

Briefing December 2018

Swiss reaction to possible expiry of EU equivalence assessment for Swiss stock exchange regulation

On 30 November 2018, the Swiss Federal Council passed an ordinance designed to remedy the possible expiry, at the end of this year, of the EU Commission's decision recognizing the equivalence of the Swiss legal and supervisory framework applicable to SIX Swiss Exchange and BX Swiss for purposes of article 23 MiFIR. The ordinance seeks to ensure that EU investment firms may continue to trade Swiss shares on Swiss stock exchanges after 1 January 2019. By requiring EU trading venues to discontinue the trading of Swiss shares, unless they obtain FINMA recognition for foreign trading venues admitting Swiss shares to trading, the ordinance aims to eliminate any market for Swiss shares listed in Switzerland in the EU and thus allow EU investment firms to continue to trade on the Swiss market. The practical impact of the ordinance will be limited in respect of foreign trading venues outside the EU as they are expected to receive the necessary recognition before the end of 2018. The ordinance has been enacted for a limited time until the end of 2021, and will only actually deploy its effects for EU trading venues if the EU Commission does not extend its equivalence decision of 2017 beyond the end of 2018.

This briefing outlines the ordinance and its impact on trading in shares of Swiss issuers in Switzerland and in the EU.

Background: obligation of EU investment firms to trade shares on EU or recognized third-country trading venues

Since 3 January 2018, EU investment firms have not been free to choose where they trade shares: Article 23(1) of Regulation (EU) No 600/2014 (MiFIR), adopted in connection with Directive 2014/65/EU (MiFID II), requires EU investment firms (as defined by MiFID II) to ensure that the trades they undertake in shares admitted to trading on a regulated market

or traded on a trading venue in the EU shall, subject to certain exceptions, take place either (i) on a regulated market or MTF or through a systematic internalizer in the EU, or (ii) at a third-country trading venue assessed as equivalent in accordance with article 25(4)(a) of MiFID II.

The trading obligation of article 23(1) MiFIR is stipulated in its IIIrd Title concerning "Transparency for Systematic Internalizers and Investment Firms Trading OTC", suggesting that its aim is to increase the transparency of share trading by concentrating it

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on trading venues as opposed to OTC trading. Investment firms are also required, in accordance with article 27(1) MiFID II, to execute orders on terms most favourable to their clients ('best execution'). This obligation is, however, subordinated to the obligation to trade on-venue. An exception to the requirement under article 23(1) MiFIR applies for trades where "their characteristics include that they are non-systematic, ad-hoc, irregular and infrequent" (article 23(1)(a) MiFIR).

When it became clear in November 2017 that the EU Commission would not be in a position, before the end of that year, to issue equivalence assessment decisions in respect of all or even most third countries on whose trading venues EU investment firms are active, the European Securities and Markets Authority (ESMA) published guidance in which it stated that "[w]hile the Commission is preparing equivalence decisions for the non-EU jurisdictions whose shares are traded systematically and frequently in the EU, the absence of an equivalence decision taken with respect to a particular third country's trading venues indicates that the Commission has currently no evidence that the EU trading in shares admitted to trading in that third country's regulated markets can be considered as systematic, regular and frequent". This statement allowed investment firms not to apply article 23(1) MiFIR for shares from most non-EU jurisdictions, since the Commission only considered equivalence for the USA, Hong Kong, Australia, and Switzerland.

At the same time, ESMA stated that where the trading obligation does apply, all EU investment firms who are part of a chain of transmission should ensure that the ultimate execution of the order complies with it – in other words, an EU investment firm cannot escape the restriction of article 23(1) MiFIR by instructing a local broker in a third country to execute a trade.

The EU Commission's 2017 equivalence decision for Switzerland

Shares of Swiss issuers listed on the SIX Swiss Exchange do not tend to be concurrently listed on

regulated markets in the EU, but they are widely admitted to trading on multilateral trading facilities (MTFs) (such as BATS Chi-X Europe and Turquoise). At the same time, EU investment firms who are foreign-based participants of SIX Swiss Exchange ('remote participants') account for a significant proportion of the trading volume on its platform (including in Swiss shares). Were they no longer permitted to trade Swiss shares on SIX Swiss Exchange, trading volumes might therefore substantially decline. EU brokers, on the other hand, would face difficulties offering 'best execution' to their clients as they would be prevented from accessing the trading venue with the highest liquidity for Swiss shares.

In December 2017, the EU Commission issued a number of decisions recognizing positive equivalence assessments for third-country trading venues, including those in Switzerland. While the decisions concerning the USA, Hong Kong, and Australia were not made subject to any time limit, the decision relating to Switzerland (i.e. the Swiss stock exchanges SIX Swiss Exchange and BX Swiss; Commission Implementing Decision (EU) 2017/2441 of 21 December 2017) was limited until 31 December 2018 and would expire unless it was extended by the Commission. This limitation was not based on any determination relating to any legal or supervisory deficiency; indeed, the Commission recognized that the Swiss legal and supervisory framework was equivalent (recital 25 of the 2017 decision). When deciding whether to extend its applicability, the Commission should, according to recital 30 of the 2017 decision, in particular consider progress made towards the signature of an agreement establishing a common institutional framework for existing and future agreements through which Switzerland participates in the Single Market. Such an institutional framework constitutes a long-standing objective of the EU Commission which is the subject of on-going negotiations with the Swiss government. The Commission's decision to set an expiry date for the equivalence recognition and link its extension to progress in the matter of the institutional framework was - in the words of a draft committee report from the European Parliament - "primarily political, and used to gain leverage in a separate policy matter"

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(Committee on Economic and Monetary Affairs, Draft report on relationships between the EU and third countries concerning financial services regulation and supervision of 4 April 2018).

The Swiss Federal Council's Ordinance

In a press release of 8 June 2018, the Swiss Federal Council had already announced the adoption of a "contingency measure to protect Switzerland's stock exchange infrastructure" in the case of non-extension of the EU's equivalence assessment. On 30 November 2018, the Federal Council passed its Ordinance on the Recognition of Foreign Trading Venues for the Trading of Equity Securities of Companies with Registered Office in Switzerland of the same date (hereinafter the 'Ordinance'). The Ordinance has its legal basis in article 184(3) of the Swiss Federal Constitution, which provides that the Federal Council may issue ordinances and rulings (which must be of limited duration) under its power to conduct Switzerland's foreign relations, where safeguarding the interests of the country so requires. The measure is, therefore, based on the Federal Council's direct constitutional authority to intervene in matters of foreign relations.

The Ordinance provides that from 1 January 2019 (and until 31 December 2021), foreign trading venues will need a recognition from FINMA if equity securities of issuers domiciled in Switzerland are traded thereon, which are at the same time listed on a Swiss stock exchange or traded on a Swiss trading venue (or if the foreign trading venue facilitates the trading of such securities). A 'grandfathering' exemption applies for foreign stock exchanges (but not MTFs) that have listed or admitted Swiss equity securities to trading (with the express consent of the issuer) prior to 30 November 2018.

FINMA shall grant the relevant recognition if a foreign trading venue (a) is subject to appropriate regulation and supervision, and (b) does not have its registered office in a jurisdiction that restricts its market participants in trading equity securities of Swiss companies on Swiss trading venues and thereby significantly

adversely affects the trading in such equity securities at Swiss trading venues (article 2(1) of the Ordinance).

The second of these conditions will permit FINMA to refuse recognition to EU trading venues as long as the EU Commission does not extend the equivalence assessment for SIX Swiss Exchange and BX Swiss. FINMA may grant recognition to foreign trading venues under the Ordinance either on request or without a request (which it is expected to do for all relevant non-EU trading venues before the end of 2018), and is mandated to publish a list of all such recognized venues. The Federal Department of Finance, in turn, publishes a list of the jurisdictions that fail the non-restriction condition of article 2(1)(b) of the Ordinance. Currently, this list refers to all Member States of the EU (including the United Kingdom, pending Brexit).

What the Ordinance is intended to achieve

The Ordinance is not intended to work as a retaliatory measure or even, strictly speaking, as a counter-measure, but rather as a remedy to ensure indirectly that EU investment firms may continue to trade Swiss shares on Swiss stock exchanges despite a possible expiry of the equivalence recognition. This aim may be achieved in two ways:

If, as of 1 January 2019, all EU trading venues where Swiss shares listed in Switzerland have previously been traded cease to permit such trading (with the possible exception of 'grandfathered' listings on regulated markets), thereby complying with the Ordinance, then the trading restriction of article 23(1) MiFIR will no longer apply to EU investment firms, because the Swiss shares are no longer "admitted to trading on a regulated market or traded on a trading venue" in the EU (except for any 'grandfathered' dual-listed shares). To avoid any substantial inconvenience for EU investment firms who would need to access Swiss trading venues directly, the Ordinance provides some facilitation for foreign firms that newly become participants of Swiss trading venues in that connection, to allow them to obtain the requisite

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FINMA licence on a temporary basis with phased-in compliance with record keeping and reporting duties. If such full compliance by EU trading venues is not achieved and some trading in Swiss shares persists, then EU investment firms will need to consider whether they are permitted to continue trading on Swiss stock exchanges under the exception provided by article 23(1)(a) MiFIR in respect of "non-systematic, ad-hoc, irregular and infrequent" trading. Prior guidance by ESMA (see above) appears to support the understanding that it is sufficient, for this exception to apply, that the trading of Swiss shares in the EU is non-systematic etc.; this is in line with a view expressed by the EU Commission (in a press release of 13 December 2017) that the trading obligation presupposes that trading in the EU constitutes a significant percentage of a share's global trading volume. It is therefore expected that EU investment firms will conclude that, if the levels of trading in Swiss shares on EU trading venues (or OTC within the EU) have decreased so as to appear non-systematic, irregular and infrequent, the firms will still be permitted under MiFIR to execute their trades on the Swiss stock exchange where the shares have their primary listing and where trading in them is most liquid. The trading of EU-based issuers' shares on Swiss trading venues will, however, remain restricted for EU trading firms under article 23(1) MiFIR.

Sanctions and enforcement

Article 5 of the Ordinance designates the Ordinance as a Swiss financial markets act. Consequently, FINMA has the authority to enforce it against supervised entities, including foreign trading venues that are already recognized in Switzerland because they admit Swiss regulated financial institutions as participants. Moreover, article 44 of the Federal Act on the Swiss Financial Market Supervisory Authority (FINMASA) provides that a person who wilfully or negligently carries out an activity requiring a licence, recognition, or registration under the Swiss financial market acts,

without actually holding such licence, recognition or registration, commits a criminal offence (punishable by a fine or, if committed wilfully, a custodial sentence of up to three years). In the context of the Ordinance, these criminal sanctions are expected to apply to the decision-makers (directors and executive managers) of any non-compliant foreign trading venue.

In addition, FINMA may also seek to take enforcement measures against supervised market participants who execute trades in Swiss shares on EU trading venues that are not recognized under the Ordinance. Its supervisory powers apply not only in respect of Swiss banks and securities dealers, but also to EU investment firms who have participant status on a Swiss stock exchange and are licensed to that effect by FINMA (article 40 of the Financial Market Infrastructure Act (FMIA)). They range from a declaratory ruling (article 32 FINMASA) to the revocation of the licence (article 37 FINMASA) and include the power to issue directions to such firms with a view to restoring compliance with the law, even where the firms themselves are not guilty of a breach of their supervisory obligations (article 31 FINMASA).

Although practical problems of EU trading venues, whose process of admission of shares to trading is relatively informal, in ensuring compliance with the Ordinance cannot be excluded, the aforementioned potential sanctions are likely to cause most venues to seek to comply with the Ordinance by ceasing to permit trading in Swiss shares as of 1 January 2019. The need to stop trading in Swiss shares on EU trading venues may, however, still be averted if the EU Commission extends (permanently or at least temporarily) the equivalence recognition for Swiss stock exchanges before the end of 2018, in which case EU trading venues would become eligible for, and would doubtless receive, the FINMA recognition required under the Ordinance.

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	Article 23(1) MiFIR	Impact of the Ordinance	Enforcement of the Ordinance
Swiss trading venues	Not directly applicable, but Swiss trading venues will cease to satisfy the equivalence requirement of article 23(1) MiFIR, if the equivalence decision expires on 31 December 2018. After that date, it will only be possible to trade on Swiss venues if trading in the EU ceases or is deemed to be non-systematic, ad hoc, irregular and infrequent.	–	–
EU trading venues	Not directly applicable, but EU trading venues satisfy the requirements of article 23(1) MiFIR.	Recognition required (except for 'grandfathered' listings on EU regulated markets), but conditions for recognition will not be satisfied if equivalence recognition has expired.	Enforcement by FINMA, possibly including revocation of recognition as a recognized trading venue for admitting Swiss regulated participants (also affects trading in other securities). Criminal sanctions for directors and senior officers.
Other foreign trading venues	Not directly applicable, but other foreign trading venues satisfy the requirements of article 23(1) MiFIR because they are recognized as equivalent or because trading of shares in the EU is deemed to be non-systematic, ad hoc, irregular and infrequent.	Recognition required, and will be granted upon request or automatically by FINMA.	

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	Article 23(1) MiFIR	Impact of the Ordinance	Enforcement of the Ordinance	Impact on Trading
EU Investment firms	Applicable	Not directly applicable, but dealing on a trading venue which does not have the requisite recognition may result in FINMA enforcement action.	Enforcement measures by FINMA, if licensed as a direct participant on a Swiss stock exchange or acting through a Swiss branch or representative office.	<p>Cease trading Swiss shares listed in Switzerland on EU trading venues as a precautionary measure.</p> <p>Continue to trade Swiss shares on Swiss trading venues, if the shares are no longer traded on any trading venue in the EU or if the trading in the EU is non-systematic, ad hoc, irregular and infrequent.</p>
Swiss banks and securities dealers	Not applicable.	Not directly applicable, but dealing on a trading venue which does not have the requisite recognition may result in FINMA enforcement action.	Enforcement measures by FINMA.	<p>Cease trading Swiss shares listed in Switzerland on EU trading venues as a precautionary measure.</p> <p>Continue to trade on Swiss trading venues.</p>

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	Article 23(1) MiFIR	Applicability	Impact on trading
Equity securities of Swiss issuers with a listing in Switzerland	Applicable (if traded on EU trading venues)	Applicable	Lack of recognition for EU trading venues should induce EU trading venues not to admit the shares to trading or, at least, reduce the trading to non-systematic, ad-hoc, irregular and infrequent levels. Trading to take place exclusively in Switzerland or on foreign trading venues outside the EU.
Equity securities of Swiss issuers with a listing in the EU only	Applicable	Not applicable	Trading in the EU continues to be possible.
Equity securities of Swiss issuers with a dual listing in Switzerland and the EU	Applicable	Applicable, but grandfathering of trading on the relevant EU regulated market (not MTFs)	Trading in the EU can continue on the EU regulated market where the listing took place. Case-by-case determination if trading is non-systematic, ad-hoc, irregular and infrequent.
Equity securities of non-Swiss issuers, other securities (e.g. debt securities) and financial instruments	Applicable to shares	Not applicable	No impact

Further guidance in connection with the Ordinance has been published (also in English language) by the Federal Department of Finance ([see here](#)), by FINMA ([see here](#)) and by the SIX Swiss Exchange ([see here](#)).

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