Establishing a banking subsidiary or bank in Switzerland - A summary of the Swiss Regulatory Framework

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I. Background

This memorandum shall give an overview over the Swiss legal and regulatory issues with regard to the regulation of financial services in Switzerland and serves the purpose to inform foreign banks of the regulatory framework in connection with the envisaged establishing of a branch or subsidiary in Switzerland.

II. Introducing Remarks

As Switzerland is not a member country of the European Union (**EU**), the pertinent EU licenses and regulatory approvals are not eligible for a "passporting" into Switzerland. Providers of financial services will fall under the scope of the Swiss financial services regulation if the engaged activity is (i) a regulated activity according to Swiss law and (ii) Switzerland has regulatory jurisdiction.

1. Regulated Activity According to Swiss Law

Banking, securities-dealer, underwriting, derivatives and collective investment scheme activities as defined by Swiss law are subject to supervision and licensing by the Swiss Federal Banking Commission (**SFBC**), the Swiss financial services supervisory authority, under one of the three main financial services acts (and implementing ordinances), namely (i) the Swiss Federal Banking Act (the **Banking Act**) with its Implementing Ordinance (the **Banking Ordinance**), (ii) the Swiss Federal Act on Stock Exchanges and Trading in Securities (**SESTA**) with its Implementing Ordinance (**SESTO**) and (iii) the Swiss Federal Act on Collective Investment Schemes (**CISA**) with its Implementing Ordinance (**CISO**). In addition, they are subject to the Swiss Anti-Money Laundering Act (**AMLA**) and, when doing consumer lending, the Consumer Credit Act (**CCA**). A bank engaging in securities-dealing needs a securities-dealer license for that purpose in addition to its bank license and shall comply with the SESTA with respect to their securities-dealing activities.

2. Switzerland's Regulatory Jurisdiction

The reach of Swiss regulatory jurisdiction is different for foreign securities-dealers (which term includes underwriting and derivatives houses) and banks on the one hand and collective investment schemes on the other:

Banks and securities-dealers (including underwriters and derivatives firms) only fall within the reach of the Swiss jurisdiction and thus need a license if they have, in Switzerland, manpower (employees, mandataries, representatives etc.) or physical infrastructure or organizational | managerial functions. For these providers, the applicable regulatory regime is still based on the principle of territoriality. *Mere cross-border activities* from abroad into Switzerland are not subject to SFBC supervision and licensing.

For *collective investment schemes*, the above "cross-border exemption" does not apply. Therefore, any promotion or distribution in, into, or out of Switzerland of financial products that fall under the CISA's definition of "collective investment schemes", in general, is subject to supervision of and licensing by the SFBC of both the product and the Swiss distributor.

With regard to *creditors* within the meaning of the CCA, above "cross-border exemption" does not apply, either.

III. Banking Act

1. General

Switzerland has always permitted the creation of universal banks. Swiss law makes no distinction between commercial banking and investment banking, and also permits Swiss banks to manage their customers' assets.

All major Swiss banks have traditionally carried on business in most areas of financial services, including securities trading. A substantial number of securities-dealers were also banks and, thus, licensed both as bank and as securities-dealer.

2. The Banking Act's Scope of Application

Banking operations in Switzerland are subject to the Banking Act. The Banking Act applies to all business associations engaged in banking: incorporated banks, private banks (i.e., sole proprietorships, general partnerships, limited partnerships) and saving institutions.

The traditional business of a bank consists of accepting deposits from the public and extending loans on its own account and at its own risk. The bank earns its income from the difference (spread) between interest rates charged for loans and interest rates paid on deposits.

Under the Banking Act, a bank is defined as an enterprise active mainly in the financial sector that performs one or both of the following functions:

- accepting or soliciting funds from the public on a professional basis for the purpose of financing, on its own account, a number of unrelated persons or entities (i.e., persons or entities not belonging to the same group of companies);

- refinancing itself to a large extent (i.e., threshold is CHF 500 million) through several unrelated banks (i.e., more than five banks) in order to finance, on its own account, a number of unrelated persons or entities outside of its own group.

The Banking Act does not apply to securities-dealers as long as such dealers do not perform any banking activities. Similarly, professional asset managers (*Vermögensverwalter*) are not subject to the Banking Act if they abstain from offering banking services. Special rules apply on so-called cantonal banks. Also, the SNB, the Bank for International Settlement, certain specialized mortgage banks (*Pfandbriefzentralen*), the Swiss postal services and employers accepting deposits only from their employees (*Betriebssparkasse*) are not subject to the Banking Act.

3. Subsidiary versus Branch

a) In General

The decision whether to establish a subsidiary or a branch resides often on organizational and accounting questions because business-wise both subsidiary and branch are permitted to perform the same activities. There are no regulatory restrictions with respect to the business objectives or the geographic terms for a branch as opposed to a subsidiary.

The establishment and operation of a branch, representative office, an agency, or a Swiss subsidiary of a foreign bank requires a license from the SFBC.

In case of a bank which is to be organized in accordance with Swiss law, but in whose case a controlling foreign influence exists, as well as in case of a foreign bank's branch, the following additional essential requirements have to be met:

- the country of residence of the ultimate controlling legal or natural person(s) shall guarantee reciprocity;

– the corporate name of the foreign-controlled bank shall not suggest that the bank is Swiss-controlled; and

– if the bank is part of a group, appropriate consolidated supervision by the foreign supervisors.

EU member countries automatically fulfill the reciprocity requirement. To financial institutions from signatory countries of the General Agreement on Trade and Services (GATS) and the fifth Protocol, such as the USA, this requirement is no longer applicable in the first place.

A new additional license would have to be obtained if a Swiss subsidiary experiences a change of its foreign controlling person(s) at a later point in time. Depending on the concrete circumstances of such change, a mere notification to the SFBC can be sufficient.

b) Banking Subsidiary

(1) Formation of a Subsidiary, *e.g.*, in Form of a Corporation (Aktiengesellschaft)

A corporation is incorporated by at least three founders declaring in a notarized deed the foundation of a corporation by adopting therein the articles of incorporation and by appointing the corporate bodies. In this deed of incorporation, the founders subscribe to the shares and establish that (i) all shares have been validly subscribed, (ii) the promised contributions correspond to the total amount of the issue and (iii) the requirements set forth by Swiss law and by the articles of incorporation concerning the performance of the contributions are fulfilled.

Under Swiss law, shares shall be issued either in the name of the holder or to the bearer. In case of registered shares, the corporation shall keep a share register in which the owners and usufructuaries shall be entered with names and addresses. Furthermore, in a privately held corporation, the articles of incorporation may provide that the registered shares shall be transferred only with consent of the corporation's board of directors. By entry into the Commercial Register the corporation comes into legal existence.

(2) Organization

The SFBC will authorize a subsidiary to incorporate as a bank in Switzerland if the following conditions are met:

– the subsidiary must have a fully paid-in capital of no less than CHF 10 million (in practice the SFBC requires a minimum capital of CHF 15 million);

– the subsidiary must define its scope of business in its constituting documents, in terms of both its scope of business and the geographical extent of its activities. A banking license granted by the SFBC covers only activities that are listed in the bank's constituting documents. Any subsequent changes in the scope of a bank's business are subject to approval by the SFBC;

– the internal organization of the subsidiary must be adequate in view of the proposed business activities. In particular, the board of directors and the management of the subsidiary must be separate corporate bodies. The board of directors must consist of at least three members. The majority of the board members must have residence in Switzerland, and the SFBC requires that the chairman or vice-chairman have residence in Switzerland. Members of EFTA | EU are equal to Swiss citizens (and the requirement to have a majority of Swiss board members has been abolished, this change, however, is not in force, yet). The board is permitted to establish board committees only if it has five members or more;

– the subsidiary must implement adequate risk management procedures in order to be able to assess, limit and supervise all conceivable operational and legal risks, in particular market, credit, default, settlement, liquidity and image risks; and

– the subsidiary must establish an effective internal control system. For this purpose, the bank must create an internal audit that is independent of management.

(3) Directors and Managers

The directors and managers of a Swiss bank must have good reputations and must offer every assurance of proper business conduct. The term "proper business conduct" ("*einwandfreie Geschäftstätigkeit*") is a key feature of Swiss

banking regulation. The SFBC has made extensive use of its discretion in interpreting this term. In some cases, the SFBC has gone as far as to outlaw business practices that were not prohibited by any statutory role. This practice, though disputed by legal scholars, is regularly protected by the courts. Taking into consideration that the SESTA sets up the same requirement of proper business conduct for securities dealers, it remains to be seen to what extent this practice will also extend to securities dealers.

(4) Significant Shareholders

The natural persons or legal entities, which directly or indirectly hold at least 10 percent of the capital or voting rights of a bank or otherwise whose business activities are such that they may influence the bank in a significant manner (qualified participation), must guarantee that their influence will not have a negative impact on a prudent and solid business activity.

The SFBC may revoke or refuse to issue a banking license if the influence of a qualifying shareholder could jeopardize the sound and prudent business conduct of the bank. In addition, if the reporting obligations of the law have been violated, the SFBC may order that the voting rights of the qualifying shareholder in the shareholders' meeting of the bank be suspended.

(5) Financial Soundness Rules

The Banking Act requires that Swiss banks must provide for an adequate ratio between their capital resources and their total liabilities. The minimum regulatory capital shall be the sum of 8 percent of the risk-weighted positions and the non-risk weighted positions for underlying the market risk, reduced by certain deductions. Further rules apply to risk diversification.

The capital adequacy rules of the Banking Act are set up in accordance with the principles of the Basle Capital Accord and apply only to banks incorporated in Switzerland, not to branches and representative offices of foreign banks.

A Swiss bank that holds interest in banking subsidiaries in Switzerland or abroad must comply with the rules on capital resources and on the spreading of risks both on a statutory and on a consolidated basis.

(6) Audit and Role of Auditors

Under the Banking Act, a bank's business is subject to inspection and supervision by an independent auditing firm that must itself be licensed by the SFBC. These auditors, which are appointed by the bank's board of directors and need not be identical with statutory auditors, are required to perform an audit of the bank's financial statements and assess whether the bank is in compliance with the provisions of the Banking Act and further relevant regulation, as well as guidelines for self-regulation. The audit report is submitted to the bank's board of directors and to the SFBC. In the event that the audit reveals violations of applicable legislation or regulation or other irregularities, the auditors must inform the SFBC if the violation or irregularity is not cured within a time limit designated by the auditors, or immediately in the case of serious violations or irregularities that may jeopardize the security of the banks' creditors.

The license application must be written in on of Switzerland's official languages (German, Italian or French). The SFBC has issued helpful guidelines with respect to the license applications for a bank.

c) Swiss Branch

(1) Ordinance on Foreign Banks in Switzerland

According to the Ordinance on Foreign Banks in Switzerland (the **OFB**) a foreign bank requires a license from the SFBC if it employs personnel in Switzerland who, on a permanent and commercial basis, in or from Switzerland: (i) enter into transactions, maintain customer accounts or legally bind the foreign bank (i.e., *branch*) or (ii) if they forward client orders to the foreign bank or if they represent the foreign bank for marketing or other purposes (i.e., *representative office*). In the following, we only consider the establishment of a branch.

The SFBC will grant a foreign bank a license to open a branch in Switzerland if, *inter alia*:

- it is organized appropriately (i.e., business plan, business rules) and possesses adequate qualified staff and financial resources to operate a branch in Switzerland;

- it is subject to adequate supervision, which includes the branch;

- the competent foreign supervisory authorities make no objection to the establishment of a branch;

- the competent foreign supervisory authorities state that they will immediately inform the SFBC in the event of circumstances arising that may seriously jeopardize the interests of bank creditors;

- the competent foreign supervisory authorities are able to provide the SFBC with official support;

- the conditions governing reciprocity and company name of the branch are met; and

- the persons charged with the administration and the management of the branch enjoy a good reputation and thereby ensure the proper conduct of business operations, have their domicile in a place where they may exercise the management in a factual and responsible manner, and the branch possesses a regulation that precisely defines its business activities and provides for an adequate organization.

Moreover, the foreign bank must show that it is subject to an appropriate consolidated supervision by the competent foreign supervisory authorities.

A foreign bank's branch would be subject to Swiss law, but it would not be required to maintain minimum (regulatory) capital in Switzerland or to comply with regulatory capital or risk diversification provisions. The SFBC may, however, require the branch to lodge security, if necessary, for the protection of creditors. The branch would have to prepare separate financial statements but would be permitted to adhere to the requirements that apply to the foreign bank itself, if these requirements satisfy international accounting standards. A complete avoidance of Swiss accounting rules is not possible because the branch would have to file with the Swiss National Bank its liquidity statements in a prescribed official form, on a monthly basis with regard to cash liquidity and on a quarterly basis with regard to total liquidity.

The Swiss branch's annual reports would have to be audited by Swiss independent external auditors that are licensed by the SFBC. These auditors are required to perform an audit of the bank's financial statements and assess whether the bank is in compliance with the provisions of the Banking Act and further relevant regulation, as well as guidelines for self-regulation. The auditors have to submit their audit report to the responsible manager of the branch and

the SFBC. In the event that the audit reveals violations of applicable legislation or regulation or other irregularities, the auditors must inform the SFBC if the violation or irregularity is not cured within a time limit designated by the auditors, or immediately in the case of serious violations or irregularities that may jeopardize the security of the banks' creditors. Furthermore, the branch must make the foreign bank's annual report available to the press and to any interested person within four months after the year-end and submit it to the SFBC. Such annual report must be written in one of Switzerland's official languages or in English.

By registration in the Commercial Register the Swiss branch establishes at its seat a place of jurisdiction with respect to its business activities, a special place of enforcement and a place for freezing orders (*Arrestort*) under the Swiss Debt Enforcement and Bankruptcy Act (the **DEBA**).

The license application must also be written in one of Switzerland's official languages (German, Italian or French).

(2) Formation and Registration Procedures

(a) License before Registration of Branch in Commercial Register

The office of the Commercial Register will not enter a foreign bank's branch without prior license from the SFBC. For that purpose the SFBC will issue a confirmation letter.

(b) Formation of a Branch

The formation procedures for a branch are relatively simple. Formally, a foreign bank's branch needs a head of the management (*Leiter der Zweigniederlassung*) who must be specifically appointed. Formation will be made by a registration application to the Commercial Register that must be accompanied by (i) a certified copy of the foreign bank's articles of incorporation, (ii) a certified excerpt of the Commercial Register concerning the foreign bank and (iii) a certified excerpt from the minutes of the foreign bank's appropriate corporate body on (x) the resolution of establishing the branch, (y) appointment of the management and (z) provision of signatory powers.

IV. Federal Stock Exchange and Securities Trading Act

The underwriting, dealing and brokerage of securities in Switzerland is primarily regulated by the SESTA and the implementing ordinance thereto (**SESTO**). Under the regulatory regime of the SESTA, foreign securities dealers may become active on the Swiss financial market (1) by means of a subsidiary, (2) by means of a branch office, (3) by means of a representative office, or (4) on a cross-border basis. As has already been noted, mere cross-border services into Switzerland trigger no licensing requirements. An offshore broker may for instance, advertise its services in Swiss newspapers, engage in marketing activities over the telephone and have their employees visit Swiss customers at the occasion of business trips to Switzerland, all of which is unregulated in Switzerland.

However, to be exempt from the licensing requirement, the foreign securities dealer must not have a business presence in Switzerland. Such business presence in Switzerland is deemed to exist if, for instance, (1) the foreign securities dealer employs in Switzerland persons who are integrated into his organization and transmit to him security trade or pass on orders, (2) the foreign securities dealer has exclusive contracts with individuals or legal entities in Switzerland for the transmittance of trades, or (3) the foreign securities dealer has non-exclusive contracts with individuals or legal entities in Switzerland for the transmittance of trades and empowers such representatives to use his corporate name.

In case of foreign securities dealer that plans to establish a branch in Switzerland, authorization is granted if:

– it is adequately organized and has sufficient financial resources and qualified staff to operate a branch in Switzerland;

– it is subject to appropriate supervision, which also includes the branch;

– the competent foreign supervisory authorities do not object to the establishment of the branch;

– the competent foreign supervisory authorities undertake to notify the SFBC without delay, should circumstances arise which could seriously jeopardize client assets at the branch;

- the competent foreign supervisory authorities are in a position to offer the Banking Commission administrative assistance;

- the Swiss branch is organized in keeping with its business activities and has regulations which precisely define the scope of business and provide for an administrative organization in keeping with its business activities;

- the senior staff responsible for the management of the Swiss branch offer the guarantee of irreproachable business conduct;

- the foreign securities dealer furnishes proof that the company name of the branch can be entered in the commercial register. Such registration of the branch in the commercial register may only be applied for if the SFBC has authorized the establishment of the branch.

However, one must pay attention to the SESTOs definition of a foreign securities dealer. A foreign securities dealer is defined to be any company organized according to foreign law which (i) holds a license as a securities dealer abroad (ii) uses the term "securities dealer" or a term with a similar meaning in the company name, in the description of its business purpose or in business documents, or (iii) conducts securities trading within the meaning of Article 2, letter d SESTO. If, however, the foreign securities dealer is effectively managed in Switzerland, or if it carries out its operations exclusively or predominantly in or from Switzerland, it must organize itself according to Swiss law and shall be subject to the provisions governing domestic securities dealers.

V. Federal Act on Collective Investment Schemes

In Switzerland, collective investment schemes are regulated by the Swiss Federal Act on Collective Investment Schemes (**CISA**) and its Implementing Ordinance (**CISO**).

Collective investment schemes are such assets that have been raised by the investors with the purpose of collective investment and that are managed by a third party on the investors behalf and account. Investors within the meaning of the CISA are such natural persons or legal entities, as the case may be, that hold units (or shares) of such collective investment schemes.

Without licensing and approval by the SFBC, units of collective investment schemes could only be distributed or otherwise made available in Switzerland to (i) qualified investors and only by means of marketing usual for such specific

markets, i.e. based on personal contacts or via "Road Shows" and (ii) otherwise to non-qualified investors in Switzerland but solely on a private placement basis, without any public distribution, offering or marketing in or from Switzerland. Qualified investors within the meaning of the CISA and CISO are (i) supervised financial intermediaries such as banks, brokers dealers or fund administrations, (ii) supervised insurance companies, (iii) corporations organized under public law and pension funds with a professional treasury, (iv) corporations organized under private law having a professional treasury, and (v) high net worth individuals, provided they either confirm in writing to their independent asset managers that they directly or indirectly possess at least CHF 2 mio in bankable assets or have concluded a written asset management contract with an asset manager who, (i), as a financial intermediary is subject to the Swiss Federal Act on the Prevention of Money Laundering in the Financial Sector, (ii) is subject to a code of conduct of an organization in the financial sector that, by the regulating authority, has been accepted as meeting the minimum standards and, (iii), whose asset management contract is in accordance with the accepted guidelines of an organization in the financial sector.

In all other cases, both the product and the distributor must first get approval by the SFBC. The requirements for getting approval as distributor equal the requirements for obtaining other licenses under Swiss law. For this reason, distributors that already have a license as funds administration, bank, securities dealer or insurance company under the respective regulations is exempted from the obligation to obtain an additional license from the SFBC.

VI. Federal Anti-Money Laundering Act

The AMLA provides for a licensing requirement for so-called financial intermediaries. Financial intermediaries are defined as persons who professionally accept third party assets or act as custodians thereof or are active in the investment or transfer of such third party assets, including persons active in the credit business.

According to guidelines issued by the competent supervisory authority - which is set up within the Federal Finance Administration -, financial intermediaries incorporated abroad which provide cross-border services only, are exempted from the licensing requirements of the AMLA. The licensing requirement only applies if one establishes a Swiss branch, representative office or agency.

A foreign bank that plans to conduct banking activities via its branch (or subsidiary, as the case may be) in Switzerland, it would be a financial

intermediary within the meaning of the AMLA. However, because the branch or subsidiary will be regulated as a bank, the SFBC will be the competent Supervisory Authority and no special additional license will need to be obtained under the AMLA.

VII. Federal Consumer Credit Act

Consumer credits are governed by the Federal Consumer Credit Act (**CCA**) and its Implementing Ordinance (**CCO**).

A consumer credit agreement is a contract whereby a creditor grants or promises to grant credits to a consumer in the form of a deferred payment, a loan or other similar financial accommodation. "Consumers" under the CCA are only natural persons, not legal entities. Furthermore, such natural persons who enter into a credit agreement for business purposes or other professional activities are no consumers, either. Credit agreements that involve an amount of less than CHF 500 or exceeding CHF 80'000 are exempted from the scope of the CCA.

The cross-border exemption does not apply to the consumer credit business. The offering of consumer credit agreements from abroad to Swiss consumers would still trigger a license requirement as set forth in the CCA. The license is granted by the canton in which the creditor or credit broker has its registered place of business. In case of foreign creditors or credit brokers without a registered place of business within Switzerland, the authorization is granted by the canton in which the creditor or credit broker intends to make its main business.

Again, the duty to get approval does not exist if the creditor's or the credit broker's activities are subject to the Banking Act. If the activity consists of giving or acting as a broker for consumer credits in order to finance the acquisition of goods or services that the creditors or credit brokers offer themselves, the authorization requirement does not exist, either.

Credit brokers, however, who apply for a license, must fulfill certain requirements:

– most importantly, they must have practical experience of three years with regard to financial services or a comparable field of business. Due to lack of case law and doctrine to this question, what exactly is considered to be a "comparable field of business", especially the answer to the question of whether insurance business is comparable, is unanswered. However, on

some cantonal authorities' homepages (cf. http://www.sg.ch/home/wirtschaft_neu/gewerbe/konsumkredite.html), "insurance" is listed in brackets after the expression financial services.

– Moreover, the potential credit broker must have a good reputation; and

– have sufficient professional indemnity.

The creditor's requirement to have sufficient own funds does not exist for credit brokers. Furthermore, the requirement to have sufficient professional indemnity (*Berufshaftpflicht*) does not exist if there is a guarantee or another sufficient insurance.

Once granted and subject to withdrawal, the license is valid for the period of five years.

If a credit agreement indeed falls within the scope of the CCA, the contract must be in writing. Moreover, certain information must be included in the contract, such as, for example, the net amount of the credit, the annual global and effective percentage rate of charge or the annual rate of interest, or a statement of the consumer's right to cancel the contract and the cooling-off period.

As regards the writing requirement, there would be some factual obstacles. In Switzerland, article 14 paragraph 2bis of the Swiss Code of Obligations provides that electronic signature based on a qualified certificate is equal to personal signature. However, consumers within the meaning of the CCA are, yet, unlikely to have obtained such a qualified certificate.