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Recent developments on the way to an EU Green Bonds Standard

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This article provides an overview of the Green Bond Regulation proposed by the EU Commission in June 2021 and the most recent developments as the Commission's proposal makes its way through the EU legislative process, in particular the draft report published by the rapporteur of the European green bond dossier at the EU Parliament in December 2021, which includes some fundamental changes, together with their analysis by the International Capital Markets Association (ICMA) in a report published in January 2022.

By Daniel Bono / Giulia Ghezzi

1) Introduction

In a global market that is getting more and more focused on climate change awareness and environment protection, the market for green bonds increased over the past years and with it the need for establishing market standards at the international level. This resulted in the establishment of market-based green bond standards such as the green bond principles (the **ICMA Green Bond Principles**) supported by the International Capital Markets Association (ICMA), and Climate Bonds Initiative's Climate Bond Standards.

On 6 July 2021, the European Commission published a legislative proposal for a regulation to create a European Green Bond Standard (EUGBS) (the **EU Green Bond Proposal**) together with its renewed Strategy for Financing the Transition to a Sustainable Economy. The European Green Bond Standard would be part of the EU's measures to achieve carbon neutrality by 2050 through the EU Green Deal and has the potential to become the new "gold standard" for green bonds.

While the EU Green Bonds Proposal is based on and designed to be compatible with existing market-based standards, which reflect market best practice, it would go further in certain key aspects, in particular by requiring alignment with the EU's taxonomy for sustainable activities (EU Taxonomy Regulation (EU) 2020/852, the **EU Taxonomy Regulation**), a classification system aimed at giving capital markets an agreed, scientifically reliable view of environmentally sustainable activities, and by requiring registration and supervision of external reviewers by the European Securities and Markets Authority (ESMA).

In October 2021, the European Union issued its first EUR 12 billion green bond to finance member states' environmentally beneficial projects as part of its COVID-19 recovery fund. Thirty percent of the EU's up to EUR 800 billion COVID-19 recovery scheme will fund environmentally beneficial projects.

2) Overview of the EU Green Bond Proposal

a) Overview

The EU Green Bond Proposal notes that despite vigorous market growth, the issuance of green bonds remains a fraction of overall bond issuance, representing about 4% of overall bond issuance in 2020 and that various existing initiatives for environmentally sustainable bonds do not ensure common definitions of environmentally sustainable economic activities. It also notes that diverging rules on the disclosure of information, on the transparency and accountability of external reviewers reviewing environmentally sustainable bonds, and the eligibility criteria for eligible environmentally sustainable projects, impede the ability of investors to identify, trust, and compare environmentally sustainable bonds, and the ability of issuers to use environmentally sustainable bonds to transition their activities towards more environmentally sustainable business models.

b) Voluntary standard

To address the above mentioned concerns, the EU Green Bond Proposal seeks to provide the basis for a common regulatory framework for the use of the *'European green bond'* or *'EuGB'* label for bonds that finance environmentally sustainable activities within the meaning of the Taxonomy Regulation. As proposed, the EU Green Bond Proposal would create a voluntary standard. This standard would co-exist with existing market standards (notably the ICMA Green Bond Principles). The EU Green Bond Proposal intends to create a 'gold standard' for green bonds that would also be available to issuers outside the EU. As proposed, the standard would be open to corporations, sovereigns and financial institutions as well as issuers of covered bonds and asset-backed securities.

c) EU Taxonomy Alignment and Grandfathering

A key feature of the EU Green Bond Proposal is its alignment with the EU Taxonomy Regulation by requiring that the proceeds of the bonds must be used for environmentally sustainable activities that meet the requirements of Article 3 of the EU Taxonomy Regulation in effect at the time the bonds are issued, specifically in accordance with the technical screening criteria established by the EU Commission under the EU Taxonomy Regulation (**TSCs**) by the time the bonds mature.

In the event of a change in the TSCs, there is a grandfathering provision that allows issuers to use the TSCs applicable at the time of the bond issuance for five years. The EU Green Bonds Proposal also supports issuers in a transition to environmental sustainability, as European green bonds can be used to fund long-term projects (up to ten years) to align an economic activity with the EU Taxonomy Regulation.

d) Transparency, External Review and ESMA Supervision

Other key aspects of the EU Green Bonds Proposal include transparency requirements and the requirement for review by an external reviewer to verify that bonds comply with the EU Green Bonds Proposal, in particular for alignment of the funded projects with the EU Taxonomy Regulation. External reviewers must be registered with and are supervised by the European Securities and Markets Authority (ESMA) and will be required to meet the conditions for registration on an ongoing basis.

The transparency requirements include the publication of (i) an European green bond factsheet together with a pre-issuance review by an external reviewer before the bonds are issued to the public, (ii) an annual report on the allocation of proceeds until full allocation thereof and (iii) an impact report at least once during the life of the bond. Issuers are also required to obtain post-issuance review by an external reviewer of the first allocation report after full allocation of the bond proceeds.

3) Amendment Proposals for the EU Parliament and associated ICMA Analysis

a) Overview

In December 2021, the rapporteur of the EU Green Bond Regulation file at the European Parliament released a draft report containing certain proposed amendments to the EU Green Bond Proposal (the **Amendment Proposal**), which, if adopted as proposed, would in some respects represent a fundamental shift from the EU Commission's Green Bond Proposal. In response, ICMA published a report in January 2022 entitled *"Analysis of the amendments to the EuGB Regulation proposed by the Rapporteur of the EU Parliament"* (the **ICMA Analysis**). The most consequential proposed amendments and the associated ICMA Analysis are described below.

b) Unintended consequences of a mandatory standard

While the EU Commission has proposed a voluntary green bond standard that is intended to set the "gold standard" for the most high-quality green bonds while also co-existing with established green bond market standards, most notably the ICMA Green Bond Principles, the Amendment Proposal requires the EU Commission to establish by December 2023 the deadline and practicalities for the mandatory adoption of the EU Green Bond Regulation between 2025 and 2028.

A mandatory application of the EU Green Bond Regulation has raised legitimate concerns among market participants. The ICMA Analysis noted that this is completely at odds with the approach proposed by the EU Commission and the various expert groups representing market participants and stakeholders that have contributed to the EU Green Bond Standard. It could cause unintended negative consequences such as market fragmentation, migration to other markets and contraction of the green bond market as issuers may decide to switch to traditional (non-sustainable) capital market or bank funding sources. In addition, the ICMA Analysis notes that in 2020, over 95% of green bonds globally were aligned with the ICMA Green Bond Principles with voluntary commitments to disclose use of proceeds, provide allocation and impact reports and use the services of external reviewers. Therefore, as a mandatory framework, the EU Green Bond Regulation may hinder rather than promote the growth of the green bond market.

c) Expansion to all types of sustainable bonds may discourage issuers

While the EU Commission's proposal focused exclusively on environmentally sustainable "green" bonds, the Amendment Proposal would expand the scope of the EU Green Bond Regulation to all types of sustainable bonds (including social bonds, sustainability bonds and sustainability-linked bonds) as of its entry into force. The ICMA Analysis noted that the Amendment Proposal would fundamentally change the liability and cost incurred by issuers of sustainable bonds in the European market and that while the stated intention is to improve transparency and integrity of the sustainable bond market, the most likely and unintended outcome would be to discourage issuers from using it.

d) More stringent rules for Taxonomy alignment plans may increase liability and reputational risks

The Amendment Proposal includes more stringent rules for Taxonomy alignment plans. Among other things, these amendments include a requirement for Taxonomy alignment plans in relation to European green bonds to be based on annual interim targets, which would be subject to an annual external review. Moreover, failure to meet these targets twice would result in loss of the European green bond designation and issuers may face administrative sanctions and actions for failing to adhere to Taxonomy alignment plans. In addition, the Amendment Proposal would require a mandatory assessment of Taxonomy alignment for all sustainable bonds by external reviewers (before and after issuance). The ICMA Analysis notes that the associated increase in liability and reputational risks would be very likely to deter the issuance of European green bonds.

4) Outlook

The EU Commission's EU Green Bonds Proposal is currently being considered by the EU Parliament and the EU Council as co-legislators. Once both co-legislators have agreed their positions, interinstitutional negotiations will commence. Although the exact timing of these further steps in the EU legislation process is not clear yet, further developments of the EU Green Bonds Standard are likely in the first half of 2022.

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SIX publishes revised notice regarding the fulfilment of the disclosure obligations in capital increase transactions and simplified disclosure of lock-up groups

Reference: CapLaw-2022-02

On 1 February 2022, SIX Exchange Regulation (SER) published a revised version of the Disclosure Office Notice I/09 (Notice I/09) confirming its practice on the disclosure obligations regarding subscription rights and lock-up groups, but overhauling the easing provisions relating to the disclosure of relevant positions of both underwriters and lock-up groups in the prospectus.

By Alexander von Jeinsen / Benjamin Leisinger

1) Background

Pursuant to article 120 of the Financial Market Infrastructure Act (FMIA) anyone who directly or indirectly or acting in concert with third parties acquires or disposes of shares or acquisition or sale rights relating to shares of a Swiss listed company and thereby reaches, falls below or exceeds certain thresholds starting at 3% of the voting rights must notify this to the issuer and to the relevant stock exchange on which the equity securities are listed. Certain market practices in Swiss equity capital markets transactions result in recurring questions how these practices have to be handled in light of this disclosure obligation. These are namely:

- the Swiss corporate law requirement that shareholders receive subscription rights in capital increase transactions unless these are excluded on the basis of a shareholder vote by a qualified majority,

- the role of the underwriter syndicate in certain equity capital markets transactions and

- the Swiss market practice that parallel (vertical) lock-up undertakings result in the formation of a group of shareholders for purposes of article 120 FMIA (cf. article 12(1) of the FINMA Financial Market Infrastructure Ordinance (FMIO-FINMA)).

2) Former practice

In 2009, SER published a notice establishing a balanced and uniform handling of these questions; the notice was amended in 2018. In summary, until 1 February 2022, the following applied:

- Neither shareholders nor issuers had to notify the market or otherwise disclose a right to acquire / the obligation to issue shares stemming from the granting of subscription rights. Consequently, neither the sale of such subscription rights nor an undertaking to exercise them triggered any disclosure obligation under article 120 FMIA. However, an acquisition of subscription rights (as well as the subsequent sale of acquired subscription rights), triggered a disclosure obligation, if the resulting purchase or sale position reached, fell below or exceeded any of the relevant thresholds.

- Underwriters could fulfill their disclosure obligations (if any) resulting from their involvement in a capital increase transaction in the prospectus and the issuer did not have to publish the information via the publication platform of the SIX Disclosure Office.

- Lock-up groups could also fulfill their disclosure obligations in the prospectus and, under certain circumstances, lock-up groups could forego the full disclosure of all group members.

3) Revised practice and outlook

In the revised Notice I/09, SER upheld the established practice regarding the disclosure of purchase and sale positions stemming from subscription rights and the easement that, under certain circumstances, not all lock-up groups need to be disclosed (which in recent transactions would otherwise have resulted in a disclosure of several hundred group members). However, apparently as a result of the entry into force of the new Swiss prospectus regime under the Swiss Financial Services Act (FinSA), the SIX Disclosure Office overhauled the general possibility for underwriters and members of lock-up groups to fulfill their disclosure obligations (if any) in the prospectus while at the same time indicating that case specific exemption or easing requests under article 26 FMIO-FINMA may be granted. The fear was that under the new prospectus regime in the FinSA, the power to regulate disclosure requirements in prospectuses has been taken away from the SIX Swiss Exchange as a listing venue and is now exclusively governed by the FinSA and its implementing ordinance – with the SER in its capacity as prospectus reviewing body (as opposed to its function as Disclosure Office) being mandated to review and approve. By partly overhauling the former regime, SER aborts a well-established market practice without increasing transparency for market participants (although SER itself will likely have more transparency on the groups). It is noteworthy that according to SER *"an important demand of the market is that (sub-) underwriters may disclose [relevant positions] in the prospectus and issuers can be exempted from the respective publication obligation"*. SER thereby offers standardized rates for the relevant exemption request.

It remains to be seen how market participants will react to the new regime, in particular since the currently most common forms of equity capital markets transactions do not involve an underwriting in the traditional sense by the participating members of the banking syndicate and "best efforts" transactions do not trigger a disclosure obligation under article 120 FMIA. A new market practice of repeated, almost identical exemption requests is certainly not in the interest of market participants (other than maybe the lawyers drafting them). The difficult challenge will certainly be to meet the deadlines of article 21 FMIO-FINMA to file an exemption request. The deadline is 15 trading days prior to the date triggering the disclosure duty so that the SIX Disclosure Office has 10 trading days time to decide on the exemption request and the Swiss Financial Market Supervisory Authority FINMA has 5 trading days to exercise its power to decide itself on the matter. Without the general possibility to disclose underwriters and lock-up groups in the prospectus, especially volume underwritings, e.g. in urgent recapitalization transactions, will have to be carefully timed without the option to get deal certainty by executing underwriting/purchase agreements early in the process.

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A few thoughts concerning Sparks and its chances of success

Reference: CapLaw-2022-03

Since 1 October 2021, small and medium-sized enterprises (SMEs) with a capitalization of less than CHF 500 million can list their shares on a new stock exchange segment of the SIX Swiss Exchange (SIX). The so-called Sparks segment of SIX offers more relaxed listing requirements compared to those of the main segment. It aims to open up the capital market in Switzerland for SMEs by developing a functioning public equity market specifically designed for them. The present article addresses mainly the capital requirements and provides some thoughts concerning Sparks and its chances of success.

By Matthias Kuert / Olivia Zingg

Since 1 October 2021, small and medium-sized enterprises (SMEs) with a capitalization of less than CHF 500 million can list their shares on a new stock exchange segment of the SIX Swiss Exchange (SIX). The so-called Sparks segment of SIX offers more relaxed listing requirements compared to those of the main segment. It aims to open up the capital market in Switzerland for SMEs by developing a functioning public equity market specifically designed for them. A listing on Sparks can be attractive for both, fast-developing SMEs, allowing them to raise the capital required to support their growth story, and established SMEs with stable revenues. The first Sparks listing took place just before we finalized the present contribution (Xlife Sciences AG on 11 February 2022).

After a short overview concerning Sparks (see in that regard also Christian Schneiter/ Peter Kühn, CapLaw-2021-59), we provide below a few calculation examples to illustrate the applicable capital requirements. A listing on Sparks is, from a legal perspective, more accessible than a listing on the main segment. However, the minimal market cap required in practice remains to be seen. We conclude that – while obviously a strenuous exercise – a going public on a regulated stock exchange such as Sparks may (still) be worthwhile, inter alia because of disciplining effects ultimately also beneficial to the business.

1) Overview of the listing requirements…

The Sparks segment is supposed to facilitate access to the capital market by way of lower listing requirements compared to the main segment. Under the SIX Listing Rules dated 21 October 2021 (LR) namely the following requirements must be fulfilled on the day of the listing:

A *market capitalization* of less than CHF 500 million (article 89a LR).

A *company track record* of more than two years (article 89b LR) and *audited financial statements in line with a recognized accounting standard for the last two financial years preceding the listing application* (article 89c LR). Recognized accounting standards are, mainly, US-GAAP, IFRS and Swiss GAAP FER (article 6 (4bis) Directive on Financial Reporting dated 19 August 2021).

A *reported equity capital* of more than CHF 12 million, of which at least CHF 8 million must come from a capital increase (contribution in cash) carried out in connection with the IPO. No capital increase is required in case of a reported equity of CHF 25 million or more (article 89d LR). The reported equity consists of all items that qualify as "equity" under the applicable accounting standard (article 89d LR). Absent an (in cash) capital increase, the necessary equity to be reported in the Sparks segment is the same as in the main segment (article 15 (1) LR, requiring – in any case – CHF 25 million).

Freely tradable shares (free float) of at least 15% of the outstanding shares (article 89e LR). The calculation of the free float is explained in article 4 of the Directive on the Distribution of Equity Securities dated 18 June 2021 (DDES), basically containing a negative definition (*i.e.* which shares are not to be counted towards the free float).

A *market capitalization of freely tradable shares* of more than CHF 15 million (article 89e LR). The relevant market capitalization is determined by way of the theoretical opening price (TOP) stated by the issuer for the opening of trading on the first trading day (article 5 DDES).

A *shareholder base* of at least 50 investors (article 89e LR).

In addition, issuers on Sparks must publish a prospectus according to the rules provided for in the Financial Services Act (FinSA; article 35 *et seqq.* FinSA; article 27 (1) LR). The relevant content of such prospectus is provided for in Annex 1 to the Financial Services Ordinance ("Minimum content of the prospectus scheme for equity securities").

2) …and the ongoing requirements for being public

Sparks companies are subject to almost the same ongoing listing requirements as companies listed on the main segment:

The duties concerning *financial reporting* (article 49 (1) LR), *ad hoc publicity* (article 53 LR) and *disclosure of management transactions* (article 56 LR) fully apply.

Issuers on Sparks are also obliged to *inform on corporate governance aspects* on a yearly basis (Directive on Information relating to Corporate Governance dated 18 June 2021 (DCG)). They can, however, fulfill this information duty with a template provided by SIX, which is not part of the annual report, but can be published separately, on the same day as the annual report (article 4 (2) DCG).

On an ongoing basis, the company must have an *average market capitalization of less than CHF 1 billion* (twelve months average). Exceeding this threshold involves a mandatory switch to the main segment (article 89f (1) LR).

Furthermore, the rules on *disclosure of major shareholdings* (article 120 *et seqq.* Financial Market Infrastructure Act, FinMIA), *public takeovers* (article 125 *et seqq.* FinMIA), *insider trading* (article 142 and 154 FinMIA) and *market manipulation* (article 143 and 155 FinMIA) are also relevant for issuers on Sparks. Eventually, issuers on Sparks have to comply with the *stock corporation law* provisions specifically applicable to listed companies. These concern, in particular, board and executive compensation (currently still contained in the Swiss Ordinance against Excessive Compensation in Listed Companies (OAEC)) and the possibility to introduce transfer restrictions (article 685d *et seqq.* of the Swiss Code of Obligations (CO)), as well as – in case of larger companies – gender equality (article 734f CO) and non-financial reporting (article 964a *et seqq.* CO).

3) Calculation examples (capital requirements)

The following calculation examples illustrate the implications of the above-mentioned thresholds on the minimal capital requirements for a listing on Sparks from a legal perspective. These requirements are compared with the requirements for a listing on the main segment.

The required market capitalization of the freely tradable shares is determined on the basis of the TOP on the first trading day (see above). Below, we assume that this (theoretical) price will correspond to the actual opening price and that shares will also be traded at this price on the day of the listing. The respective market value of the company involves often a discount (IPO discount) to the value determined by the valuation methods relied on earlier in the IPO process (namely multiple or discounted cash flow (DCF) method; see Wüest in *Going Public on SIX*, 2nd edition, 2015, available under https://www.six-group.com/dam/download/the-swiss-stock-exchange/listing/equity/ipo/publication.pdf (SIX Going Public Guide), 49).

Established SME example: A family entrepreneur plans to list the shares of his/her long-established SME. The entrepreneur wants to keep a controlling stake of 51%. The other 49% of the shares shall be publicly offered.

Scenario 1 "Direct Listing" (entrepreneur sells 49% to the public; no capital increase):

Sparks:

- Reported equity: At least *CHF 25 million*, because there is no capital increase.
- Free float:
  - The minimum percentage threshold is met given that the entrepreneur offers 49% of the shares to the public.
  - However, these 49% of the shares must have a minimum market capitalization of CHF 15 million. This corresponds to an *overall market cap* at the opening price on the day of the listing of at least *CHF 30.61 million*.

Main Segment:

- Reported equity: At least *CHF 25 million*.
- Free float:
  - The minimum percentage threshold of 20% (article 19 (2) LR) is met, as 49% of the shares are freely tradable.
  - The 49% of the freely tradable shares must have a market capitalization of at least CHF 25 million (article 19 (2) LR), corresponding to an *overall market cap* at the opening price on the day of the listing of at least *CHF 51.02 million*.

Scenario 2 "Capital Increase" (creation of 96% additional capital to be issued to the public (49% overall); no (direct) sale by the entrepreneur):

Sparks:

- Reported equity: The (in cash) capital increase must generate reported equity in the amount of CHF 8 million in order that the lower Sparks thresholds apply (see above). Accordingly, the *overall reported equity* must amount to at least *CHF 16.33 million*.

- Free float:

  - The minimum percentage threshold is met given that 49% of the shares are issued to the public.

  - However, these 49% of the shares must have a minimum market capitalization of CHF 15 million on the day of the listing, which corresponds (again) to an *overall market cap* at the opening price on the day of the listing of *CHF 30.61 million*.

Main Segment:

- Same calculation as above, considering that the capital requirements do not depend on whether there is a capital increase or not, *i.e.* minimal *reported equity* of *CHF 25 million* and *overall market cap* of at least *CHF 51.02 million*.

Growth SME Example: A growth company seeks to raise capital through a 100% capital increase. Pre-IPO, the founders own 30% and a financial investor owns 70% of the shares. Post-IPO, the founders shall have a remaining 15% share. The financial investor plans to sell his/her shares in the IPO.

Sparks:

- Reported equity: The (in cash) capital increase must (again) generate reported equity in the amount of CHF 8 million, with the consequence that the *overall reported equity* must amount to at least *CHF 16 million*.

- Free float:

  - The minimum percentage threshold is met. 85% of all shares will be freely tradable as the founders only keep 15% post-IPO and the pre-IPO financial investor will sell his/her shares in the IPO.

  - The 85% freely tradable shares must have a market capitalization of at least CHF 15 million. This corresponds to an *overall market cap* at the opening price on the day of the listing of at least *CHF 17.65 million*.

Main Segment:

– Reported equity: The overall *reported equity* must (again) amount to at least *CHF 25 million*.

– Free float:

  – The minimum percentage threshold is met since 85% of all shares will be freely tradable.

  – The 85% freely tradable shares must have a market capitalization of at least CHF 25 million, corresponding to an *overall market cap* at the opening price on the day of the listing of at least *CHF 29.41 million*.

Considering the calculation examples, the market capitalization necessary to meet the minimum free float will often be the higher hurdle for IPO candidates than the required reported equity (the required overall market cap always exceeding the required reported equity). Nevertheless, both requirements need to be assessed separately by every candidate. Moreover, the examples presume that there are, besides the legacy shareholders, no investors with a stake of more than 5% post-IPO. The shares of such investors would not count towards the free float (article 4 (1) (ii) DDES). If there were respective investors, the percentage amount of the freely tradeable shares would decrease, with the consequence that an (even) higher overall market cap would be required.

The calculation examples show that a listing on Sparks presupposes a lower overall market cap compared to the main segment indeed (the provisions concerning Sparks requiring in both examples approximately 60% of what is needed for the main segment). Furthermore, the calculation examples show that candidates with a free float worth CHF 15 million and an overall market cap of CHF 30 million should often meet the capital requirements for Sparks, provided that also the necessary reported equity is present. At least if a substantial (in cash) capital increase is planned in the realm of the IPO (triggering the lower Sparks thresholds, see above), the equity requirement is also achievable for companies fit for a market value on the first trading day in the CHF 30 million range or even below. Taking into account that such value may involve a certain discount (IPO discount; see above), companies valued by way of a multiple or DCF method at around CHF 30-40 million will – in sum – often meet the applicable capital requirements for a listing on Sparks *from a legal perspective*.

Having said that, an IPO must (obviously) also be marketable *commercially*. Generally (*i.e.* without specifically addressing Sparks), investment banks deem a free float of at least CHF 40-50 million necessary (see also Nikitine/Bähler, in Europainstitut, Kapitalmarkt: Recht und Transaktionen XV, *IPO Readiness: Stolpersteine auf dem Weg zum Börsengang*, 13). This implies a (potentially considerably) higher market cap and company value, exceeding the above-mentioned CHF 30-40 million (potentially by far).

Companies with a corresponding value might well also fulfill the capital requirements of the main segment. Hence, there is persuasion required in the corporate finance field and with investors in order that Sparks will indeed attract smaller issuers. Otherwise, the legally lower capital requirements compared to the main segment might remain a theoretical advantage.

4) A listing on Sparks may (still) be worthwhile

In light of the above, it remains to be seen whether the lower entry thresholds of Sparks will do the trick and facilitate listings compared to the main segment in practice. Furthermore, Sparks offers a special trading model (in particular a condensed trading window) with the intention to optimize the price determination and the execution of trades, taking into account that companies with a smaller market capitalization generally trade at lower volumes. However, this trading model will also have to pass the practical test yet (see also Christian Schneiter/Peter Kühn, CapLaw-2021-59).

On the other hand, a listing on Sparks is a going public on a fully regulated stock exchange and thus a strenuous exercise in terms of both, (internal) resources and (external) costs (see Ammann, in Going Public Guide, 18 *et seq.*; Nikitine/Bähler (above), 26 *et seq.*).

Against that background, SMEs may raise the question why they should envisage a listing on a regulated stock exchange such as Sparks (or also the main segment), in particular given that private equity seems to be available almost abundantly and there are foreign over-the-counter markets and other foreign markets with considerably less strict admission rules, which sometimes also Swiss companies use.

An important aspect of a going public on a regulated stock exchange are disciplining effects. From an *economic perspective*, the share price has such effects, catering for a market-based benchmark to measure the actions of board and management, including through potential unfriendly take-over offers if the share price reaches (too) low levels (see Ammann (above), 18).

Disciplining effects are also present *from a legal perspective*. Companies often deem additional regulations a burden. However, preparing the financial statements in line with a recognized accounting standard, compiling a prospectus, complying with the corporate governance provisions provided for in the OAEC and the DCG, etc., also implies an intense confrontation of the responsible persons with their company, which will ultimately also be beneficial to the business. Furthermore, the requirements concerning listed companies pick-up megatrends such as ESG or gender equality timely, and addressing such trends is, again, generally beneficial to the business.

A listing on Sparks may thus still be attractive for SMEs – all the more if there will be room for listings of smaller companies in practice and the trading model will prove to be suitable.

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FinSA and FinIA: Update on Transition Periods

Reference: CapLaw-2022-04

On 1 January 2022 the Swiss Financial Services Act ("**FinSA**") and the Swiss Financial Institutions Act ("**FinIA**") entered into force. While the FinSA provides for a wide range of new rules applicable to financial service providers, irrespective of their licensing status, and new documentation rules applicable to financial instruments, the FinIA introduced, among other things, new licensing requirements for portfolio managers and trustees. The two acts provided for a number of transition periods; on 31 December 2021 the clock ran out on most of these transition periods.

By Patrick Schärli

1) Rules of conduct and organization measures: in full force and effect

The FinSA introduced, among other things, a wide array of conduct rules (just to name a few of them: client categorization, suitability and appropriateness tests, rules around the execution of financial instruments transactions) and organizational rules and requirements (e.g. measures to prevent conflicts of interest, obligations to disclose payments received from third parties such as retrocessions). These new rules apply to all types of financial service providers, irrespective of their regulatory or supervisory status.

While many of the FinSA rules may not be all that new for more sophisticated, internationally active financial service providers, the new FinSA rules present somewhat of a challenge for the large number of smaller (and sometimes unregulated) financial service providers. Moreover, financial service providers have to adapt their already existing internal processes and procedures to comply with the FinSA rules or create such internal processes and procedures from scratch. To address these challenges and provide ample time for the required implementation work, the FinSA provided for various transition periods. The most important of these transition periods, i.e. the deadline to implement the rules of conduct and organizational requirements, ended on 31 December 2021. Thus, as of 1 January 2022, the FinSA rules on conduct and organizational measures are in full force and effect.

2) Key information documents (KID): extension of transition period

In addition to the above mentioned rules of conduct and organizational measures for financial services providers, the FinSA also introduced and harmonized product documentation rules and requirements for financial instruments. These new rules include prospectus requirements for the public offering or admission to trading of securities (similar to rules known in other European jurisdictions) and a requirement to prepare a so-called key information document ("**KID**") for more complex financial instruments and/or financial instruments with derivative elements (e.g. structured products, derivatives, collective investment schemes) if such instruments are offered to retail investors in Switzerland. The FinSA KID requirements largely follow similar rules laid out in its European counterpart, the EU PRIIPs Regulation (Regulation (EU) 1286/2014). In fact, a KID that has been prepared in accordance with the EU PRIIPs Regulation is considered an equivalent document for purposes of the FinSA, and such equivalent document can be used instead of a Swiss KID.

The new FinSA KID is supposed to harmonize KID requirements and replace a number of similar type of documents that have existed previously in various different Swiss financial markets regulations. More specifically, the FinSA KID replaces the simplified prospectus for structured products, the key investor information document for securities funds and other funds for traditional investments, and the simplified prospectus for real estate funds.

Originally, the use of the new FinSA KID was envisaged for products that would be offered to retail customers as of 1 January 2022. However, at the beginning of December 2021, the Swiss Federal Council extended the transitional period for the introduction of the KID. The extension of the transitional period was justified in light of similar developments in the European Union, where the European Council and the European Parliament extended the transitional period for the replacement of the UCITS KIID (i.e. the key investor information documents for European retail funds) by the PRIIPS KID to the end of 2022.

In light of these European developments and in order to ensure equal treatment and avoid additional burdens for issuers of financial instruments, the transition period for the FinSA KID was also extended by one year and now ends on 31 December 2022. As a consequence, until 31 December 2022 simplified prospectuses for structured products, key investor information documents for securities funds and other funds for traditional investments, and simplified prospectuses for real estate fund may continue to be used instead of the new FinSA KID. The relevant rules on transition periods in articles 110 and 111 of the Financial Services Ordinance and article 144 of the Collective Investment Schemes Ordinance have been amended accordingly with effect as of 1 January 2022.

3) Portfolio managers and trustees: the clock is ticking

The FinIA governs licensing requirements for a number of different financial institutions, such as securities firms, managers of collective assets or fund management companies. While changes to the licensing requirements for the afore-mentioned financial institutions were generally limited, the FinIA also introduced completely new licensing requirements for portfolio managers and trustees. In the pre-FinIA world, portfolio managers and trustees were not subject to licensing requirements and they only had to register with a self-regulatory organization for purposes of compliance with anti-money laundering legislation. Thus, the FinIA brought about significant change in terms of regulatory rules and requirements for portfolio managers and trustees.

The FinIA defines portfolio manager as someone that, based on a mandate agreement, may dispose of a client's asset by way of the following activities: (i) purchase or sale of financial instruments, (ii) acceptance and transmission of client orders relating to financial instruments, (iii) management of financial instruments (asset management), or (iv) advice relating to financial instruments (investment advice). A trustee is defined as someone that based on a trust deed may dispose of the assets of a trust within the meaning of the Hague Trust Convention. While the FinIA provides for certain exemptions from the scope of the portfolio managers or trustee licensing requirements (e.g. because of "economic" or "family" ties), the new licensing requirements still apply to a rather large number of financial institutions. According to a communication of the Swiss regulator FINMA in September 2021, a total of around 2,400 portfolio managers and trustees had indicated to FINMA that they intended to obtain a license under the FinIA.

In terms of supervisory concept, the FinIA introduced a dual-layered supervision for portfolio managers and trustees. While FINMA is responsible for granting licenses and taking enforcement action, so-called supervisory organizations ("**SO**") have been entrusted with the day-to-day supervision of portfolio managers and trustees. The SO are privately organized, but licensed by FINMA. In order for a portfolio manager or a trustee to obtain a license from FINMA, it first has to obtain an affiliation with an SO. For this purpose, the SO will review the license application before it can be submitted to FINMA. Thus, only once the SO has approved the application and granted affiliation, the relevant license application gets submitted to FINMA.

Realizing that the transition from a previously mostly unregulated business to a fully supervised and regulated financial activity will be a challenge for many portfolio managers and trustees, the FinIA provided for a rather long transition period of three years, i.e. until 31 December 2022. By that deadline, portfolio managers and trustees that started their business activities prior to 1 January 2020 (i.e. before the entry into effect of the FinIA), have to file a license application with FINMA (which includes, as mentioned above, proof of an affiliation with a SO). If a license application has been filed by or before deadline on 31 December 2022, the relevant portfolio manager or trustee is permitted to continue operating its business until a decision on the license has been taken.

It is important to note that the FinIA requires that the license be submitted to FINMA by the end of 2022, i.e. the review and affiliation process with the SO has to be completed well ahead of the 31 December 2022 deadline. Given the large number of portfolio managers and trustees that will apply for SO affiliation, FINMA has urged portfolio managers and trustees to file for an affiliation with one of the SO by no later than the end of June 2022 to ensure that the SO can complete the review process sufficiently ahead of the 31 December 2022 deadline. Only a submission of the license application to FINMA, along with proof of SO affiliation, ensures that the deadline is respected. This is of particular importance given the fact that so far only a small fraction of the around 2,400 portfolio managers and trustees actually have submitted their license application (according to a FINMA communication of September 2021, only around 180 license applications have already been submitted).

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Reform of withholding tax and transfer stamp duty

Reference: CapLaw-2022-05

On 17 December 2021, Parliament concluded a legislative project that had taken more than ten years to complete. The main goal was to enable the issuance of domestic bonds free of withholding tax and thus strengthen the Swiss capital market. Further, transfer stamp duty on domestic bonds will also be abolished. The following article will discuss what the consequences of this reform are.

By Stefan Oesterhelt / Philippe Gobet

1) Introduction

The goal to strengthen the Swiss capital market is achieved by the abolition of withholding tax on bond interest already proposed by the Federal Council in its dispatch of 14 April 2021 (see Oesterhelt/Gobet, CapLaw-2021-35; Oesterhelt/Opel, Reform der Verrechnungssteuer, EF 8/21, p. 435) (see Section II below). The introduction of a paying agent tax, which was the core of the earlier reform proposals (see Oesterhelt, CapLaw-2020-41), has been dispensed with.

However, Parliament has made considerable changes to the Federal Council's bill. In particular, a transitional provision was introduced according to which only new issues are affected by the abolition of withholding tax (see Section II.B below).

On the other hand, in line with the Federal Council's proposal, Parliament adopted the abolition of the transfer stamp duty on domestic bonds (see Section V below).

2) Abolition of withholding tax on bond interest

a) Principle

Interest and equivalent income on domestic bonds is subject to withholding tax of 35% pursuant to article 4(1)(a) Federal Withholding Tax Act (WTA). This means that domestic groups almost always issue bonds that are to be placed internationally via a foreign group company in order to avoid the withholding tax. As of 1 January 2023, this will probably no longer be necessary.

The term "obligation" within the meaning of article 4(1)(a) WTA is extremely broad and can also cover syndicated loan agreements. As a result, loan agreements with a domestic debtor (or possibly also a domestic guarantor) are currently regularly subject to the so-called 10/20 non-bank rules in order to prevent a syndicated loan from being reclassified as a "bond" (*Anleihensobligation*) or debenture (*Kassenobligation*) subject to withholding tax. These restrictions should be unnecessary as of 1 January 2023.

Structured products with an interest component (e.g. reverse convertibles) are also regularly considered bonds within the meaning of article 4(1)(a) WTA, which is why these are today usually issued from abroad even if issued for the Swiss market. This will also no longer be necessary. In the future, structured products will be subject to withholding tax only if they are fund-like structured products governed by article 4(1)(c) WTA (i.e. in cases of tax evasion) or if income qualifies as benefit in kind within the meaning of article 4(1)(b) WTA.

The abolition of withholding tax on bond interest is clearly to be welcomed despite the associated weakening of the safeguarding purpose (*Sicherungszweck*) of withholding tax. The paying agent tax originally favoured by the Federal Council would have strengthened the safeguarding purpose of the withholding tax for income tax, but at the same time would have been extremely complicated to implement in practice.

b) Restriction to new issues (article 70e nWTA)

According to article 70e D-WTA in the Federal Council's version of 14 April 2021, withholding tax would have been abolished for all interest due from 1 January 2023. In other words, interest on bonds already issued would also have been exempt from withholding tax.

However, article 70e nWTA now adopted by Parliament provides that withholding tax will continue to be levied on interest on bonds "formally issued by a resident" before 1 January 2023. This essentially avoids the tax losses associated with the abolition of withholding tax on bond interest for many years without harming the objective of the proposal or having a negative impact on the domestic capital market. Since the cost-benefit ratio of the reform is significantly improved by the restriction to new issues, such a transitional provision has previously already been called for by the authors (see Oesterhelt/Gobet, CapLaw-2021-35).

c) Repatriation of foreign issues and refinancing of domestic issues

The limitation of article 70e nWTA to "bonds formally issued by a resident" clarifies that the replacement of a foreign issue by a domestic issue (repatriation) is not affected by the provision of article 70e nWTA. Consequently, a transfer of the seat of a foreign finance company to Switzerland does not result in the bonds issued by this company before 1 January 2023 becoming subject to withholding tax. The same applies to a repatriation of a foreign issue through a change of issuer (issuer substitution).

Article 70e nWTA is to be understood strictly formally. The refinancing of a domestic issue subject to withholding tax by a domestic issue made on or after 1 January 2023 cannot be regarded as a "new issue" subject to withholding tax.

d) Foreign issues with restrictions on the use of funds

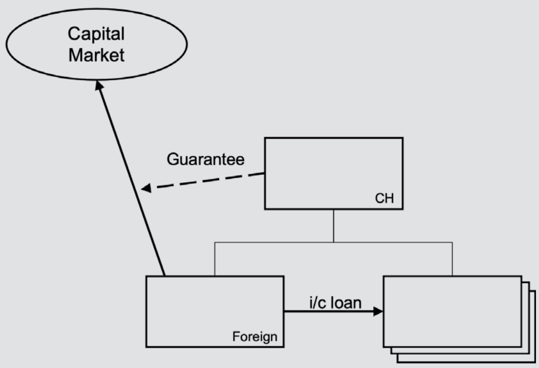
According to the current practice of the Federal Tax Administration (FTA), foreign issues guaranteed by a domestic company may, under certain circumstances, be considered a domestic issue subject to withholding tax if the domestic use of funds (*inländische Mittelverwendung*) exceeds the equity of the foreign companies of the group (see Oesterhelt, CapLaw-2018-01). These restrictions on the use of funds will cease to apply as of 1 January 2023. This also applies to existing issues, as such issues are not "bonds formally issued by a resident". Thus, for foreign issues guaranteed by a domestic company, the restrictions on the use of funds no longer have to be complied with as of 1 January 2023 if the terms and conditions of the bond permit this (see *Example*).

Consequently, the same applies to foreign issues for which the restriction on the use of funds was already violated before 1 January 2023 and which were thus reclassified as domestic issues subject to withholding tax. These are not "bonds formally issued by a resident" and are therefore not affected by the transitional provision of article 70e nWTA. The previously applicable principle of "once a domestic issue, always a domestic issue" (see Oesterhelt, CapLaw-2018-01) is thus overridden by the legislative amendment of 17 December 2021 (see *Example*).

The same applies to an issue by a foreign finance company that was qualified as a resident by the FTA due to the lack of substance of the issuer abroad pursuant to article 9(1) WTA. The requirements imposed by the FTA regarding the substance abroad no longer need to be complied with as of 1 January 2023, without this resulting in withholding tax consequences on interest of bonds issued before 1 January 2023. If the required substance abroad did not exist before 1 January 2023, withholding tax is due on the interest due dates before 1 January 2023, but not on later interest due dates.

Example: Foreign bond with guarantee of the domestic parent company.

A domestic group issued a bond bearing interest at 4% p.a. through its foreign subsidiary (FinCo) on 1 June 2021. To prevent the bond from being reclassified as a domestic bond, the domestic use of funds was restricted to the equity of the foreign group companies. In addition, as part of the ruling confirmation, the FTA required FinCo to have a self-financing ratio of at least 5%.



When article 70e nWTA enters into force on 1 January 2023, the withholding tax restrictions on the use of funds and the issuer's substance will cease to apply *ex nunc*. Thus, future interest payments will no longer be subject to withholding tax. This applies even if the rules on the use of funds or substance were disregarded before 1 January 2023. In this case, only interest due before 1 January 2023 would be subject to withholding tax.

In the case of a bullet repayment syndicated loan (*endfällige Anleihensobligation*) or debenture (*endfällige Kassenobligation*), a breach of the restriction on the use of funds or the substance requirements for the foreign issuer before 1 January 2023 is harmless if the interest is due only after article 70e nWTA comes into force.

e) Relationship to withholding tax pursuant to article 94 DTA or article 35(1)(e) THA

The tax at source (*Quellensteuer*) pursuant to article 94 Federal Direct Tax Act (DTA) or article 35(1)(e) Federal Tax Harmonisation Act (THA) on bonds secured by domestic real estate is currently pushed back to the extent that the interest payment is subject to withholding tax. The abolition of withholding tax on bonds leads to a revival of the withholding tax according to article 94 DTA or article 35(1)(e) THA.

However, the transitional provision of article 70e nWTA prevents the tax at source from being due again on bonds already issued before 1 January 2023 and thus subject to withholding tax.

For domestic bonds issued after 1 January 2023 that are secured by domestic real estate, however, the tax at source must be considered in accordance with the provision in article 94 DTA or cantonal law modelled on article 35(1)(e) THA. Since such bonds are no longer subject to withholding tax, the tax at source on interest payments to foreign creditors and usufructuaries must in principle be levied again in the future. The only exception is if a double taxation agreement pushes back Switzerland's right of taxation, i.e. assigns the exclusive right of taxation to the state of residence. In such a case, there is an exemption at source. In the case of loans secured by domestic real estate, transfers are therefore usually contractually limited to so-called "treaty lenders", i.e. lenders that are resident in a state with which Switzerland has concluded a double taxation agreement that reserves the right of taxation exclusively to the state of residence ("zero rate on interest").

3) Customer credit balances (article 4(1)(a) nWTA)

The amendments proposed by the Federal Council on withholding tax on client deposits pursuant to article 4(1)(d) WTA (now article 4(1)(a) nWTA) were adopted unchanged. If the bill is accepted, the 100 non-bank rule will be a thing of the past (as will the 10/20 non-bank rules).

4) Manufactured payments (article 4(1)(d) nWTA)

The legal provision proposed by the Federal Council for levying withholding tax on manufactured payments (article 4(1)(d) nWTA) was also adopted unchanged by Parliament despite the criticism that had been voiced in this regard. In particular, Parliament ultimately refrained from limiting article 4(1)(d) nWTA to manufactured payments by domestic debtors, as originally demanded by the National Council.

The declared aim of article 4(1)(d) nWTA is to be able to continue practice lived previously through the "Gentlemen's Agreement" (see Oesterhelt/Gobet, CapLaw-2021-35, Section III.E), which was unhinged by the ruling of the Federal Supreme Court of 21 November 2017 (2C_123/2016). In this respect, it will be decisive how the (in our opinion somewhat unfortunate) wording of article 4(1)(d) nWTA is implemented in the practice of the FTA.

5) Abolition of transfer stamp duty on domestic bonds

As already proposed by the Federal Council, domestic bonds will no longer be considered taxable securities for the purposes of transfer stamp duty. Since primary market transactions with domestic bonds (article 14(1)(a) Federal Stamp Duties Act [SDA]) as well as the redemption (*Rückgabe zur Tilgung*) (article 14(1)(e) SDA) are already exempt from transfer stamp duty, the amendment primarily affects secondary market transactions with domestic bonds (with a tenor of above one year, article 14(1)(g) SDA).

Since domestic bonds will no longer be taxable securities within the meaning of article 13(2) SDA, they are also no longer relevant for the definition of securities dealer under article 13(3)(d) SDA.

For the same reason, domestic issues of structured products with a bond component will no longer be subject to transfer stamp duty.

Domestic bonds issued prior to the legislative amendment will also no longer be taxable securities within the meaning of article 13(2) SDA. This also applies if a formerly foreign issuer relocates its seat to Switzerland. However, due to the formal nature of stamp duties, it is not sufficient if only the effective place of administration of the issuer is transferred to Switzerland.

For the transition, the relevant point in time is the entry into of the (unconditional) contractual obligation in relation to the transaction (*Verpflichtungsgeschäft*) rather than the transfer of ownership under civil law (*Verfügungsgeschäft*). This is because the entry into of the transaction is the point in time at which the stamp duty claim arises pursuant to article 15(1) SDA.

6) Turnover tax on foreign bonds (article 13(2)(a^{bis}) nSDA)

Bonds issued by a foreigner, on the other hand, are still taxable securities for the purposes of transfer stamp duty. Due to the repeal of article 13(2)(a)(1) SDA, a new legal basis had to be created in article 13(2)(a^{bis}) nSDA in this regard.

Trading in foreign bonds (secondary market transaction) as well as the issuance of foreign bonds denominated in Swiss francs (primary market transaction) will continue to be subject to the transfer stamp duty if a domestic securities dealer is involved in the transaction as a party or intermediary. However, as before, the redemption (*Rückgabe zur Tilgung*) (article 14(1)(e) SDA) and secondary market transactions in which either the buyer or the seller is a foreign contracting party (article 14(1)(h) SDA) are exempt.

Bonds issued by a foreign branch of a domestic company are – as is already the case today – treated as "bonds issued by a foreigner" within the meaning of article 13(2)(a^{bis}) nSDA at least if the branch is a regulated bank branch.

7) Entry into force

Parliament has set the abolition of withholding tax on bond interest and the entry into force of the transitional provision of article 70e nWTA for 1 January 2023. This applies even if the referendum that has already been initiated is successful but the people approve the bill. The referendum period expires on 7 April 2022, so that a referendum vote could take place in September or November 2022.

The entry into force of the other amendments to the WTA and the SDA will be determined by the Federal Council. In this regard, it is highly uncertain whether these can also enter into force as early as 1 January 2023. The changes in the area of customer deposits as well as the transfer stamp duty make it necessary for the banks to adapt their IT systems, for which a certain lead time is needed. This applies even if the referendum deadline were to expire unused.

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Xlife Sciences First Listing on SIX Swiss Sparks (SME) Segment

Reference: CapLaw-2022-06

On 14 February 2022, Xlife Sciences successfully listed its shares on the standard "Sparks" of SIX Swiss Exchange—making it the very first listing on the new and regulated SME segment of SIX Swiss Exchange. Xlife Sciences focuses on the value development and commercialization of promising early-stage research projects from universities and other research institutions in the life sciences industry.

Liechtensteinische Landesbank Intends to Fully Acquire its 75% Subsidiary Bank Linth LLB

Reference: CapLaw-2022-07

On 27 January 2022, Liechtensteinische Landesbank AG (LLB) has published the pre-announcement for a public takeover offer to acquire the approximately 25% of

Bank Linth held by the public. LLB offers the shareholders of Bank Linth the free choice between a partial ex-change offer with a cash component or a full cash settlement. The State of Liechtenstein as the majority shareholder of LLB, represented by the government, will provide LLB with a maximum of 1.25 million LLB shares (corresponding to 4.1 per-cent of the shares of LLB) for the partial exchange offer.

In view of the launch of the tender offer, LLB has entered into a transaction agreement with Bank Linth and a share purchase rights agreement with the State of Liechtenstein on 26 January 2022.

IPO of Allwyn Entertainment on NYSE by way of De-SPAC

Reference: CapLaw-2022-08

On 22 January 2022, Allwyn Entertainment Ltd, a leading multinational lottery operator operating lotteries in Austria, the Czech Republic, Greece, Cyprus and Italy, announced that it intends to become a publicly-listed company on the NYSE in partnership with Cohn Robbins Holdings Corp. (NYSE: CRHC.U, a special purpose acquisition company (SPAC)), resulting in an expected total enterprise value for Allwyn Entertainment of approximately USD 9.3 billion.

Axpo Sustaiability Linked Bonds Issuance

Reference: CapLaw-2022-09

On 25 January 2022, Axpo Holding AG announced the successful placement of the first sustainability-linked bond placed by a Swiss utility provider. Tranche A in the amount of CHF 200 million is due in 2025 and provides for an interest rate of 0.25 per cent. Tranche B in the amount of CHF 300 million is due in 2027 and provides for an interest rate of 0.625 per cent. The financing costs are linked to the achievement of targets, relating to the further expansion of the capacity of renewable energies.

UBS Group Notes Issuances

Reference: CapLaw-2022-10

Between 11 and 13 January 2022, UBS Group AG successfully completed the issuance of USD 1.5 bn in aggregate principal amount of Fixed Rate/Fixed Rate Senior Notes due February 2033 and USD 1.5 bn in aggregate principal amount of Fixed Rate/Fixed Rate Senior Notes due February 2043 under its Senior Debt Programme as well as the issuance of USD 1.5 bn 4.875 per cent. Tier 1 Capital Notes. The Notes are governed by Swiss law and have been admitted to trading on the SIX Swiss Exchange.

BKB Bonds Issuance

Reference: CapLaw-2022-11

On 11 January 2022, Berner Kantonalbank AG announced the successful placement of CHF 200 m 0.85 per cent. Tier 2 bonds. Zürcher Kantonalbank acted as Structuring Advisor and Lead Manager and Berner Kantonalbank AG acted as Co-Manager. The bonds were listed on the SIX Swiss Exchange.

SFS acquires Hoffmann SE

Reference: CapLaw-2022-12

On 22 December 2021, SIX listed SFS Group has announced the entry into an agreement to join forces with and acquire 100 per cent of Hoffmann SE. The current owners of Hoffmann SE agreed to contribute 100% of the shares of Hoffmann SE to the SFS Group. Hoffmann SE is a leading international systems partner for quality tools which is active in over 50 countries with around 3,000 employees. A part of the purchase price will be paid in the form of SFS shares resulting in the current owners of Hoffmann SE to become significant shareholders of SFS.

UBP Bonds Issuance

Reference: CapLaw-2022-13

On 15 December 2021, Union Bancaire Privée UBP SA (UBP) made its first issuance of bonds listed on the SIX Swiss Exchange, in an aggregate amount of CHF 335 million, maturity 2026.