatic adjustments provided for in a contract) once such obligation has come into force following the transitional regime discussed below. Hence, there is no general requirement to amend all contracts. We note, however, that in practice, many master agreements entered into prior to such date will have to be amended as entering into a new transaction under an existing master agreement constitutes entering into a new contract (to the extent it falls into one of the categories set-out above) so that an amendment of the master agreement itself will be the most efficient way to satisfy the recognition requirement.

Art. 56 para. 2 BIO-FINMA also specifies in a negative catalogue the type of contracts that are exempt from the recognition obligations of Art. 12 para. 2$^{bis}$ Banking Ordinance, such as contracts traded or cleared with financial market infrastructures or organized trading platforms (lit. b) or contracts entered into with foreign central banks (lit. c) and more generally any contracts of group companies that are not themselves active in the financial sector (lit. d). For

clarity's sake lit. a references any contracts the termination of which is not predicated upon the order of protective or reorganization measures, which is, however, not so much an exemption but rather a requirement to fall under Art. 30a Banking Act and thereby Art. 12 para. 2$^{bis}$ Banking Ordinance in first place.

In terms of a transitional regime for the implementation of the recognition obligations by its addressees, FINMA proposes to implement the obligation of Art. 12 para. 2$^{bis}$ Banking Ordinance, as clarified by Art. 56 of the revised BIO-FINMA, following 3 months from the entry into force of Art. 56 of the revised BIO-FINMA, where the counterparty is a bank or a securities dealer or a foreign equivalent, and 6 months for any other counterparties.

The proposal of a transitional regime was, as referred to above, expected and indeed is a necessity against the background that Art. 12 para. 2$^{bis}$ Banking Ordinance needed further clarification and market participants have as a practical matter be waiting for further clarification. Although FINMA has not made any statement to this effect in the context of the launch of this consultation one has to assume that in effect enforcement of Art. 12 para. 2$^{bis}$ Banking Ordinance will be deferred to such point in time as the revised BIO-FINMA will have come into effect and the finally retained transitional regime will have lapsed.

The transitional regime may seem somewhat short, although one has to admit that any more restrictive catalogue would have come as a surprise and one would not expect major changes to such catalogue in the final revised BIO-FINMA, so that the addressees could now start or as the case may be continue implementation of the recognition obligations. While there is certainly little of an issue with respect to truly new or amended agreements, the volume of master agreements that needs to be amended in order to be further used for transaction following the lapse of the transitional regime may still be quite significant, but on the other hand it is the area in which one would assume banks and securities dealers have already started identifying and implementing the recognition obligations.

Furthermore, the FINMA may grant a further extension to a financial institution upon a justified request.

Finally, one should note that the revised BIO-FINMA only clarifies and thereby narrows the scope of the recognition obligations under Art. 12 para. 2$^{bis}$ Banking Ordinance, but does not purport to narrow the scope of Art. 30a Banking Act as such.

**Please do not hesitate to contact us in case of any questions.**

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