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Cross-border financial services in and from Switzerland

Regulatory frameworks and practical considerations

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I. Introduction

Largely publicized events have recently focused the attention to the risks associated with the cross-border provision of financial services. Several Swiss financial institutions were and are under investigation, both in and outside of Switzerland, for failing to comply with the rules governing cross-border financial services. In the wake of the financial crisis, local regulators in several European jurisdictions and the USA have scrutinized the activities of Swiss financial intermediaries in these jurisdictions.

Over the years, consumers of financial services, typically investors and issuers, have increasingly engaged into transactions outside of their home jurisdictions. Thus, issuers regularly tap funding sources abroad, whereas investors seek to geographically diversify their investments.

The trend towards the internationalization of financial services poses challenges to lawmakers and regulators alike. The Basel Committee on Banking Supervision first attempted to address these issues and released, in 1996, a report on the «Supervision of Cross-Border Banking»[1], which was followed, in 2003, by a report on «Management and Supervision of Cross-Border Electronic Banking Activities»[2].

Against this background, it appears worthwhile to review the regulation of cross-border financial services from a Swiss perspective. Cross-border financial services represent a significant part of the activities of Swiss financial institutions. For example, Switzerland is one of the most important players worldwide on the «offshore

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1 Basel Committee on Banking Supervision, The Supervision of Cross-Border Banking, Basel 1996 (available online at: http://www.bis.org/publ/bcbs27.pdf?noframes=1).

2 Basel Committee on Banking Supervision, The Supervision of Cross-Border Electronic Banking Activities, Basel 2003 (available online at: http://www.bis.org/publ/bcbs99.pdf?noframes=1).

private banking» market, with a 27 % market share in 2007[3].

This contribution is divided into two parts. The first part is dedicated to an analysis of the Swiss rules governing cross-border financial activities targeted at the Swiss market (*inbound perspective*) (see Section **II.** below). In the second part, we will examine some of the restrictions that Swiss financial institutions face when providing their services outside of Switzerland, in particular in the EU (*outbound perspective*) (see Section **III.** below).

As an initial *caveat* to the reader, it ought to be pointed out that the focus of this contribution is the provision of *financial services* in or from Switzerland. This contribution will not address specifically the authorization requirements that apply to the *financial products* which may be distributed in or from Switzerland.

II. Activities conducted in Switzerland (inbound perspective)

This first section analyzes the offering and performance of financial services on Swiss soil by financial institutions incorporated outside of Switzerland. We shall distinguish between the businesses of banking (1.), securities dealing (2.), offering consumer credits (3.), accepting a Swiss member to a foreign securities exchange (4.) and asset management (5.). We shall also address the activities related to the distribution and management of collective investment schemes (6.) and the distribution of so-called «insurance wrappers» (7.). As will be shown hereunder, Switzerland places a strong emphasis on the principle of *home country control* and has, as a result, taken a relatively liberal stance with respect to the regulation of cross-border financial services.

1. Banking services

From a Swiss perspective, the regulation of cross-border banking activities on the domestic market hinges upon a «physical presence» test, which will be discussed in more detail hereinafter. Regulation focuses on the structure, if any, used by the non-Swiss market participant, rather than on the services actually offered or rendered to Swiss-based customers[4].

1.1 Definition of the regulated activities

Banking business is defined as the acceptance or solicitation of deposits from the public, on a professional basis and with a view to finance, for own account, an unlimited number of unrelated individuals or business enterprises (interest-differential business[5], Article 2*a* (a) BO[6] / [7]). The activity is deemed conducted «on a professional basis» if it involves the acceptance of more than 20 deposits on an ongoing basis from the public (Article 3*a* (2) BO)[8].

The BA regulates the conduct of a banking activity in or from Switzerland. The required license by the FINMA (Article 3 (1) BA) calls for compliance with a series of prudential requirements, including the following:

- The bank must have a minimum capital, fully paid up, of at least CHF 10 million (Article 4 (1) BO). Depending upon the nature of its activities, capital adequacy requirements may necessitate a significantly higher equity basis[9].
- The bank must comply with certain organizational rules corresponding to the scope and nature of the planned activity (Articles 7 *et seq.* BO).
- The individuals in charge of the management of the bank must have appropriate professional qualifications necessary to the exercise of their activities and present all guarantees of an irreproachable business conduct (*fit and proper test*, Article 3 (2) (c) BA). This requirement also applies to shareholders whose stake in the bank exceeds 10 % (Article 3 (2) c^{bis} BA).

We shall examine in further detail below the regulator's use made of this last requirement in order to monitor

3 Urs Zulauf, (Zunehmende) Rechtsrisiken im grenzüberschreitenden Finanzgeschäft, FINMA press conference of October 22, 2010, 1 (German version available online at: http://www.finma.ch/d/medien/medienanlaesse/Documents/pdp-genf-referat-urs-zulauf-20101022-d.pdf).

4 David Wyss/Urs Zulauf, Fiktiver Sitz oder faktische Zweigniederlassung – Der Räumliche Geltungsbereich schweizerischer Finanzmarktaufsichtsgesetze und ihre Durchsetzung durch die Eidg. Bankenkommission gegenüber ausländischen Banken und Effektenhändler, in: Spühler (Ed.), Internationales Zivilprozess- und Verfahrensrecht, Zurich 2001, 117, 125.

5 BSK BankG-Bahar/Stupp, Art. 1 NN 2 and 4.

6 It is worth noting that, pursuant to Article 2*a* (b) BO, the definition of the business of banking also covers entities that «are engaged in substantial financing activities in favour of unrelated individuals or business entities if such activities are funded by several unrelated banks». Pursuant to the practice of the Swiss regulator, this provision applies if the refinancing activities of the relevant entity exceed CHF 500 million during four consecutive quarters and if the relevant funds are provided by more than five banks (SFBC Annual Report 1989, 14).

7 As an aside, currency traders for the account of clients (*forex traders*) are regulated in Switzerland as banks since April 1, 2008.

8 Conversely, any business entity which is not regulated under the BA is not permitted to accept deposits from the public on a professional basis (Article 1 (2) BA) and is not allowed to engage into any type of promotional activities for such services (Article 3 (1) BO). There is however an exception for corporate bodies, or entities established under public law, and whose liabilities benefit from a public guaranty (Article 3*a* (1) BO).

9 Swiss capital adequacy rules are currently in the process of being updated to conform to the Basel III requirements. See FINMA, Report on an amendment to the Capital Adequacy Ordinance, July 14, 2010 (German version available online at: http://www.finma.ch/d/regulierung/anhoerungen/Documents/eb-eigenmittel-risikoverteilung-20100714-d.pdf) and the report of the expert group on the «Too Big Too Fail» issue dated October 4, 2010 (available online at: http://www.sif.admin.ch/dokumentation/00514/00519/00592/index.html?lang=en).

the activities conducted by Swiss banking institutions outside of Switzerland (see Section III.1 below).

1.2 Exemption for cross-border activities

As already indicated, the principle of home country control is solidly engrained in the Swiss legal and regulatory framework. As a result, the Swiss approach to cross-border banking services is a fairly liberal one[10]: a non-Swiss banking institution[11] may freely offer and provide banking services to Swiss-based customers, provided (A) the foreign banking institution does not have a physical presence in Switzerland (Article 2 (1) BA)[12] and (B) the foreign banking institution does not intend to become a member of a Swiss exchange (see Section II.4 below for further details on this topic).

The «physical presence» test[13] is met if the foreign institution establishes in Switzerland a branch, a representative office or an agency:

- A Swiss *branch* is deemed to exist if individuals, located permanently in Switzerland and acting in a professional capacity in or from Switzerland, either (A) enter into transactions for the foreign bank, (B) maintain client accounts or (C) have the authority to act on behalf of the foreign bank (Article 2 (1) (a) FINMA-OFB[14]). Thus, a Swiss branch is an organizational unit set up to conduct business activities in or from Switzerland on behalf of a foreign bank[15]. It can exist even though it is not formally registered in the relevant (cantonal) Trade Register[16]. The criterion of independence from the main office, which normally applies to branches of unregulated business enterprises (Article 935 SCO[17]), is not relevant when determining the existence of a branch of a non-Swiss bank[18]. Typically, the licensing requirement is triggered when the non-Swiss banking institution maintains staff[19] on a permanent basis in Switzerland[20].
- The prudential requirements applicable to a Swiss *representative office* are alleviated as compared to those applicable to a branch. The distinguishing element between these two forms of corporate presence is the fact that the individuals forming a representative office are not entitled to maintain client accounts or to act on behalf of the non-Swiss bank[21]. The purpose of a representative office is to support the business development of the non-Swiss bank by other means, for instance by passing on client orders or by marketing the services of the foreign bank (Article 2 (1) (b) FINMA-OFB). An «upgrade» to a license as a branch is required if a representative office expands its activities to include transactions with customers or on behalf of the main office[22].
- The characteristics of a Swiss *agency* can probably best be understood by defining it as a representative office of the Swiss branch of a foreign bank[23]. The services rendered *via* an agency must be client-related; the conduct of back office services (*e.g.*, accounting services, strategic planning and administrative activities) in a location distinct from the branch is not characterized as an agency[24]. The establishment of an agency must necessarily be connected to the Swiss branch of a foreign bank and is subject to the FINMA's prior approval (Articles 2 (2) and 12 FINMA-OFB).

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10 Alessandro Bizzozero/Christopher Robinson, Activités financières cross-border vers et depuis la Suisse, Fribourg 2010, 73.

11 Pursuant to Article 1 FINMA-OFB, a «non-Swiss banking institution» is an entity that either (A) benefits from a license to conduct banking activities in its home jurisdiction, (B) uses the terms «bank» or «banker» in its corporate name, its corporate purpose or its corporate documentation or (C) conducts banking activities within the meaning of Article 2*a* BO (*i.e.,* in substance, an interest-differential business).

12 BSK BankG-Bahar/Stupp, Art. 1 N 85; Wyss/Zulauf (FN 4), 126.

13 Swiss branches and representative offices of foreign banks are subject to all the provisions of the BA, except for the capital adequacy and risk allocation requirements (Article 2 (1) (a) and (b) BA and Article 3 (1) FINMA-OFB).

14 If a foreign bank intends to establish several branches in Switzerland, it must obtain a specific license for each of them and designate a «lead branch» which is in charge of the contacts with the FINMA (Article 6 (1) FINMA-OFB). The liquidation of a branch is also subject to the approval of the FINMA (Article 11 FINMA-OFB).

15 Urs P. Roth/Renate Schwob, in: Bodmer/Kleiner/Lutz (Ed.), Kommentar zum Bundesgesetz über die Banken und Sparkassen, Zurich 2004, Art. 2 N 3.

16 SFBC decision of November 24, 2005 in the matter *Pro Futura Gruppe*, published in SFBC-Bulletin 48 (2006), 312 *et seq.*, para. 23.

17 According to the case law of the Swiss Supreme Court, only a local office that conducts effective business activities with its own personnel and within its own premises independently from the parent entity would qualify as a branch (Swiss Supreme Court decision n° ATF 108 II 122 of March 17, 1982 in the matter *Tradax SA*, para. 1).

18 *Contra*: BSK BankG-Chapuis, Art. 2 N 6, who refers to the Explanations of the SFBC on the FINMA-OFB, published in the SFBC-Bulletin 32 (1997), 7 *et seq.*, 13 and argues that the Swiss branch of a foreign bank must meet all the requirements of the SCO, which would include the independence test. See also FN 46 below.

19 It is not a regulatory requirement that the individuals acting in Switzerland be employees of the foreign bank. The relevant activities could be carried out on a different contractual basis, for instance an agency agreement, but still fall within the definition of a Swiss branch or representative office (BSK BankG-Chapuis, Art. 2 N 36). See also the Swiss Supreme Court decision n° ATF 108 II 122 (FN 17), para. 3 b), where, in a case that did not involve financial regulation, the Swiss Supreme Court ruled that a Swiss branch can exist even though the relevant individuals are not bound to the foreign entity by employment agreements.

20 SFBC decision of July 14, 1994 in the matter *Fidenas AG*, published in SFBC-Bulletin 29 (1995), 17 *et seq.*, para. 2c.

21 Explanations of the SFBC on the FINMA-OFB (FN 18), 7 *et seq.*, 14.

22 BSK BankG-Chapuis, Art. 2 N 7; Wyss/Zulauf (FN 4), 124.

23 BSK BankG-Chapuis, Art. 2 N 8.

24 Explanations of the SFBC on the FINMA-OFB (FN 18), 7 *et seq.*, 18.

From a practical perspective, the availability of the cross-border exemption hinges upon the presence, on a permanent basis, of employees of a non-Swiss banking institution on Swiss soil[25]. The negotiations or conclusion of financial transactions by individuals travelling to Switzerland occasionally on behalf of a non-Swiss bank fall outside the ambit of the Swiss regulatory framework[26]. Similarly, the marketing of cross-border banking services is not regulated, even if it specifically targets Swiss customers[27]. Thus, the offering of banking services on an electronic basis (*e-banking*) can generally fall within the ambit of the cross-border exemption. The FINMA will only intervene, to the extent practicable, if a non-Swiss entity inaccurately represents that it is based in Switzerland or regulated in this country[28].

In light of the above, it is thus fair to state that the provision of cross-border banking services has been completely liberalized in Switzerland[29].

The liberal approach to cross-border activities should not overshadow the fact that the FINMA does not hesitate to initiate enforcement proceedings against non-Swiss banking institutions which maintain a physical presence on Swiss soil without the required license. When confronted with such a situation, the FINMA generally appoints an observer to ascertain the nature and the activities being conducted in Switzerland (Article 36 FINMA Act). If it appears that the relevant activities do not fall under the cross-border exemption, the FINMA's approach[30] is to order the registration of a branch in the relevant Swiss (cantonal) Trade Register. Such registration formalizes the *ratione loci* jurisdiction of the FINMA over the activities conducted by that entity[31]. The regulator then acknowledges the existence of an unlicensed Swiss banking branch and, typically, orders the liquidation of the concerned activities[32]. In the course of these enforcement proceedings, the FINMA must abide by the general principles of administrative proceedings, in particular the principle of proportionality[33]. The second track of enforcement proceedings is of a criminal nature: individuals intentionally pursuing banking activities in Switzerland without a proper license are subject to 3 years of imprisonment or a fine capped at CHF 1'080'000 (Article 44 (1) FINMA Act and Articles 34 and 333 (1) SCC).

The issues surrounding the setting up of a *de facto* or *de jure* branch or representative office in Switzerland must be distinguished from the situation in which a banking institution incorporated outside of Switzerland is deemed effectively managed from this country or conducts the lion's share of its business activities in or from

25 As an aside, we note that the services provided by a Swiss banking subsidiary of a non-Swiss banking institution would not be deemed to be rendered on a «cross-border» basis. The BA and its implementing ordinances would apply to such entity in substantially the same way as they do to a Swiss bank (Beat Kleiner/Renate Schwob, in: Bodmer/Kleiner/Lutz (Ed.), Kommentar zum Bundesgesetz über die Banken und Sparkassen, Zurich 2004, Art. 3 N 152). Such a subsidiary would be characterized as a «Swiss bank under foreign control» and subject to slightly more stringent prudential requirements than locally controlled Swiss banks (Articles 3*bis* and 3*ter* BA, Articles 5 and 6 BO). The FINMA would be entitled to refuse extending a license to a «Swiss bank under foreign control» if the home jurisdiction of the controlling shareholders does not comply with the *principle of reciprocity*, meaning that a Swiss bank would not be entitled to operate in such jurisdiction under conditions that are similar to those applicable to a bank from such jurisdiction intending to operate in Switzerland (Article 3bis (1) (a) BA). That being said, the commitments undertaken by Switzerland as a WTO Member State preclude the FINMA from invoking this escape clause *vis-à-vis* controlling shareholders domiciled or incorporated in a WTO Member State. This clause has thus been deprived of much of its practical relevance (SFBC Annual Report 1999, 50).

26 SFBC Annual Report 2002, 92; BSK BankG-Chapuis, Art. 2 N 36; Roth/Schwob (FN 15), Art. 2 N 6.

27 Michael Kunz, Aufsichtsrechtliche Probleme des E-Banking, in: Wiegand (Ed.), E-Banking – Rechtliche Grundlagen, Bern 2002, 23, 87.

28 When confronted with such a situation, the FINMA attempts to liaise with the regulatory authorities of the State where such financial intermediaries are located, as well as with the Internet service provider, in order to put an end to the misleading practices (see for instance SFBC Annual Report 2003, 63).

29 The conclusion according to which cross-border banking services are unregulated in Switzerland applies from the perspective of Swiss banking regulations. That being said, provisions in other areas of Swiss law might constitute obstacles for a non-Swiss bank that envisions offering its services on Swiss soil. As regards Swiss retirement benefit institutions (pension funds), the Swiss Federal Office for Social Security requires, as a general rule, that the custodian bank for a Swiss pension fund be a Swiss bank, based upon an extensive interpretation of Article 50 (2) of the Swiss Federal Ordinance on Pension Funds. Under the current position of the Swiss Federal Office for Social Security, non-Swiss banks could thus be prevented from acting as custodian banks for Swiss pension funds.

30 Wyss/Zulauf (FN 4), 134.

31 The FINMA's rationale is then that the foreign banking institution maintains in Switzerland a branch without benefiting from a proper license (Wyss/Zulauf (FN 4), 138). It is to be noted in this context that the registration of a branch in a Swiss cantonal Trade Register only has a «declarative» effect, meaning that a Swiss branch can exist even in the absence of a registration in a Swiss cantonal Trade Register. Consequently, the registration of a branch in a Swiss (cantonal) Trade Register only formalizes the *ratione loci* jurisdiction of the FINMA.

32 Swiss Supreme Court decision in the matters n° 2A.127/2007 and n° 2A.717/2006, consolidated into one single decision of October 11, 2007, para. 6.3; SFBC decision of January 28, 2004 in the matter *UIB Servizi SA et al.*, published in SFBC-Bulletin 46 (2004), 61 *et seq.*, para. 46 and subsequent Swiss Supreme Court decision n° ATF 130 II 351 of July 15, 2004, para. 6.1; SFBC decision of November 24, 2005 in the matter *Pro Futura Gruppe* (FN 16), para. 26. Despite the absence of an express statutory basis, the power of the Swiss regulator to order the liquidation of the Swiss corporate presence of a foreign banking institution has never been seriously challenged (Wyss/Zulauf (FN 4), 132-133). As of January 1, 2009, Article 37 (3) FINMA Act expressly grants such authority to the FINMA.

33 Swiss Supreme Court decision n° ATF 130 II 351 (FN 32), para. 6. In this case, the Swiss Supreme Court held that a SFBC decision to force the registration of a Swiss branch ran afoul of the principle of proportionality, to the extent some of the non-Swiss entities that were targeted by the liquidation order were regulated in their home jurisdiction and had no client base in Switzerland.

this country[34]. In this scenario, the foreign banking institution must adopt a Swiss legal form[35] and is automatically subject to the regulatory framework applicable to Swiss banks (Article 1 (2) FINMA-OFB). The rationale behind this provision is to dovetail the liberal approach to cross-border activities with the necessary prevention of «shell banks» being set up in jurisdictions having a substandard level of regulation, but effectively managed in Switzerland[36].

The FINMA benefits from a wide discretion when determining whether the intensity of the activities conducted in Switzerland is such that a foreign entity is obliged to adopt a Swiss legal form. For instance, the Swiss regulator has held that the BA applied to a non-Swiss entity that lacked any economic substance at its (formal) place of registration, whose board of directors met exclusively on Swiss soil and that outsourced all of its back office services to a Swiss-based affiliate[37]. The performance in Switzerland of all, or substantially all, the activities that are essential to the banking business also constitutes a strong indication towards a *de facto* management from Switzerland[38]. In its case law, the Swiss regulator rejected claims that back office activities are, as such, not regulated in Switzerland or that the non-Swiss entity was regulated in its home jurisdiction[39].

2. Securities dealing services

Cross-border services in the field of securities dealing is regulated substantially along the same lines applying to cross-border banking. From a Swiss perspective, regulation is only triggered if the «physical presence» test is met, with the additional *caveat* that the SESTA also regulates *remote members* of a Swiss exchange, even if the concerned entity does not maintain a physical presence in Switzerland.

2.1 Definition of the regulated activities

The Swiss legal and regulatory framework broadly defines cross-border securities dealing activities[40]. Under Article 2 (d) SESTA, a securities dealer is «any person or entity who purchases and sells securities in a professional capacity on the secondary market, either for its own account with the intent of reselling them within a short period of time or for the account of third parties, or makes public offers of securities to the public on the primary market, or creates derivatives and offers them to the public».

This wide definition is generally split into the following five categories:

- trading in securities as a principal on a short term basis (own-account dealer) (Article 3 (1) SESTO);
- underwriting and public offering, on the primary market, of securities issued by third parties (issuing house) (Article 3 (2) SESTO);
- issuance and public offering, on the primary market, of derivatives as a principal or as an agent (derivative supplier) (Article 3 (3) SESTO);
- trading in securities as a principal on a short-term basis and offering sale/purchase prices in certain securities, either on a permanent basis or upon request (market maker) (Article 3 (4) SESTO); and
- trading in securities as an agent for clients and (i) either holding settlement accounts for the clients or (ii) holding securities in safe custody for the account of clients, either directly or with third parties but in the name of the relevant entity (securities dealer operating for the account of clients, broker-dealer) (Article 3 (5) SESTO).

The activities listed above only fall within the ambit of the SESTA if they involve «securities». This term of art encompasses any financial instrument which is (A) standardized and (B) suitable for mass trading. The relevant financial instrument should further be offered to the public or sold to more than 20 clients (Article 4 SESTO). As regards standardization, it is not necessary that the financial instruments be identical in all respects to qualify as securities; however, their main features (*e.g.,* interest rate and duration) and their denomination should be the same. In turn, customized (or tailor-made) financial instruments (*e.g.*, OTC instruments) are excluded from the scope of the SESTA.

One single type of securities dealer license is available, with the result that a regulated entity can conduct any of the five activities listed above, provided these activities are covered by its organizational documents. A bank that intends to carry out any of the activities listed above must obtain a separate license as a securities dealer[41]. As a practical matter, the regulatory framework applicable to securities dealing mirrors the one applicable to banking activities. This ensures a level-playing field

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34 SFBC decision of November 24, 2005 in the matter *Pro Futura Gruppe* (FN 16), para. 23.

35 In practical terms, this means an organization as a Swiss company limited by shares (Articles 620 *et seq.* SCO) or as a Swiss cooperative (Articles 828 *et seq.* SCO).

36 Swiss Supreme Court decision in the matters n° 2A.127/2007 and n° 2A.717/2006 (FN 32), para. 6.1; see also Roth/Schwob (FN 15), Art. 2 N 2.

37 SFBC decision of January 28, 2004 in the matter *UIB Servizi SA et al.* (FN 32), 61 *et seq.*, para. 27 (b), 37 and subsequent Swiss Supreme Court decision n° ATF 130 II 351 (FN 32), para. 5.3.4.1.

38 Swiss Supreme Court decision in the matters n° 2A.127/2007 and n° 2A.717/2006 (FN 32), para. 6.3.

39 Swiss Supreme Court decision n° ATF 130 II 351 (FN 32), para. 5.

40 Institutions licensed as banks in Switzerland must obtain a separate license as a securities dealer if they intend to offer one or several of the five securities dealer services defined in the SESTA and the SESTO.

41 BSK BEHG-Huber, Art. 10 Abs. 1-4 N 4.

between non-banking securities dealers and banks benefiting from an additional license as a securities dealer[42].

2.2 Exemption for cross-border activities

The SESTA provides for a liberal regime for cross-border activities, which is closely modeled on the one applicable to cross-border banking activities and thus hinges upon a similar «physical presence» test[43]. The inbound offering of securities dealer services is not regulated in Switzerland[44], except if the foreign securities dealer[45] maintains a branch or a representative office in Switzerland:

- A Swiss *branch* exists if individuals, located permanently in Switzerland and acting in a professional capacity, in or from Switzerland, either (A) trade in securities for the foreign securities dealer, (B) maintain client accounts or (C) have the authority to act on behalf of the foreign securities dealer (Article 39 (1) (a) SESTO). In substance, the developments made under Section II.1 above with respect to the Swiss branch of a foreign bank apply *mutatis mutandis* to the Swiss branch of a foreign securities dealer[46].
- If the requirements for a Swiss branch are not met, it is still necessary to ascertain whether Swiss-based individuals do not conduct other activities in Switzerland in support of the main office, for instance by passing on client orders or by marketing the services of the non-Swiss securities dealer[47]. Should this be the case, the Swiss presence would be characterized as a *representative office*, which is also subject to a license requirement (Article 39 (1) (a) (2) SESTO).

Again, as for banking entities, the setting up of a Swiss branch or representative office must be distinguished from the establishment of a Swiss subsidiary by the foreign securities dealer. Such a distinct legal entity would be subject to the prudential requirement applicable to ordinary Swiss securities dealers and could not rely on the cross-border exemption. In addition, the corollary to the liberal cross-border exemption is again the requirement that foreign securities dealers that are (A) *de facto* managed from Switzerland or (B) exclusively or predominantly active from Switzerland must adopt a Swiss legal form (Article 38 (2) SESTO)[48]. Finally, the FINMA, as the consolidated supervisor over the Swiss financial markets, benefits from the same procedural tools, as in the banking area, in order to stop unauthorized activities in the securities dealing area[49].

Three sets of rules that are specific to securities dealers are worth mentioning here: (A) the concept of «introducing brokers», (B) the concept of a «remote member» of a Swiss exchange and (C) the territorial scope of the Swiss rules of conduct.

Firstly, a particular regulatory regime applies to *introducing brokers*, meaning individuals or entities acting as an intermediary between a foreign securities dealer and Swiss-based customers[50]. *Prima facie*, the promotional activities of an introducing broker should fall within the ambit of the definition of a representative office. That being said, the FINMA makes a distinction depending upon the intensity of the subordination existing between the introducing broker and the foreign securities dealer[51]. The Swiss regulator has taken the position that Swiss introducing brokers are not regulated if (A) the agreement entered into with the intermediary lacks an exclusivity provision[52] and does not allow the intro-

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42 SFBC Annual Report 1996, 62.

43 BSK BEHG-Huber, Art. 10 Abs. 1-4 N 21; Urs Roth in: Hertig/Meier-Schatz/U. Roth/D. Roth/Zobl (Ed.), Kommentar zum Bundesgesetz über die Börsen und den Effektenhandel, Zurich 2000, Art. 10 NN 61 and 63.

44 Some legal scholars query whether this liberal regime is actually in line with the intent expressed by Swiss lawmakers when enacting the SESTA. Indeed, Article 10 (4) SESTA provides that the Swiss Federal Council (*i.e.,* the Swiss government) is to establish «criteria to regulate foreign securities dealer which are active in Switzerland without maintaining a branch or a representative office in this country.» (Roth (FN 43), Art. 10 N 63). A possible answer to this is the fact that the Swiss government fulfilled its mandate by regulating the remote members of Swiss exchanges (Article 39 (1) (b) SESTO).

45 Under Article 38 SESTO, a «non-Swiss securities dealer» is defined as an entity that either (A) benefits from a license to conduct securities dealing activities in its home jurisdiction, (B) uses the terms «securities dealer» (or a similar term, such as «(securities) broker») in its corporate name, its corporate purpose or its corporate documentation, or (C) conducts securities dealing within the meaning of the five categories listed in Article 3 SESTO. It is important to point out that the FINMA pays close attention to the regulatory status of the non-Swiss entity in its home jurisdiction. The Swiss branch or representative office of a non-Swiss entity that benefits from a license, in its home jurisdiction, which is comparable to a Swiss securities dealer license, would be subject to regulation in Switzerland, even if the activities conducted in Switzerland are not, as such, regulated in this country. For example, the Swiss branch of a non-Swiss securities dealer would be subject to a licence requirement in Switzerland even if the sole purpose of such branch is to conduct asset management activities, which are, as a general rule, not subject to a prudential supervision in Switzerland (see Section II.5 below).

46 As regards the criterion of «independence» (see FN 18), the Swiss Supreme Court, in its case law, has clearly indicated that this test is not relevant when examining whether or not the physical presence of a foreign securities dealer qualifies as a «branch» (Swiss Supreme Court decision n° ATF 126 II 71 of November 19, 1999 in the matter *Comfinor et al.*, para. 5.a, a German translation of this decision was published in SFBC-Bulletin 40 (2000), 94 *et seq.*). See also BSK BEHG-Huber, Art. 10 Abs. 1-4 N 24 and Rolf H. Weber, Börsenrecht, Zurich 2001, Art. 10 N 7.

47 BSK BEHG-Huber, Art. 10 Abs. 1-4 N 28.

48 BSK BEHG-Huber, Art. 10 Abs. 1-4 N 21; Roth (FN 43), Art. 10 N 58.

49 Swiss Supreme Court decision n° ATF 126 II 71 (FN 46) para. 6.a); Swiss Supreme Court decision n° 2A.65/2002 of May 22, 2002, para. 5.3; BSK BEHG-Huber, Art. 10 Abs. 1-4 N 25.

50 BSK BEHG-Huber, Art. 10 Abs. 1-4 N 21; Roth (FN 43), Art. 2 lit. d N 48-50.

51 BSK BEHG-Huber, Art. 2 lit. d N 63.

52 The relevant exclusivity is that the introducing broker is the only one acting as an intermediary for the relevant foreign securities dealer (FINMA Circular 2008/5, para. 59).

ducing broker to use the corporate name of the foreign securities dealer, or (B) if there is no specific contractual relationship between the foreign securities dealer and the introducing broker which transfers orders to the foreign securities dealer (FINMA Circular 2008/5, para. 62-63). Apart from these two exceptions, the foreign securities dealer must obtain a license if one of its (unregulated) Swiss agents (regardless of whether such agent is an affiliated entity or not) acts as an introducing broker in Switzerland (FINMA Circular 2008/5, para. 58). So far the FINMA has maintained its practice, despite the uncovering of some abuses in this area[53].

Secondly, a foreign securities dealer must obtain a license to become a *remote member* of a Swiss exchange (*i.e.*, EUREX Zürich AG, Scoach Schweiz AG or SIX Swiss Exchange AG), irrespective of the traditional «physical presence» test (Article 39 (1) (b) SESTO)[54]. In a nutshell, the FINMA will grant the license if (A) the *remote member* is subject to an appropriate level of supervision in its home jurisdiction, (B) the home regulator does not object to the membership with a Swiss exchange and (C) the home regulator is in a position to provide international administrative assistance upon request (Article 53 (1) SESTO).

Thirdly, an issue arises as to whether foreign securities dealers conducting cross-border activities in Switzerland are subject to one specific provision of the SESTA, namely Article 11, notwithstanding the fact that their activities are for the rest unregulated in this country. Article 11 SESTA sets forth a duty of information, of care and of loyalty[55], which applies to all regulated Swiss securities dealers. It is now generally considered that this statutory provision features both a regulatory and a contractual component[56]. This means that compliance with this provision can be enforced by the regulator, but also, directly, by the clients of the securities dealer. In a civil litigation involving a domestic dispute, the Swiss Supreme Court has resorted to Article 11 SESTA in order to identify the duties of a securities dealer *vis-à-vis* its client[57]. To our knowledge, Swiss courts are yet to rule on the application of Article 11 SESTA in a cross-border scenario, but the following developments can be made at this juncture:

- *Prima facie* the *regulatory component* of Article 11 SESTA applies only to Swiss securities dealers and to non-Swiss securities dealers which meet the «physical presence» test and thus fall within the ambit of the Swiss regulatory framework (Article 40 (1) SESTO). To the extent that activities conducted on a strict cross-border basis are not regulated in Switzerland, it could be argued that the regulatory component of Article 11 SESTA should not apply in such a context. That being said, one cannot exclude that the FINMA elects to distinguish between, on the one hand, the scope of the license requirement and, on the other hand, the scope of the rules of conduct. The Swiss regulator could thus consider that a non-Swiss securities dealer active in Switzerland on a strict cross-border basis is also subject to Article 11 SESTA. To our knowledge, the FINMA has, so far, not applied this (possible) reasoning to an actual case. For the reasons further discussed below, the regulatory risk for securities dealer incorporated in the EU, and thus subject to the MiFID, should not be material.
- The scope of the *contractual component* of Article 11 SESTA in a cross-border scenario will hinge upon the parties' choice of law: if the agreement between the foreign securities dealer and the Swiss customer is governed by Swiss law, Article 11 SESTA applies to the contractual relationship. Conversely, Article 11 SESTA should not apply if the parties elect a law other than Swiss law or if a conflict of law provision leads to the application of the laws of another jurisdiction[58]. That being said, even in such a situation, a Swiss court adjudicating a dispute could consider, along with certain scholars, that Article 11 SESTA nevertheless should apply. In doing so, the Swiss court could construe the provision of the SESTA as a mandatory *ordre public* provision protecting Swiss-based investors and the good functioning of the Swiss securities markets[59] (Article 18 PILA). As an alternative, the Swiss court could also rely on the so-called «negative» approach to the concept of *ordre public* and hold that Swiss investors are entitled to expect that the rules governing cross-border activities do not fall short of the minimum level of protection granted by Article 11 SESTA (Article 17

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53 SFBC Annual Report 2005, 41; Wyss/Zulauf (FN 4), 132.

54 BSK BEHG-Huber, Art. 10 Abs. 1-4 NN 18 and 33; SFBC Annual Report 1998, 75.

55 The purpose of this contribution is not to detail the scope of these duties. For further information on this topic, see Benoît Chappuis/Franz Werro, Le devoir d'information de l'article 11 LBVM et son rôle en droit civil à la lumière des Règles de conduite de l'ASB, AJP 2005, 560, 565; Roth (FN 43), Art. 11 N 58 *et seq.*; BSK BEHG-Stupp/Dubs, Art. 11 N 30 *et seq.*

56 Swiss Supreme Court decision n° 4A_213/2010 of September 28, 2010, para. 4; see also Chappuis/Werro (FN 55), 564; Luc Thévenoz, Les règles de conduite des négociants, SZW Spezialheft 1997, 20, 23.

57 See for instance Swiss Supreme Court decision n° 133 III 97 of January 4, 2007, para. 5.

58 Article 117 (3) (c) PILA provides that, in the absence of a choice of law, the law of the State in which the party performing the characteristic obligation is residing. In the case at hand, the party performing the characteristic obligation would be the (foreign) securities dealer. Accordingly, foreign law would govern the contractual relationship in the absence of a choice of law provision.

59 Those two objectives are mentioned in Article 1 SESTA, the purpose clause of the SESTA.

PILA)[60]. It is important to bear in mind however that the application of Article 11 SESTA as an *ordre public* provision presupposes that a Swiss court has jurisdiction. This will generally not be the case, to the extent the general terms and conditions of the (non-Swiss) securities dealer will, in all likelihood, contain a *forum selection* clause in favor of its home courts[61].

- In view of the above, one must therefore keep in mind that the Swiss rules of conduct could apply to cross-border services in the area of securities dealing, irrespective of the fact that the activities as such are not regulated in Switzerland. From a consumer protection perspective, the practical importance of this debate should however not be overstated. Indeed, investment firms based in the EU are subject, in their home jurisdiction, to rules of conduct which, in some respect, are even more stringent than Article 11 SESTA (see Articles 19 *et seq.* MiFID).

3. Offering consumer credits

Pursuant to Article 120 PILA, Swiss law is most likely applicable in the event a (non-Swiss) banking institution provides a consumer credit to a consumer domiciled in Switzerland. Under certain circumstances, in particular when the consumer credit is in the range of CHF 500 to CHF 80'000 and if the consumer is not obliged to reimburse the credit within less than three months or in no more than four installments within one year (Article 7 (e) and (f) CCA), the CCA will regulate the consumer credit relationship. This applies even if the bank is located outside of Switzerland. The CCA sets out a series of mandatory consumer protection rules, which cannot be varied to the detriment of the consumer, in particular:

- The lender must obtain an authorization from the Swiss canton in which it intends to conduct most of its business, which authorization will then be valid in the rest of Switzerland (Article 39 (2) CCA).
- Consumer credit agreements must be made in the written form (Article 9 (1) CCA).
- A consumer credit agreement must list a series of information (including the effective net interest rate and the installments), absent which it is considered null and void (Articles 9 (2) and 15 CCA).

Moreover, pursuant to Article 3 (k) and (n) of the Swiss Unfair Competition Act, whoever advertises in Switzerland consumer credit services must clearly state its corporate name, provide clear information as to the net amount, the total cost and the annual interest of the consumer credit and duly draw the customer's attention on the fact that the granting of a consumer credit is forbidden if it causes excessive indebtedness.

4. Accepting a Swiss member to a foreign securities exchange

Under Swiss law, the running of an exchange via a Swiss-registered entity requires a license (Article 3 SESTA). An exchange is defined in this context as an organization set up for the purposes of securities trading and which (A) enables the simultaneous exchange of offers of securities among a number of securities dealers and (B) the execution of transactions.

Securities exchanges that are not organized under Swiss law are only regulated in Switzerland if deemed to «conduct activities» in this country. The relevant test is met if a Swiss trader is given access to the trading facilities of the exchange (Article 14 (1) SESTO)[62]. As compared to

[60] For more information on this topic, see BSK BEHG-Stupp/Dubs, Art. 11 N 22; Roth (FN 43), Art. 11 N 54, 57; Rolf Watter/Ralph Malacrida, Das Börsengesetz im internationalen Kontext, in: Meier-Schatz (Ed.), Das neue Börsengesetz der Schweiz, Bern/Stuttgart/Wien 1996, 135, 151-159; *contra*: Manfred Küng/Felix M. Huber/Matthias Kuster, Kommentar zum Börsengesetz, Zurich 1998, Volume II, 184-185, who take the position that Article 11 SESTA does not apply if the foreign securities dealer is not subject to regulation in Switzerland.

[61] It is debated whether or not such *forum selection* clauses are valid against the background of the (mandatory) jurisdiction rules that apply to consumer transactions. The Swiss Supreme Court has held that, depending upon the circumstances (in particular the relationship between the parties, the purpose of the transaction and its economic importance for the concerned individual), financial services could be characterized as services «rendered to a consumer» (Swiss Supreme Court decision n° ATF 132 III 268 of November 23, 2005, para. 2.2.3 and 2.2.4; Swiss Supreme Court decision n° 133 III 295 of March 28, 2007, para. 7). The *Oberlandesgericht* of Hamburg (Germany) reached a similar conclusion in the case n° 4 U 156/03 of June 23, 2004 (available online at: http://www.tilp.de/files/olghamb20040623.pdf), which was rendered under the auspices of the Lugano Convention. If (A) the relevant relationship is characterized as a «consumer» transaction and (B) the consumer took in his or her own State the steps necessary for the conclusion of the contract, which conclusion was preceded, in the State of the consumer, by a specific invitation addressed to the consumer or promotional efforts, the Lugano Convention allows the consumer to sue in its home courts, notwithstanding a *forum selection* clause (Article 14 (1) Lugano Convention, see also Article 114 (1) and (2) PILA). The possibility for the consumer to sue in his home state will be extended under the auspices of the revised version of the Lugano Convention, which is to enter into force, in Switzerland, as of January 1, 2011. The revised version of the Lugano Convention will provide that it is sufficient that the counterparty of the consumer has directed its activities to the State of the consumer (*i.e.*, it will no longer be required that a specific invitation or promotional activities were actually made in the State of the consumer and that the contractual relationship was actually entered into in this State). The above developments obviously only apply if the relevant contractual relationship falls within the ambit of the definition of a «consumer relationship».

[62] The FINMA's practice has been to require that the Swiss member of a non-Swiss exchange must benefit from a license as a (Swiss) securities dealer. This requirement stems from a strictly literal interpretation of Article 14 (1) SESTO and an analogy with the

the situation prevailing for banks and securities dealers (see Sections II.1.2 and II.2.2 above), the «physical presence» test has been replaced by a «technical presence» test. Typically, the mere fact of granting a Swiss-based trader an electronic access to the trading would be sufficient to trigger the license requirement[63].

One should however bear in mind that the license as a non-Swiss securities exchange does not generate the same (stringent) level of supervision as the other licenses granted by the FINMA. In practice, the FINMA's involvement is limited to a verification that the foreign exchange is subject to an adequate supervision in its home jurisdiction.

5. Asset management services

Contrary to the situation prevailing in a number of other jurisdictions, asset management services are not, as a matter of principle, subject to prudential supervision in Switzerland. The only exception is the management of collective investment schemes, which will be addressed under Section II.6.2 below. As a result, there is no regulatory restriction to the conduct of asset management activities in Switzerland on a cross-border basis.

That being said, asset managers are generally[64] characterized as a «financial intermediary» within the meaning of Article 2 (3) AMLA and, as such, subject to the Swiss regulatory framework against money-laundering. Such legal characterization means that the relevant entity must register with, and is subject to, the supervision of a self-regulated body recognized by the FINMA (Article 12 (c) (1) AMLA). Where a financial intermediary is not affiliated to any self-regulated recognized body, it will be directly supervised by the FINMA (Article 12 (c) (2) AMLA).

The duties imposed on the financial intermediary are essentially KYC rules and procedures, as well as certain organizational requirements (*e.g.*, internal controls, documentation, continuing education, etc.) (see Articles 3 *et seq.* AMLA). In addition to these KYC rules and procedures, financial intermediaries must also comply with the duties to report and to block assets in the event they have knowledge or suspicion of criminal activity. The reporting duty presupposes that the financial intermediary is aware of or has reasonable suspicion as regards the criminal origin of the assets involved (Articles 9 and 10 AMLA). A financial intermediary may incur a criminal liability should it fail to comply with these duties.

As regards asset management activities conducted on a cross-border basis, Article 2 (1) OPFI provides, in substance, that the AMLA applies to a foreign financial intermediary if the latter employs, in Switzerland, individuals that, on a professional basis, enter into transactions of financial intermediation[65] or act on behalf of the foreign financial intermediary. In turn, the AMLA does not apply to non-Swiss financial intermediaries that are active on a strict cross-border basis, meaning that their staff travels to Switzerland only for purposes of negotiations or entering into of specific transactions (Article 2 (2) OPFI).

It is worth noting at this juncture that, in addition to being subject to the AMLA, certain asset managers have recently fallen under the indirect supervision of the FINMA. The Swiss regulator has issued the FINMA Circular 2009/1, whose stated purpose is to set forth a series of minimum standards that must be met by asset managers in order to allow them to benefit from the status of a «qualified investor» within the meaning of the CISA and to fall within the ambit of the Swiss private placement rules (see Section II.6.1a below). The scope of the FINMA Circular 2009/1 however exceeds by far its stated purpose, inasmuch as this circular subjects asset managers to a series of far-reaching duties of loyalty, care and information[66], as well as to a duty to comply with a *fit and proper test*[67]. The duty to enforce the provisions of the FINMA Circular 2009/1 has been allocated to the self-regulatory bodies to which asset managers must adhere for anti-money laundering purposes. These self-regulatory bodies are in turn supervised by the FINMA. Following the enactment of the FINMA Circular 2009/1, it is thus fair to say that a large segment

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rules applicable to Swiss exchanges, which may only accept Swiss securities dealers as their members (Article 7 (1) SESTA). On this basis, the FINMA developed a practice whereby foreign exchanges are required to notify the FINMA on an on-going basis of any new Swiss member (SFBC Annual Report 1999, 82-83). In addition, the foreign exchange has to submit on an annual basis to the SFBC a list of all of its Swiss members. Swiss legal scholars and practitioners have criticized the FINMA's position, arguing that it overstretches the authority's regulatory powers. In 2007, the FINMA accepted to amend its practice to a certain extent and allowed (unregulated) Swiss commodity traders to become members of a non-Swiss securities exchange, subject to certain requirements (see Stefan Breitenstein, Die Regulierung von Rohwarenhändlern, in: Vogt/Stupp/Dubs (Ed.), Unternehmen – Transaktion – Recht (Liber Amicorum für Rolf Watter), Zurich/St. Gallen 2008, 77).

63 In practice, some foreign exchanges limit the information made available to Swiss-based traders to market data and require the Swiss-based trader to give their trading orders through the telephone (both these activities are unregulated in Switzerland). See Breitenstein (FN 62), 65, 74, footnote 33.

64 It is important to note that the AMLA does not apply to a Swiss entity that has no decision-making authority over investments, but only acts as an investment advisor (Article 6 (1) (b) OPFI *a contrario*, Ralph Wyss, in: Thelesklaf/Wyss/Zollinger/van Thiel (Ed.), Geldwäschereigesetz, Zurich 2009, Art. 2 N 13).

65 If the activities are not subject to the AMLA (*e.g.*, back-office services), the branch as such is not subject to the AMLA.

66 FINMA Circular 2009/1, para. 11-26.

67 FINMA Circular 2009/1, para. 10.

of Swiss independent asset managers are indirectly supervised by the FINMA.

In view of the above, it appears that asset management services can be conducted in Switzerland by non-Swiss providers on a strict cross-border basis (*i.e.,* without a physical presence in Switzerland) without triggering any requirement to obtain a license from the regulator[68], neither from a prudential, nor from an anti-money laundering perspective.

6. Financial activities related to collective investment schemes

We have shown above that the Swiss approach to cross-border financial services is a fairly liberal one, inasmuch as the provision of such services on a strict cross-border basis, without a physical presence in Switzerland, is possible on an unregulated basis. The regulation of collective investment schemes operates under a different paradigm: the regulatory focus is put on the financial product, as well as the market participants offering such product. As a result, activities in Switzerland that are connected to a (regulated) collective investment scheme are likely to be subject to official supervision and the availability of the cross-border exemption is severely restricted[69].

Collective investment schemes are governed in Switzerland by the CISA. This statute was enacted to govern (A) all forms of Swiss collective investment schemes, irrespective of their structure or legal form, (B) Swiss-based individuals and firms which are involved in the administration, management and custody thereof and (C) the public offering in or from Switzerland of non-Swiss collective investment schemes.

6.1 Distribution of collective investment schemes in Switzerland

a. Definition of the regulated activities

The distribution of shares of or interests in Swiss or non-Swiss collective investment schemes in or from Switzerland is subject to a license requirement if such activities are conducted by way of a «public offering» (Articles 19 and 120 CISA). Pursuant to the CISA, the concept of «public offering» encompasses all forms of direct and indirect marketing of collective investment schemes, regardless of the form of the offering (*i.e.,* public advertisement, mass mailing, NAV publication, cold calls, road shows etc.), with the following three exceptions, which do not constitute a form of public offering:

- distribution at the unsolicited request from investors (reverse solicitation)[70];
- the publication of subscription prices, NAV and similar information (including tax values), which is made by regulated financial intermediaries, provided that any such publication contains no contact details (Article 3 CISA and Article 3 (2) CISO); and
- any publicity which is directed at qualified investors[71] only and which is made through the usual channels in that market (*e.g.,* one-to-one contacts, road shows, etc.), without any advertising being made to the general public (Article 3 CISA and Article 3 (1) CISO).

The FINMA specified the concept of «public offering» in the FINMA Circular 2008/8 and took the position that every solicitation made to an investor which does not meet the requirements of a qualified investor[72] automatically amounts to a «public offering» (FINMA Circular 2008/8, para. 9). This would mean that the solicitation of a single non-qualified investor in Switzerland would be deemed to be a «public offering». In a November 26, 2009 decision[73], the Swiss Federal Administrative Court held that this interpretation of the concept of «public offering» was overly restrictive. Pursuant to the holding of this decision, promotional activities directed at a very limited circle of investors should not be char-

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68 Wyss (FN 64), Art. 2 N 3.

69 SFBC Annual Report 2002, 92.

70 The unsolicited nature of the inquiry from the prospective investor must be properly documented and presupposes the absence of any prior communication made to the said investor in relation to the relevant collective investment scheme.

71 From a Swiss perspective (Article 10 (3) and (4) CISA and Article 6 CISO), the concept of «Qualified Investors» comprises the following categories of investors:
(1) regulated financial institutions such as banks, securities dealers and fund management companies;
(2) regulated insurance companies;
(3) public entities and retirement benefit institutions (pension funds) with professional treasury management;
(4) companies with professional treasury management;
(5) high-net-worth individuals, defined as being individuals holding, directly or indirectly, a minimum wealth of CHF 2 million in net financial assets (as well as private holding companies of such high-net-worth individuals, also subject to the same CHF 2 million threshold);
(6) investors having entered into a written discretionary management mandate with either:
(a) a regulated financial institution (*i.e.,* those which are referred to under (1) above); or
(b) an independent asset manager, provided that the said asset manager is subject to (i) AMLA supervision, (ii) rules of conduct of a recognised professional organisation and (iii) the relevant management agreement complies with the directives of a recognised professional organisation (*e.g.,* guidelines issued by the SBA) (a «Qualified Asset Manager»); and
(7) Qualified Asset Managers.

72 See FN 71 for the Swiss definition of «qualified investors».

73 Decision of the Swiss Federal Administrative Court of November 26, 2009 in the case n° B-7764/2008, para. 8.4.4. The carve-out set out in this decision applies if the solicitation is made to «only one prospective investor or very few prospective investors» (in the German original wording of the decision: «einen oder ganz wenige potenzielle Anleger»).

acterized as a «public solicitation» within the meaning of the CISA.

Regulation as a fund distributor triggers a number of duties, the most important of which being (A) a requirement to enter into a written distribution agreement which complies with the minimum standards set forth by the SFA, the self-regulatory organization of the Swiss fund industry (Article 30 (1) (b) and (2) CISO)[74], (B) the compliance, by the individuals managing the distributor, with a *fit and proper test* somewhat similar to the one applicable in the banking regulation[75] (Article 14 (1) (a) CISA) and (C) the provision of a CHF 250'000 financial guarantee, either in the form of a liability insurance or in the form of a bank guarantee (Article 30 (1) (a) CISO).

As an aside, it is worth noting that this license requirement does not apply to a financial institution already regulated in Switzerland as a fund management company, a bank, a securities dealer, an insurance company or a manager of collective investment schemes (Article 19 (4) CISA and Article 8 (1) and (2) CISO)[76].

b. No exemption for cross-border activities

The CISA does not provide for a cross-border exemption in the field of the distribution of collective investment schemes. Thus, a non-Swiss entity that intends to distribute «to the public» units or shares in collective investment schemes (irrespective of the jurisdiction in which they have been originated) must first obtain a distributor license.

The lack of cross-border exemption in this area appears to be only of limited importance. Indeed, in most cases, non-Swiss distributors rely on the private placement exemption to conduct their activities on Swiss soil, as this exemption allows distribution to qualified investors[77] on an unregulated basis.

6.2 Management of collective investment schemes

a. Definition of the regulated activities

The regulation of the management of collective investment schemes is two-pronged: the *mandatory* license requirement for the managers of Swiss collective investment schemes (Articles 19 *et seq*. CISO), which will be discussed in this section, and the *optional* license requirement for the managers of certain non-Swiss collective investment schemes, which will be addressed under Section III.2.1 below in connection with the provision of cross-border services on an outbound basis.

The manager of a Swiss collective investment vehicle needs to obtain a prior authorization from the FINMA in order to be appointed as manager of a contract-based investment fund, a SICAV, a SICAF or a limited partnership. The applicant must demonstrate that it fulfils a number of financial requirements (for instance a fully paid-in share capital of at least CHF 200'000 and compliance with capital adequacy requirements, capped at an amount of CHF 20 million, Articles 19 (1) and 21 (1) CISO) and personal criteria (in particular a *fit and proper test* somewhat similar to the one applicable in the banking regulation[78]). Furthermore, the manager must enter into written asset management agreements with all its clients (*i.e.,* not only with collective investment schemes, but also with private clients) (Article 25 CISO) and must comply with the rules of conduct released by the SFA (Article 27 CISO). Otherwise regulated financial intermediaries, such as fund management companies, banks, securities dealers and insurance companies, are exempted from the license requirement (Article 19 (4) CISA and Article 8 (1) CISO).

b. Exemption for cross-border activities

A literal interpretation of Article 18 (1) CISA would lead to the conclusion that only fund managers domiciled or registered in Switzerland must obtain a manager license. *A contrario*, this would mean that a non-Swiss financial institution would be entitled to manage a Swiss collective investment on an unregulated basis.

That being said, the picture would be incomplete if the situation were only reviewed from the regulatory perspective of the manager. Indeed, in the course of the authorization procedure of a Swiss collective investment scheme (*i.e.*, the procedure leading to the authorization of the financial product), the FINMA will examine whether the management activities have been delegated to a manager which is subject to a «recognized supervision» (see for instance Article 31 (3) CISA for contractual investment funds and SICAVs[79] / [80]). In this context,

[74] The SFA has published Guidelines on the Distribution of Collective Investment Schemes, dated May 29, 2008, which have been recognized by the FINMA as a minimum standard (Annex to the FINMA Circular 2008/10, para. 19).

[75] See Section II.1.1 above and Section III.1.1 below.

[76] Agents of insurance companies who are involved in the organizational structure of that insurance company on a contractual, legal or *de facto* basis are also exempted from the requirement to obtain a license as a distributor (Article 8 (4) CISO).

[77] See FN 71 for the Swiss definition of «qualified investors».

[78] See Section II.1.1 above and Section III.1.1 below.

[79] Article 66 CISO provides that Article 31 CISA applies also to SICAVs.

[80] As regards the limited partnership for collective investments, Article 117 CISO requires that the fund manager be selected in such a way as to ensure that the entity meets the *fit and proper test* applicable to it (Article 14 CISA). In turn, Article 117 CISO does not require expressly that the fund manager be subject to a «recognized supervision» within the meaning of Article 31 para. 3 CISA. Similarly, no «recognized supervision» requirement applies in the context of the appointment of a fund manager for a SICAF, the only requirement being that the designation of a fund

the Swiss regulator has considered that (A) legal entities that are incorporated in an OECD Member State, in Hong Kong or in Singapore and benefit from a banking license in their home jurisdiction[81] or (B) legal entities that are incorporated in a EU Member State and benefit from a license as a manager of collective investment schemes in their home jurisdiction[82] are subject to a «recognized supervision» within the meaning of Article 31 (3) CISA. By contrast, the Swiss supervisory authority considered that an entity that is regulated by the SEC as an «investment advisor» (see Section III.3 below) is not subject to a «recognized supervision» within the meaning of the CISA[83]. In that event, a specific exemption from the requirement to appoint a manager which is subject to a «recognized supervision» would need to be obtained from the FINMA (Article 31 (3) second sentence CISA).

It is to be noted at this juncture that these rules are likely to be amended in the wake of the adoption of the AIFM Directive, which is discussed under Section III.2.2 below.

6.3 Sanction in case of non-compliance

The FINMA benefits from enforcement powers, pursuant to which the authority can, among other things, liquidate entities conducting distribution or management activities without being properly licensed (Article 135 (1) CISA). Such activities conducted in breach of the CISA can also lead to criminal prosecution and sanctions of up to 3 years of imprisonment or a fine of up to CHF 1'080'000 (Article 44 (1) FINMA Act and Articles 34 and 333 (1) SCC).

6.4 Cross-border activities related to structured products

Structured products are also regulated in Switzerland under the CISA. Here again, the regulation is focused on the product being offered, as well as on the service. As a result, no general exemption from regulation is available for activities conducted on a cross-border basis.

To be offered to the public[84] in or from Switzerland, structured products must be issued, guaranteed or distributed by a Swiss bank, a Swiss insurance company or a Swiss securities dealer (Article 5 (1) (a) (1) to (3) CISA). Non-Swiss financial institutions may also issue, guarantee or distribute structured products, provided (A) the FINMA considers that these institutions are subject to an equivalent prudential supervision (Article 5 (1) (a) (4) CISA) (which should be the case for any EU-based financial institution) and (B) these institutions maintain a «presence» in Switzerland (Article 4 (1) (b) CISO). The required «presence» in Switzerland can take the form of a representative office, a branch, a subsidiary or an affiliate which is subject to the same consolidated supervision than the non-Swiss issuer, guarantor or distributor[85]. The prospectus (which will be discussed in the next paragraph) must be made available at this Swiss «presence». There is however no requirement that this Swiss presence otherwise plays a role in the distribution process[86]. The Swiss «presence» requirement is lifted if the structured product is listed on an exchange in Switzerland[87].

The second requirement for the public offering of structured prospectus in or from Switzerland is that a so-called «simplified prospectus»[88] be made available to investors free of costs in a simplified and easy to read form, containing minimum disclosure requirements, such as the key terms of the product, appropriate risk warnings and a legend indicating that the structured product is not a collective investment scheme and is not supervised by the FINMA[89]. In case the structured products are not issued by a financial institution within the meaning of Article 5 (1) (a) CISA (*i.e.,* a Swiss bank), a specific legend to this effect must be included in the simplified prospectus (Article 4 (2) CISO).

Thus, the cross-border offering of structured products in Switzerland is subject to a Swiss presence requirement, typically in situations in which no regulated

manager does not affect the proper management of the SICAF (Article 122 (2) CISO).

81 SFA Circular n° 21/07 of August 29, 2007 on the concept of «recognized supervision» within the meaning of Article 31 para. 3 CISA.

82 SFA Circular n° 28/07 of November 5, 2007 on the concept of «recognized supervision» within the meaning of Article 31 para. 3 CISA.

83 SFA Circular n° 28/07 (FN 82), 2.

84 The concept of «public offering» is the same than the one that applies in relation to the distribution of collective investment schemes (see Section II.6.1 above).

85 FINMA, Häufig gestellte Fragen (FAQ) – Strukturierte Produkte, April 1, 2009, n° 5 (German version available online at: http://www.finma.ch/d/faq/beaufsichtigte/Documents/faq-strukturierte_produkte-d.pdf).

86 FINMA, Häufig gestellte Fragen (FAQ) – Strukturierte Produkte (FN 85), n° 4.

87 The transparency requirements applicable at such exchange must provide for the availability of a level of information equivalent to the one disclosed in the simplified prospectus (Article 4 (1) (b) CISO).

88 The minimum content of such prospectus is set forth in the Guidelines on informing investors about structured products, published by the SBA in July 2007 (available online at: http://www.swissbanking.org/999989_e.pdf) and recognized by the FINMA (see Annex to the FINMA Circular 2008/10, para. 8).

89 Article 4 (4) CISO expressly provides for two circumstances in which the obligation to publish a simplified prospectus does not apply. First, in case of a listing of the products on a Swiss exchange providing for transparency rules that are equivalent to those governing the simplified prospectus and, second, in case the product is not offered in Switzerland, but from Switzerland into another jurisdiction as long as the latter provides for equivalent transparency rules.

Swiss regulated financial intermediary is acting as issuer, guarantor or distributor.

7. Distribution of «insurance wrappers» in Switzerland

From a Swiss perspective, an «insurance wrapper» is an insurance product that is structured as follows: a (generally non-Swiss) insurance company opens an account with a (Swiss) bank or securities dealer for the purpose of holding the assets which a client of the insurance company has transferred to the insurance company in connection with a life insurance agreement. This transfer of assets corresponds, economically, to a single insurance premium payment. Typically, the client can exercise some influence on the management of the assets (which, from a legal perspective, are assets of the insurance company held with the bank)[90]. This set-up thus results in an insurance structure being «wrapped» around the client's assets.

Even though this contribution is focused on *financial* services, we shall address briefly the cross-border distribution of insurance wrappers in or from Switzerland, inasmuch as this type of insurance business is closely related to a financial activity.

From a Swiss perspective, the insurance business is regulated if it is conducted by Swiss entities (Article 2 (1) (a) ISA) or by non-Swiss entities which conduct insurance activities «in or from Switzerland» (Article 2 (1) (b) ISA). Insurance activities are deemed to occur «in or from Switzerland» if the policyholder, or the insured person or entity, is domiciled in Switzerland or if assets located in Switzerland are insured (Article 1 (1) (a) and (b) ISO). The place where the insurance agreement is entered into is not relevant in this context. The same principles apply *mutatis mutandis* to the regulation of «insurance intermediation» (Articles 1 (3) and 182 ISO), an activity which comprises, from a Swiss perspective, any intermediation activity which is designed to lead to the entering into of insurance contracts (Article 40 ISA).

The regulatory framework summarized above triggers the following practical consequences[91]:

- A Swiss financial institution may act as an intermediary between a (non-Swiss) based client and a (non-Swiss) insurance company in connection with the setting up of an insurance wrapper, without the financial institution being characterized as insurance intermediary. The conclusion should not be different if the Swiss financial institution is the custodian of the assets held through the insurance wrapper. From the insurance company's perspective, this activity does not trigger regulation in Switzerland, to the extent the insurance company is not deemed to be active «in Switzerland» if the insured is not domiciled in this country. In this hypothesis, both the financial institution and the insurance company benefit from a «cross-border exemption».
- By contrast, if the client is domiciled in Switzerland, the bank will be characterized as an insurance intermediary and thus subject to the regulatory framework applicable to this type of activity[92]. In addition, the insurance company would also be deemed to be active «in Switzerland» and would thus have to obtain a license from the FINMA and to comply with the Swiss legal and regulatory framework for insurance activities.

In addition to the insurance regulatory perspective summarized above, insurance wrappers have also been, and continue to be, in the focus of the FINMA from an anti-money laundering perspective. Swiss financial intermediaries must identify the beneficial owner of the assets they are handling. An exception to this general principle applies when the contracting party is itself a Swiss-licensed financial intermediary or a non-Swiss financial intermediary subject, in its home jurisdiction, to a comparable supervisory authority in respect of combating money laundering and terrorism financing (CDB 08, para. 34). The FINMA has considered that this exception does not apply in the context of insurance wrappers[93]. As a result, Swiss financial intermediaries must identify the beneficial owner of an account associated with an insurance wrapper in the following three situations:

- the financial intermediary has a pre-existing relationship with the client of the insurance company;
- the client of the insurance company holds a power of attorney or another type of information right towards the financial intermediary in relation with the relevant account; or
- the financial intermediary is instructed by the insurance company to implement an individualised investment strategy, except in the event where the investment strategy corresponds to a pre-defined standardised client profile.

The FINMA announced on October 22, 2010 that it will issue further regulations with respect to insurance wrappers. Further developments in this field are therefore expected in the near future[94].

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90 FINMA Newsletter 9 (2010), 1 (available online at: http://www.finma.ch/e/finma/publikationen/Documents/finma-mitteilung-09-2010-e.pdf).

91 Bizzozero/Christopher Robinson (FN 10), 116 *et seq.*

92 Articles 40 ISA *et seq.*, Articles 182 *et seq.* ISO.

93 FINMA Newsletter 9 (2010) (FN 90), 2.

94 FINMA position paper on legal and reputational risks in cross-border financial services («Position paper on legal risks»), October 22, 2010, 16 (available online at: http://www.finma.ch/e/fin-

8. Conclusion on the offering of inbound cross-border services

To conclude on the offering of inbound cross-border services, it should be underlined that, as a rule, the regulation of inbound cross-border banking and securities dealer services is subject to a «physical presence» test. If this test is not met, the relevant activities are not regulated in Switzerland. By contrast, in the field of collective investment schemes and structured products, the emphasis is put on the regulation of the product and the scope of the cross-border exemption is significantly more limited.

It is to be noted that, in a discussion paper published recently, the FINMA questioned whether Switzerland's liberal stance with respect to the provision of cross-border financial services on an inbound basis is appropriate from a consumer protection perspective and announced that this type of activities might be subject to more stringent regulatory requirements in the future[95].

III. Activities conducted from Switzerland (outbound perspective)

We shall now turn to the regulation of cross-border financial services which are offered on an outbound basis from a Swiss perspective. First and foremost, the purpose of this chapter is to review the FINMA's position with respect to the activities conducted by Swiss regulated financial institutions outside of Switzerland. Recent events have indeed prompted the FINMA to monitor more closely the cross-border activities of the Swiss financial institutions which are subject to its supervision. As will be explained, this new approach of the Swiss regulator implies a review by Swiss financial institutions of their compliance with foreign rules. For this reason, we shall also provide a brief overview of the regulatory frameworks that apply in some of the jurisdictions that are particularly relevant, from a business perspective, for Swiss financial institutions. For clarity's sake, we will distinguish again between the business of banking and securities dealing (1.), on the one hand, and the activities related to collective investment schemes, in particular in the EU, on the other hand (2.). Finally, we shall summarize a recently enacted legislation, the Dodd-Frank Act, that is likely to affect the offering of cross-border financial services into the USA (3.).

ma/publikationen/Documents/positionspapier_rechtsrisiken_e.pdf).

95 FINMA discussion paper on the regulation of the production and distribution of financial products to retail clients («FINMA Distribution Report 2010»), November 10, 2010, 37 (German version available online at: http://www.finma.ch/d/regulierung/anhoerungen/Documents/diskussionspapier-vertriebsregeln-20101110-d.pdf).

1. Banking and dealing in securities

1.1 Regulatory review by the Swiss home regulator

Prima facie, the Swiss legal and regulatory framework contains only few provisions dealing with the business operations of Swiss banks or securities dealers outside of Switzerland[96].

Pursuant to Article 3 (2) (a) BA and Article 7 (3) BO, a *Swiss bank*'s organization and geographical business scope must be in line with its corporate purpose, its financial means and its internal organization[97]. An expansion of business activities outside of Switzerland must only be notified to the FINMA if it involves the creation of a foreign subsidiary, branch, agency or representative office (Article 3 (7) BA)[98]. Article 7 CDB 08, a self-regulatory text which has been adopted by the SBA[99], prohibits Swiss banks from providing active assistance in transferring capital from countries whose legislation restricts the investment of funds abroad (flight of capital). Further, pursuant to Article 8 CDB 08, Swiss banks must not provide any assistance to their clients in acts aimed at deceiving Swiss or foreign authorities, in particular tax authorities, by means of issuing incomplete or otherwise misleading attestations[100].

Similarly, the geographical scope of the activities of a *Swiss securities dealer* must correspond to its corporate purpose, its financial resources and its internal organization (Article 18 (3) SESTO). The Swiss securities dealer must notify the FINMA if it intends to become a member of a Swiss or a foreign exchange[101] (Article 18 (4) SESTO). Furthermore, in the event a Swiss securities dealer intends to establish a subsidiary, a branch or a representative office abroad, it must provide the FINMA with all relevant information in order to allow the Swiss regulator to assess whether such activities abroad

96 By contrast, Article 4 (2) (c) ISA provide that, in connection with the issuance the (mandatory) licence to conduct insurance activities in or from Switzerland, the FINMA has to review whether an applicant intending to pursue insurance activities outside of Switzerland is in compliance with the legal and regulatory framework applicable in such foreign jurisdictions. The same principle applies when a Swiss insurance company active on the domestic market intends to expand outside of Switzerland (Article 5 (2) ISA).

97 Each Swiss bank must have an internal auditor whose task is, among other things, to assess the risks deriving from changes in the regulatory environment (FINMA Circular 2008/24, para. 70).

98 Kunz (FN 27), 84.

99 Even though the CDB 08 was formally enacted by the SBA, this self-regulatory text has been recognized by the FINMA in the Annex to the FINMA Circular 2008/10, para. 11, as a minimum standard which has to be complied with by all Swiss banks (regardless of their SBA membership) as part of the *fit and proper test*.

100 In the area of anti-money laundering regulations, a breach of the provisions of the CDB 08 by a Swiss bank is deemed to constitute a breach of the *fit and proper test* (Article 14 (3) AMLO-FINMA 1).

101 A non-Swiss securities exchange is regulated in Switzerland if it accepts Swiss members (see Section II.4 above).

are permissible in the light of the securities dealer's internal organization (Article 18 (5) SESTO)[102].

From a practical perspective, the two cornerstones of the FINMA's supervision of outbound cross-border activities have been (A) the *fit and proper test* and (B) the requirement to implement an *adequate organization*:

- The *fit and proper test* is anchored in Article 3 (2) (c) BA, for Swiss banks, and in Article 10 (2) (d) SESTA, for Swiss securities dealers. In a nutshell, this test is met if the persons in charge of the management of the Swiss bank or securities dealer (as well as the qualified shareholders) have the appropriate professional qualifications which are necessary to the exercise of their activities and present all guarantees of an irreproachable business conduct[103]. In its practice, the Swiss regulator has extended the scope of the *fit and proper test* from the management and qualified shareholders to the regulated institution as such[104]. This institutional component of the *fit and proper test* is closely tied with the duty to implement an internal organization which ensures that the business activities are conducted in a lawful way[105].
- The requirement of an adequate organization encompasses in particular a duty to implement a risk management system that monitors market, credit, default, settlement, liquidity and image risks, as well as operational and legal risks (Article 9 (2) BO[106], Articles 18 (3) and 19 (3) SESTO[107]). According to the FINMA's recent practice which will be discussed below, the monitoring of «legal risks» also comprises a duty to verify the compliance of the activities of the Swiss licensed financial institution with the rules prevailing in the (foreign) jurisdictions in which it operates. The Swiss bank's internal documentation with respect to the decisions on and the monitoring of risk-related transactions must be structured in such a way as to ensure that its auditors can review the business conduct (Article 9 (3) BO).

Failure to comply with these requirements can prompt the FINMA (Articles 29 *et seq.* FINMA Act) to take corrective measures or, as an *ultima ratio*, to withdraw the banking license (Article 37 FINMA Act).

The number of situations in which the FINMA relied on this regulatory tool to admonish Swiss banks that failed to comply with non-Swiss rules has markedly increased in recent years:

- In a December 21, 2004 decision, later confirmed by the Swiss Supreme Court, the Swiss regulator held that certain activities conducted by a Swiss bank through an affiliated entity incorporated outside of Switzerland (in the case at hand, the Bahamas) could fall within the ambit of the Swiss anti-money laundering regulatory framework[108]. Both the decision of the Swiss regulator[109] and the judgment of the Swiss Supreme Court[110] explicitly mention that, in parallel to the review under the Swiss anti-money laundering regulatory framework, the activities conducted abroad by a Swiss bank are to be examined in light of the requirement to maintain an adequate organization and to comply at all times with the *fit and proper test*. This is, in our view, the first case where the Swiss regulator indicated a willingness to review the activities conducted abroad by Swiss regulated financial intermediaries.
- In March 2006, the Swiss regulator held that a Swiss bank had breached the *fit and proper test* by assisting an affiliated entity, and the clients thereof, to circumvent the Italian regulations with respect to the disclosure of significant shareholdings in listed companies[111]. In this case, the FINMA held that the controlling shareholders and the directors had failed to live up to the *fit and proper test* and required the replacement of the entire board of directors of the Swiss entity.
- A few months later, in October 2006, the Swiss regulator reached a similar conclusion when confronted with a situation in which a Swiss bank inaccurately confirmed to a foreign exchange that a transaction had been entered into in the course of the bank's proprietary trading activities, whilst the relevant investment had in fact been made on behalf of a client of the bank[112]. In this case, the published decision does not indicate the sanction ordered, but clearly

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102 Pursuant to Article 18 (5) SESTO, the information to be furnished to the FINMA include (A) a business plan which describes the contemplated business activities and the organizational structure, (B) the address of the presence abroad, (C) the name of the persons involved in the administration and management, (D) the identity of the auditors and (E) information regarding the regulatory authority in the foreign country.

103 Alain Hirsch, La garantie d'une activité irréprochable: l'évolution de la pratique, SFBC-Bulletin 50 (2007), 29 *et seq.*, 43.

104 Swiss Supreme Court decision n° ATF 111 Ib 126 of June 27, 1985, para. 2a; SFBC decision of March 19, 2003 in the matter *Think Tools*, published in SFBC-Bulletin 45 (2004), 164 *et seq.*, 175, para. 4 c).

105 BSK BankG-Winzeler, Art. 3 N 23.

106 Urs Zulauf, Rechtsrisiken im grenzüberschreitenden Privatkundengeschäft – Herausforderung für Finanzplatz und Behörden, FINMA press conference of March 23, 2010, 3 (German version available online at: http://www.finma.ch/d/medien/medienanlaesse/Documents/referat_zulauf_20100323_d.pdf); Kleiner/Schwob (FN 25), Art. 3 N 151.

107 Roth (FN 43), Art. 10 N 19.

108 Swiss Supreme Court decision n° 2A.91/2005 of February 9, 2006, para. 5 (German version available online at: http://www.finma.ch/archiv/ebk/d/archiv/2006/20060616/20060616_01.pdf).

109 Swiss Supreme Court decision n° 2A.91/2005 (FN 108), para. 2.2.1.

110 Swiss Supreme Court decision n° 2A.91/2005 (FN 108), para. 6.2.2.

111 SFBC decision of March 31, 2006 in the matter *Antonveneta*, published in SFBC-Bulletin 49 (2006), 133 *et seq.*, 145, N 50.

112 SFBC decision of October 25, 2006, published in SFBC-Bulletin 50 (2007), 65 *et seq.*, 70–71, N 38–39.

states that the bank had breached both its duty to adequately monitor its legal and reputational risks and the *fit and proper test*.

- The FINMA's indirect review of compliance with foreign rules is also reflected in its decision regarding the activities of a Swiss bank that were deemed, in the USA, to have run afoul of the embargo imposed on Iran by the U.S. Office of Foreign Assets Control (OFAC)[113]. Following the initiation of proceedings in the USA in 2007, the FINMA started monitoring certain cross-border activities of the concerned bank. After its investigation, the FINMA held that the Swiss prudential framework required Swiss supervised entities active on a global scale to duly capture, limit and control their risks (*appropriate risk management*) and take the organizational measures required to achieve this goal (*organizational requirement*)[114]. The FINMA's report on this case indicates that the Swiss regulator «harshly reprimanded» the bank and required it to report on disciplinary measures and provide other clarifications within a specified timeframe[115].
- In May 2008, the Swiss regulator opened an investigation against another major Swiss bank[116]. The main focus of this investigation was to examine (A) whether the bank had adequately captured, limited and supervised the legal and reputational risks associated with the implementation of the QI Agreement and with the restrictions applicable to cross-border business operations into the USA (see Section III.3 below) and (B), more generally, whether the bank met the *fit and proper test*. This investigation of the bank's activities revealed an inadequate internal organization[117], in particular in view of the dichotomy existing between the insistence on compliance with the U.S. regulatory regime and a remuneration scheme heavily geared towards the acquisition of new (U.S.) clients and so-called «net new money»[118]. Whilst stressing that the FINMA's role is not to monitor compliance with the laws of every jurisdiction in which a Swiss financial intermediary is active, the FINMA insisted on the organizational requirements that apply as a matter of Swiss law: given «the significant exposure of [the bank] in the USA, the adherence to U.S. law is an absolute must from a risk management perspective»[119]. As a sanction, the FINMA prohibited the bank from conducting cross-border activities in the USA, except through a SEC-registered entity. On a more general note, the Swiss regulator also instructed the bank to adequately capture, limit and supervise the legal and reputational risks with respect to the provision of cross-border financial services out of Switzerland[120].
- In a January 10, 2010 decision, the FINMA emphasized once again its power to review the compliance with foreign regulations under the fit and proper test[121]. A Swiss bank was actively marketing German-based retail investors through a network of representatives (in the German text: «Vermittler») active on German soil. An investigation conducted by the FINMA revealed that the Swiss bank had never determined whether or not its activities in Germany through its network of «representatives» would trigger a duty for the bank to obtain a license from the German authorities (this was probably the case[122], see also Section III.1.2ba below). In light of the above, the FINMA held that the Swiss bank had breached the fit and proper test, in particular because the Swiss bank had not made any effort to clarify its regulatory duties in foreign jurisdictions, despite the fact that its business model was heavily geared towards cross-border activities. Given the cooperation of the bank during the investigation, the replacement of its senior management and the termination of the relationships with the «repre-

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113 According to the U.S. authorities, the Swiss bank had processed payment in U.S. Dollars for Iranian institutions and had systematically sought to avoid any reference to Iran in the SWIFT message that was sent to the U.S. correspondent bank for clearing purposes. As a result, the payments were not caught by the filters maintained at the U.S. correspondent bank in order to monitor compliance with the embargo rules issued by the U.S. Office of Foreign Assets Control. The relevant payments could thus be processed contrary to the OFAC rules.

114 See FINMA, Processing of USD payments for countries and persons sanctioned under the OFAC-Rules, December 16, 2009 (available online at: http://www.finma.ch/e/aktuell/Documents/bericht-cs-usbehoerden-20091216-e.pdf).

115 FINMA, Processing of USD payments for countries and persons sanctioned under the OFAC-Rules (FN 114), 7. As regards transactions with Iran, the FINMA issued on October 18, 2010 a notice whereby it specifically drew the attention of Swiss-licensed financial intermediaries on the legal and reputational risks deriving from cross-border transactions with Iran, in particular in light of the fact that the sanctions implemented by the EU and the USA against Iran go beyond the sanctions imposed in the framework of the United Nations (FINMA Newsletter 15 (2010), 3 (available online at: http://www.finma.ch/e/finma/publikationen/Documents/finma-mitteilung-15-2010-e.pdf)).

116 SFBC decision of December 21, 2008, published in FINMA-Bulletin 1 (2010), 76 *et seq.*

117 The Swiss regulator refrained from blaming any individuals within the bank, stating that «these failures have to be attributed to the bank as a whole, as a complex company» (SFBC decision of December 21, 2008 (FN 116), 99, para. 88).

118 SFBC decision of December 21, 2008 (FN 116), 92, para. 75, 96 para. 83; see also Christian Bovet/Anath Guggenheim, Surveillance des marchés financiers: rétrospective pour perspectives II, in Thévenoz/Bovet (Ed.), Journée 2009 de droit bancaire et financier, Geneva 2010, 115 *et seq.* Pursuant to the FINMA Circular 2010/1, para. 36, compensation systems implemented by Swiss-licensed financial intermediaries must be structured in such a way as to ensure compliance with applicable regulations.

119 SFBC decision of December 21, 2008 (FN 116), 97, para. 85.

120 SFBC decision of December 21, 2008 (FN 116), 100, para. 89–92.

121 FINMA decision of January 11, 2010, published in FINMA-Bulletin 1 (2010), 102 *et seq.*

122 FINMA decision of January 11, 2010 (FN 121), 114, para. 54–55.

sentatives», the FINMA did not order any sanction, except for the finding of a serious breach of the fit and proper test[123].

These cases clearly illustrate the FINMA's approach towards the outbound cross-border activities by Swiss regulated financial intermediaries. Rightly, the FINMA does not construe its mandate as encompassing the comprehensive review as to whether or not, when offering its services, a Swiss bank complies with the obligations imposed on it by foreign cross-border rules. In its 2008 Annual Report, the Swiss regulator summarizes its understanding of its role as follows:

> «*The role of the Banking Commission* [now the FINMA] *is not to monitor or enforce the compliance with foreign regulations. That being said, the Banking Commission expects, as a matter of principle, that banking institutions active on a global scale comply with the rules and regulations applicable in the countries in which such institutions conduct their business operations. Otherwise, the institution can be subject to legal risks which may jeopardize its existence.*»[124]

In the context of its 2010 annual press conference, the FINMA confirmed that a breach of the regulatory and tax framework applicable in a jurisdiction in which a Swiss-licensed institution operates is relevant from a Swiss regulatory perspective. A breach of foreign law will be taken into account when reviewing whether or not a Swiss banking institution, on an ongoing basis, (A) complies with the *fit and proper test* and (B) has adequately identified and monitored legal and reputational risks[125].

On October 22, 2010, the FINMA released a position paper[126] to formalize its practice with respect to the cross-border activities of Swiss financial institutions that are subject to its supervision. This position paper encapsulates the general principles underlying the various decisions summarized above. In particular, the Swiss regulator stresses that the review of the cross-border activities will constitute going forward an essential pillar of the ongoing supervision of Swiss regulated financial intermediaries[127]. The FINMA requires every Swiss financial institution that is regulated by it (A) to identify the legal risks flowing from its cross-border activities and (B) to implement measures, including, as the case may be, a strategic reorientation, to mitigate such risks[128]. In this context, the review of cross-border activities should not be limited to asset management activities, but include also, for instance, payment services (in particular in relation to countries facing international embargoes and sanctions). The Swiss regulator specifically indicates that the bank cannot consider that the risk is reduced if the client relationship management has been externalized to an independent asset manager[129] (the contrary being actually true according to the FINMA[130]). In order to increase its own awareness of possible regulatory problems faced by Swiss-licensed institutions in foreign jurisdiction, the FINMA takes the position that any contact between a foreign regulator and a Swiss-licensed institution with respect to the cross-border activities of the latter constitutes an «important fact» which the concerned institution must report immediately to the FINMA pursuant to Article 29 (2) FINMA Act.

As an aside, the FINMA's new stance prompted the SBA to announce the creation of a database listing the rules and regulations applicable in a series of jurisdictions in which Swiss banking institutions are traditionally active[131].

The FINMA's approach is thus based on the risks that Swiss financial institutions are facing. In turn, the FINMA will not act as the «long arm» of a foreign regulator. When facing an infringement of non-Swiss rules, the Swiss regulator will assess whether such infringement can be traced back to, or is an indication of, a deficient internal organization within the bank. In this context, important and repeated breaches of foreign laws will be a strong indication of a non compliance by the relevant Swiss bank, along with its management, board and shareholders, with the *fit and proper test*.

1.2 Regulatory review in the State of destination

We shall now provide an overview of the rules that apply to cross-border financial services in some of the ju-

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123 FINMA decision of January 11, 2010 (FN 121), 120–121, para. 69–71.

124 Original German text in the SFBC Annual Report 2008, 33: «Es ist zwar nicht Aufgabe der Bankenkommission, die Einhaltung ausländischer Vorschriften zu prüfen und aufsichtsrechtlich durchzusetzen, die Bankenkommission erwartet aber grundsätzlich von global tätigen Banken, dass sie die Regulierung der Länder beachten, in denen sie tätig sind. Andernfalls können sich Rechtsrisiken realisieren, die im schlimmsten Fall die Existenz der Bank gefährden.»

125 Urs Zulauf, Rechtsrisiken im grenzüberschreitenden Privatkundengeschäft – Herausforderung für Finanzplatz und Behörden (FN 106), 3.

126 FINMA position paper on legal and reputational risks in cross-border financial services (FN 95).

127 FINMA position paper on legal and reputational risks in cross-border financial services (FN 95), 20–21.

128 FINMA position paper on legal and reputational risks in cross-border financial services (FN 95), 15.

129 FINMA position paper on legal and reputational risks in cross-border financial services (FN 95), 17.

130 Zulauf, (Zunehmende) Rechtsrisiken im grenzüberschreitenden Finanzgeschäft (FN 3), 5. In the authors' view, the FINMA's «invasive» approach on this issue is legally questionable. Indeed, the independent asset manager is not the service provider to which the bank has outsourced the management of the client's assets, but rather the client's agent towards the bank. From a practical perspective, the bank will often have no direct contact with the client, who is represented by the independent asset manager for all of his or her dealings with the bank.

131 SBA, Circular n° 7669, Länderinformationen im Crossborder-Geschäft, October 7, 2010.

risdictions with which Swiss financial intermediaries have traditionally had a strong links. We shall start by presenting the «EU passport» system (a.), and then give an overview of the restrictions that apply to the Swiss institutions that are not entitled to passport their services into the EU (b.). This chapter is a brief summary of a complex set of laws and regulations; readers are therefore warned to read it in that spirit.

a. The «EU passport» system

Achieving an integrated market for banks and financial conglomerates is a core component of the EU policy in the area of financial services and an upshot of the freedom of services (Article 56 TFEU) and the free movement of capital (Article 63 TFEU)[132]. This policy is based on the principle of mutual recognition. Financial services providers legally established and licensed in one EU Member State benefit from a so-called «EU passport» which allows them to provide their services in the other EU Member States without further authorization requirements (see, *inter alia*, Articles 23 and 24 of the EU Banking Directive and Articles 31 *et seq.* MiFID)[133].

Insofar as Switzerland is not a member of the EU, Swiss-based financial institutions cannot «passport» their license from Switzerland into an EU Member State. In the absence of a meaningful cross-border exemption in the EU, the only alternative for Swiss financial institutions is to follow the standard authorization procedure that applies to the establishment of a branch or a subsidiary in the relevant EU Member State. Once properly licensed in an EU Member State, the Swiss entity, or a related entity, can acquire a EU passport which it may then rely upon to expand its business activities into other EU Member States.

Unlike the freedom of services, the free movement of capital can be invoked by non-EU individuals or entities. This is however not of great help to Swiss financial institutions seeking to expand their business activities into the EU. In its *Fidium* decision[134], the European Court of Justice indeed held that a Swiss consumer credit enterprise could not rely on the free movement of capital to offer its consumer credit services in the EU, because these services fell within the ambit of the freedom of services, which, as indicated, cannot be relied upon by non-EU individuals or entities[135].

b. Cross-border offering of banking and financial services in specific jurisdictions

ba. Germany

As a general rule, only financial institutions licensed by the German regulator, the BaFin, can conduct banking and financial activities (a term which includes asset management services)[136] on a professional basis in Germany (Article 32 (1) KWG). Non-German financial institutions are required to establish a German subsidiary (Article 33 (1) (6) KWG) or a German branch (Article 53 KWG) in order to offer their services on a professional basis to German-based customers.

In September 2003, the BaFin published a circular (*Merkblatt*), with a view to clarify its interpretation of Article 32 KWG in the context of cross-border activities[137]. According to this circular, the cross-border activities which, if conducted in Germany, would trigger a license requirement include *inter alia* the following: the extension of credits to customers, trips by employees for client acquisition purposes[138], the establishment of a sales network, the sending of mail or email communication to prospective customers (communications with existing customers are, as a general rule, exempted), the establishment of a website targeting the German market[139].

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132 These two freedoms are interconnected by Article 58 (2) TFEU, which provides that «[t]he liberalisation of banking and insurance services connected with movements of capital shall be effected in step with the liberalisation of movement of capital.»

133 Strictly speaking, the EU passport applies to the entire territory of the European Economic Area, comprising the EU Member States, Iceland, Liechtenstein and Norway. For the sake of simplicity, we shall however only refer to the EU in this contribution.

134 European Court of Justice decision n° C-452/04 of October 3, 2006 in the matter *Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht*, para. 49.

135 Christa Tobler, Die Fidium Finanz-Entscheidung des EuGH: ein Vorbote der Luxemburger Rechtsprechung zum bilateralen Recht?, SZIER 2006, 397 *passim*.

136 Article 1 (1a) (3) KWG, see also Hans-Peter Schwintowski, Die rechtlichen Rahmenbedingungen grenzüberschreitend tätiger schweizerischer Vermögensverwalter, AJP 2005, 457, 458.

137 The circular published by the BaFin was controversial in Germany, because some German legal scholars argued that the BaFin had overstretched the statutory text of Article 32 (1) KWG (see Herbert Rögner, Zur «Auslegung» des Inlandsbegriffs des § 32 KWG durch die Verwaltungspraxis der Bundesanstalt für Finanzdienstleistungsaufsicht, WertpapierMitteilungen, Heft 16/2006, 745 *et seq.*). These doubts were shared by the Appeal Court of Hessen in Administrative Matters (*Hessischer Verwaltungsgerichtshof*), which held that: «[d]ie Ansicht, der in § 32 Abs. 1 Satz 1 KWG enthaltene Erlaubnisvorbehalt erfasse auch solche gewerblichen Betätigungen im Bereich von Bankgeschäften und sonstigen Finanzdienstleistungen, die ohne verfestigte Form einer Zweigniederlassung oder Hauptverwaltung im Inland ausgeübt würden – begegnet erheblichen rechtlichen Bedenken.» (free English translation: «The view according to which the license requirement set forth in Section 32 (1) first sentence KWG would also apply to commercial activities in the area of banking and finance, which are not conducted through a corporate presence or a branch on German soil, is highly questionable from a legal perspective.») (Decision of the *Hessischer Verwaltungsgerichtshof 6. Senat* n° 6 TG 1568/04 of January 21, 2005, published in WertpapierMitteilungen, Heft 2005, 1123).

138 Schwintowski (FN 136), 460.

139 The issue of whether or not a website targets the German market is reviewed on the basis of *inter alia* the language used, the inclusion of information specifically relevant to German customers or the insertion of contact details in Germany (Mathias Hanten, Aufsichtsrechtliche Erlaubnispflicht bei grenzüberschreitenden

At the same time, the circular also listed the following exemptions from the license requirement:

- Financial institutions licensed in an EU Member State may, as a general rule, rely on the EU passport in order to provide financial services in Germany on an unregulated basis (Article 53b KWG).
- The license requirement set forth in the KWG does not apply if the business solicitation emanates from a German-based customer (*i.e.,* when such a customer *sua sponte* liaises with a non-German financial institution)[140].
- A non-German financial institution is entitled to maintain a representative office in Germany, provided the activities of this office are limited to «representative functions»[141]. Such a representative office may not participate in any way to banking or financial transactions and its establishment must be notified to the BaFin and to the German Central Bank (*Bundesbank*) (Article 53a KWG).
- Certain banking and financial activities conducted in Germany can be exempted on the basis of Article 2 (4) KWG, if a prudential supervision in Germany is not necessary given the nature of the activities. Such exemption is only available if the non-German institution is subject to an adequate level of supervision in its home country. We shall take a closer look at this exemption below.

The 2003 BaFin circular was clearly meant to curtail the cross-border activities that could be performed by non-EU financial institutions in Germany. The release of this circular prompted the Swiss regulator, at the time the SFBC, to liaise with the BaFin in order to examine to what extent the activities of Swiss banking and financial institutions could be exempted from this circular[142]. The moans of the Swiss financial industry were heard and the BaFin confirmed that, in accordance with Article 2 (4) KWG, some of the most stringent requirements of the circular could be alleviated for Swiss regulated financial institutions (which, *a contrario*, meant that Swiss asset managers could not benefit from this exemption)[143]. Under a revised version of the circular, dated April 1, 2005[144], the following set of exemptions is now available:

- German institutional investors[145] can be approached, provided the Swiss financial institution files with the BaFin a series of documents, including a description of the contemplated activities, the draft contractual documentation to be used for purposes of the contemplated activities and a statement of non-objection by the Swiss regulator.
- For transactions with German non-institutional customers, the BaFin put forward the additional *proviso* that such transactions be initiated through a German-licensed credit institution[146]. A Swiss institution without a German license may thus initiate its relationship with German customers only through a direct competitor. Needless to say that this unrealistic requirement severely constrains any private banking business with German customers.

From a bird's eye view, it appears that the 2005 BaFin circular, while providing for some additional flexibility, is still not in line with the principle of reciprocity, to the extent the access to the Swiss market by German financial institutions is not hindered by any regulatory barrier (see Section **II.** above). From an internal EU perspective, the European Court of Justice held in its *Fidium* decision[147] that the German restrictions on cross-border financial activities were not questionable under EU law[148]. As indicated, the European Court of Justice chose to subsume consumer credit activities under the freedom of services (and, as such, only available to EU entities). It is highly likely that the European Court of Justice would reach the same conclusion as regards the private banking activities of Swiss banking institutions, to the extent the «service» component is clearly predominant over the «movement of capital» element[149].

As a result, Swiss financial institutions are required to establish a regulated branch or subsidiary in Germany in order to offer their services to German-based indi-

Bankgeschäften und Finanzdienstleistungen, WertpapierMitteilungen, Heft 29/2003, 1412, 1413). Another indication is that transactions are actually entered into with German-based customers as a result of the set-up of the website. As a matter of principle, general promotional activities are admissible, while a reference to specific banking services is not (Dirk Voge, Zur Erlaubnispflicht grenzüberschreitend betriebener Bank- und Finanzdienstleistungsgeschäfte zugleich Anmerkung zum Urteil des EuGH vom 3.10.2006, Zeitschrift für Wirtschafts- und Bankrecht, Heft 09/2007, 381). It is certainly extremely difficult to draw this distinction in practice.

140 Schwintowski (FN 136), 459.

141 In the German original text of the BaFin circular: «*repräsentative Funktionen*».

142 Christoph Eisenring, Schweizer Banking in Deutschland einfacher, Neue Zürcher Zeitung, July 14, 2004, 21.

143 Schwintowski (FN 136), 459; Voge (FN 139), 382.

144 The updated version of the BaFin circular is available (in German) at: http://www.bafin.de/cln_170/nn_724262/SharedDocs/Veroeffentlichungen/DE/Service/Merkblaetter/mb__050400__grenzueberschreitend.html.

145 The 2005 version of the BaFin circular defines the term «institutional investors» («*Institutionelle Anleger*») to mean public institutions (the German Federal State, the German *Länder*, municipalities and other public-law entities), regulated financial intermediaries (such as banks), certain investment companies, insurance companies and corporations (subject to certain requirements in terms of balance sheet size, revenues and workforce).

146 SFBC Annual Report 2004, 117.

147 See above FN 134.

148 Simon Hirsbrunner/Simone Seidl, Ein Urteil gegen grenzüberschreitende Dienstleistungen von Schweizer Finanzinstituten, Jusletter, November 13, 2006, 17.

149 Michael Kunz, Deutscher Grenzzaun hält Schweizer Banken ab – Schlechte Aussichten auf eine rasche Liberalisierung der Praxis, Neue Zürcher Zeitung, November 24, 2006, 27; Voge (FN 139), 387.

viduals. The only exception is the business with institutional investors can be freely conducted on a cross-border basis, subject only, as a rule, to a notification to the BaFin. In a joint declaration dated October 27, 2010, Switzerland and Germany undertook to initiate negotiations in order to improve the access of banking institutions of each State to customers located in the other State[150].

bb. France

French law provides for strict rules with respect to the so-called «direct marketing» of financial services and products to French-based customers (see Articles L.341-1 *et seq.* of the French Code).

From a French perspective, the concept of «direct marketing» encompasses any unsolicited contacts, by any means, with identified individuals or legal entities, or any physical meetings irrespective of the person initiating the meeting, at the prospective customer's home, workplace or any other place which is not designed for the marketing of financial products, provided such contacts are initiated and conducted with a view to obtaining the customer's consent to the entering into of a transaction related to financial instruments, the entering into of a banking (or a non-core banking) transaction or the provision of an investment (or a non-core investment) services (Article L.341-1 French Code).

«Direct marketing» activities as defined in the preceding paragraph may only be carried out in France by regulated entities, meaning (A) French entities licensed as credit institutions, investment firms or insurance companies, (B) EU-licensed entities which can rely on the EU passport or (C) any of their agents duly appointed to carry out solicitations on behalf and for account of the entities mentioned above (Articles L. 341-3 and L. 341-4 French Code). An exemption also applies, subject to certain requirements, to contacts with pre-existing customers (Article L. 341-2 (5) French Code) and with qualified investors (meaning regulated financial institutions and individuals meeting certain requirements, including a financial assets base in excess of EUR 500'000[151]) (Article L. 341-2 (1) French Code). Non-compliance with the rules and regulations applicable to the direct marketing in the financial and banking sector may give rise to criminal, disciplinary or civil sanctions (Articles L. 353-2 to L. 353-4 French Code).

As a practical matter, the provision of banking and financial services to French customers is almost impossible without establishing a physical (and regulated) presence in this country, either in the form of a branch or a subsidiary.

The above situation has led to the creation of a special regulatory status, the *conseiller en investissements financiers* (or «*CIF*», in English: «financial advisor») (Articles L541-1 *et seq.* French Code and Articles 325-1 *et seq.* AMF Regulations), which allows non-French individuals or entities to target French-based customers on a cross-border basis. In order to benefit from this status, the concerned individual or entity must, among other things, adhere to one of several recognized French self-regulatory organizations (which are themselves supervised by the AMF), comply with a series of rules of conduct *vis-à-vis* its clients and subscribe a professional liability insurance. In turn, this status does not trigger the stringent and burdensome residence and capital adequacy requirements (and associated costs) that apply to a French-licensed asset management firm. From a practical perspective, the main drawback of the CIF status is that it only allows the provision of investment *advisory* (as opposed to management) services.

bc. Italy

The offering of banking and financial services in Italy is regulated primarily under the Legislative Decree n° 385 of September 1, 1993 (also called the Consolidated Banking Act).

Italy replicated in its internal legislation the EU passport system: as a result, financial institutions established and licensed in an EU Member State may offer banking and financial services on Italian soil, subject only to a duty of notification by the home country supervisor to the Italian supervisor, the Bank of Italy[152].

One particularity of the Italian regulatory regime is however that it provides for a specific license for banking and securities dealing activities conducted strictly on a cross-border basis, *i.e.,* without a physical presence in Italy[153]. Banking institutions established in a non-EU Member State can also operate on the Italian market without establishing a branch or a subsidiary in Italy (*libera prestazione di servizi*)[154], provided they have been authorized by the Bank of Italy. The CONSOB is entitled to extend such cross-border license to securities trading activities. Swiss banking institutions that rely on such a cross-border license can only offer their services through *promotori finanziari* (namely individuals which have been specifically registered with the Italian supervisory authorities). This restriction does however not apply if the services are offered exclu-

[150] The (German) text of this joint declaration is available online at: http://www.news.admin.ch/NSBSubscriber/message/attachments/20991.pdf.

[151] See Section D411-1 of the French Code.

[152] Article 16.3 of the Italian Consolidated Banking Act. An English version of this statutory text is available online at: http://www.bancaditalia.it/vigilanza/banche/normativa/leggi/tub/tub_en.pdf.

[153] Bizzozero/Christopher Robinson (FN 10), 215.

[154] Article 16.4 of the Italian Consolidated Banking Act (FN 152).

sively to professional clients (*clienti professionali*)[155], a term which has substantially the same meaning than in the MiFID[156].

2. Financial services related to EU-based collective investment schemes

2.1 Current situation

From an EU regulatory perspective, one must distinguish between collective investment schemes that meet the requirements of the UCITS Directive and those who do not.

- As regards UCITS, Article 5g (1) (c) UCITS Directive provides that a non-EU-based institution can only manage UCITS if such institution is «authorized or registered for the purpose of asset management and subject to prudential supervision» in its home country. Accordingly, in order to manage a UCITS, a Swiss institution must apply for and obtain a license as Swiss manager of non-Swiss collective investment schemes.
- With respect to collective investment schemes that fall outside the scope of the UCITS Directive, the regulation of management activities has not yet been unified at an EU level and depends upon each EU Member State. As a practical matter, the most important jurisdiction for Swiss financial institutions is Luxembourg, a jurisdiction which allows the delegation of management of non-UCITS collective investment schemes to an institution based outside of the EU[157]. This situation will however change with the entry into force of the AIFM Directive (see Section **III.2.2** below).

From a Swiss regulatory perspective, asset management, investment advisory or research activities for a non-Swiss collective investment scheme are, as a rule, not regulated in Switzerland, except as regards the required compliance with the Swiss anti-money laundering legal framework (see Section **II.5** above). That being said, in order to ensure that a Swiss financial institution can act as manager of a UCITS, the CISA allows, besides the mandatory license requirement for managers of Swiss collective investment schemes (Article 18 CISA, see Section **II.6.2** above), an *optional license* for managers of non-Swiss collective investment schemes (Article 13 (4) CISA). This license is subject to substantially the same requirements than those applicable to the manager of a Swiss collective investment scheme (Article 9 CISO)[158]. A Swiss institution can thus apply for such a license in order to demonstrate to the regulator in an EU Member State that it is subject to an adequate level of supervision in its home country.

2.2 The AIFM Directive

The AIFM Directive will fundamentally change the rules applicable to the distribution and management of non-UCITS funds in the EU. It is generally expected that each EU Member State will have to transpose the AIFM Directive into its domestic law by 2013.

In the first semester of 2010, two separate versions of the proposed AIFM Directive were circulating, the first was voted by the European Parliament on May 17, 2010 and the second was voted by the EU Economic and Financial Affairs Council on May 18, 2010. On October 26, 2010, a new compromise solution proposed by the Belgian Presidency of the EU was agreed upon in the so-called «trialogue» between the EU Economic and Financial Affairs Council, the EU Commission and the EU Parliament[159]. The European Parliament approved the AIFM Directive on November 10, 2010.

The AIFM Directive is to apply (A) to all EU-based AIF managers, (B) to all non-EU-based AIF managers that manage an EU-based AIF and (C) to all non-EU-based AIF that intend to market a (EU- or non-EU-based) AIF in the EU. The definition of the term of «AIF» is large and covers any collective investment scheme which is not subject to the UCITS Directive[160].

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155 Article 79 (6) of the *Regolamento recante norme di attuazione del decreto legislativo 24 febbraio 1998, n. 58 in materia di intermediari* (Italian version available online at: http://www.consob.it/main/documenti/Regolamentazione/normativa/reg16190.htm).

156 The concept of «professional clients» is defined in Annex II of MiFID to include a client «who possesses the experience, knowledge and expertise to make its own investment decision and properly assess the risks that it incurs». Under the MiFID, the concept of «professional clients» encompasses credit institutions (banks), investment firms, insurance companies and other regulated financial institutions. Private individuals may be treated as «professional investors» under the MiFID provided they meet a *qualitative* and a *quantitative* test (Annex II of MiFID, Section II). The qualitative test requires the financial intermediary to undertake an adequate assessment of the expertise, experience and knowledge of the client to give «reasonable assurance, in the light of the nature of transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved». The client must also satisfy at least two of the following quantitative criteria: (i) the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters, (ii) the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds EUR 500'000 or (iii) the client works or has worked in the financial sector for at least one year in a professional position which requires knowledge of the transactions or services envisaged.

157 Alessandro Bizzozero, Directive sur les gestionnaires de fonds d'investissement alternatifs, in: Thévenoz/Bovet (Ed.), Journée 2009 de droit bancaire et financier, Geneva/Zurich/Basel 2010, 69, 70.

158 See Section II.6.2a above.

159 This proposal is available online at: http://register.consilium.europa.eu/pdf/en/10/st15/st15053.en10.pdf

160 Under a *de minimis* provision, the AIFM Directive will not, as a general rule, apply (A) to AIF with less than EUR 100 million in AUM and (B) to AIF with less than EUR 500 million in AUM, no leverage and a redemption period of at least 5 years following the

Reverse solicitation does not fall within the ambit of the AIFM Directive. The number of EU-based investors in an AIF will thus not be a relevant criterion when examining the applicability of the AIFM Directive.

We shall summarize hereinafter the provisions of the AIFM Directive which could be of relevance for Swiss financial institutions intending to operate in the EU.

a. Between 2013 and 2015: national private placement regimes

At the outset, it is expected that the domestic private placement regimes of each EU Member State will be the main route of access to EU-based investors by non-EU-based AIF managers (such as Swiss fund managers). Such private placement regimes are to be defined at a domestic level in each EU Member State, but their application will nevertheless be subject to the minimum requirements set forth in Article 35i of the AIFM Directive:

- The non-EU-based AIF manager must comply with the *transparency requirements* set forth in Articles 19 (preparation of an annual report), 20 (disclosure to investors) and 21 (reporting to supervising authorities) of the AIFM Directive (Article 35i (1) (a) of the AIFM Directive).
- *Cooperation arrangements* for the purpose of systemic risk oversight must be put in place between the regulator of the non-EU-based AIF manager and the regulator of the EU Member State in which the private placement is to take place. ESMA is to develop guidelines with respect to these cooperation arrangements (Article 35i (1) (b) of the AIFM Directive).
- The jurisdiction in which the non-EU-based AIF, or AIF manager, is registered has not been characterized as a «non-cooperative country and territory» by the *FATF* (Article 35i (1) (c) of the AIFM Directive).

It is important to point out at this juncture that the AIFM Directive does not force EU Member States to implement a private placement regime, which remains optional.

The above rules only govern the marketing of AIF to *professional investors*[161]. That being said, pursuant to Article 35j of the AIFM Directive, EU Member States may allow AIF managers to market shares or units of AIF to retail investors. In such event, EU Member States may, in their discretion, impose stricter requirements than those set forth in the AIFM Directive.

b. After 2015: general availability of a «EU passport» for non-EU-based AIF and AIF managers

After 2015 and subject to ESMA's green light[162], a non-EU-based AIF manager could obtain a EU passport, meaning the possibility to market any AIF, be it a (EU- or non-EU-based) AIF, in the EU without having to comply with specific requirements in every EU Member State (Article 35f of the AIFM Directive).

Such a EU passport would only be granted to a non-EU-based AIF manager that undertakes to comply with substantially all of the provisions of the AIFM Directive (Article 35d of the AIFM Directive)[163]. This could be costly and burdensome, especially in light of the provisions of the AIFM Directive dealing with compensation, leverage, depositaries, conflict of interests, organizational and capital requirements, restrictions with respect to outsourcing and valuation.

Furthermore, a non-EU-based AIF manager would have to satisfy *inter alia* the following additional requirements in order to obtain a EU passport (Article 35d (7) of the AIFM Directive):

- The State of the non-EU-based AIF manager and its «EU Member State of reference»[164] have entered into a *cooperation agreement* which allows an efficient exchange of information for prudential purposes (Article 35d (7) (d) of the AIFM Directive).
- The State of the non-EU-based AIF manager has not been blacklisted by the *FATF* (Article 35d (7) (e) of the AIFM Directive).
- A double taxation treaty which fully complies with *Article 26 of the OECD Model Tax Convention* has been put in place between the State of the non-EU-based AIF manager and its EU Member State of reference (Article 35d (1) (f) of the AIFM Directive).

If the non-EU-based AIF manager satisfies these requirements, it may, as a general rule, obtain a EU passport for the marketing of EU AIF in the EU.

Should the non-EU-based AIF manager intend to obtain a EU passport for the marketing of non-EU-based

initial investment (Article 2a (2) (a) and (b) of the AIFM Directive).

161 Pursuant to Article 3 (1) (ah) of the AIFM Directive, the term «professional investor» is equivalent to the term «professional client» under the MiFID (see FN 156).

162 The deadline for ESMA's review corresponds to two years after the expiration of the two year period allocated to the EU Member States for the implementation of the AIFM Directive in their domestic legislation (Article 54a (1) of the AIFM Directive). On the basis of the ESMA's positive recommendation, the EU Commission is to determine the entry into force of the provisions dealing with non-EU-based AIF and AIF managers (Article 54a (6) of the AIFM Directive).

163 As indicated under Section III.2.2a above, under the domestic private placement regime, the non-EU-based AIF managers would only have to comply with certain transparency provisions (Articles 19, 20 and 21 of the AIFM Directive)

164 The determination of the «EU Member State of reference» is to occur in accordance with the criteria set forth in Article 35d (4) of the AIFM Directive. In substance, the EU Member State of reference is the EU Member State in which most of the activities of the non-EU-based AIF manager is to occur.

AIF in the EU, the following additional requirements would *inter alia* apply to the financial product, namely the AIF (Article 35g of the AIFM Directive):

- The State of the non-EU-based AIF and the EU Member State of reference have entered into a *co-operation agreement* which allows an efficient exchange of information for prudential purposes (Article 35g (2) (a) of the AIFM Directive).
- The State of the non-EU-based AIF has not been blacklisted by the *FATF* (Article 35g (2) (b) of the AIFM Directive).
- A double taxation treaty which fully complies with *Article 26 of the OECD Model Tax Convention* has been put in place between the State of the non-EU-based AIF and its EU Member State of reference (Article 35g (2) (c) of the AIFM Directive).

From 2015 to 2018 approximately, it is likely that the domestic private placement rules (as referred to in Section **III.2.2a** above) and the EU passport regime described above will coexist. Subject to another positive assessment of the ESMA (to be rendered in 2018 approximately), the domestic private placement rules would then be phased out (Article 54b (1) and (6) of the AIFM Directive). The EU passport regime would then be the only one available after 2018.

c. Conclusion on the AIFM Directive

The above description is a short summary of somewhat protracted provisions set out in the AIFM Directive. It appears likely that Swiss financial institutions active in the non-UCITS funds area will be forced to adapt their business models to the new EU regulatory environment. It must however be underlined that the last version of the AIFM Directive, unlike previous versions, does not close the EU market to Swiss financial intermediaries. As already indicated[165], it is expected that the Swiss regulatory framework dealing with collective investment schemes will be adjusted as a result of the entry into force of the AIFM Directive.

3. Overview of the rules applicable in the USA with respect to cross-border financial services

On July, 21 2010, the U.S. President signed into law the Dodd-Frank Act, which materializes an unprecedented revision of financial services regulation. This framework legislation delegates to the regulatory authorities, in particular to the SEC, a wide discretion to issue the rules and regulations that will implement some of the key concepts of the Dodd-Frank Act. At the date of this contribution, most of these rules and regulations were still subject to consultation or had not yet been released. Accordingly, we will hereinafter only provide a brief overview of the rules applicable as regards the provision of financial services in the USA on a cross-border basis.

From a U.S. perspective, the conduct of brokerage[166] or investment advice activities[167] on a cross-border basis triggers a requirement of registration with the SEC, either as a broker-dealer (Section 15 (a) of the Exchange Act)[168] or an investment advisor (Section 203 (a) of the Advisors Act), if such activities are conducted through «the mails or any means or instrumentality of interstate commerce». These terms refer to U.S. concept of «U.S. jurisdictional means», which includes most communications (*e.g.*, by telephone, by fax, by regular mail or by email) sent from outside into the USA[169]. Travelling on an interstate highway in the USA also constitutes a use of a U.S. jurisdictional mean. It is important emphasize at this juncture that there is no numerical exemption to the duty of registration: one contact with a single client made through U.S. jurisdictional means is sufficient to trigger the duty to register as a broker-dealer or as an investment advisor. The exceptions from this registration requirement are very limited. Advisory services are for instance subject to a «private advisor exemption» which will be summarized hereinafter.

Prior to the enactment of the Dodd-Frank Act, many non-U.S. advisors of private equity funds and other private investment funds had relied on the so-called «private advisor exemption» in order to avoid the duty to register with the SEC. This exemption was available to those investment advisors who (A) had not more than

165 See Section **II.6.2b** above.

166 The term «broker» is defined in Section 3 (a) (4) (A) of the Exchange Act to mean «any person engaged in the business of effecting transactions in securities for the account of others.»

167 The term «investment advisor» is defined in Section 202 (a) (11) of the Advisors Act to mean «any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.»

168 Ethiopis Tafara/Robert J. Peterson, A Blueprint for Cross-Border Access to U.S. Investors, 48 Harvard International Law Journal, 48.

169 This concept is rooted in Article I, Section 8, Clause 3 of the U.S. Constitution (the *Commerce Clause*) which authorizes the U.S. Congress to regulate «[c]ommerce with foreign Nations, and among the several States, and with the Indian tribes». From a U.S. constitutional law perspective, this federal power is split into the following three categories: (A) the power to regulate the channels of interstate commerce, (B) the power to regulate the instrumentalities of interstate commerce and (C) the power to regulate local activities that have a substantial economic effect on interstate commerce. *Channels of interstate commerce* include navigable waterways, airspace, highways, railroad tracks and telephone lines. *Instrumentalities of interstate commerce* are means used to transport goods and persons in interstate commerce including railroad cars, buses, trucks, airplanes, and boats. As a result, the scope of federal laws such as the Exchange Act or the Advisors Act is generally limited to activities that fall within the purview of the Commerce Clause of the U.S. Constitution.

14 clients (with the advisor being permitted to treat the fund, as opposed to the fund's investors, as its client) and (B) avoid holding themselves out to the public in the USA as investment advisors (former Section 203 (b) (3) of the Advisors Act). This exemption has been repelled by Title IV of the Dodd-Frank Act, the so-called Registration Act. Non-U.S. investment advisors to private funds[170] active in the USA will be compelled to register with the SEC before July 21, 2011 (*i.e.,* one year after the enactment of the Dodd-Frank Act), except if one of the following two narrowly-tailored exemptions is met:

- The «foreign private advisor exemption» is available to a non-U.S. investment advisor (A) with no place of business in the USA, (B) not more than 14 U.S. clients (investors in the United States in private funds advised by the adviser must also be counted against this cap), (C) for which the aggregate AUM attributable to such U.S. clients represent less than USD 25 million (or such higher amount as deemed appropriate by the SEC) and (D) who does not hold themselves out to the public in the USA as investment advisors (Section 403(2) of the Dodd-Frank Act). This new exemption thus retains the previously-applicable limit of 14 clients, but modifies it by a requirement to count U.S. investors in private funds towards the numerical limit and by imposing a USD 25 million cap on AUM attributable to U.S. clients or investors.
- An exemption from the registration duty is also available to (U.S. or non-U.S.) investment advisors that act solely as advisors to private funds and whose «AUM in the U.S.» are less than USD 150 million (Section 408 of the Dodd-Frank Act). Although such advisors are exempt from registration, they still are subject to a record-keeping and a reporting obligation, whose exact scope is yet to be defined. The terms «AUM in the U.S.» are yet to be defined by the SEC.

It is worth noting at this juncture that the Dodd-Frank Act, unlike the CISA (see Section II.6.1a above) or the AIFM Directive (see Section III.2.2 above) does not contain any reverse solicitation exemption. The Dodd-Frank Act applies a strict numerical test, regardless of the party, investor or advisor, that initiated the investment process. Historically, the SEC's policy has been to limit its extraterritorial reach by providing that *non-U.S. registered* investment advisors must comply with the substantive duties under the Advisors Act (*e.g.,* extensive record-keeping obligations[171]) with respect to their U.S. clients only. It is for the time being unclear whether this policy will be maintained in the context of the Registration Act.

IV. Outlook and conclusion

Prudential supervision in the financial sector has generally focused on limiting the disastrous economic consequences deriving from a failure of a financial institution. In this respect, Switzerland has traditionally relied on the principle of *home country control*. The logical corollary to this approach is that today the provision of cross-border financial services into Switzerland is to a large extent unregulated. This approach, along with the absence of regulatory entry barriers, are signs of confidence in the strength and competitiveness of the Swiss financial industry.

Other jurisdictions, in particular in the EU and the USA, have taken routes that are in sharp contrast to the Swiss approach. In these jurisdictions, the provision of cross-border services is severely constrained under the principle of *host country control*. In some instances, one wonders whether consumer protection, which is often invoked to justify the regulation of cross-border financial services in these jurisdictions, is not used to conceal other objectives, such as the protection of the local financial industry or the maximization of tax income.

In the aftermath of the 2008 financial crisis, several jurisdictions have added teeth to their regulatory framework regarding cross-border services. As a reaction, the Swiss supervisor has somewhat shifted its approach of the problem and is increasingly assessing compliance with foreign (non-Swiss) rules under the (Swiss) *fit and proper test*, which applies to most Swiss licensed financial institutions. This trend is likely to continue. The new set of double taxation treaties ratified by Switzerland, which incorporate Article 26 of the OECD Model Tax Convention, will allow foreign States to obtain additional information with respect to taxpayers, but also with respect to the services rendered to them by Swiss financial intermediaries. It is likely that the additional information thus available to foreign regulators will lead to further inquiries into the cross-border activities of Swiss institutions. As a corollary, the initiation of proceedings abroad will prompt the FINMA to review more and more frequently whether the requirements of the *fit and proper test* have been complied with.

All Swiss financial institutions are now forced to take into account these fundamental changes and adapt their business models, structures and operations accordingly. The risk deriving from the enforcement of foreign rules governing the cross-border business is heightened for those financial institutions which, in parallel to the *offshore* business, have substantial *onshore* operations in the relevant jurisdictions.

170 Pursuant to Section 3 of the Investment Company Act, the term «private fund» encompasses hedge funds, private equity funds and other private investment vehicles.

171 See for instance Section 204 of the Advisors Act.

For some institutions, especially the larger ones, the way ahead is likely to be an expansion of the *onshore* business, at least in the area of private banking. This will involve the setting up of branches or subsidiaries in an EU Member State, a step which will give access to an EU passport and the development of their activities from a European platform, with the support of their Swiss base. For other market players, the focus will probably be to regroup on Switzerland and a smaller number of geographical markets for which they can ensure compliance with the relevant securities and, increasingly, tax law requirements. In all instances, the Swiss institutions will need to rethink the type of services they render to their cross-border clientele and the manner in which they offer those.

Glossary of defined terms

Advisors Act	U.S. Advisors Act of 1940
AIF	Alternative Investment Fund
AIFM Directive	Directive of the European Parliament and of the Council on Alternative Investment Fund Managers
AMF	Autorité des marchés financiers (French supervisory authority)
AMF Regulations	Règlement général de l'AMF (regulations enacted by the AMF)
AMLA	Swiss Federal Act on combating money-laundering and terrorism financing in the financial sector of October 10, 1997
AMLO-FINMA 1	Ordinance n° 1 of the FINMA combating money-laundering and terrorism financing in the areas of banks, securities dealers and collective investment schemes of December 18, 2002
AUM	Assets under management
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (German supervisory authority)
BO	Swiss Banking Ordinance of May 17, 1972
CCA	Swiss Federal Consumer Credit Act of March 23, 2001
CDB 08	Agreement on the Swiss banks' code of conduct with regard to the exercise of due diligence of April 7, 2008
CISA	Swiss Collective Investment Schemes Act of June 23, 2006
CISO	Swiss Ordinance on Collective Investment Schemes Act of November 22, 2006
CONSOB	Commissione Nazionale per le Società e la Borsa (Italian supervisory authority)
Dodd-Frank Act	U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
ESMA	(Future) European Securities and Markets Authority
EU	European Union
EU Banking Directive	Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast)
Exchange Act	U.S. Securities Exchange Act of 1934
FATF	Financial Action Task Force
FINMA	Swiss Financial Market Supervisory Authority
FINMA Act	Swiss Federal Act establishing the FINMA of June 22, 2007
FINMA Circular 2008/5	FINMA Circular n° 2008/5 on the definition of the term «securities dealer»
FINMA Circular 2008/8	FINMA Circular n° 2008/8 on the public offering of collective investment schemes
FINMA Circular 2008/10	FINMA Circular n° 2008/10 on the recognition of self-regulatory provisions as minimum standards
FINMA Circular 2008/24	FINMA Circular n° 2008/24 on supervision and internal control within the banking sector
FINMA Circular 2009/1	FINMA Circular n° 2009/1 setting forth guidelines for the recognition of self-regulation in asset management as minimum standards
FINMA Circular 2010/1	FINMA Circular n° 2010/1 on the minimum standards for compensation schemes in financial institutions
FINMA-OFB	Ordinance of the FINMA on Foreign Banks of October 21, 1996
French Code	French Code monétaire et financier
ISA	Swiss Insurance Supervision Act of December 17, 2004

ISO	Swiss Insurance Supervision Ordinance of November 9, 2005
KWG	German Kreditwesengesetz
KYC	Know your customer
Lugano Convention	Lugano Convention of September 16, 1988 on jurisdiction and the enforcement of judgments in civil and commercial matters
MiFID	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments
OECD	Organization for Economic Cooperation and Development
OECD Model Tax Convention	Model Tax Convention on Income and on on Capital published by the Organization for Economic Cooperation and Development
OFAC	U.S. Office of Foreign Assets Control
OPFI	Swiss Federal Ordinance on Professional Financial Intermediaries of November 18, 2009
PILA	Swiss Private International Law Act of December 18, 1987
QI Agreement	Qualified Intermediary Agreement
Registration Act	U.S. Private Fund Investment Advisors Registration Act of 2010
SBA	Swiss Bankers Association (the self-regulatory organization of the Swiss banking industry)
SCC	Swiss Criminal Code of December 21, 1937
SCO	Swiss Code of Obligations of March 30, 1911
SEC	U.S. Securities and Exchange Commission
Securities Act	U.S. Securities Act of 1933
SESTA	Swiss Federal Act on Stock Exchanges and Securities Trading of March 24, 1995
SESTO	Swiss Ordinance on Stock Exchanges and Securities Trading of December 2, 1996
SFA	Swiss Funds Association (the self-regulatory organization of the Swiss fund industry)
SFBC	Swiss Federal Banking Commission, which was replaced by the FINMA as of January 1, 2009
SICAF	Investment company with fixed capital (société d'investissement à capital fixe)
SICAV	Investment company with variable capital (société d'investissement à capital variable)
Swiss Unfair Competition Act	Swiss Unfair Competition Act of December 19, 1986
TFEU	Treaty on the Functioning of the European Union
UCITS Directive	Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)
USA	United States of America
WTO	World Trade Organization