Banks – Impact of the New Financial Market Regulation

30.09.2016

- **Licensing cascade**
- **More standardized processes**
- **Conduct, disclosure and organizational obligations**

1. Current Regulatory Regime

Banks and Swiss branches of foreign banks must have a license when operating in Switzerland and they are subject to the prudential supervision of the Swiss Financial Market Supervisory Authority (FINMA). The key regulatory framework for the supervision of banks currently includes, inter alia, the Financial Market Supervision Act (FINMASA), the Banking Act (BA), the Stock Exchange Act (SESTA) and their implementing ordinances. Because FINMA is the responsible regulator, further provisions are included in multiple FINMA circulars. Further, self-regulation has been an important cornerstone of the Swiss banking structure. The Swiss Banking Association has issued various guidelines applicable to banks.

Many business areas of banks, however, are not yet (or, according to prudential policymakers, not sufficiently) regulated because banks can still trade a vast range of less risky and highly risky financial instruments, such as derivatives, with very limited oversight by the regulator despite the existence of minimum capital requirements in line with the Basel III rules and the "too big to fail" regulations (which have been put in place after the 2008 credit crisis). The same lack of supervision and regulation currently applies to structured products and other high risk financial sideproducts.

2. Overview of the New Financial Market Regulation

With the implementation of the Federal Financial Institutions Act (FINIG), the licensing rules for banks will be dealt with in one single act, together with the respective rules for all financial institutions that operate in Switzerland. Banks with an existing license do not require a new license. A license to operate as a bank will automatically provide the bank with the license to operate as a securities house and even a qualified asset manager (so called cascade).

The new Federal Financial Market Infrastructure Act (FinfraG) introduces detailed rules for one of the most volatile business areas of banks, the trading of derivatives. The derivatives business will be subject to new rules introduced by FinfraG. Clearing obligations (across asset classes), risk mitigation duties and transparency and reporting rules will apply. Of significance, the details of the covered OTC derivative trades and products are still to be defined in form of regulations (by delegation in the FinfraG to FINMA).

Market conduct and the provisions of financial services by banks will be subject to the new Federal Financial Services Act (FIDLEG). Most banks offer the entire catalogue of financial instruments as listed in FIDLEG to clients and thus, they must comply with all the detailed conduct requirements, disclosure rules and organisational obligations to guarantee client protection and the protection of the financial market per se.

3. Selected Key Points for Banks

Major banks will most likely offer certain additional services in regard to the trading of financial instruments, especially for investment banking purposes (such as seen in the US and the EU). As such, they will become clearing members of licensed clearing houses (central counterparties) and offer, inter alia, derivatives clearing services (in line with the FinfraG rules) to smaller market participants.

Also of significance is that – despite the fact that existing licenses will not require a re-assessment - banks will need to prove compliance with FINIG provisions within one year after FINIG is implemented.

Despite the standardization of licensing provisions in one act, the distinction between systemically important banks and non-systemically important banks will remain in place (as an important criterion). Systemically important banks must fulfil more restrictive obligations than non-systemically important banks, for example, with regards to the (already existing) post 2008 capital requirements and the liquidity, as well as the risk diversification rules.

Against the background of greater client protection, banks must familiarize themselves and comply with a number of rules of conduct under FIDLEG, including FIDLEG’s stricter information and documentation obligations.

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