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SIX Published Criteria for Crypto Assets as Eligible Underlyings

Reference: CapLaw-2018-42

On 10 September 2018, the SIX Exchange Regulation Ltd. published its revised Circular No. 3 that includes rules on the eligibility of certain crypto assets (crypto currencies) as underlyings of derivatives listed at SIX.

By Benjamin Leisinger

On 10 September 2018, the SIX Exchange Regulation Ltd. (SER) published its revised Circular No. 3 that includes rules on the eligibility of certain crypto assets (crypto currencies) as underlyings of derivatives listed at the SIX Swiss Exchange (SIX). The SER defined certain criteria that such crypto assets have to meet as well as the process to be adhered to prior to the registering for provisional admission to trading of products with new crypto assets as underlyings.

According to that Circular No. 3 crypto currencies are permitted as underlying assets for derivatives, provided that the following criteria are met. Before each application for provisional admission of a product, the respective issuer must check whether the following criteria are still fulfilled.

– The permissible crypto asset underlyings are crypto currencies in the form of coins (tokens, *i.e.*, shares in a project, which are frequently issued as part of an initial coin offering (ICO), are *not* permissible as underlying instruments). Further, such coins must be based on open source software that functions on the principles of blockchain technology. A consensus protocol must be used and transactions must be verified by the network participants using a clearly defined process. The issuance of further crypto currency agreements must be clearly regulated and must not systematically favor individuals.

– At the time of application for provisional admission to trading, the relevant crypto currency must be one of the 15 largest crypto currencies in terms of market capitalization in USD. The information provided on the website: https://coinmarketcap.com/coins/ serves as a reference for this purpose.

– In order for the respective crypto currency being eligible as an underlying, it has to be ensured that the prices for the crypto currency used are regularly quoted and are readily publicly accessible via the internet. In addition, it must be ensured that the crypto currency can be traded directly against a common fiat currency such as USD or EUR and that a price feed is available via a common information system such as SIX Financial Information, Bloomberg or Reuters.

– There must be at least one trading venue for the relevant crypto currency that meets the following criteria: (1) It offers trading against a common fiat currency; (2) it creates

transparency through the publication of prices; (3) the trading venue provides an API interface; and (4) the website of the trading venue must at least be written in English.

If a specific crypto currency is used (or intended to be used as underlying) for the first time, the applicant must clearly show to SER how the aforementioned requirements are met. This explanation can be submitted by e-mail to listing@six-group.com before submitting the application for provisional admission.

In the event of a fork in a crypto currency used as the underlying during the term of a derivative traded on the SIX, the derivative that relates to the new crypto currency and is allocated to existing investors free of charge may also be admitted to trading. Another permissible way to settle such a fork is to add the new crypto currency as an extra underlying instrument of the existing product. This may be done if the new crypto currency meets all the above requirements but for the requirement of being one of the 15 largest crypto currencies.

The provisional admission of new derivatives to the new crypto currency is only possible when all requirements including the requirement to belong to the 15 largest crypto currencies are met.

Furthermore, in the case of crypto currencies, information on the following points must be provided in the listing prospectus:

– The most important differences and the resulting risks between conventional (fiat) currencies and the crypto currency must be explained. These are in particular non-existent intrinsic value, trading of the crypto currency on unregulated online exchanges, lower trading volume, and greater volatility.

– The specific risks in connection with products in crypto currencies, in particular fraud risks and risks arising from possible hacker attacks, must be explained.

– SIX Exchange Regulation reserves the right to require the inclusion of further information in the listing prospectus if the crypto currency or the product structure so require.

This amendment to the Circular No. 3 is very welcome and certainly brings clarity and a clear procedure to the new generation of products that give investors an indirect exposure to eligible crypto assets. The requirements should ensure that only established and non-problematic crypto currencies can be used and that the investors are transparently informed about the unusual (or rather new) risks involved with this asset class.

This – as well as SIX's announcement to launch full end-to-end and fully integrated digital asset trading, settlement and custody service – shows that the SIX is ahead of the curve with respect to crypto assets and will continue to contribute to an attractive and modern Swiss financial center.

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Insider Trading and Market Manipulation in Tokens

Reference: CapLaw-2018-43

Trading in tokens is currently in the spotlight of the public's and the regulator's attention. Based on distributed ledgers-technology, blockchain technology is used to issue tokens as tradable digital units and to record ownership and transactions of the issued tokens. At present, there are no specific laws and little regulation applying to trading in tokens in Switzerland. With a view to improve market confidence as well as to ensure proper functioning and transparency of token trading, a variety of legal issues have yet to be resolved. In particular, the question of insider trading and market manipulation needs to be clarified.

By Thomas U. Reutter / Daniel Raun

1) Introduction

Coinbase, a cryptocurrency exchange platform, is currently facing a class action lawsuit in connection with the announcement of the listing of Bitcoin Cash (BCH) on its cryptocurrency trading platform Coinbase Pro (formerly GDAX). The claimants accuse Coinbase of tipping off insiders ahead of the launch of BCH trading.

This case and others show that fraudulent behavior, such as exploitation of insider information and market manipulation, is a real risk also in token markets. This risk is arguably further increased by the distinct shortage of information in connection with trading in tokens on trading platforms and Initial Coin Offerings (ICOs) and the lack of specific rules and regulations in many jurisdictions. In order to prevent such behavior, the question arises whether existing regulations in Switzerland can be applied to token trading or whether new rule-making is required.

There is a great variety of tokens with very different features. In February 2018, the Swiss Financial Market Supervisory Authority (FINMA) issued (non-binding) guidelines regarding ICOs categorizing tokens into three types:

- **Payment tokes** are synonymous with cryptocurrencies and are designed as a means of payment. They have no further functions or links to any asset development project or the like. They do not grant the holder any specific right other than to hold and act on the token itself.

- **Utility tokens** are tokens which grant the holder the right to use certain services or provide access to an application.

- **Asset tokens** represent assets such as a debt or equity claim against an issuer, e.g. participations in real physical underlyings or an entitlement to dividends or interest payments. Due to their economic function such tokens have characteristics similar to equity, bonds or derivatives.

Using the above classification of FINMA, this article provides a brief analysis as to whether the existing regulation on insider trading and market manipulation are applicable to and suitable to govern also the trading in tokens.

2) Existing Regulation on Insider Trading and Market Manipulation

a) Insider Trading

Under Swiss law, the use of insider information may constitute both a criminal offence (article 154 Financial Market Infrastructure Act (FMIA)) and a violation of public administrative law (article 142 FMIA). Swiss law defines insider information as confidential information whose disclosure would significantly affect the prices of securities admitted to trading on a Swiss trading venue (article 2 lit. j FMIA). Information is considered price-sensitive if an investor would typically deem the information important in deciding whether to buy or sell securities. Examples include material acquisitions, financial results, significant product developments and other circumstances of similar importance. Persons who come into possession of insider information are prohibited from (i) exploiting insider information to acquire or dispose of securities admitted to trading on a trading venue in Switzerland or to use financial instruments derived from such securities, (ii) disclosing it to a third party, or (iii) exploiting it to recommend to a third party to acquire or dispose of securities admitted to trading on a trading venue in Switzerland or to use financial instruments derived from such securities.

b) Market Manipulation

Market or price manipulation may also constitute a criminal offence (article 155 FMIA) and/or a violation of public administrative law (article 143 FMIA) under Swiss law. According to article 143 FMIA, a person violates these rules if he or she (i) publicly disseminates information or (ii) effects transactions or acquisitions or disposal orders that he or she knows or should know give false or misleading signals regarding the supply, demand or price of securities admitted to trading on a trading venue in Switzerland. The object of article 143 FMIA are securities (*Effekten*) within the meaning of article 2 lit. b FMIA (see definition further below).

c) Applicability on Trading with Tokens

Whether the aforementioned provisions are applicable on token trading hinges on the following questions:

– whether tokens can be considered securities within the meaning of article 2 lit. b FMIA; and

– whether tokens can be regarded as being admitted to trading on a Swiss trading venue, i.e. an exchange (article 26 lit. b FMIA) or multilateral trading facility (MTF) (article 26 lit. c FMIA).

i. Qualification of Tokens as Securities

According to article 2 lit. b FMIA, the definition of securities (*Effekten*) comprises standardized certificated and uncertificated securities (*Wertpapiere, Wertrechte*), derivatives and intermediated securities that are suitable for mass trading. With regard to tokens, a distinction needs to be made between the different types of tokens described above. According to FINMA's guidelines on ICOs, asset tokens are deemed securities within the meaning of article 2 lit. b FMIA. Utility tokens can only be regarded as securities if the tokens embody, at least partially, an investment purpose, while payment tokens (cryptocurrencies) fall outside the scope of the definition altogether. Therefore, utility tokens without an investment purpose and payment tokens are, in principle, not considered securities under the FMIA and the rules on insider trading and market manipulation thus do not apply to these categories of tokens. In contrast, based on FINMA's guidance it stands to reason that asset tokens are subject to the restrictions of the FMIA regarding the use of insider information and market manipulation.

ii. Qualification of Token Trading Platforms as Trading Venues

Pursuant to article 26 lit. a FMIA, a trading venue means either a stock exchange or an MTF. Both are institutions for multilateral securities trading whose purpose is the simultaneous exchange of bids between several participants and the conclusion of contracts based on non-discretionary rules.

According to article 23 of the Financial Market Infrastructure Ordinance (FMIO), rules are deemed to be non-discretionary if they grant the trading venue or the operation of an organized trading facility no discretion in the amalgamation of offers. The difference between stock exchanges and MTFs is that on a stock exchange securities are listed, i.e., they are admitted to trading pursuant to a standardized procedure in which requirements regarding the issuer and the securities specified by the stock exchange are examined. Absent such a standardized admission process it can be excluded that trading platforms for tokens are stock exchanges in the sense of article 26 lit. b FMIA. However, token trading platforms could qualify as MTFs (and in Switzerland would thus be subject to FINMA's authorization and supervision) because they typically operate a simultaneous exchange of offers among several participants as well as the conclusion of contracts according to non-discretionary rules.

3) Conclusion and Outlook

Tokens have given rise to debate whether existing laws are suitable to govern these new technological applications or whether new legislation needs to be adopted.

The trading of asset tokens and utility tokens may fall under the administrative provisions regarding insider trading and market manipulation of the FMIA (articles 142 and 143 FMIA) if such trading takes place on an MTF. For reasons of investor protection and to further the credibility of token markets and the crypto world, in general, these provisions can and should be applied on payment and utility tokens that have an investment purpose – at least as a preliminary measure – at this stage of development. Based on the fundamental principle of *nulla poena sine lege* of the Swiss Criminal Code (article 1), the criminal provisions (articles 154 and 155 FMIA) may in our view not be applied by analogy.

Despite FINMA having issued its guidelines, significant legal uncertainty still exists. The current legislation needs to be adapted to provide a suitable means to address the issue of insider trading and similar behavior in blockchain technology based instruments.

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The Proposed Strengthening of Group Action in Swiss Civil Procedure

Reference: CapLaw-2018-44

In Switzerland, plaintiffs are forced to litigate their claims in court individually, even if they are part of a group that is affected by the same underlying damaging event. In the context of the ongoing partial revision of the Civil Procedure Code the Swiss Federal Council is seeking to facilitate actions for damages for large groups. To this end it is proposing amendments to the existing mechanism of a group action through an organization and the introduction of a novel group settlement method.

By Thomas Werlen / Remo Decurtins

In Switzerland, *de lege lata*, plaintiffs are forced to litigate their claims in court individually, even if they are part of a group that is affected by the same underlying damaging event (e.g. a group of consumers damaged by a defective product). Such parties, whose rights were violated but who may have incurred a (financial) damage which is relatively low, face significant procedural barriers, in particular the relatively high costs of going to court. These high costs are a combination of high court fees and significant attorney costs. Plaintiffs also face the prospects of protracted legal proceedings, which may increase costs further. As a result, "dispersed damages" (i.e. a large number of affected people, minor damage for each individual) and "mass damages" (i.e. a large number of affected people, medium-size damage for each individual) are often

not brought to court, as it is economically not a viable option for any of the damaged individuals to seek legal action.

In the Volkswagen emissions scandal, the *Swiss Foundation for Consumer Protection ("Stiftung für Konsumentenschutz", "SKS")* chose to tackle this problem by having approximately 6,000 Swiss car owners assign their claims for damages against Volkswagen (ranging from CHF 3,000 to 7,000 per car owner) in order for *SKS* to bring these claims to court collectively. This approach proves to be the expected "uphill battle": *SKS's* group action through an organization ("*Verbandsklage*") on the basis of the Swiss Law on Unfair Competition for a determination of the unlawful conduct by Volkswagen was dismissed by the Zurich Commercial Court on 12 June 2018. The reason for dismissal was that Volkswagen in the meantime had ceased the allegedly unlawful conduct which, in the view of the court, renders the legal action moot (it is understood that *SKS* is appealing this decision to the Swiss Federal Supreme Court). A parallel lawsuit against Volkswagen brought by SKS seeking damages for each car owner is currently pending with the Zurich Commercial Court. Following the "traditional" approach provided by the Civil Procedure Code (CPC), this lawsuit is detailing each car owner's claims *individually*, making it extremely lengthy (consisting of approximately 160,000 pages). Thus, it likely will take years before the court will render a decision.

The challenges for damaged car owners to obtain redress from Volkswagen exemplify that there is currently no strong mechanism of group action in place in Switzerland. While the emissions scandal may be the most prominent case, there are many more imaginable situations, which leave a large number of individuals with a relatively low financial damage, such as bank and credit card fees that are too high, violations of data protection regulations, breaches of cybersecurity, prospectus liability, antitrust and unfair competition law violations, defective consumer products, and selling of misleading and/or unfit financial and insurance products.

The Swiss Federal Council is seeking to address this and to facilitate actions for damages for large groups. It is proposing relevant amendments in the context of the ongoing partial revision of the CPC, see 1. below. These proposed amendments are in line with one of the main goals of the ongoing partial revision of the CPC, which is to lower the barriers of access for individuals to court (e.g. through certain facilitations for advance payments on court costs). In the draft CPC of 2 March 2018, the Swiss Federal Council proposes amendments to the existing mechanism of a group action through an organization ("*Verbandsklage*", see 2a) below) and the introduction of a novel group settlement method ("*Gruppenvergleichsverfahren*", see 2b) below).

1) Background and Previous Developments

Particularly in light of the bankruptcy of Lehman Brothers and the Madoff case, the European Commission in June 2013 issued non-binding recommendations inviting mem-

ber states to introduce collective redress mechanisms at the domestic level. In line with these recommendations, several EU countries have strengthened existing measures of group action and introduced new measures that are distinctively different from a US style class action model (cf. Thomas Werlen/Jonas Hertner, The Globalization of Class Actions, *CapLaw-2013-26*).

Switzerland, too, has begun considering amending its laws with a view to introducing group action mechanisms. With the introduction of the CPC in January 2011, there had been a deliberate decision against group action. However, shortly thereafter, the Swiss Federal Council in its report of 3 July 2013 detected deficiencies of the current legal system since factually there is no satisfactory access to court, in particular in cases of "dispersed damages" and "mass damages". Following up on this report, the *Birrer-Heimo* motion in 2013 (no. 13.3931) requested the proposition of new laws to strengthen group action.

In this context, the preliminary version of the draft Financial Services Act (FinSA), published in June 2014, contained collective redress mechanisms (cf. Christian Rehm/Thomas Werlen, Paradigmenwechsel in der Primärkapitalmarktregulierung, in: Thomas Reutter/Thomas Werlen (Hrsg.), Kapitalmarkttransaktionen IX, Zurich 2014, S. 87-115). Following strong opposition by the business industry during the FinSA consultation process, however, in the final draft FinSA, published in November 2015, there was nothing left of the originally intended improvements with regards to collective legal protection (cf. Thomas Werlen/Jonas Hertner, Draft Financial Services Act to Expand Clients' Enforcement Rights vis-à-vis Financial Services Providers, Leaves Key Questions Unaddressed, *CapLaw-2016-4*; Thomas Werlen/Matthias Portmann/Jonas Hertner, The Enforcement of Clients' Rights in the Draft Financial Services Act (FinSA) – Update, *CapLaw-2017-05*). According to the Swiss Federal Council, rather than applying a sectoral approach, collective redress mechanisms should be addressed more generally and, accordingly, they should be included in the process of the ongoing partial revision of the CPC.

2) Proposed Revisions to the Civil Procedure Code to Strengthen Group Action

In the draft CPC of 2 March 2018, the following two revisions are proposed by the Swiss Federal Council to strengthen group action: amendments to the existing mechanism of a group action through an organization ("*Verbandsklage*", see 2.1 below) and the introduction of a novel group settlement method ("*Gruppenvergleichsverfahren*", see 2.2 below).

a) Amendment of Group Action through an Organization ("*Verbandsklage*") to also allow for Reparatory Actions

De lege lata, associations and other organizations which protect collective interests have the possibility of bringing *non-monetary actions* for injunction, removal or determination of unlawful conduct in accordance with Article 89 CPC.

This mechanism of group action has proven not to be effective. Since the introduction of the CPC in January 2011, not a single claim according to Article 89 CPC has been launched. Article 10 of the Law on Unfair Competition, which allows for non-monetary actions by associations and other organizations for alleged infringements of unfair competition law, has suffered from a similar fate (recently, it was unsuccessfully invoked by *SKS* in the Volkswagen emissions scandal, see above).

In the new Article 89a, the draft CPC proposes to extend the existing mechanism of a group action through an organization to also allow for reparatory actions, such as actions for damages and surrender of profits according to the provisions of management without mandate ("*Geschäftsführung ohne Auftrag*"). Thus, claims resulting from "dispersed damages" and "mass damages" may be litigated in one single proceeding by a non-profit organization that according to its bylaws is authorized to enforce the interest of its members and is suited to do so.

Such proposed reparatory group action through a competent organization will be permitted under the following conditions:

- Each member of the group, on whose behalf the organization litigates, has an underlying individual claim for damages and/or surrender of profits according to applicable law (i.e. Article 89/89a CPC is not the legal basis for individual claims). Having said this, due to its highly personal character, the assertion for compensation for pain and suffering according to Articles 47 and 49 of the Code of Obligations is necessarily excluded from reparatory group action;

- A potential gain in litigation from the assertion of claims by the organization is predominantly allocated to the group of people for whom the organization is active, or is used by the complaining organization exclusively in the interest of these people;

- The affected members of the group have duly authorized the organization to conduct the litigation; and

- The organization is suited to assert reparatory claims, in particular because (i) it is active for the whole of Switzerland or is of importance for the whole of Switzerland or (ii) has long-time experience in the relevant legal field or is authorized by the majority of the members of the group.

Due to the "opt-in system", a group action judgment has *no* legally binding effect on people who have not authorized the complaining organization to litigate on their behalf. This cuts both ways: on the one hand, people that do not form part of the group will not benefit from a potential collective gain in litigation. On the other hand, these people would not be barred to litigate their claims individually, if they would choose to do so.

In order to ensure that damaged people actually know of a collective lawsuit to be filed by an organization (and thus may opt in), the organization must properly inform the members of the group known to them and also the public of the lawsuit and its content.

b) Introduction of a Novel Group Settlement Method ("*Gruppenvergleichsverfahren*")

A group settlement method, a new mechanism proposed in Articles 352 a–k of the draft CPC, is based in particular on a similar method used in the Netherlands since 2005 (cf. Thomas Werlen/Jonas Hertner, The Globalization of Class Actions, *CapLaw-2013-26*) and was the favored mechanism by the Swiss Federal Council in its report of 3 July 2013 (see above in 1.).

This new mechanism allows organizations that have standing for a group action according to Article 89 CPC on behalf of their represented people to enter into a settlement with a damaging party.

Such settlement is then to be submitted to the competent court, with a request for approval of the group settlement and for declaring it binding for all people affected by the damage caused. The competent court will convene the parties to a public hearing and will also order the parties to inform all damaged people known to them as well as the public of the settlement and the possibility to attend this hearing.

The court will approve the group settlement and will declare it binding for all people affected if the following statutory criteria are met:

- The group settlement is in writing, contains certain minimum information and has been duly submitted to the court by both parties;
- The agreed upon compensation seems to be appropriate;
- If the amount and means of damages are not specified yet, an independent instance is determined that will assess the damages;
- The group of affected people is large enough so that it is justified that the settlement is declared binding for all people;
- The relevant organization can validly represent the affected people; and
- The interests of the people affected by the group settlement are safeguarded from an overall perspective.

This group settlement method follows an "opt-out system". This means that through the court's approval and binding declaration, the group settlement has the impact of a final court decision for all people affected by the damage caused, whether they were directly involved in the proceedings or not. Affected people that do not want to be bound by the group settlement need to declare their wish to opt out within a period of three months (or immediately after they find out about it). Following such opting out, they are free to individually pursue their legal claims against the damaging party.

3) Notes and Outlook

The aforementioned proposed revisions to the CPC – (i) the amendment of the mechanism of a group action through an organization to also allow for reparatory actions and (ii) the novel group settlement method – would certainly facilitate collective redress in the event of "dispersed damages" and "mass damages", at least to some extent. In a future Volkswagen emissions scandal case, a stronger mechanism of group action would be in place than there is now.

The consultation process for the draft CPC was completed on 11 June 2018. Not surprisingly, while there was positive feedback from the consumer side (including *SKS*), the proposed measures were met with resistance by various stakeholders of the Swiss economy (including *economiesuisse*). *Inter alia*, it is alleged that the effectiveness of these measures has not been proven, that these measures are not compatible with the Swiss legal system and that, due to such consumer-friendly measures, the economy would be destabilized.

While some of the reservations certainly are justified and need to be carefully assessed, a fear of an "Americanization" of Swiss civil proceedings – that at least for some seems to inform their resistance – is not warranted. Such a Swiss system of group action would still be rather moderate and in any event far away from the notoriously plaintiff-friendly system of group action in the United States. The US style group action model not only allows a group of people with related legal claims to bring their claim to court together in one action and a verdict to be generally binding on all members of the group (class action with an "opt-out system"), but also provides for punitive damages (in addition to actual damages), extensive discovery and trial by jury.

In any event, it remains interesting to see whether the proposed new mechanisms to facilitate group action in Switzerland will stand their ground in the current review phase and later in the parliamentary discussion. For the time being, it is difficult to predict when a revised CPC (with or without these new mechanisms to facilitate group action) would enter into effect.

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Revised FINMA Anti-Money Laundering Ordinance

Reference: CapLaw-2018-45

On 18 July 2018, FINMA published its revised Anti-Money Laundering Ordinance (the AMLO-FINMA). The revised AMLO-FINMA is noteworthy not so much for what it contains, but rather for what it does *not* contain.

By Katrin Ivell

On 18 July 2018, FINMA published its revised Anti-Money Laundering Ordinance (the AMLO-FINMA). During the public consultation period (*Vernehmlassungsprozess*), 29 parties (mostly banks and self-regulation organizations, but also e.g. Transparency International Switzerland and the Swiss Law Society (*Schweizerischer Anwaltsverband*)) commented on (and criticized) what was then the draft AMLO-FINMA. Among the planned changes that attracted particular criticism featured (1) the mandatory verification of the beneficial owner of assets, and (2) the mandatory periodic review (and, if necessary, update) of the customer information (KYC). Some parties doubted that there was a sufficient legal basis for FINMA to introduce these obligations by way of including them in the AMLO-FINMA. Recognizing that an introduction of these obligations might consequently lead to increased legal uncertainty, FINMA dropped these two proposals for inclusion in the AMLO-FINMA. Instead, they now feature as proposals in the Anti Money Laundering Act (AMLA) which is currently also undergoing a revision process. Another notable provision that did *not* survive the draft stage of AMLO-FINMA relates to FINMA's proposal to include business relationships that involve other service providers among the catalogue of "increased risk"-examples. FINMA's proposal specifically singled out scenarios where third parties are involved (1) in the referral of the business relationship to the bank (e.g. finders, introducers) or (2) in its management (such as external asset managers) for constituting potential "increased risk"-factors.

The result is a revised AMLO-FINMA that contains new (or revised) provisions relating, among other things, to the following:

- Requirements for the global monitoring of risks;
- Mandatory risk management measures where domiciliary companies or complex structures are used and where there are links with high-risk countries; and
- The identification measures for cash transactions (specifically, the previous threshold of CHF 25,000 has been lowered to the FATF level of CHF 15,000)

Somewhat unusually, it is already foreseeable that some of the provisions of the AMLO-FINMA that have now been revised may need to be revised yet again even before they

are due to enter into force. This is because the AMLA is also currently undergoing a revision process (see above). One of the proposed changes to the AMLA concerns the simplification of what is currently a two-tiered system of notification of suspicious activity (one voluntary regime, one mandatory regime) into one mandatory notification reporting system of suspicious activities. If the changes to the AMLA will survive the public consultation period and enter into force, the provisions of the revised AMLO-FINMA that deal with the voluntary reporting of suspicious activities will become obsolete and will have to be deleted.

Subject to the comments made above, the revised AMLO-FINMA will enter into force on 1 January 2020, together with (1) what is anticipated by then to be the revised AMLA; and (2) the revised Agreement on the Swiss Banks' Code of Conduct with regard to the Exercise of Due Diligence (VSB).

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EU PRIIPs Regulation and MiFID II – Impact on Debt Capital Markets Offerings

Reference: CapLaw-2018-46

In January 2018, two next sets of European rules affecting debt capital markets offerings into the European Economic Area (EEA) have come into effect: the PRIIPs Regulation (EU 1286/2014) on key information documents for packaged retail and insurance-based investment products (PRIIPs) and MiFID II (Directive 2014/65/EU on markets in financial instruments). The PRIIPs Regulation requires that a key information document be prepared and published for all offerings to retail investors that are in scope of the regulation. Its applicability to different types of bonds has been subject to much debate. This article presents an overview of the new regulation and consequences for debt capital markets transactions that include offers to European retail investors. In addition, the article discusses the implications of the new MiFID II rules, which have imposed new product governance obligations on MiFID firms when they manufacture and/or distribute financial instruments. Both sets of rules have resulted in new selling restrictions and contractual provisions being introduced in bond documentation.

By Dorothee Fischer-Appelt

1) Overview

a) What is a PRIIP?

The PRIIPs Regulation includes a broad definition of what investment constitutes a PRIIP (Article 4(1), (2) and (3), and Recital 6): an investment, where "regardless of the legal form of the investment, the amount repayable to the retail investor is subject to

fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor" (Art. 4(1)), or an insurance-based investment product which offers a maturity or surrender value that is wholly or partially exposed, directly or indirectly, to market fluctuations. The Regulation lists examples of investment products such as investment funds, life insurance policies with an investment element, structured products and structured deposits. The characteristics of a PRIIP include that assets are packaged or wrapped together so as to create "different exposures, provide different product features or achieve different cost structures as compared with a direct holding". The Regulation specifically excludes a list of products from its scope, including deposits solely exposed to interest rates as well as assets that are held directly such as corporate shares or any debt securities issued by, or guaranteed by, EEA member states or one of their regional or local authorities and related public international bodies and central banks (Art. 2). Third country sovereign entities are not specifically excluded from the scope in the body of the rules.

b) Retail investors

The Regulation defines retail investors as:

- Retail clients defined in Art. 4(1)(11) of MiFID II (i.e., a client who is not a professional client as defined in MiFID, which may include corporates, public sector bodies, local authorities and municipalities), or

- customers as referred to in the Insurance Mediation Directive (2002/92/EC), where they would not qualify as professional clients under Art. 4(1)(10) of MiFID.

c) KID

The PRIIPs Regulation requires a new, pre-contractual disclosure document to be prepared that needs to be "made available" before retail consumers invest in investment products that are PRIIPs. This key information document (KID) is a stand-alone document, although it may contain cross-references to other documents including a prospectus, and is intended to enable retail investors to compare products and make a more informed investment choice. The template for KIDs is set out in a delegated regulation (EU 2017/653), which comprises the regulatory technical standards implemented under the PRIIPs Regulation. The Joint Committee of the European Supervisory Authorities has also published Q&As on the KID. The KID should be no longer than three pages in length and has to be clearly separate from any marketing materials and not contain cross-references thereto. The key information presented needs to be consistent with the bond transaction documents, the offering memorandum and the bond's terms and conditions.

The KID is a very technical document and includes a section titled "What are the risks and what could I get in return?" In addition, a summary risk indicator (SRI), supple-

mented by a narrative explanation of that indicator, has to be included as well as a standardised risk score between one and seven, based on quantitative analysis (Art. 6(1), (2)). Different methodologies are used in the SRI to calculate the risk score, depending on the characteristics of the product and whether the product has a performance history. The main methodologies estimate the risk based on historical changes in the price of the product or on other factors on which the product's return is based or may be assumed to be based. In addition, firms are required to describe the other main risks that are not included in the SRI, although this is limited to 200 characters.

d) Responsibilities and Updating KIDs

A KID has to be produced by the "PRIIPs manufacturer" before it is made available to retail investors, and the manufacturer, in the case of debt securities typically the issuer, has to publish the document on its website. In practice, banks will help issuers with the preparation of KIDs, as some of the information included in a KID relates to marketing and investment returns. Any person selling a retail investor a PRIIP (including managers in a bond offering) must provide those investors with a KID before they are bound by any contract or offer relating to a PRIIP. There is no definition of what "make available" (Art. 5(1)) means under the Regulation, although it is likely that in addition to publication on a website a further distribution process would be required to ensure that the KID has been provided to a retail investor before the investor is taking its investment decision and with sufficient time to consider the decision.

A new requirement for bond issuers is the obligation to review the information in the KID regularly and make a revised document available promptly on their website where the review indicates that changes need to be made (different from the prospectus rules, where a prospectus once a transaction has completed does not need to be updated). In its PRIIPs guidelines, the EU Commission stated that this requirement does not mean that a 'real time' KID needs to be provided (although systems for producing such KIDs are allowed), but that the frequency with which the manufacturer must review and revise the KID depends on the nature of the PRIIP and the extent to which the information provided in the KID remains accurate and not misleading.

e) Territorial application

In its guidelines issued in July 2017 (OJ C 218/11, 7.7.2017), the EU Commission confirmed that non-EEA persons who produce or distribute PRIIPs are also caught by the Regulation if they sell products to EEA retail investors.

f) Penalties and Liability

There are significant penalties for not providing a KID before "making available" PRIIPs to a retail investor in the EEA. For legal entities, the fine can be up to EUR 5,000,000

or up to 3% of the total annual turnover or up to twice the amount of profits gained or losses avoided because of the infringement where those can be determined.

A retail investor who shows it has incurred a loss resulting from reliance on a KID may claim damages from the PRIIP manufacturer for that loss in accordance with applicable national law. However, the manufacturer will not have civil liability solely on the basis of the KID, unless at the time of the investment the KID is misleading or inaccurate, inconsistent with the relevant parts of the legally binding documents or inconsistent with the required form and content for a KID under the PRIIPs Regulation. This position is similar to the liability for summaries of prospectuses under the EU prospectus rules.

2) Bond Documentation and Selling Restrictions

In order to be sure not to trigger an obligation to prepare a KID, where a bond could be considered a PRIIP, market participants need to include selling restrictions and legends to ensure the bonds will not fall under the PRIIPs regime, excluding sales to EEA retail investors.

The International Capital Market Association (ICMA) has published standard form selling restrictions aimed at ensuring that no securities are offered or otherwise made available to retail investors where no key information document (KID) has been prepared. Different forms are available for program and standalone bond documentation.

The exclusion of sales to retail investors is different from the common selling restrictions under the Prospectus Directive (2003/71/EC) and the appropriate selling restrictions under the Prospectus Directive still have to be included (the combined ICMA form now includes a three-prong set of restrictions, combining the PD public offer regime and the PRIIPs Regulation). In particular, the definition of retail investor under the PRIIPs Regulation is not identical with the distinction between retail and "wholesale" securities under the EU Prospectus Directive, such that securities sold solely in denominations of at least EUR 100,000 may still be within the scope of the PRIIPs regime. In addition, excluding "qualified investors" under the Prospectus Directive would not be sufficient to ensure that there is no retail distribution under the PRIIPs regime and therefore both sets of selling restrictions have to be included.

The Prospectus Regulation (EU 2017/1129), which will apply in full from July 2019, creates a new "qualified investor" only segment of the market for non-equity securities, which will also still need PRIIPs restrictions due to the differences in definitions of retail investor. The Prospectus Regulation also provides that the prospectus summary may be substituted by the KID where issuers have produced a KID and home Member States are allowed to require that the prospectus summary be substituted by the KID.

Legends should also be included on announcements, and standard form wording is available for contractual provisions prohibiting sales in the EEA to retail investors.

3) Scope – which bonds are PRIIPs?

As noted above, the question of whether an investment constitutes a PRIIP, turns on whether the "amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the retail investor".

For debt securities, their characteristics need to be considered on a case-by-case basis, unless the securities in question are very vanilla debt products, such as fixed or floating rate bonds with bullet redemption, or bonds redeemed at par, or bonds with fixed amortisation, as in each such case the amount repayable to investors is not subject to fluctuation. Securities that would likely be PRIIPs include securitisations, convertible bonds, products with exposure to underlying, subordinated debt and repackagings, bonds that include a put or call option, or bonds with make-whole features (a call provision that allows the issuer to pay off all or part of the debt early), as those features could make the "amount repayable" subject to fluctuation, even where that is only in a limited set of circumstances.

Absent specific guidance from the European Securities and Markets Authority (ESMA) on the issue, much debate has taken place in the last year in particular with respect to corporate bonds with "make-whole" clauses or callable bonds. In July 2018, the UK Financial Conduct Authority issued a "Call for Input regarding the PRIIPs Regulation", including what the FCA could do to clarify the kinds of products covered by the new rules, specifically referring to the issue of whether certain corporate bonds are in or out of scope of the Regulation. The deadline for responses is 28 September 2018 and the FCA feedback statement is expected to be published in the first quarter of 2019.

It has been argued that "repayable" in the Regulation should be read to refer to a bond's principal amount rather than any interest payments, which would significantly narrow the applicability of the PRIIPs Regulation and exclude from the scope bonds with make-whole clauses as well as floating rate bonds with coupon exposure to reference rates (see B. Reynolds/T. Donegan/K. Stehl/E. Teo/I. Song, Shearman & Sterling, Perspectives, PRIIPs and Capital Markets Transactions: A Better Way Forward?, April 26, 2018).

The EU Commission must review the PRIIPs Regulation by 31 December 2018. Therefore, further clarification and/or amendments may be published after that date, which may include more guidance on the scope of the Regulation and its applicability to particular types of bonds.

4) MiFID Product Governance

Another important new set of rules affecting debt capital markets are the MiFID II rules establishing a new product governance regime, which requires persons that manufacture or distribute financial instruments to have a specified process for approval of each financial instrument and to identify a compatible target market of investors for each financial instrument and assess all risks relevant to the identified target market in order to ensure that the financial instrument and intended distribution strategy are consistent and compatible with the needs and objectives of the identified target market. This regime has to be complied with in an "appropriate and proportionate" way. ESMA has published Guidelines on product governance requirements that manufacturers should use when considering the potential target market for a financial instrument, including the type of clients, their knowledge and experience, financial situation with a focus on the ability to bear losses, risk tolerance and compatibility of the risk/reward profile of the product with the target market and the clients' objectives and needs.

A MiFID firm is an investment firm established in the EEA and subject to MiFID II, and it is considered a manufacturer if it is one that is involved in the creation, development, issuance and/or design of the bonds. Banks have internal policies in place to determine whether they are a MiFID firm manufacturer on a bond issue. In the case of a bond offering, the lead manager acting as adviser to the issuer would be treated as the manufacturer under MiFID II and would have to establish and maintain policies for approval of the debt securities before they are marketed and distributed to an identified target market and for periodic review thereof. A lead manager would also likely be a distributor in a bond issue (and would therefore comply with both obligations as manufacturer and distributor), whereas any other MiFID firms in a syndicate of underwriters offering or recommending the bonds would be distributors. Distributors determine the actual target market by adopting the manufacturer's target market or refining it.

Where the lead manager is not a MiFID II firm (e.g., because it is not established in the EEA), but another distributor is a MiFID II firm, then that other manager would be obligated to seek information from the lead manager and would determine its own target market of EEA investors for the bonds. Where none of the issuer or any of the managers is a MiFID firm manufacturer, the product governance obligations do not apply and the parties do not need to identify a target market of investors for the bonds. Typically, under this fact pattern no MiFID legends would be included in the documentation. Where a non-EEA issuer establishes a MTN programme, given that it is possible that a MiFID Firm accedes as a manager on a drawdown, MiFID legends are typically included. It has to be noted that the PRIIPs Regulation is entirely separate from MiFID and its applicability (and whether any legends are needed to exclude it) depends on whether any packaged products are sold to retail investors in EEA Member States.

MiFID II firms wishing to limit their disclosure requirements under MiFID II product governance rules may limit their identified target market to sophisticated investors by

including legends and selling restrictions similar to those used under the PRIIPs Regulation and could use high denominations. ICMA has developed a paper setting out suggested procedures for bond offerings to professional investors only, including legends, a co-manufacturer agreement, high denominations, EEA selling restrictions and the absence of a KID, in an attempt to develop "appropriate and proportionate" compliance. In practice, these selling restrictions have been widely used whenever a MiFID firm is involved in an offering, providing (in case of a stand-alone bond) as follows: "the target market assessment in respect of the Notes has led to the conclusion that: (i) the target market for the Notes is eligible counterparties and professional clients only… and (ii) all channels for distribution of the Notes to eligible counterparties and professional clients are appropriate. Any person subsequently offering, selling or recommending the Notes (a "distributor") should take into consideration the manufacturer['s/s'] target market assessment; however, a distributor subject to MiFID II is responsible for undertaking its own target market assessment in respect of the Notes (by either adopting or refining the manufacturer['s/s'] target market assessment) and determining appropriate distribution channels".

5) Conclusion and Outlook

The application of the new MiFID II product governance rules and what constitutes "appropriate and proportionate" compliance continues to evolve in practice. For bond issuances, selling restrictions limiting offerings to eligible counterparties and professional clients have been widely used in practice. As to the PRIIPs Regulation, absent further pronouncements by EU authorities, or guidance from national EU regulators (such as the FCA), if there is a chance that a particular bond could be categorised as a PRIIP, issuers would want to prepare a KID prior to the bond being offered to EEA retail investors, unless there is certainty that the bond would not be sold to retail investors, in order to avoid potential liability for a breach of the PRIIPs Regulation, both on the part of the issuer and the distributing banks. In practice, many offerings are excluding retail offerings and using selling restrictions to that effect. From a policy point of view, it would be sensible for EU regulators to exclude bonds that are otherwise "plain vanilla" and only make the amount repayable subject to fluctuation in limited circumstances, such as in case of make-whole features which are often included in corporate bonds. There does not seem to be much value for retail investors to have access to KIDs for those corporate bond issuers to compare a bond in question to another bond, where the bond as such is not a complex structured instrument and the credit rating will turn on the underlying credit of the corporate issuer. It would also be helpful for EU regulators to exclude non-EEA sovereign offerings from the scope, and to clarify how KIDs have to be "made available" to investors. It remains to be seen, what clarifications ESMA and the EU Commission will provide as part of the year-end 2018 review foreseen in the PRIIPs Regulation.

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Overview of SIX's Directive on the Use of Alternative Performance Measures

Reference: CapLaw-2018-47

For many companies listed on the SIX Swiss Exchange Ltd (SIX), the use of alternative performance measures (APMs) has become a regular tool for communicating the business and financial performance of a company to investors. In light of the widespread use of APMs, their diverse application and the increasing risk of investors being misled, SIX Swiss Exchange Regulation Ltd has issued a new Directive on the Use of Alternative Performance Measures (the Directive). This article provides a brief introduction to the Directive and its application to issuers listed on SIX.

By Deirdre Ní Annracháin

On 20 March 2018, SIX Exchange Regulation issued a new directive on the use of alternative performance measures (the Directive) by issuers in their financial reporting. The aim of the Directive is to promote the clear and transparent use of alternative performance measures (APMs) (article 1).

1) Definition of APMs

The Directive defines an APM as "a financial measure of historical or future financial performance, financial position or cash flows other than a financial measure defined or specified in the applicable recognised accounting standards" (article 3 para.1). It cites the following as examples of APMs:

- operating earnings;
- cash earnings;
- earnings before non-recurring expenses;
- earnings before interest, tax, depreciation and amortisation (EBITDA);
- net debt;
- organic growth; and
- similar terms designating adjustments to line items of income statements and statements of comprehensive income, balance sheets or cash flow statements.

(article 3 para. 2)

Within this (non-exhaustive) list of APMs, EBITDA (and related measures, such as Adjusted EBITDA) may be one of the most widely used by issuers. As a non-IFRS/Swiss

GAAP measure, the way in which it is calculated may vary from company to company. The adjustments made in calculating Adjusted EBITDA are another source of potential discrepancy as such adjustments reflect a range of management judgements that are often unique to each company.

Specifically excluded from the definition of an APM are physical measures, such as number of tonnes (often used, for example, by issuers operating in food-related industries), and other non-financial performance measures. Such other non-financial performance measures could include, for example, number of subscribers or average revenue per user (ARPU) often reported by telecom companies. Performance measures which are defined by other regulations that are applicable to issuers, such as solvency, are also excluded. As a result of this exclusion, it is likely that capital adequacy metrics which banking and financial institutions are required to report under Swiss and European financial regulations, such as regulatory capital ratios (e.g. Common Equity Tier 1 capital ratios), will not be deemed APMs.

2) Application of the Directive

The Directive applies to all issuers whose registered offices are in Switzerland and have equity securities listed on SIX Swiss Exchange Ltd (SIX), as well as issuers who do not have a registered office in Switzerland, but whose equity securities are listed on SIX and not on the stock exchange of their home country (article 2).

The requirements of the Directive, which are set out further below, apply to information disclosed by issuers periodically or for a specific event for the purpose of maintaining listing which contains APMs that are not included in the issuer's financial statements as prepared in accordance with applicable accounting standards (e.g. Swiss GAAP or IFRS). Such information includes, *inter alia*, annual reports, management commentaries and press releases relating to periodic financial reporting (article 4 para. 1).

The Directive explicitly states that it does not apply to prospectuses relating to the listing of securities and investor presentations (article 4 para. 2). However, best practice in Switzerland suggests that the level of financial disclosure provided by an issuer in a prospectus or presentation material to investors should generally be maintained in future financial reporting, such as annual reports etc. Therefore, where an APM is introduced for the first time in a prospectus or investor presentation, and the issuer intends to maintain the same level of disclosure in future financial reports (as is best practice), then the requirements of the Directive will apply indirectly and by extension to such prospectus or presentation.

The Directive enters into force on 1 January 2019, and is applicable for the first time to annual statements for all financial years commencing on or after that date (article 10).

3) Requirements of the Directive

The Directive sets out five requirements for the presentation of APMs by issuers.

The first is that APMs must be meaningfully labelled and explained using clear and comprehensible definitions. The label of the APM must not be misleading under the circumstances, and should reflect the manner in which the APM was calculated (article 5).

The second is that where an APM is based on or derived from a measure included in financial statements prepared in accordance with recognised accounting standards, and has been adjusted by adding or omitting specific items, then a reconciliation statement to a comparable measure in the financial statements must be disclosed, along with an explanation of significant reconciliation items. For example, EBITDA financial figures are usually accompanied by a reconciliation to net income or similarly titled line items from an issuer's financial statements. An exception to this rule is that if the APM is directly apparent from the financial statements prepared according to recognised accounting standards (e.g., if it is a subtotal indicated in the financial statements), then no reconciliation is required (article 6).

Third, issuers may not present APMs more prominently than measures that are defined in financial statements prepared in accordance with recognised accounting standards. Issuers are required to ensure that there is a "balance" between APMs used and the performance measures defined or specified in the applicable accounting standards (article 7). This is likely to be of particular relevance to issuers who have historically given significant prominence to EBITDA and other related measures, as it may be necessary to reduce the emphasis on such figures in favour of measures that are consistent with recognized accounting standards, such as revenue and profit.

Fourth, APMs must be presented consistently. Comparative information for previous periods must be disclosed, and the definition and method of calculation for the APM must be used consistently over time. Any inconsistency must be disclosed, along with a description of the change, and comparative information must be adjusted accordingly (or, failing this, an explanation as to why an adjustment was not made must be given under the "comply or explain" principle) (article 8).

Finally, in providing the information required by the Directive, issuers may refer to other documents, such as an appendix to the annual report or a central document on a web page. However, any such documents referred to must be publicly accessible at the time the relevant disclosure is made (article 9).

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SIG Combibloc Group IPO on SIX Swiss Exchange

Reference: CapLaw-2018-48

SIG Combibloc Group, a leading provider of aseptic carton packaging solutions for the food and beverage industry, sucessfully priced its IPO and listed its shares on the SIX Swiss Exchange, where trading commenced on 28 September 2018. The offering consisted of a base offering of both new and existing shares and a fully exercised over-allotment option of additional existing shares. The shares priced at CHF 11.25 per share, implying a total market capitalization of approximately CHF 3.6 billion.

Credit Suisse Group AG Issuances of Tier 1 Contingent Write-down Capital Notes

Reference: CapLaw-2018-49

Credit Suisse Group AG (CSG) completed the issuances of CHF 300 million 3.5 per cent. Perpetual Tier 1 Contingent Write-down Capital Notes and USD 1.5 billion 7.250 per cent. Perpetual Tier 1 Contingent Write-down Capital Notes on 4 September and 12 September 2018, respectively. The Notes are "high trigger" regulatory capital instruments that are eligible to fulfill CSG's Swiss going concern requirements, featuring a full contractual write-down if (among other events) CSG's consolidated common equity tier 1 capital falls below 7 per cent. of its consolidated risk weighted assets. The Notes are traded on the SIX Swiss Exchange. Since the Notes are eligible to fulfill Swiss going concern requirements, they also qualify for an exemption from the Swiss withholding tax that would normally be applicable to bonds directly issued by the Swiss-domiciled CSG.

Leonteq AG Completes Rights Offering

Reference: CapLaw-2018-50

On 3 August 2018, Leonteq AG, a SIX Swiss Exchange listed independent expert for structured investment products and long-term savings and retirement solutions, completed the issuance of 2,989,593 new shares from existing authorized capital in a fully underwritten rights offering. The offering generated net proceeds of approx. CHF 118 million which Leonteq intends to use to further strengthen its capital base in order to facilitate and support the continued growth of its business. The new shares were listed and first traded as of 3 August 2018.

Tender Offer for Bank Cler by Cantonal Bank of Basel

Reference: CapLaw-2018-51

On 2 August 2018, the Cantonal Bank of Basel, which already holds 77.52% of the share capital and the voting rights of Bank Cler Ltd., published the offer prospectus regarding its public tender offer for all publicly held bearer shares of SIX Swiss Exchange listed Bank Cler following the publication of a pre-announcement in June 2018. On the basis of the results of the fairness opinion of an independent expert, the board of directors of Bank Cler recommended to its shareholders to accept the offer at CHF 52 per share. Based on the indicative timetable the offer, if declared successful, is expected to be settled on 17 October 2018.

AC Immune SA Rights Offering and Public Offering

Reference: CapLaw-2018-52

On 23 July 2018, AC Immune SA, a Swiss-based, clinical-stage biopharmaceutical company focused on neurodegenerative diseases, completed the placement of 8.5 million newly issued shares for gross proceeds in the amount of approx. USD 99.9 million. The offering SEC-registered subscription rights offering to the company's eligible shareholders and a simultaneous SEC-registered public primary offering to institutional investors of any shares not subscribed for by eligible shareholders in the subscription rights offering.

5th Symposium on Compliance in the Financial Services Industry (5. Tagung zur Compliance im Finanzdienstleistungsbereich)

Tuesday, 13 November 2018, Lake Side, Zurich

http://www.eiz.uzh.ch/uploads/tx_seminars/Programm_Compliance_13.11.2018.pdf

Capital Markets and Transactions XIV (Kapitalmarkt – Recht und Transaktionen XIV)

Tuesday, 27 November 2018, Metropol Zurich

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