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INTERNATIONAL FINANCIAL LAW REVIEW

The shock of the new

How fintech is modernising traditional banks –
and their regulators



High yield bond
covenants

Saudi's new Parallel
Market

US risk retention rules
in the ABS market

**Fintech special focus: the
view from the EU**

Regulating innovation

Peter Hsu and Daniel Flühmann of Bär & Karrer survey new Swiss Federal Council proposals to amend rules to facilitate fintech, and look at some of the pros and cons of the current system

Regulatory framework for fintech

The Swiss financial regulatory regime does not specifically address fintech. Rather, the legal framework governing the activities of fintech operators consists of a number of federal acts and implementing ordinances mainly in the areas of corporate law and financial market regulation, as well as circulars and supervisory messages issued by the Swiss Financial Market Supervisory Authority (Finma).

In particular, depending on their specific business models, fintech operators can become subject to the Banking Act (if engaging in activities involving the acceptance of deposits from the public); the Anti-Money Laundering Act (if active as a financial intermediary, for example in connection with discretionary asset management, payment services or lending); the Stock Exchange Act (if engaging in securities broker-dealer activities); the Collective Investment Schemes Act (if issuing or managing investment funds or engaging in other activities relating to collective investment schemes); the Consumer Credit Act (if granting or intermediating loans to consumers); or the Financial Market Infrastructure Act (if acting in a financial market infrastructure function, for example as a trading venue).

Relevant legal and regulatory requirements include, again depending on the specific business model, prudential licence and other regulatory authorisation or registration requirements as well as ongoing compliance and reporting requirements regarding organisation, capital adequacy, liquidity, documentation and other key aspects of a fit and proper business conduct. The laws and regulations provide for *de minimis* and other exemptions from their scope of application or from specific requirements, which may benefit fintech operators depending on their business or client base.

It is worth noting that the Swiss inbound cross-border regulatory regime for financial services is relatively liberal. In particular, Swiss banking and anti-money laundering regulations do not apply to fintech operators that are domiciled abroad and offer their services into



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Hsu has published several books and articles on topics in banking, insurance and capital markets and is regularly invited to speak on these topics. Hsu is ranked as a leading individual in the practice areas of banking and finance as well as insurance and reinsurance and listed as 'most highly regarded' practitioner in Insurance & Reinsurance (Who's Who Legal). In IFLR1000, a client characterizes him as 'very knowledgeable, detail-oriented and very open to novel solutions and approaches' (2016). The Legal 500 2014 refers to him as a 'key individual within the banking and insurance sector' and recommends him for insurance advice. In Who's Who Legal, he is quoted as the "go-to guy" for clients in need of insurance and reinsurance regulatory advice' (2013) and a 'key player in the Swiss insurance and reinsurance regulatory field' (2014), and wins praise for his 'unparalleled abilities'. In addition, he is described as 'extremely knowledgeable' in insurance and regulatory matters and lauded for his 'business oriented approach' (2016).

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Switzerland on a pure cross-border basis, that is without employing persons permanently on the ground in Switzerland and without establishing a branch or representative office or any other form of relevant physical presence in Switzerland. However, other areas of financial regulation are more restrictive with regard to cross-border activities, notably the regulation of collective investment schemes.

Although the legal framework for fintech is based on various laws and regulations, the fact that Finma acts as main financial regulator in Switzerland ensures a consistent approach to the qualification and regulatory treatment of fintech operators. Furthermore, Switzerland provides for an established system of industry self-regulation in respect of specific areas of financial services (for example in the area of money laundering prevention or with respect to certain activities in connection with collective investment schemes).

Recent legal developments

A diverse and dynamic fintech scene has the potential to contribute significantly to the quality and competitiveness of Switzerland as a financial centre. Not least for this reason, the Swiss Federal Council has launched a proposal for amendments to the Banking Act and the Banking Ordinance to ease the regulatory framework for fintech operators. A public consultation procedure regarding the proposed amendments was opened on February 1 2017. The planned exemptions and reliefs are based around three main pillars:

- Creation of a largely unregulated innovation sandbox: This will allow operators to accept deposits from the public in an amount up to CHF1 million (\$1 million) without requiring a banking licence, creating an opportunity to test innovative business models without unnecessary regulatory burden.
- Specific regulatory amendments regarding settlement accounts: It is proposed to extend the maximum period during which third party monies can be held in so-called settlement accounts without qualifying as deposits from the public from currently seven days (Finma practice) to 60 days. This is meant to enable business models that require operators to hold substantial amounts of third party monies, but only for a limited time, by carving out a longer period during which this is possible without triggering any prudential licence requirement.
- Creation of a new licence type (banking licence light): To facilitate the step-up from an unregulated activity to a prudentially regulated status, it is proposed to create a new type of licence for operators that have a need to accept deposits from the public but do not intend to engage in traditional banking business. The new licence type will allow the acceptance of deposits from the public up to a maximum of CHF100 million, subject to certain limitations but with the benefit of substantially less burdensome regulatory requirements than a fully-fledged banking licence.

While the proposals are primarily aimed at fintech operators, the regulatory approach is neutral in terms of technologies and business models. This means that the new exemptions and reliefs will also be available to businesses outside the fintech space. The proposed new regulation is currently expected to enter into force by 2018.

Pros and cons of Switzerland as a base for fintech operators

While Swiss financial market laws are not specifically tailored to fintech, the principle-based approach to regulation generally copes well with the challenges of innovative business models. It also offers a high level of flexibility to address the rapid developments in the financial industry. In addition, Finma has implemented certain enhancements to existing regulation to make it more technology-neutral (and thereby technology-friendly) in the interest of a level playing field for all market participants (for example by dropping the requirement for a written agreement for discretionary asset management or by enabling video identification for money laundering prevention purposes).

That said, the current limitation that only regulated banks are allowed to accept and hold deposits from the public in a professional capacity results in an all-or-nothing approach for certain fintech operators. This is because holding third party monies, at least for a certain period of time, is a crucial element of many fintech business models, such as crowdfunding platforms and certain payment services. As a banking licence is usually impractical or not economically viable for fintech operators, they are forced to offer their services on a cross-border basis from abroad into Switzerland or to tailor their business around the regulatory restrictions, which can prove difficult. However, the planned amendments to the Banking Act and the Banking Ordinance (see above) can be expected to address these shortcomings, making Switzerland considerably more attractive as a base for deposit-based fintech business models.

Furthermore, the following factors add to the attractiveness of Switzerland as a base for

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fintech operators: financial and political stability; excellent universities and educational system; availability of expertise and opportunity to recruit skilled workforce; presence of global players and competitors in the industry; liberal labour laws; availability of venture capital; and a generally innovation-friendly climate. For example, the region around the city of Zug has established itself as a centre for innovation in the areas of blockchain and cryptocurrencies.

Impact of the revised Directive on Payment Services (PSD2)

Switzerland is not a member of the EU nor of the European Economic Area. Consequently, it is in principle not bound by the Payment Services Directive nor by the revised Directive on Payment Services (PSD2), which is set to replace it.

However, many Swiss financial institutions participate in the Single Euro Payments Area (Seps) schemes that define standards for euro payments and that have been developed with a view to European legislation. In order to participate in the Seps schemes, Swiss financial institutions have to provide evidence to the European Payments Council (in legal opinions) that substantially equivalent provisions exist in national law and, in addition, enter into a Seps Adherence Agreement.

Regtech

Regtech is understood as a collective term for innovative technologies that relieve the compliance functions of financial institutions while promoting efficiency in regulatory oversight. This is especially important in the context of increasingly dense regulation in an international context, with regtech solutions promising superior agility and flexibility in addressing new requirements.

In Switzerland, the legal policy debate regarding regtech is still in its infancy. However, on June 17 2016, the Swiss National Council (the large chamber of Swiss Parliament) adopted a postulation (*Postulat*) regarding the promotion of digitisation in regulation. Finma also shows a generally positive attitude towards regtech. It might be expected that regtech will lead to a reduction of the regulatory efforts in the financial sector by facilitating the administrative burden of complying with regulatory requirements. *Inter alia*, this should lead to reduction of the costs associated with compliance (for the market participants as well as for Finma). However, regtech might also promote an increase in regulation, for example in the context of risk management system design.