CapLaw

SWISS CAPITAL MARKETS LAW

No. 1/2021

Insurance Supervision Act – Overview of the Ongoing Revision

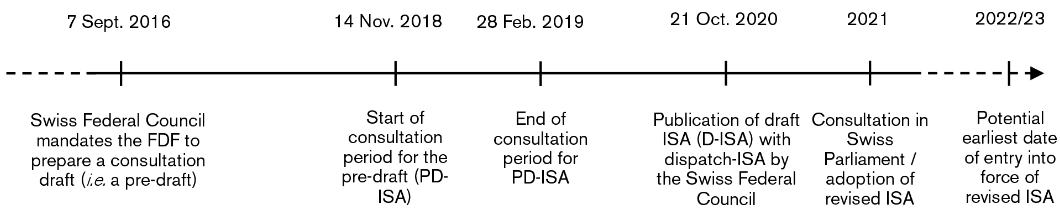
Reference: CapLaw-2021-01

On 21 October 2020, the Swiss Federal Council published the draft of the revised Insurance Supervision Act together with a dispatch to Swiss Parliament. The revised act is expected to enter into force by 2022 at the earliest. This article provides an overview and discusses selected key topics of the revision.

*By Peter Ch. Hsu**

1) Introduction

The Insurance Supervision Act of 17 December 2004 (ISA) has been in force since 1 January 2006. It codifies the regulation of Swiss (re)insurance undertakings and insurance intermediaries in one single Federal act and replaced the insurance supervisory law that previously was implemented in various Federal acts. Since ISA's entry into force, there have been minor amendments to its text only, mainly to align it with changes to other Swiss laws (*e.g.* enactment of the Financial Market Supervisory Act (FINMASA)). In 2016, the Swiss Federal Council entrusted the Federal Department of Finance (FDF) with a project to elaborate a draft for a partial revision of ISA. The FDF subsequently published a pre-draft of a partial revision of ISA (PD-ISA) for public consultation on 14 November 2018. Two years later, on 21 October 2020, the Swiss Federal Council published the draft ISA (D-ISA; BBI 2020 9061) together with a dispatch (*Botschaft*) to Swiss Parliament (dispatch-ISA; BBI 2020 8967), a report on the consultation process (consultation report) and a report on a comparison with developments on an international level and a regulatory impact assessment. Currently, the Economic Affairs and Taxation Committees (EATC) of the National Council (*Kommission für Wirtschaft und Abgaben des Nationalrates; WAK-N*) is in the course of deliberations on the D-ISA and expected to conclude them by 12/13 April 2021 and publish its proposal in its comments (*Fahne*). Subsequently, D-ISA will be debated in the special session (*Sondersession*) of the National Council on 3–6 May 2021 (see <https://www.parlament.ch/press-releases/Pages/mm-wak-n-2020-02-02.aspx>) and might enter into force by 2022 at the earliest. However, in view of the legislative process, 2023 appears to be more realistic.



* Many thanks to MLaw Ramin Paydar, Junior Associate at Bär & Karrer, for his support in writing this article.

This abstract discusses selected key topics of the new provisions of D-ISA. The partial revision pursues the following three key goals of the Swiss Federal Council's financial market strategy by various pinpoint amendments (dispatch-ISA, p. 5 *et seqq.*):

Goals of the Swiss Federal Council for financial market strategy	Proposals for amendment in D-ISA
1. Enhancement of the competitiveness of the market participants and improvement of high-quality products / services for clients	– **Less stringent rules for insurance undertakings if** and to the extent they contract with professional insured only *i.e.*, a result of a client protection-oriented approach of regulation and supervision – **Less stringent rules for captives** – **Potential exemption by FINMA** from license requirement for **small insurance businesses** – **Exemption for ancillary insurance** (*Annexversicherung*) – **No introduction of new license requirement for Swiss pure reinsurance branch offices of foreign insurers**: the initial proposal of the PD-ISA has been dropped in D-ISA. D-ISA only provides for a delegation by the legislator to the Swiss Federal Council of the competence to implement a license requirement in the future depending on future developments at an international level.
2. Foster stability of the financial system	– **Additional regulation on supervision of insurance groups and conglomerates** – **Requirement for stabilization plan**
3. Integrity of the financial marketplace and appropriate **customer protection**	– **Restructuring procedure for insurance undertakings/ material group companies** to improve customer protection (without impairing competitiveness) – **Rules of conduct for insurance intermediaries** – **Regulation of qualified life insurance products** – **Ombudsman's office: Affiliation requirement for insurance undertakings and insurance intermediaries**

The above table is simplified, and it should also be noted that some of the goals and measures are interdependent and some of the measures serve multiple goals.

Further, D-ISA aims to address new developments in the insurance industry as well as the financial sector (*e.g.* innovative business models/insurtech) of the recent past. In addition, D-ISA implements certain provisions in the act that to date have been regulated in the Insurance Supervision Ordinance (ISO) to ensure a sound legal basis (*e.g.* certain provisions on the Swiss Solvency Test (SST)).

2) Key topics of the amendments by D-ISA

a) Introduction of a Restructuring Framework (Article 52*a*–52*m* D-ISA)

Currently, **ISA lacks specific provisions on the restructuring** of a (re)insurance undertaking, in contrast *e.g.* to the banking regulation. ISA only mentions restructuring as a potential measure by stating that an insurance undertaking may only enter bankruptcy proceedings in the absence of a prospect of a restructuring (article 53 ISA). Further, ISA explicitly excludes the application of the restructuring provisions in the Debt Collection and Bankruptcy Act (DEBA) (article 53 para. 2 ISA).

Because of the absence of any restructuring rules in ISA, FINMA can only decree "**safeguarding measures**" if an insurance undertaking, *e.g.*, is challenged by financial difficulties and the interests of the insured are endangered (article 51 ISA). FINMA, *e.g.*, may decree the measure of a transfer of the insurance portfolio to another insurance undertaking with the consent of the latter (article 51 para. 2 lit. d ISA). However, **ISA does not include any capital measures or the possibility of intervening in the rights of third parties** to carry out a restructuring.

As a result, under current law, **FINMA is *de facto* forced to open bankruptcy proceedings**, even if a successful restructuring of the insurance undertaking were possible.

The new provisions of D-ISA aims to offer the possibility to **restructure an insurance undertaking rather than to liquidate it**. This may safeguard the interests of the insured because the insured are typically more interested to continue their insurance contract than to terminate it due to the bankruptcy of the insurance undertaking. In particular, in the area of supplemental medical insurance and life insurance, it is often difficult to find similar alternative coverage (*e.g.*, because of preexisting illness, old age or higher premiums). The new provisions enable various restructuring measures, inspired by the banking regulation, but taking into consideration the specifics of the insurance insurance business (see articles 52*a*–52*m*).

See for a more detailed discussion Monica Mächler, New Regulatory Regime for Financially Distressed Insurance Companies, CapLaw 1/2021, p. 15 *et seqq.* (see below) and Peter Ch. Hsu, Insurance Supervision Act – Overview of the Ongoing Revision, Bär & Karrer Publication (available at <https://www.baerkarrer.ch/en/publications>).

b) Reliefs and Exemptions from Insurance Regulation/Supervision

i. Insurance for Professional Insured (Articles 30a–30c D-ISA)

The supervisory regime under ISA is based on the principle that all insured **require the same level of protection** and does not differentiate between the different levels of protection required by the various categories of insured (*e.g.*, private individuals, small and medium-sized enterprises, large customers, direct insurers). The only exception to this rule is the lighter supervisory regime for reinsurance undertakings (article 35 ISA).

Under D-ISA, a lighter regulatory regime continues to apply to pure reinsurance undertakings and mixed direct and reinsurance undertakings with regard to their reinsurance business (article 35 para. 2 D-ISA). In addition, D-ISA further takes into account the different protection requirements of insured by providing supervisory relief to insurance undertakings that only have professional clients (or insurance undertakings that service both professional and other clients with regards to their business with professional clients). Upon request, FINMA grants those insurance undertakings (in general or for their business with professional clients) an exemption from the following obligations and requirements (article 30*a* para. 1 D-ISA) (subject to certain limitations under article 30*a* para. 4 D-ISA):

- Obligation to hold an organizational fund (article 10 ISA).
- Tied asset requirement (articles 17–20 ISA; article 54*a*^{bis} D-ISA).
- Different adjustment of various categories of insurance agreements in the restructuring procedure (article 52*e* para. 2 D-ISA).
- Obligation to affiliate with an ombudsman's office (articles 82–82*i* D-ISA).

If an insurance undertaking benefits from the exemptions for professional insured, it must **inform** the professional insured of the status and comply with further information obligations (articles 30*b* and 30*c* D-ISA).

The following entities are deemed professional insured i) financial intermediaries in the meaning of the Federal Banking Act (BankA) and the Federal Act on Collective Investment Schemes; ii) insurance undertakings in the meaning of ISA; iii) foreign insured subject to prudential supervision equivalent to that of the persons referred to in i) and ii); iv) public law corporations, public law institutions and public law foundations with professional risk management; and v) companies with professional risk management (article 30*a* para. 2 D-ISA with reference to article 98*a* lit. b–f of the amended Federal Insurance Contract Act that into force on 1 January 2022 (Amended ICA)). In contrast, pension funds and large companies in the meaning of article 98*a* para. 2 lit. a and g Amended ICA do not qualify as professional insured.

If an insurance undertaking provides its services to both professional and non-professional insured, the relief shall only apply to the business with professional insured (article 30*a* para. 3 D-ISA).

ii. Captives (Article 30d D-ISA)

Furthermore, D-ISA provides for exemptions for **intra-group direct insurance and reinsurance (captives)** from the following provisions (article 30*d* para. 1 D-ISA):

- Obligation to hold an organizational fund (article 10 ISA; article 15 para. 1 lit. d D-ISA).
- Obligation to join the National Insurance Office and the National Guarantee Fund (article 13 ISA).
- Tied asset requirement (articles 17–20 ISA; article 54*a*bis D-ISA).
- Application of various specific provisions for individual insurance classes (articles 32–34 and 36–39 ISA).
- Different adjustment of various categories of insurance agreements in the restructuring procedure (article 52*e* para. 2 D-ISA).
- Additional safeguarding measures for foreign insurance undertakings (articles 57–59 ISA).
- Obligation to affiliate with an ombudsman's office (articles 82–82*i* D-ISA).
- Provision on the transfer of an insurance portfolio under article 62 ISA.

Under the new rules, a captive may also provide insurance services to third parties. However, the exemptions do not apply to this part of the business (article 30*d* para. 3 D-ISA).

iii. Small Insurance Business / Insurtech

Under current law, FINMA may exempt from supervision an insurance undertaking whose insurance activities are of minor economic importance or cover only a small group of insured persons (article 2 para. 3 ISA). **In practice, this exemption has been very narrowly interpreted and hardly ever applied**. PD-ISA also included the proposal that FINMA shall have the ability to exempt small insurance undertakings, in particular those with innovative business models, from insurance supervision (article 2 para. 3 PD-ISA). In the consultation procedure, the introduction of the exemption as such was generally much welcomed. However, the generic wording of the requirements for the exemption was heavily criticized and the concern has been raised that FINMA might, therefore, be reluctant to grant the exemption in practice.

Under D-ISA, the Swiss Federal Council has the competence to exempt small insurance undertakings from supervision (article 2 para. 5 lit. b D-ISA), *e.g.,* by way of introducing a regulation in the ordinance (*e.g.*, in ISO). Pursuant to the wording of the draft provision, the exemption shall serve the purpose to safeguard the future viability of the Swiss financial center. The Swiss Federal Council may introduce conditions to the granting of exemptions, such as domicile in Switzerland, guarantees (*e.g.*, also in the form of reinsurance), adequate information of clients, organizational requirements, etc. When adopting a regulation of the exemption the Swiss Federal Council shall in particular take into account the business model, the economic importance and the risks of the insurance product for the insured concerned, the volume of business and the group of insured persons.

iv. Further Exemptions from Insurance Supervision

SERV/ECA: While the **Swiss Export Risk Insurance** (SERV) is exempted from the scope of application of ISA (article 2 para. 2 lit. b ISA), there is currently no such exemption for **foreign Export Credit Agencies** (ECA) that insure Swiss exporters in relation of trade activities and Swiss banks in relation to trade financing. D-ISA now provides for an express exemption for foreign state-owned or state-guaranteed export risk insurance undertakings (article 2 para. 2 lit. b^{bis} D-ISA).

Associations (*Vereine*), organizations (*Verbände*), cooperatives (*Genossenschaften*) and foundations: Associations, organizations, cooperatives and foundations that offer and enter into security arrangements, including, *e.g.*, sureties and guarantees with their members, are exempt from insurance supervision if i) their local area of activity is limited to the territory of Switzerland, and ii) any profit generated by such contracts will be allocated in full to the contract partners (article 2 para. 2 lit. e D-ISA).

Annex insurance: When selling goods and services, there may be a demand on the part of the customer for insurance coverage that complements the product or service and is tied to it (annex insurance) (*e.g.*, display damage insurance when purchasing a cell phone). D-ISA expressly excludes insurance intermediaries of annex insurance of minor importance from its scope of application (article 2 para. 2 lit. f D-ISA). The Swiss Federal Council will define the criteria by ordinance (article 2 para. 4 lit. c D-ISA). This exclusion from the scope of application (as it is well known under the Insurance Distribution Directive (IDD) in the EU/EEA regulation 2016/97) is sensible.

c) New Rules regarding the Sale of Insurance Products with Investment Character (Qualified Life Insurance Products)

In its debates on the Federal Act on Financial Services (FinSA), the Swiss Parliament decided that the rules of conduct of financial service providers should not apply to the insurance sector. Instead, D-ISA shall introduce such regulation and adapt it to the specific needs of the insured. The regulation in D-ISA aims to create a *level playing field* for investment products. It contains provisions on qualified life insurance products that have the character of investment products and that shall be subject to the corresponding regulations for the protection of the investor (see the definition of qualified life insurance products in article 39*a* D-ISA), including, *e.g.*:

- An insurance undertaking offering qualified life insurance products must prepare a **key information document** (KID) in advance (article 39*b* para. 1 D-ISA, see further article 39*c*–39*h* D-ISA) (see the similar regulation for financial intermediaries in article 58 *et seqq.* FinSA). The Swiss Federal Council may issue supplementary provisions (article 39*f* D-ISA).

- **Advertising** for qualified life insurance products must be clearly recognizable as such. The advertising must refer to the KID for the respective qualified life insurance and to the reference agency (*Bezugsstelle*) (article 39*i* D-ISA) (see regulation to financial service providers in article 68 FinSA)

- Before recommending a qualified life insurance policy, an insurance undertaking or an insurance intermediary must examine whether the product is **appropriate** for the insured and what knowledge and experience the insured has (article 39*j* D-ISA; *cf.* appropriateness assessment in article 11 FinSA).

- An insurance undertaking and insurance intermediary must, *e.g.*, document what qualified life insurance contract has been concluded, which knowledge and experience of the insured has been gathered, that no appropriateness assessment has been carried out based on article 39*j* para. 3 or 4 (*e.g.*, because the information received from the insured is insufficient for an appropriateness assessment), or that the insured was advised against purchasing a qualified life insurance product. Insurance undertakings and insurance intermediaries shall provide a copy of such documentation to the insured persons upon request or make it available to them in another appropriate manner (article 39*k* D-ISA; *cf.* article 15 and 16 FinSA).

- Further, an insurance intermediary will be subject to a **duty to provide certain basic information** to their clients in advance in relation to all insurance products (article 45 D-ISA, see current regulation in article 45 ISA).

- The **regulation of compensation** of insurance undertakings and third parties for non-tied insurance intermediaries (article 45*b* D-ISA; *cf.* article 26 FinSA; see below).

See for a more detailed discussion Bertrand Schott/Simon Bühler, Insurance Supervision Act: Proposed New Rules regarding Distribution of Insurance Products (Point of Sale) and Insurance Intermediaries, CapLaw 6/2020, p. 10 *et seqq.*

d) New Rules for Insurance Intermediaries

D-ISA continues to distinguish between tied and non-tied insurance intermediaries that have currently been defined in ISO only (see article 43 para. 1 ISA for tied and article 183 ISO for non-tied insurance intermediaries). **Under D-ISA the definitions will be implemented into the law in article 40 para. 2 and 3 D-ISA**. Under D-ISA, an insurance intermediary cannot be simultaneously engaged in business as a tied and non-tied insurance intermediary (article 44 para. 1 lit. b D-ISA) taking into account that a non-tied insurance intermediary stands in a fiduciary relationship to the insured (article 40 para. 2 D-ISA).

Non-tied insurance intermediaries must register with the register of insurance intermediaries (article 41 para. 1 D-ISA). Tied insurance intermediaries need not to register in the register of insurance intermediaries. In contrast to current law, **tied insurance intermediaries cannot generally voluntarily register** but may only register in the register of insurance intermediaries if they prove that they intend to take up a business activity abroad in a jurisdiction that requires a registration in the register in Switzerland (article 42 para. 1 and 4 D-ISA). This applies in particular to insurance intermediaries that are or intend to engage in business in the Principality of Liechtenstein. **Tied insurance intermediaries** have an identifiable fiduciary relationship with their employers, typically insurance undertakings. FINMA can indirectly and effectively supervise tied insurance intermediaries via the insurance undertakings – **a registration in the register is not necessary for this purpose** (dispatch-ISA, p. 9008).

Newly included are the requirements of good reputation and the guarantee of fulfillment of the obligations under D-ISA (article 41 para. 2 lit. b D-ISA; *cf.* article 11 FinIA). Furthermore, the **requirement of a domicile, residence or branch office in Switzerland** is included, which is considered as important for the effective supervision of FINMA (article 41 para. 2 lit. a D-ISA). Consequently, in contrast to current regulation non-tied insurance intermediaries will, in principle, no longer be able to operate without a physical presence in Switzerland. In justified cases, FINMA, however, may grant exceptions (article 41 para. 5 D-ISA).

D-ISA introduces **new rules regarding the disclosure of compensation** and waiver requirements for **non-tied insurance intermediaries** (article 45*b* D-ISA). A distinction is made between two types of arrangements: i) If a non-tied insurance intermediary receives compensation from an insurance undertaking or a third party only (*e.g.,* a commission, rebate or similar financial benefits), the insurance intermediary may accept it if and to the extent it informed the insured expressly (article 45*b* para. 1 D-ISA); ii) if the non-tied insurance intermediary receives remuneration from the insured, then the insurance intermediary may only accept compensation from an insurance undertaking or a third party if a) the insured has been expressly informed about the compensation and the insured expressly waives the compensation or b) if the non-tied insurance intermediary passes the compensation on to the insured (article 45*b* para. 2 D-ISA). The latter is similar to the general rule on inducements/retrocessions for financial service providers (article 26 para. 1 FinSA). The disclosure of the compensation must indicate the type and the amount of the compensation and take place prior to the provision of the service or entering into an agreement. If the amount cannot be determined in advance, the policyholder must be informed the calculation parameters and the range amounts of the compensation (article 45*b* para. 3 D-ISA). This, in principle, reflects the case law of the Supreme Court on retrocessions in the asset management in the financial services business. It goes, however, further as in the current wording of the provision an express waiver (as opposed to, *e.g.*, as well a silent waiver) is required (see also article 26 para. 2 FinSA).

These rules on disclosure and waiver do not apply to the **compensation of tied insurance intermediaries** (*cf.* dispatch-ISA, p. 9006).

Tied and non-tied insurance intermediaries must provide for the necessary skills and knowledge for their activities (article 43 D-ISA; *cf.* article 6 FinSA). As under current law, insurance intermediaries will be subject to a duty to provide certain basic information to their clients in advance in relation to all insurance products (article 45 D-ISA). Furthermore, tied and non-tied insurance intermediaries must avoid conflicts of interest (article 45*a* D-ISA and see also article 14*a* D-ISA). Non-tied insurance intermediaries are required to register with an ombudsman's office (article 82*c* para. 1 D-ISA).

e) Introduction of an Obligation to Affiliate with an Ombudsman's Office (Articles 82–83*c* D-ISA)

Currently, there is already an ombudsman's office in the field of private and health insurance. Since 1 January 2021, financial service providers have also been subject to the obligation to affiliate themselves with an ombudsman's office (article 77 FinSA). Under D-ISA, in principle, all insurance undertakings and non-tied insurance intermediaries must affiliate with an ombudsman's office (article 82*c* para. 1 D-ISA). Reinsurance undertakings and captives are exempted from the affiliation requirement (articles 35 and 30*d* D-ISA) and insurance undertakings that are exclusively engaged in the business of insurance of professional insured may be exempted from such requirement upon request to FINMA (article 30*a* D-ISA). However, more recently, the EATC of National Council has proposed removing the affiliation requirement with the ombudsman's office from the D-ISA (<https://www.parlament.ch/press-releases/Pages/mm-wak-n-2020-02-02.aspx>).

f) Proposed Amendments of Penal Provisions (Articles 86 and 87 D-ISA)

D-ISA shifts the enforcement model away from penal provisions and the threat of monetary fines towards supervisory review and enforcement (*cf.* articles 89–92 FinSA). It maintains only those penal provisions that protect crucial elements of the supervisory framework and lowers the maximum level of fines. In particular, lit. a (violation of the duty to join the National Insurance Office and the National Guarantee Fund according to article 13 ISA), c (late submission of the annual report; article 25 ISA), d (not forming the prescribed technical provisions) and f (violation of the proper execution of claims settlement in motor vehicle liability insurance) of article 86 para. 1 ISA will be abolished and the maximum fine (*Busse*) for contraventions (*Übertretungen*) shall be reduced from CHF 500,000 to CHF 100,000 (in case of intent) and from CHF 150,000 to

CHF 50,000 (in case of negligence) (article 86 D-ISA) (misdemeanours (*Vergehen*) can still be punished by imprisonment up to 3 years or monetary penalty (*Geldstrafe*) (in case of intent) or fines up to CHF 250,000 (in case of negligence)). Also, the criminal liability for failure to submit or late submission of changes to the business plan shall no longer apply (*cf.* article 87 para. 1 lit. b ISA). These reliefs are remarkable. The concept of focusing on supervisory review and enforcement is in our view sensible.

g) Proposed Amendments regarding Group and Conglomerate Supervision

Systemic risks do typically not arise from the traditional insurance of customer risks but tend to be incurred rather in other activities and by affiliates of insurance undertakings. Therefore, the revision also aims to strengthen group supervision, which should contribute to system stability, see *e.g.*: FINMA approval requirement for business plan changes regarding changes in the board of directors and senior management, control etc. at group or conglomerate level (article 71bis para. 1 and article 79bis para. 1 D-ISA), reporting obligation for all undertakings of the group pursuant to article 29 FINMASA (article 71 D-ISA), formal legal basis for solvency requirements in article 69 and 77 D-ISA, obligation to prepare stabilization plans (article 67 para. 4 and article 75 para. 4 D-ISA), etc.

Swiss domiciled material group and conglomerate companies (without supervision by FINMA on an individual level) are subject to FINMA's jurisdiction for bankruptcy (articles 71bis and 79bis ISA with reference to articles 53–54*e* ISA). Such jurisdiction will be extended to Swiss domiciled material group and conglomerate companies irrespective of the existence of group or conglomerate supervision and to Swiss domiciled parent companies of an insurance group or conglomerate (article 2*a* para. 1 lit. a and b D-ISA). Furthermore, such jurisdiction will be extended to protective measures, measures in the event of a risk of insolvency, restructuring and liquidation (article 2*a* para. 1 D-ISA with reference to articles 51–54*i* D-ISA).

3) Further proposed amendments

In PD-ISA it was proposed that **foreign reinsurance undertakings with a branch in Switzerland are to be made subject to an insurance supervision** requirement in Switzerland (article 2 para. 1 lit. b no. 2 PD-ISA). This was heavily criticized in the consultation process because the liberal Swiss regime for reinsurance branches has proven to be very successful to encourage foreign insurers to establish a Swiss reinsurance branch instead of transacting on a pure cross-border basis from abroad into Switzerland. So far, no significant incidents have occurred that would have called for such extension of the scope of ISA license requirements. D-ISA no longer provides for such license requirement. However, under D-ISA the Swiss Federal Council has the competence to introduce such license requirement (by way of an amendment of the ordinance) to address development in international standards (article 2 para. 5 lit. a D-ISA).

The **SST** is the risk-based solvency regime. The regulation on SST has been based on article 9 ISA but most of the regulation has been implemented in ISO. The new provisions on SST in D-ISA shall provide for a formal legal basis in the law (articles 9–9b D-ISA). Further, they adjust certain terminology to the SST. The provisions, however, do not aim for a change of the calibration of the SST. Furthermore, under D-ISA the Swiss Federal Council has the authority to introduce additional capital requirement systems for insurance undertakings with international activities, insurance groups and conglomerates, in addition to the solvency regulations, in order to meet international capital standards (article 9*c* D-ISA).

Under D-ISA, FINMA may require economically significant Swiss insurance undertakings to prepare a **stabilization plan** (article 22*a* para. 1 D-ISA) (*cf.* similar requirement for systemically important banks under article 7 *et seqq.* BankA). In this plan, the insurance undertaking will describe the intended measures to stabilize itself in an event of a crisis to continue its business activities without government support (article 22*a* D-ISA).

As under ISA, insurance undertakings in addition to their insurance business may only engage in other business activities if such **other business activities** have an immediate nexus to the insurance activities (article 11 para. 1 ISA, see article 11 para. 1 lit. b D-ISA). Further, under ISA FINMA *may* authorize other business (that do not have an immediate nexus to the insurance activities) if such business activities do not jeopardize the interests of the insured. The new provision shall make it clearer that FINMA has to grant such authorization if the requirements are met (article 11 para. 1 lit. b D-ISA). The Swiss Federal Council shall specify the conditions and details in the ordinance (article 11 para. 2 D-ISA). In view of the new developments in the insurance industry, including, *e.g.*, the new distribution channels (electronic platforms), specialized consultancy and service provision and parametric (re-)insurance, a more liberal regime would be helpful being understood that the equivalency requirements on the international level sets certain limits (consultation report, p. 22 *et seq.*).

Furthermore, to eliminate uncertainties regarding the legal capacity of **Lloyd's as a party in a civil or supervisory procedure** (see the decision of the Swiss Federal Supreme Court 4A_116/2015, 4A_118/2015, consideration 3.1 and 3.4), a specific provision for Lloyd's in view of its nature as a unique insurance market has been included in D-ISA (article 15*a* D-ISA).

One further change that is noteworthy is the following: Under ISA, a person who intends to directly or indirectly participate in a Swiss domiciled insurance undertaking must notify FINMA if the participation reaches or exceeds the thresholds of 10, 20, 33 or 50% of the capital or voting rights of the insurance undertaking (article 21 para. 2 ISA). However, based on the wording of ISA only a reduction of a *direct* participation (but not of any indirect participation) in a Swiss domiciled insurance undertaking below the relevant thresholds (and the change of the direct participation so that the insurance undertaking no longer qualifies as a subsidiary) have to be notified to FINMA (article 21 para. 3 ISA). **Under D-ISA the reduction as well of an *indirect* participation in a Swiss domiciled insurance undertaking below the thresholds must be notified to FINMA** (article 21 para. 3 D-ISA).

Finally, it was proposed in PD-ISA that changes to the regulatory **business plan** relating to i) a change of directors of the board of directors, senior management and control (article 4 para. 2 lit. g ISA and article 5 para. 1 PD-ISA) and ii) a material change in the outsourcing of functions (article 4 para. 2 lit. j ISA and article 5 para. 1 PD-ISA) should require prior submission for approval to FINMA. Usually, as a practical matter an insurance undertaking is well advised to submit such changes to the regulatory business plan in advance to FINMA to avoid any surprises and be required to unwind a transaction. However, it is sensible that the timing requirement of a *prior* submission of changes of business plan forms g and forms j for approval by FINMA has been dropped in D-ISA so that the current rules remain in force.

4) Outlook

D-ISA proposes various amendments to ISA and includes also some relief measures and exemptions from regulation (*e.g.*, for insurance undertakings with only professional insured, small insurance business and captives). This is rather unusual for a project of new regulation as we have become used to the principle that new regulation introduces additional regulatory burden on the regulated entities rather than to bring relief. This is a positive development. The deliberations of the Swiss Parliament scheduled for this spring will certainly be followed with great interest.

Peter Hsu (peter.hsu@baerkarrer.ch)

New Regulatory Regime for Financially Distressed Insurance Companies

Reference: CapLaw-2021-02

One of the key goals of the proposed revision of the Swiss Insurance Supervision Act is to insert provisions on restructuring into the Swiss insurance regulations that so far do not exist. Together with some related amendments, these provisions are designed to form a regulatory regime for financially distressed insurance undertakings.

By Monica Mächler

On 21 October 2020, the Federal Council approved for the attention of Parliament the **Dispatch on the Amendment of the Swiss Insurance Supervision Act** (ISA, SR 961.01) (the Dispatch) along with a draft ISA (D-ISA; Federal Gazette (Switzerland), 2020, 8967 ff. and 9061 ff.). An overview of the legislative history and the key elements of D-ISA can be found under PETER CH. HSU, Insurance Supervision Act – Overview of the Ongoing Revision, CapLaw No. 1/2021, 2 ff.

One of the key goals of the revision is to insert provisions on **restructuring** (articles 52a-52m D-ISA) into the Swiss insurance regulations that so far do not exist. This comes contextually together with partially amended provisions on **protective measures** and **measures in case of an insolvency risk** as well as on **liquidation** (articles 51, 51a/b D-ISA and 52 ISA) and on **bankruptcy** (articles 53-54j D-ISA). Articles 55 and 56 ISA representing special provisions regarding the bankruptcy of life insurance companies are planned to be deleted. The remaining articles 57-59 ISA with additional protective measures for foreign insurance undertakings should, however, remain unchanged. It is further proposed that Swiss domiciled Group parent companies and companies domiciled in Switzerland performing essential functions for licensed activities be subject to FINMA's jurisdiction regarding protective measures, restructuring and bankruptcy (article 2a D-ISA). Together, these provisions are designed to form a **regulatory regime for financially distressed insurance companies**. This article focuses on such proposed new rules and their interaction with already existing provisions.

The present proposal should be read against responses to the financial crisis of 2007-2009 developed in the **global standard setting** arena. The most prominent sources are the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions of 2011/2014 (including its II-Annex 2: Resolution of Insurers; <https://www.fsb.org/wp-content/uploads/r_141015.pdf>). They include principles of an effective resolution regime for systemically important financial institutions "without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms which make it possible for shareholders and unsecured and uninsured creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation." Of relevance is the translation of these Key Attributes and related aspects into the Insurance Core Principles and ComFrame (ICP, CF) of the International Association of Insurance Supervisors (https://www.iaisweb.org/page/supervisory-material/icp-on-line-tool>). It is particularly worth noting the entire ICP 12 (Exit from the Market and Resolution) and individual standards under ICP 6.4 (Portfolio Transfer), ICP 10 on preventive and corrective measures, ICP/CF 16.15 on recovery planning, ICP 17.4 on intervention thresholds and ICP/CF 25.7 as well as ICP 25.8 on cooperation in crisis situations. Importantly, the Key Attributes serve as signposts for national resolution regimes, even for non-systemically relevant institutions, be it in the banking, in the insurance and in other regulated sectors of the financial market. Thus, the present regulatory regime for financially distressed insurance companies in D-ISA goes in tandem with the evolution of similar regulations for *financial institutions in general*.

1) Protective measures, measures in case of an insolvency risk and liquidation

The renamed *protective measures* ("Schutzmassnahmen", to date called "sichernde Massnahmen") serve to restore compliance with the regulatory regime and to address threats to the interests of the insureds. They include, among others, potential measures to prohibit the disposal of assets, the transfer of portfolios and assets to another consenting insurance company as well as moratoria (article 51 D-ISA).

Measures in case of an insolvency risk provide an overview of the toolkit, namely protective measures, restructuring, and bankruptcy. *Insolvency risks* are defined as "reasoned concerns that the insurance undertaking is overindebted or suffers from serious liquidity problems" (article 51a(1) D-ISA). The identification of insolvency risks is informed by the accounting balance sheet (e.g. article 725(1) Swiss Code of Obligations; CO, SR 220) and the consequences attributed to it under the Swiss Debt Enforcement and Bankruptcy Act (DEBA, SR 281.1), whereas the economic balance sheet used for purposes of the Swiss Solvency Test is not "relevant" (Dispatch, p. 49). Some related provisions of the CO and of DEBA are, however, superseded by specific provisions of the D-ISA (article 51a(3) D-ISA).

Pre-existing agreements regarding set-off, voluntary disposal of certain collateral and transfer of rights, obligations and collateral prevail over the regime on financially distressed insurance undertakings (article 51b D-ISA). No change is noted regarding the *liquidation* of an insurance undertaking from which FINMA withdraws the licence (article 52 ISA).

2) Restructuring

In order to eliminate the risk of insolvency FINMA may initiate **restructuring proceedings** (articles 52a ff. D-ISA).

a) Prerequisites and restructuring plan

Restructuring proceedings are conditioned upon reasonable prospects to achieve a successful restructuring of the insurance company or to continue select insurance services. FINMA will define the details and may nominate a restructuring delegate (article 52a D-ISA). The restructuring plan according to article 52b D-ISA is the master document of the restructuring process and sets out the measures to eliminate the risk of insolvency. It is subject to the approval of FINMA.

b) Restructuring measures

The possible measures relate to the following three areas.

i. Transfer of portfolios, assets and liabilities

The restructuring plan should address whether insurance portfolios in whole or in part or other assets and liabilities are to be transferred to another legal entity. The transfer of the entire portfolio of insurance contracts or parts of it to another insurance carrier follows the same logic as the portfolio transfer according to article 62 ISA. They are based on ISA, not on the Swiss Merger Act (SR 221.301). The acquiring company may benefit of some relaxations for a transition period if the interests of policyholders are safeguarded. In case of partial transfers, FINMA is supposed to provide for compensation between the entities involved (article 52c D-ISA).

ii. Actions impacting equity capital and receivables of third parties

The restructuring plan should also indicate whether and to what extent existing equity capital is to be reduced and new equity to be created; likewise, it should cover whether and how receivables of third parties are to be converted into equity or to be reduced (article 52d D-ISA). In case of issuing new equity, the subscription rights may be excluded. The conversion of debt into equity or the reduction of debt may only take place if, as a precondition, the share capital has been fully reduced and the risk-absorbing capital instruments (as defined under article 22a Swiss Insurance Supervisory Ordinance [ISO, SR 961.011], see Dispatch p. 55) have been fully reduced or converted into equity (article 52d(3)(a) and (b) D-ISA). Debt that is either subject to compensation mechanisms, or with collateral protection, or incurred under protective measures or in the context of a restructuring, or claims resulting from insurance contracts for which tied assets had to be established (to the extent they suffice) is not subject to conversion or reduction.

The conversion of debt to equity and the reduction of receivables affects first subordinated debt instruments, particularly those designed as bail-in instruments to absorb losses in the event of insolvency (article 52d(4)(a) D-ISA, where an explicit clarification of the interaction with the above-mentioned article 52d(3)(b) D-ISA might be helpful). The process then follows the (quasi-inverse) ranking of creditors according to article 219(4) DEBA. Insurance contracts for which no tied assets have to be established, are converted or reduced after exhaustion of other receivables of third parties in class 3 and before those in class 2. Lastly, those insurance contracts will be included in the conversion or reduction process for which tied assets are required, to the extent they do not suffice to secure the claims (see p. 55 f. of the Dispatch, evidencing that the wording of article 52d(4)(f) D-ISA is likely to be aligned accordingly).

iii. Adjustment of terms of insurance contracts

Similarly, the restructuring plan should indicate whether the terms of insurance contracts should be adjusted. The conditions and ranking mentioned before apply also (article 52e D-ISA). Insurance contracts of different categories may be modified in a differentiated manner if this is in the overall interest of the insured persons. Such an overall interest is seen in providing a more important contribution to the restructuring than in case of equal treatment of all insurance contracts.

In case of *any one of the above-mentioned three types of restructuring measures* being put in place, insureds are notified within thirty days from the approval of the restructuring plan and are granted the right of termination within another three months with immediate effect. In case of a transfer of a portfolio, the insured may seek redress from the transferring insurance company (article 52f D-ISA).

If protective or insolvency measures are in place, FINMA may postpone the termination of contracts and the exercise of related rights for up to two days and the termination of reinsurance contracts or the exercise of related rights for up to four months (article 52g and 52h D-ISA).

c) Approval of the restructuring plan and effects

FINMA will approve the restructuring plan according to article 52j D-ISA after assessing, among other elements, whether the assets and liabilities and the financial needs for a successful restructuring are prudently valued, whether the creditors are not worse off than in an immediate bankruptcy (in application of the principle of "No creditor worse off than in liquidation, NCWOL"), and whether the creditors are treated more favourably than the owners.

The owners do not have to consent or support the restructuring plan, but at least 50% of the known creditors are required to support it. In case more than 50% of the known creditors reject the plan, FINMA immediately proceeds to bankruptcy (article 52k D-ISA).

Once the restructuring plan becomes effective, the insurance company (or creditors, if the insurance company is not permitted to do so) may seek frustration of certain transactions according to the rules of articles 285-292 DEBA (article 52m D-ISA). When the restructuring has been completed, the insurance company must in principle again comply with its licensing conditions and further legal requirements (insofar as the company will remain a going concern, articles 52b(2) and (3) D-ISA).

3) Bankruptcy

To the extent an insolvency risk exists and a restructuring is either not in reach or failed, FINMA will withdraw the license to do insurance business, declare bankruptcy and inform the public accordingly (articles 53 ff. D-ISA).

The bankruptcy liquidator(s) nominated by and reporting to FINMA direct the bankruptcy proceedings. The bankruptcy proceedings follow in principle the article 197-270

DEBA, subject to ISA's prevailing rules or FINMA issuing differing pronouncements (article 54 ISA). The articles 53-59 ISA are complemented by the Ordinance of FINMA on the bankruptcy of insurance companies of 17 October 2012 (SR 961.015.02). A representation of the creditors, if applicable with an executive committee, may be established to interact with the liquidator(s) (article 54b ISA).

Article 54a(1) D-ISA clarifies that claims of insureds are allocated to the priority class 2 according to article 219(4) DEBA. However, they will only be satisfied after the other claims in class 2 have been satisfied. Super-priority is given to the satisfaction of claims the insurance company has entered into based on protective measures or during the restructuring with the consent of FINMA (article 54b^{bis} D-ISA).

The proceeds of the sale of tied assets are primarily applied to satisfy the claims to be covered by tied assets. The surplus will be utilised to satisfy insurance claims for which separate pools of tied assets were formed but did not suffice. The remainder following these steps is allocated to the bankruptcy estate (article 54a^{bis} D-ISA). The proceeds are usually distributed at the end of procedure, but, under certain conditions, they can be paid out before the completion of the collocation proceedings (articles 54a^{bis} D-ISA and 54c ISA).

Once all assets are liquidated and liabilities are established the liquidator(s) submit to FINMA the final distribution list and the definitive accounts. The approval of FINMA is publicly disclosed and creditors and owners are informed accordingly (article 54c ISA).

4) Complaints

Complaints can be brought by creditors and owners against the approval of the restructuring plan, the liquidation, the approval of the distribution list and the final accounts (article 54e D-ISA). In case of complaints against the restructuring plan, they can only claim relief that may be honoured in the form of shares or surrogates thereof (article 54d D-ISA).

5) International coordination

Foreign bankruptcy decrees and insolvency measures may be recognized by FINMA (article 54i D-ISA). Domestic assets can be attributed to the foreign bankruptcy if the priority claims and insurance claims covered by tied assets of creditors domiciled in Switzerland are treated equivalently, and other claims of Swiss domiciled creditors are adequately being taken into account. Details follow the rules of the Federal Act on Private International Law (PIL, SR 291). In case of concurring proceedings, FINMA is expected to coordinate as much as possible with the foreign proceedings (article 54j D-ISA).

6) Conclusion

The proposed regime for insurance companies in financially distressed situations is not debated intensively (ISA Consultation – Results Report 2020, p. 5 f. <https://www.newsd.admin.ch/newsd/message/attachments/63362.pdf>). The draft mainly serves to close gaps regarding restructuring including bankruptcy, and, to a certain extent, align the insurance regulatory regime with the banking regulations. Therefore, in restructuring proceedings even those parts of the claims of insureds that should be covered by tied assets, but where the tied assets do not suffice are included in the regime of conversion or reduction of debt. This could have been handled differently by excluding insurance claims subject to tied assets requirements from the conversion and reduction mechanisms entirely.

In the upcoming parliamentary process, some provisions may undergo select changes, but the substance seems to be reasonably stable. Given the parliamentary deliberations starting in 2021, the revised ISA might enter into force of law in the next few years.

Monica Mächler (monica.maechler@lawreg.ch)

Prospectuses without Pricing Information

Reference: CapLaw-2021-03

Annexes 1 and 2 of FinSO require the indication of at least a maximum price in the prospectus. There are many situations where that is not adequate. This contribution shows that there is no need to apply the annexes of FinSO word by word, but that there is interpretative leeway. In that setting, article 41 FinSA that provides the review body the power to grant exemptions has mainly the function of granting certainty over and above the interpretation of the checklists.

By Matthias Courvoisier

Article 50 (1) of the Financial Services Ordinance (FinSO) provides that a prospectus for securities must contain the minimum information stipulated in Annexes 1–5 of FinSO. Annex 1 for equity securities and Annex 2 for debt securities provide that if the final issue price cannot be stated in the prospectus, the prospectus needs to indicate the maximum issue price.

Now, there are many situations where prospectuses do not even contain the maximum issue price. That is for example often the case in bond offerings where the preliminary prospectus available at the time of marketing the offering contains very little or no pricing information. The same is true in case of at-market rights offerings where the offer price is only determined in the (often) so called international offering that only occurs or still continues after the end of the rights offering period. The reason for not even providing a maximum interest rate in bond offerings or maximum issue prices in such equity offerings is that such maximum prices have no function in the particular situation. The market produces a market price. Setting a maximum price would condition this market which would at best interfere with the price setting at a proper market price. Of course, one could set the price artificially high, but such price setting apparently makes no sense. It is neither a proper guidance nor a protection for investors. In the IPO situation, where a price range is set, the situation is considerably different. In an IPO there is usually no previous pricing information, be it in the form of a rating or in the form of trading prices, available. The upper and the lower band result from the pricing information received by the banks in the pilot fishing exercises and from the discussions with analysts as well as own pricing considerations. Here, the market is provided valuable information it would otherwise not have. The setting of a maximum price is also no protection for investors. Even if they cannot set a maximum price by themselves, they are protected by the fact that a market price will result from a proper offering of the securities.

This shows that there is an apparent gap between practice and what the mentioned Annexes of FinSO provide.

This gap results from the inherent problem of checklists if they become part of the law. Checklists are precise, but also inflexible. The Annexes of FinSO aim at specifying article 40 (1) of the Financial Services Act (FinSA) that provides that the prospectus needs to contain the information that is material for the decision of the investor and lists very general categories of information. The checklists of the Annexes are however by nature not made such that they would fill the gap between very general terms and specific items on the list. No one has thought about all the various situations where the checklist items have no function or those situations where it is even detrimental to provide the respective information. That problem can be tackled in two ways: either by interpretation or by applying article 41 FinSA that allows the review body to provide for exemptions. It is also possible to combine the two approaches.

The way through interpretation recognizes the nature of the checklists as described above and allows the correction of the checklist by interpretation in the specific situation. This is based on article 40 (1) FinSA which provides that the prospectus needs to contain information material for the decision of the investors and article 46 (c) FinSA that requires that when specifying the minimum content of the prospectus, the Federal Council needs to take into account the specific properties of the issuers and the securities. In other words, where the specific requirements have not been taken into account one must have the possibility to deviate from the specific item of the Annex. It is not required to argue that in this specific situation the Federal Council overstepped its competence to determine the minimum content of a prospectus. It is sufficient to recognize that precise checklists have their inherent limitations and need to be treated with flexibility, thereby always keeping the general provision of article 40 (1) FinSA in mind. That is also the way jurisdictions that appear to be much more prescriptive than Switzerland deal with their provisions that are too detailed. At hand, the specific type of offer does not require the indication of a maximum price and that such indication would even be counterproductive in the cases discussed. Therefore, the list has to be interpreted such that it does not require that maximum pricing information at the beginning of the offer is provided where this is not sensible.

The second route is through article 41 FinSA that allows the review body to grant exemptions mainly in case the disclosure would be detrimental to the issuer or the information would be of minor importance as in the case at hand the indication of a maximum price. In either case, no exemption may be granted for information that is material for the decision of the investors according to article 40 (1) FinSA. Against this background, article 41 FinSA appears as a provision designed for correcting situations where the application of the checklists contained in the Annexes of FinSO leads to undesired results. Interpreted in this way, article 41 FinSA could be understood as the formal way of handling the interpretative approach described above. That is however not correct since there are situations where a prospectus is published in connection with a public offer without the prior review by the review body. That is namely the case in bond issuances where the bank or securities trader confirmation according to article 51 (2) FinSA is sufficient and the review by the review body only occurs subsequently. Of course, one could in each case obtain a declaratory decision by the review body, but that appears not an appropriate procedure designed to allow the efficiency gains aimed at by article 51 (2) FinSA.

From our point of view, the two approaches exist together and are not strictly separated. The interpretative approach grants the required flexibility and helps the banks and securities traders to issue their confirmations according to article 51 (2) FinSA. It is also helpful for the review body since it does not have to grant special exemptions in each case, but can profit from some leeway for interpretation. On the other hand, article 41 FinSA gives the issuer certainty that it is not in breach of the regulations when it explicitly asks for and is granted an exemption. Needless to say that in case article 41 FinSA would be regarded as the formal way to handle the interpretative approach, the banks and securities trader confirmation pursuant to article 51 (2) FinSA could be granted even without a declaratory exemption based on article 41 FinSA provided the bank may reasonably expect that such exemption be granted.

Matthias Courvoisier (matthias.courvoisier@bakermckenzie.com)

Partial Revision of Circular 2016/7 "Video and Online Identification"

Reference: CapLaw-2021-04

On 16 November 2020, the Swiss financial markets regulator FINMA published details of the partial revision of circular 2016/7 on video and online identification. The notable changes relate to the use of biometric passport data and a clarification regarding the engagement of specialized third party service providers for remote client identification. The consultation period for the proposed changes has ended on 1 February 2021. The revised circular is expected to enter into force in mid-2021.

By Aline Anthenien / Katrin Ivell

1) Background

With ever growing digitalization, communication between financial intermediaries and their clients is increasingly taking place electronically via the internet and mobile devices. Recognizing this development, in 2016, the Swiss financial markets regulator FINMA responded to the demand for a technology-neutral design of its rules on client identification and issued a circular on video and online identification (the Circular). FINMA's stated aim was the interpretation of the due diligence requirements under the Swiss Anti-Money Laundering Act and its implementing provisions in the context of the digital provision of financial services. Subject to compliance with certain conditions, financial intermediaries were permitted to establish business relationships with customers by means of video transmission, which was thereby put on an equal footing with a personal meeting. In addition, various avenues were presented to facilitate the establishment of a business relationship via the Internet.

Almost two years after the Circular first came into force, FINMA issued a revised version. This was prompted by further technological developments and feedback from various financial intermediaries. For example, for online identification, requiring a transfer of funds from an account in the name of the customer at a bank in Switzerland was felt to be too restrictive. Therefore, under certain conditions, money transfers from countries with equivalent rules on the prevention of money laundering compared to Switzerland were also permitted, specifically from Liechtenstein and member states of the Financial Action Task Force (FATF), whose core tasks include the drafting of international standards to combat money laundering and the financing of terrorism and proliferation.

Another point of criticism of the original Circular was that the requirement to abort the online and video identification process in the event of indications of increased risks. Therefore, in the course of the first revision, the continuation of the identification process was generally permitted even in the presence of increased risks. In addition, it was no longer required to verify the contracting party by means of a Transaction Authentication Number (TAN) or similar methods. This circumstance was compensated by increased requirements regarding the verification of the identification document.

2) New Rules

As a result of yet further technological advances and renewed proposals for amendments and clarifications from the financial industry, FINMA felt compelled to revise the Circular again in 2020. The revised Circular is designed to address two aspects in particular: On the one hand, fully automated online identification using a biometric passport is to be made possible. On the other hand, the Circular contains a helpful clarification regarding the involvement of specialized service providers.

With regard to fully automated online identification, the financial intermediary should now be able to waive the requirement to have money transferred from an existing bank account in order to verify the customer's identity if relevant data can be read from the chip of the biometric passport. The data contained on the chip is to be scanned by the customer using a smartphone app, and personal details and a photo (but no other biometric data) are to be transmitted to the financial intermediary. In addition to obtaining the data, its authenticity and integrity must also be checked. For this purpose, certificates required for checking Swiss passports can be obtained from the website of the Federal Office of Information Technology, Systems and Telecommunication. For international biometric passports, FINMA refers *e.g.* to the master lists of the International Civil Aviation Organization (ICAO).

In FINMA's view, dispensing entirely with additional security measures for online identification (such as using biometric passport data or a bank transfer) would reduce the security level of digital onboarding and facilitate abuse, especially since automatic facial recognition is still heavily dependent on external influences and attempts at abuse are higher in the digital environment compared to face-to-face customer meetings. In support of this argument, FINMA refers to various Suspicious Activity Reports submitted to the Swiss Money Laundering Reporting Office MROS as a result of suspected use of forged or false IDs in the area of digital onboarding.

With regard to the involvement of service providers, the revised Circular contains the following clarification: According to FINMA, financial intermediaries often do not carry out video and online identification themselves, but commission specialized service providers to do so. However, if a financial intermediary has already engaged another financial intermediary to fulfill the identification obligations (*e.g.* in the constellation of a custodian bank and an external asset manager, where the external asset manager often performs the identification obligations for the custodian bank), the financial service provider so engaged was previously prohibited from engaging additional third parties to fulfill its obligations. The Circular now specifies that if a financial intermediary commissions another financial intermediary with client identification and if this financial intermediary in turn engages a specialized service provider, the involvement of the latter is permitted.

However, FINMA has not included in the revised version of the Circular the request for an explicit rule that the signature of the contracting party on the form that declares the beneficial owner does not have to be handwritten when the beneficial owner is identified digitally. In FINMA's opinion, its practice on the digital identification of the beneficial owner is already sufficiently clearly stated elsewhere. It states that the declaration of beneficial ownership can be completed electronically by the contracting party using an online form provided by the financial intermediary and signed with a qualified electronic signature issued by a Swiss provider of certification services. Alternatively, under certain conditions, the signature can also be made via other electronic procedures. (Prior to the introduction of this practice, the beneficial ownership statement generally had to be signed by hand and physically delivered to the financial intermediary.)

3) Comment

The biometric passport was introduced in Switzerland in 2010 and has also been in use in large parts of the EU for some time. Identification by means of a biometric passport introduced with the revision of the Circular is thus based on proven technologies and uses the experience gained in handling biometric data. FINMA's insistence on some form of additional safeguards for online identification is understandable, particularly with regard to the uncertainties that still exist in the use of automatic facial recognition. However, while offering an additional means to safeguarding security by allowing financial intermediaries to use biometric passport data is generally to be welcome, time will tell whether this type of identification is in fact more practicable and efficient compared to the verification of identity by other means.

The current pandemic situation shows that rapid technological advances are possible and, above all, that the digitization of work is accelerating. Since the majority of communication in all areas takes place via the Internet, the possibility of electronic identification of customers by financial intermediaries has gained additional importance. Against this background, the partial revision of the Circular is to be welcomed overall.

Interested parties were invited to comment on the revised Circular until 1 February 2021. The results of the consultation will be published thereafter, and the revised Circular is expected to enter into force in mid-2021.

Aline Anthenien (aline.anthenien@homburger.ch)
Katrin Ivell (Katrin.ivell@homburger.ch)

Transparency on Climate-Related Financial Risks

Reference: CapLaw-2021-05

Climate (as well as other ESG topics) is high up on the agenda since countless years, including for financial institutions, and has now also reached the average investor's attention and Swiss financial market regulation. In addition to long-established voluntary standards and private initiatives, FINMA plans to revise its circulars on public disclosure for climate-related financial risks of banks and insurers in line with these standards.

By Benjamin Leisinger

1) Background – Not a "New" Topic

a) International Background

Long before Greta Thunberg became a household name and green or ESG bonds made their way into retail investors' portfolios, political and business leaders around the world realized that climate and climate-related risks become increasingly important. In April 2015, the G20 Finance Ministers and Central Bank Governors asked the Financial Stability Board (FSB) to review how the financial sector can take account of climate-related issues. The FSB identified the need for better information to support informed investment, lending, and insurance underwriting decisions and to improve understanding and analysis of climate-related risks and, in December 2015, established the Task Force on Climate-related Financial Disclosures (TCFD) for this purpose. The initial members included representatives from various organizations, including large banks, insurance companies, asset managers, pension funds, large non-financial companies, accounting and consulting firms and credit rating agencies. In 2017, after numerous drafts and consultations, the TCFD released its climate-related financial disclosure recommendations designed to help companies provide better information to support informed capital allocation. The recommendations were endorsed by over 100 business leaders, including some Swiss large companies and financial institutions, from the beginning. To make the recommendations work in practice, the TCFD and the Climate Disclosure Standards Board (CDSB) in May 2018 announced the launch of a platform with relevant insights, tools and numerous resources on quality climate-related disclosures in line with the recommendations of the TCFD – called the TCFD Knowledge Hub (tcfdhub.org). According to the 2020 status report of the TCFD, 1,500 organizations globally, including over 1,340 companies with a market capitalization of USD 12.6 trillion and financial institutions responsible for assets of USD 150 trillion now support the TCFD.

This is just one example for an international initiative to address climate-related risks. Other initiatives include the Coalition of Finance Ministers for Climate Action, the International Platform for Sustainable Finance or the Network for Greening the Financial System (NGFS).

Some European jurisdictions, notably France or the UK, have issued regulation or regulatory expectations, respectively, for disclosing and/or managing the financial risks from climate change.

b) Switzerland

Also in Switzerland, climate and climate-related risks have been on the political and regulatory agenda for many years. After closely following the activities of the NGFS, a network of international central banks and supervisors committed to better understanding and managing the financial risks of climate change, since its launch in 2017, FINMA joined the NGFS in April 2019. In its Risk Monitor 2019, FINMA identified financial risks arising from climate change as one of the most important long-term risks and announced that it will refine its analyses of climate-related risks in the balance sheets of financial institutions and develop approaches for improved voluntary or regulated disclosure of financial climate risks. FINMA has a separate "dossier" on green finance on its website (https://www.finma.ch/en/documentation/dossier/dossier-green-finance/), showing how high it is on its priorities list. In June 2020, the Swiss Federal Council adopted a report and guidelines on sustainability in the financial sector. Welcoming the Swiss Federal Council's initiative to examine the subject of sustainability and climate risks for the financial sector in further depth, FINMA already in June 2020 announced that it will address the subject of climate-related financial risks as part of its supervisory remit and review regulatory approaches for improved transparency regarding climate-related financial risks by major financial institutions.

2) FINMA's Proposal on Public Disclosure of Climate-related Financial Risks

From 10 November 2020 until 19 January 2021, FINMA consulted on a partial revision of the FINMA-Circulars 2016/1 and 2016/2 for public disclosure of banks and insurers, respectively. The proposed new disclosure requirements are largely based on the TCFD framework and build on, or continue, the initiatives and publications of FINMA in earlier years.

The proposal states to follow the principle of proportionality in regulation and only defines minimum requirements from a supervisory perspective. In addition, the scope of application is limited to supervisory categories 1 and 2 (*i.e.*, for banks internationally active systemically relevant banks (G-SIB) and non-internationally active systemically relevant banks (D-SIB)).

a) How to Define Climate-related Financial Risks?

The FINMA proposal addresses the question of how climate-related financial risks should be defined: There is, however, no uniform definition of what a climate-related financial risk is. Typically, they are merely categorized into two types, also by the Basel

Committee on Banking Supervision or the International Association of Insurance Supervisors as well as the TCFD. FINMA also follows these categories:

1. *Physical risks*: Due to climate-related natural disasters and gradual changes in the climate, there is a threat of increased damage to the economy. Climate change can thus lead, for example, to unexpected, increased loss amounts for insurance companies. Physical risks in the form of landslides or decreasing snowfall in mountain and ski resorts can affect banks' mortgage portfolios and credit risks, even despite insurance coverage. Business interruptions at key service providers in exposed regions can cause cross-sector failures (operational risks).

2. *Transition risks*: Financial institutions may also be indirectly affected by intervening climate policy measures, changing customer preferences or disruptive technological breakthroughs. Changes in the framework conditions or new political requirements (*e.g.*, CO^2 levies, emissions standards) can trigger asset price adjustments and be reflected in the market risk of banks and insurance companies. Credit risks can also be affected if stricter energy efficiency standards increase default risks in the mortgage business and at the same time cause losses in the value of real estate. The creditworthiness of companies in "unsustainable" sectors (*e.g.*, coal and oil industries) may decline and counterparty default risks under credit risk may increase significantly. It cannot be ruled out that the markets will price in transition risks late, but then with strong adjustments. Corresponding losses may affect the profitability of banks (asset side of the balance sheet), asset managers and insurance companies, for example.

The FINMA proposal acknowledges that climate-related financial risks, hence, do not introduce a new risk category but rather are a new risk driver that can be captured and managed in the traditional risk categories such as credit, market, insurance or operational risks. In principle, financial institutions can build on their existing risk management.

b) Specific Aspects to be Disclosed

The proposal contained four general aspects that should be disclosed: governance, strategy, risk managements and relevant metrics.

The ***governance*** aspect of the disclosure requests that the institutions describe how the board of directors exercises its overall supervision with regard to climate-related financial risks. According to FINMA, it is the management bodies and the responsibilities and reporting lines within the institution, which ultimately determine the quality and extent to which climate-related financial risks are addressed ("Tone From the Top").

As to ***strategy***, the identified "material" climate-related financial risks shall be disclosed, *i.e.*, short-, medium- and long-term risks and their qualitative and quantitative impact on the business strategy, business model and financial planning. The disclosure must indicate which time periods are used as short-, medium-, and long-term.

The ***risk management*** related disclosure focuses on the process for identifying, assessing and addressing climate-related financial risks.

With respect to ***metrics***, the quantitative information (ratios and targets) on climate-related financial risks and the methodology used to measure them shall be disclosed.

It follows from the principle-based regulation that the financial institutions intentionally retain sufficient flexibility to implement the disclosure in concrete terms, taking into account their size, complexity, structure, business activities and risks. The institutions themselves must then determine to a large extent how detailed their reporting should be or how it should be integrated into their annual report or the report on the financial situation, *e.g.*, under the existing risk categories or as a separate chapter. The intention of FINMA is that the structures of current reporting, the conventional formats and data systems already used by the supervised entities should be leveraged and be used as a basis.

Where applicable, disclosure should be made at the level of the individual institution (stand-alone) and at the group consolidated level as for other risks. To avoid introducing additional burdens, the exceptions and exemptions applicable under current banking and insurance supervisory practice (*e.g.*, reference options within group disclosures) also apply.

c) Criteria for Determining Materiality

The explanatory report of FINMA emphasizes that in banking and insurance regulation, disclosed information should be relevant/material. As a result, also as per the FINMA proposal, institutions are only required to disclose material risks.

In the case of climate-related financial risks, however, the criteria and valuation methods used to assess the materiality of their climate-related financial risks must be disclosed in line with the TCFD framework in every case. To prevent institutions from making a blanket statement that they have no material risks, in FINMAs words "perhaps too quickly or without serious consideration of the issue", this also applies in particular in the event that an institution classifies its climate-related financial risks as not material and thus not subject to disclosure requirements. According to the explanatory report, this special feature is justified in the case of climate-related financial risks in particular because there is as yet no firmly established, standardized or internationally recognized methodology for recording these risks. If such standards are recognized and defined in the future, financial institutions can simply reference them in their disclosure if applied by the respective financial institution.

Until then, according to the explanatory report, disclosing the criteria and valuation methods used, promotes comparability among institutions and market discipline in disclosure.

3) Effects on the Covered Financial Institutions

In the explanatory report, FINMA confirms that the majority of the covered institutions in Switzerland (supervisory categories 1 and 2) have already committed themselves to disclose their climate-related financial risks in accordance with the principles of the TCFD. Notwithstanding this, FINMA observed significant differences in the implementation and maturity of this disclosure. The new proposed minimum requirements in the FINMA-Circulars are, accordingly, mainly intended to lead to improvements in the quality of these disclosures and, in the longer term, to a certain degree of comparability of the information disclosed.

The proposals did not come as a surprise to the covered financial institutions. FINMA undertook a preliminary consultation with stakeholders and interested parties before. According to the explanatory report, in this preliminary consultation, various parties also called for the introduction of mandatory disclosure of quantitative information as being of particular relevance for investors. Because of such requests, FINMA now included these metrics (quantitative information (ratios and targets) on climate-related financial risks) in its consultation draft. FINMA, however, highlighted that institutions remain completely free to choose the methods, models and data used behind such quantification for the time being – *i.e.*, likely until there is an established international standard.

4) Further ESG Topics Noted by FINMA

In addition to the disclosure of climate-related risks, FINMA – as a noteworthy side note – also mentions in the explanatory report for the consultation that it is concerned with the risks of so-called *green-washing* in the provision of financial services and distribution of financial products. According to FINMA, from the perspective of client protection, financial institutions must not mislead clients or investors with untenable or misleading promises about "green" features, for example in the case of investment products. Even without FINMA explicitly mentioning this, issues such as prospectus liability, contactual duties, general regulatory duties, and/or rules of the unfair competition act also demand that this is adhered to.

Benjamin Leisinger (benjamin.leisinger@homburger.ch)

The Carlyle Group to acquire the Acrotec Group

Reference: CapLaw-2021-06

On 7 December 2020, the global investment firm The Carlyle Group announced that it has agreed to acquire the Acrotec Group, in partnership with its management team, from Castik Capital. The transaction is subject to regulatory approvals and is expected to close in Q1 2021. The Acrotec Group is a leading independent supplier of high precision industrial applications to the watchmaking and MedTech industries as well as other high value industrial end markets, such as Automotive, Electronics and Aerospace. The Acrotec Group employs approximately 1,200 people across 18 locations and exports to over 40 countries. Leveraging Carlyle's global Healthcare expertise and network, the partnership will seek to broaden Acrotec's MedTech business with expansion into new services and geographies in Europe and in the United States.

FE fundinfo acquired CSSP

Reference: CapLaw-2021-07

On 7 January 2021, FE fundinfo, a leading fund data and technology provider, announced that it expanded its environmental, social and governance (ESG) capabilities with the acquisition of the Liechtenstein based Center for Social and Sustainable Products AG (CSSP). FE fundinfo acquired all of CSSP's share capital, including its yourSRI.com platform which provides ESG screening and labels on thousands of funds.

Credit Suisse Group AG Issuance of EUR 3 billion bail-inable notes

Reference: CapLaw-2021-08

On 11 January 2021, Credit Suisse Group AG launched, and on 18 January 2021, successfully completed, the issuance of (i) EUR 1.5 billion aggregate principal amount of Floating Rate Senior Callable Notes due January 2026 and (ii) EUR 1.5 billion aggregate principal amount of 0.625 per cent. Fixed Rate Senior Callable Notes due 2033 under its Medium Term Note Programme. The respective notes are bail-inable bonds that are eligible to count towards Credit Suisse's Swiss gone concern requirement.

Strateo sells and transfers its online trading business and client base to Saxo Bank Switzerland

Reference: CapLaw-2021-09

In January 2021, Strateo, the Swiss branch of Arkéa Direct Bank, has signed an agreement to sell and transfer its online trading business and client base in Switzerland to Saxo Bank Switzerland. The transaction and migration of the clients and their assets are expected to be completed by the end of the first quarter of 2021.

EFG International successfully issues USD 400m inaugural AT1 bonds and repurchases outstanding Tier 2 bonds

Reference: CapLaw-2021-10

On 25 January 2021, Swiss global private banking group EFG International successfully issued USD 400 million inaugural perpetual Additional Tier 1 bonds. The AT1 bonds, which were issued at par, carry a coupon of 5.5 per cent. for the first seven years, after which a redemption option can be exercised. The AT1 bonds are listed on SIX Swiss Exchange. After a short book-building process the order book exceeded USD 4.7 billion.

IPO of NLS Pharmaceutics with a listing on Nasdaq

Reference: CapLaw-2021-11

On 28 January 2021 NLS Pharmaceutics Ltd. priced its USD 20m IPO of 4,819,277 units with each unit consisting of one common share and one warrant to purchase one common share which are immediately separable from the units and issued separately. The common shares and the warrants have been approved for listing on the Nasdaq Capital Market under the symbols "NLSP" and "NLSPW", respectively, and trading began on 29 January 2021. The offering closed on 2 February 2021. Headquarted in Stans, Switzerland, NLS Pharmaceutics Ltd. is a clinical-stage pharmaceutical company focused on the discovery and development of innovative therapies for patients with rare and complex central nervous system disorders.

4th Conference on Distribution Contract Law in Practice *(4. Tagung zum Vertriebsvertragsrecht in der Praxis)*

17 March 2021, Metropol, Zurich (or Live-Stream)

https://www.eiz.uzh.ch/EIZ/CustomUpload/374035703400370035603690350032403720369036603670352032803650370037103600371037203710352036503550356036903400365036000/20210317_Seminarprogramm_Vertriebsvertragsrecht_Webseite.pdf

18th Zurich Stock Corporation Law Conference – Freedom of design in stock corporation law *(18. Zürcher Aktienrechtstagung – Gestaltungsfreiheit im Aktienrecht)*

30 March 2021, Metropol, Zurich (or Live-Stream)

https://www.eiz.uzh.ch/EIZ/CustomUpload/374035703400370035603690350032403720369036603670352032803650370037103600371037203710352036503550356036903400365036000/20210330_Seminarprogramm_Aktienrecht_Website_1.pdf

FinTech 6.0 – Die Cloud

31 March 2021, Metropol, Zurich (or Live-Stream)

https://www.schulthess.com/download/Seminarprogramm_FinTech_6_31.03.2021_website.pdf?FILE=3G9QJVRD4T2U.pdf