Swiss rules on the requirements for the contractual recognition of stays on termination rights

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- **Stay recognition requirement**
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- **FINMA Guidance 01/2018 "Implementation of the requirement for amending financial contracts (Art. 12 para. 2bis BO in conjunction with Arts. 56 and 61a BIO-FINMA)"**

1. Revised FINMA-Banking Insolvency Ordinance

The Financial Market Supervisory Authority ("FINMA") has the authority to temporarily prevent the termination of contracts (so-called "stay") in the critical phase of resolution proceedings of a bank licensed in Switzerland.

The stay imposed by FINMA also impacts the exercise of any set-off, enforcement of collateral and transfer rights and with a limited duration of only two business days.

In January 2016, Art. 12 para 2bis Banking Ordinance entered into force requiring that a bank and a securities dealer, both licensed in Switzerland, which wish to enter into contracts or to amend pre-existing contracts, either governed by foreign law or providing a foreign jurisdiction, assure that their counterparties contractually acknowledge a possible stay imposed by FINMA.

On 1 April 2017 the partially revised Banking Insolvency Ordinance-FINMA ("BIO-FINMA") entered into force. To create more legal certainty for affected banks, licensed in Switzerland the amendments make clear what is subject to the requirements for the contractual recognition of stays on termination rights regarding financial contracts in line with international standards (namely, the revised BIO-FINMA sets out the details of the requirements, pursuant to Art. 12 para 2bis Banking Ordinance in its new Art. 56).

Pestalozzi Rechtsanwälte AG
Feldeggstrasse 4
CH-8008 Zürich
T +41 44 217 91 11
zrh@pestalozzilaw.com

Pestalozzi Avocats SA
Cours de Rive 13
CH-1204 Genève
T +41 22 999 96 00
gva@pestalozzilaw.com

pestalozzilaw.com

2. Stay recognition requirement

Stay recognition requirement means that banks licensed in Switzerland can only enter into new contracts or amend pre-existing contracts that are governed by foreign law or that provide for a foreign jurisdiction if their counterparties contractually acknowledge FINMA's authority to order a stay in the critical phase of resolution proceedings.

This stay recognition requirement aims to ensure that not only crucial contractual relationships remain valid and active in situations of stress but also that FINMA's restructuring measures can be enforced globally.

3. Types of contracts subject to stay recognition requirement

The new Art. 56 BIO-FINMA determines the types of contracts for which a stay must be contractually recognized.

Art. 56 para 1 BIO-FINMA details contractual liability along with the obligation to acknowledge stays imposed by FINMA. In-scope financial arrangements are (i) agreements relating to transferable securities or a group or index of transferable securities (including for their purchase, sale or loan and options, and their repurchase transactions); (ii) agreements for future delivery (including for their purchase, sale or loan, options and their repurchase transactions); (iii) futures and forwards contracts, including contracts (other than a commodities contract) for purchase, sale or transfer of a commodity, service, right or interest for a specified price at a fixed future date; (iv) swaps and options regarding interest rates, spot or other foreign exchange agreements, currency, commodities, or weather, emissions or inflation, (and any similar agreements or transactions that are the subject of recurrent dealing in the swaps or derivatives markets); (v) any other derivatives and master agreements for these derivatives, any of the arrangements referred to above, and for contracts for the sale, purchase, or delivery of any currency; (vi) intrabank loan contracts; and finally (vii) all other agreements with the same effect as the in-scope agreements specified above.

Certain exemptions apply. Inter alia, the following agreements are excluded from the stay recognition requirement: Contracts entered into through financial market infrastructures; loan contracts with companies that are not Swiss banks; contracts entered into with a central bank; contracts regarding the placing of financial instruments in the market; contracts with private persons if they are not wealthy persons who enter into contracts on investment companies.

4. Critical points

a) "Catch-all" Clause

In the consultation process, banks requested that the "catch-all" provision be removed (2vii above). The banks argued that it seems unclear what "all other agreements with the same effect" means in practice. With this provision, FINMA aims to capture future developments on the financial market, whereby it will be a case by case interpretation of whether future contracts will fall within this general clause.
In fact, the "catch-all" clause is not in line with the purpose of the partially revised BIO-FINMA, which is to create more legal certainty.

b) No distinction between material and non-material amendments

The new rules do not distinguish between material and non-material amendments of pre-existing contracts, although a clear distinction was requested by the banks in the consultation process. Thus, for instance, a single transaction under a master agreement (e.g. ISDA Master Agreement) can trigger an adjustment duty.

5. Implementation and Timeline

The obligation to include resolution stay clauses into the relevant financial contracts, those governed by foreign law or providing for foreign jurisdiction, must be implemented by 1 April 2018 for: contracts with banks licensed in Switzerland; securities dealers licensed in Switzerland; or with counterparties that would qualify as such if they were domiciled in Switzerland. For contracts with other counterparties, the implementation deadline is 1 October 2018.

The implementation has proven to be difficult for banks. On 21 March 2018 FINMA published its Guidance 01/2018 according to which FINMA will accept if banks do not stop trading for a limited period of nine months after the expiration of the respective implementation deadline, provided that the efforts to implement the resolution stay regulation are continued, i.e. the banks taking appropriate measures to make the necessary amendments to financial contracts as quickly as possible.

Oliver Widmer

Partner
Attorney at law
Head Financial Services

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 92 42
oliver.widmer@pestalozzilaw.com



Robert Furter



Senior Counsel
Attorney at law

Pestalozzi Attorneys at Law Ltd
Feldeggstrasse 4
8008 Zurich
Switzerland
T +41 44 217 91 55
robert.furter@pestalozzilaw.com