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Implementation of the revised FATF Recommendations in Switzerland

The Financial Action Task Force (FATF) Recommendations for Combating Money Laundering were revised in 2012. Swiss legislators followed with a speedy implementation that entails many important changes for financial intermediaries and other stakeholders.

NEW RULES UNDER THE FATF REVISION

On an increasingly frequent basis, money laundering and the financing of terrorism are being combated on the basis of rules based, in turn, on international standards and recommendations. A leading role is played here by the Financial Action Task Force (FATF), of which Switzerland is a member. The recommendations issued by the FATF (FATF Recommendations) do not represent any directly applicable law, but rather constitute so-called “soft law”, which must first be implemented into national law. A failure to implement could result in reputational damages or the imposition of sanctions by other states. In December 2014, following a somewhat heated debate, the Federal Parliament reached a consensus in this regard, making reference to the consequences resulting from a failure to implement the rules on a timely and consistent basis.

The legislative package that was adopted has an impact on a number of different areas of law. The deadline for a referendum against the implementation will expire on April 2, 2015, but a referendum is not anticipated and it is assumed that a speedy implementation will take place, in part already during the current year.

The implementation of the FATF Recommendations has resulted in numerous new rules for financial intermediaries that they must incorporate into their business processes. Above all, additional clarification and documentation effort and expense must be expected.

Peter Lutz, Attorney-at-Law, Dr. iur., LL.M.

PEP

The Anti-Money Laundering Act (AMLA) assumes that transactions involving politically exposed persons - so-called PEPs – are particularly sensitive with a view to potential money laundering and that adherence to special duties is therefore necessary. The PEPs are now newly defined in the AMLA itself. As to date, foreign persons who have been entrusted with prominent public functions fall under the PEP definition. What is new, on the other hand, is the fact that even persons domiciled in Switzerland can be deemed to be a PEP, provided that they are entrusted domestically with prominent public functions in politics, the administration, the military or the judiciary.

Foreign politically exposed persons, so-called PEPs, retain this status even after their term of office has ended, an aspect that financial intermediaries must take into account in connection with the opening of business relationships.

What is also new is the fact that persons having a prominent function in an international organization or international sports association are also deemed to be PEPs. Furthermore, someone who is classified as a PEP now continues to be classified as a PEP even after that person has left office. Whereas this continued classification as a PEP is limited to 18 months in the case of Swiss PEPs, no such time limitation applies with respect to other PEPs. Currently, it is still unclear as to whether this continued classification as a PEP also applies in cases where the term of office ended prior to the effective date of the new rules.

SPECIAL DUE DILIGENCE OBLIGATIONS

A financial intermediary is required in each case to perform general due diligence inquiries to identify the contracting party. In addition, the financial intermediary must clarify the background and purpose of a transaction or a business relationship when, among other things, it constitutes a transaction or business relationship with an increased risk. The AMLA itself now stipulates that a transaction must be viewed as having an increased risk whenever a foreign PEP or a person closely associated with a foreign PEP (based on family, personal or business reasons) is involved in the transaction. In all other cases, an increased risk exists only if other criteria are fulfilled. Due to the expansion of the PEP definition both in terms of substance and duration, an increase in the number of these cases can be expected.

BENEFICIAL OWNERS

Whereas a financial intermediary has until now only been required to identify the beneficial owner in certain situations, it must now do so in each case, thus, including in the case of operating companies, applying the level of due care required under the circumstances. An exception applies to exchange-listed companies and the companies under their control. In the case of an operating legal entity, the beneficial owner is whoever directly or indirectly, either alone or in concert with third parties, owns at least 25% of the capital or voting interests or otherwise controls the company. If no such controlling ownership interest can be ascertained, the identity of the top member of the managing body, for example, the chairman of the board of directors or the CEO, is to be verified.

CASH TRANSACTIONS

The debate that received the greatest amount of attention in the public arena was the debate on a prohibition on cash transactions for amounts over CHF 100,000. This rule was not implemented in a strict form and therefore only applies in the case of public auctions under the Swiss Federal Act on Bankruptcy and Debt Collection. In day-to-day business, however, for example, in connection with a purchase of real estate, art, jewelry or cars, dealers must observe special due diligence obligations if they accept more than CHF 100,000 in cash in connection with a commercial transaction. In this case, they must identify their contracting party, ascertain the beneficial owner of the transaction and fulfil certain documentary obligations. If the circumstances surrounding the transaction appear unusual to the dealer, he must additionally clarify the background and purpose of the transaction. An auditor must then review compliance with these due diligence obligations. These due diligence obligations do not apply if the amount exceeding CHF 100,000 is processed via a financial intermediary (for example, a bank).

NOTIFICATION TO MONEY LAUNDERING REPORTING OFFICE OF SWITZERLAND (MROS) AND ASSET FREEZE

In the case of suspected money laundering, a financial intermediary is required to submit a report. This report does not, as it has to date, automatically result in a freeze of the relevant assets. The financial intermediary may continue to carry out customer instructions provided that this does not thwart a later seizure of the assets and does not constitute terrorist financing. A freeze of the assets takes place only if and when the Reporting Office gives notice that it is forwarding the matter to the criminal prosecution authorities.

A new requirement is the unlimited prohibition on providing information, i.e., the financial intermediary may not inform its customer about the report at any point in time. As an exception,

disclosure is allowed if the financial intermediary is dependent on such disclosure in order to protect its own interests in civil litigation or criminal or administrative proceedings.

TERRORISM LISTS

Lists of suspected terrorists have been maintained at an international level for some time now. The revised AMLA now governs the treatment of such lists. Lists issued based on Resolution 1373 of the UNO Security Council will be sent by the Swiss Federal Department of Finance, following a formal inspection, to the self-regulatory organizations to the attention of their member financial intermediaries. Financial intermediaries must then fulfil special clarification and reporting obligations if a contracting party is on the list.

PREDICATE OFFENSE FOR MONEY LAUNDERING

In the revised FATF Recommendations, fiscal offences are now explicitly included as predicate offenses for money laundering.

According to present Swiss law only fraud with regards to assets originating from a felony may constitute a predicate offence for money laundering. Fiscal offences are not felonies and are therefore not in the scope of a predicate offence for money laundering. When implementing the new FATF Recommendations, Swiss Parliament therefore agreed that tax fraud may constitute a predicate offense to money laundering if the evaded taxes amount to at least CHF 300,000 per tax year.

In contrast to a simple tax evasion, tax fraud is currently committed only when a person uses forged, falsified or substantively untruthful documents in order to deceive the tax authorities. Not before the pending revision of fiscal offences is introduced a taxpayer may commit a tax fraud when maliciously evading taxes. By not declaring a bank account held directly, a taxpayer commits a simple tax evasion only. Even if the account is held by a trust or a foundation, no tax offence is committed per se, and, thus, no predicate offence for money laundering is given.

SUMMARY

The tougher, expanded obligations will trigger implementation costs. Financial intermediaries must incorporate the new rules into their clarification and documentation processes. It should be further noted that, as will be discussed in the following section, fundamental changes that the financial intermediary must take into account in connection with its business activities have also occurred in connection with company law issues. §

Peter Lutz, Martin Kern, Natalie Peter

Persons who already hold bearer shares or acquire them in the future will need to take care that they comply with the new statutory reporting duties on a timely basis, since otherwise their pecuniary claims will be forfeited in part.

Thomas Schmid, Attorney-at-Law, lic. iur., LL.M.

Impact of the revised anti-money laundering legislation on company law.

The amendments to Swiss legislation based on the revised FATF Recommendations are not limited to the direct anti-money laundering-related standards under the Anti-Money Laundering Act, but also include certain significant changes to Swiss company law.

REPORTING OBLIGATION REGARDING BEARER SHARES

Up until now, Swiss stock corporation law has permitted shares to be issued in two fundamentally different forms: bearer shares and registered shares. In the case of bearer shares, all that is required in order to exercise the shareholder rights is the mere possession of the share itself. A transfer of the bearer share and the rights thereby entailed correspondingly is simple and anonymous. On the other hand, in the case of registered shares, an additional prerequisite for the company's recognition of shareholder status is that the owner of the shares discloses to the company his position as shareholder and is entered in the company's share ledger, with his name and address.

The anonymity of the bearer shareholders, and the inability to trace share transfers, were considered to constitute a deficit in the combat against money laundering in Switzerland. The FATF Recommendations basically provided for two approaches to address the deficit: either the complete elimination of bearer shares or the elimination of the anonymity entailed by bearer shares. At the end of the day, what prevailed was the position that while formally the concept of bearer shares will be maintained, they will nonetheless be de facto eliminated due to the obligation to disclose one's position as shareholder to the company.

As to date in the case of registered shares, the acquirer of bearer shares will now also be required to disclose his position as shareholder to the company.

The new rules provide that the acquirer of bearer shares in an unlisted Swiss stock company must, within one month of the acquisition, notify the company about the acquisition as well as report his name and address (as well as each subsequent change in this respect). This applies regardless of whether or not a certain threshold has been reached. However, the reporting obligation does not apply if the bearer shares are structured as book-entry securities (Bucheffekten). The company, on the other hand, is required to keep and retain a register of the bearer

shareholders or to have a corresponding register be kept by a financial intermediary. The bearer share thus de facto is converted into a registered share.

In addition to the reporting obligation on the part of the direct acquirer of the bearer shares, the new rules also prescribe a reporting obligation regarding the beneficial owner of shares. The corresponding reporting obligation applies in connection with both bearer shares as well as registered shares and arises if someone acquires shares of a company, either alone or acting in concert with third parties, and therefore attains or exceeds the threshold of 25% of the share capital or the voting rights.

Instead of relying on the formal ownership situation, an economic perspective is used to setermine beneficial ownership: a person is considered to be the beneficial owner is the person who enjoys the economic benefits of ownership associated with the share in question – this does not necessarily need to be the person holding the ownership title. What comes to mind, for example, is a fiduciary relationship, where the direct owner of a share holds the share for the account of a third party – the beneficial owner. This reporting obligation also applies under the same conditions in the case of limited liability companies (GmbHs).

CONSEQUENCES OF A BREACH OF THE REPORTING DUTY

An acquirer of bearer shares who fails to comply with his reporting obligation or submits a tardy report must accept far-reaching legal consequences. First of all, the shareholder rights associated with the bearer share remain suspended until the report has been submitted. Thus, the acquirer is not entitled, in particular – despite his ownership of the shares – to exercise his voting rights as shareholder of the company at the annual shareholders' meeting. Furthermore, once the one-month reporting period has passed, the pecuniary rights associated with the acquired bearer shares are forfeited for the period between the date of acquisition and the date on which the reporting duty is met. Claims to dividends that have been forfeited cannot be restored, even once the reporting duty is subsequently met.

In the event that the report is not made on a timely basis, the dividend claims of the bearer shareholder may be forfeited.

NEED FOR ACTION BASED ON THE NEW RULES

There is a need for action on the part of both acquirers of bearer shares as well as companies that have issued bearer shares. Persons who acquire bearer shares following the effective date of the new legislation must notify these to the company, since otherwise they will forfeit the pecuniary rights associated with the shares for the duration of the period that the report remains outstanding. Persons already holding bearer shares upon the effective date of the new rules must likewise comply with the reporting duty, whereby in this case the forfeiture of the pecuniary rights will not take effect unless the reporting obligations are not met until six months after the effective date.

Companies with bearer shares must implement the necessary structures and processes to ensure the maintenance of the register relating to the bearer shares.

Members of the board of directors are also required to put in place the necessary structures and controls to ensure that the registers relating to the bearer shares and the beneficial owners are kept and retained. It should be noted in this regard that it is possible to have the register be maintained by a third party, provided that the third party qualifies as a financial intermediary under the Anti-Money Laundering Act. Such a delegation requires a corresponding resolution by the shareholders' meeting. §

Thomas Schmid, Martin Kern

The OECD standard for administrative assistance in tax matters definitively eliminates banking secrecy for all parties concerned. In connection therewith, the financial institutions will increasingly become the "extended arm" of the tax administrations.

Natalie Peter, Attorney-at-Law, Dr. iur., LL.M., TEP

Amendments to the rules on administrative assistance and the automatic exchange of information

At its meeting of January 14, 2015, the Federal Council launched two consultation procedures on the international exchange of information in tax matters. The first bill relates to the Administrative Assistance Convention of the OECD/Council of Europe signed by Switzerland in 2013. The second bill concerns Switzerland's participation in the Multilateral Competent Authority Agreement and the implementing act for the automatic exchange of information (AEOI).

CURRENT SITUATION

In March 2009, the Federal Council decided to adopt in full the OECD standard on administrative assistance in tax matters pursuant to Article 26 of the OECD Model Convention and to withdraw its reservation to the OECD Model Convention on this provision. Since then, a total of 49 double taxation agreements (DTAs) in accordance with the international standard have been signed, of which 41 are in force. Moreover, Switzerland has signed 7 tax information agreements (TIAs), of which 3 are in force. Since then, joining the OECD standard has permitted Switzerland to increase the number of countries with which it can exchange information on a case-by-case basis upon a specific and substantiated request. Within the scope of its strategic directions for a competitive Swiss financial center that adheres to international standards in the tax area and, in particular, those with respect to transparency and the exchange of information, the Federal Council resolved, among other things, to join the Convention of the Council of Europe and the OECD on Mutual Assistance in Tax Matters (Administrative Assistance Convention). The Convention was signed at the OECD in Paris on October 15, 2013.

ADMINISTRATIVE ASSISTANCE CONVENTION

Since entering into force in 1988 and undergoing revision in 2009, the Administrative Assistance Convention has been signed by all G20 countries and nearly all OECD members. Further, during the past two years, its scope of application has been further expanded to include 153 overseas territories and colonies. Due to this broad fundament of signatory states, accession to the Administrative Assistance Convention now represents the standard in terms of international cooperation in tax matters.

The Administrative Assistance Convention contains the substantive legal basis for the administrative assistance between two contracting states and provides for three forms of information exchange:

1. The contracting parties are obligated to exchange information concerning a certain situation upon **specific request** by another state. The content and scope of the exchange are governed, in particular, by Article 26 of the OECD Model Convention and the related commentary. Group requests are also governed by this provision. The Administrative Assistance Convention will substantially increase the number of partner states with which Switzerland may exchange information upon request based on the OECD standard.

2. Based on the Administrative Assistance Convention Switzerland will have to introduce the **spontaneous exchange of information.** Data will not be transmitted following a prior specific request, but rather when the transmitting state suspects that another state may have an interest in the information that it already has in its possession.

3. The Administrative Assistance Convention also provides that one or more contracting parties may agree upon the **automatic exchange of information** (AEOI). In connection with the AEOI, information that is defined in advance will be transmitted to the other state on a routine basis and at regular intervals.

By making a reservation, the Federal Council intends to restrict the applicability of the Administrative Assistance Convention for tax offenses committed willfully and subject to criminal sanctions to a time period following the Convention's signing by Switzerland in 2013.

AUTOMATIC EXCHANGE OF INFORMATION

Basis

In October 2014, 51 countries and territories signed a multilateral agreement on the principles for the implementation of the AEOI (Multilateral Competent Authority Agreement; MCAA). Subsequently, in November 2014, the Federal Council resolved to sign the MCAA and signed it the same day.

The MCAA is an instrument intended to implement the AEOI developed by the OECD. Each signatory state had to indicate the date by when it intends to implement the AEOI. The so-called "early adopters" intend to collect data as from 2016 and to carry out an initial exchange in September 2017. Other states, including Switzerland, intend to carry out their

Upon the implementation of the new FATF Recommendations for combating money laundering as well as the changes to administrative assistance, many new obligations will result for both financial intermediaries well as non-financial intermediaries. Our specialists are tracking these changes and can competently advise and support you on pragmatic implementation processes and the questions arising in this regard.

initial exchange of data in 2018, based on data from 2017.

In order for Switzerland to be under a legal obligation towards another state under the AEOI, however, the following prerequisites must be met:

- both states have implemented the Administrative Assistance Convention.
- both states have signed the MCAA.
- both states have confirmed that they have at their disposal the necessary legislation to implement the AEOI standard.
- both states have informed the Secretariat of the MCAA that they would like to automatically exchange information with the other state.

REPORTING STANDARD

The AEOI provides for a systematic and periodic exchange of information on accounts that a taxpayer (of one state who is a natural person or legal entity) maintains with a financial institution located in another state. The state of domicile should be given an opportunity to review and ultimately improve tax compliance on the part of its taxpayers.

In order to mitigate avoidance by the taxpayer, the information specified by the reporting standard is intended to be exchanged to the broadest extent possible. In this regard, the reporting standard defines the absolute minimum amount of information to be exchanged. The participating member states remain free, however, to exchange further-reaching information.

The financial institutions collect the information to be exchanged and transmit it to the tax authority of their country of domicile. That tax authority then forwards the information to the tax authority of the other contracting state.

The reporting standard defines, in particular:

- **the financial information to be reported**

This basically consists of information on the identity of the person being reported (name, address, date of birth, tax identification number, etc.) as well as on the account (account number, balance, interest, dividends, etc.). An exception applies to accounts that present a low risk of abuse (e.g., rental deposit accounts and pillar 3a retirement accounts). The report shall also include information relating to the financial institution.

- **the type of account holders that are subject to reporting**

In addition to individuals, passive investment entities such as trusts and foundations must also be reviewed, and, in certain cases, the person controlling the legal entity has to be reported. This is intended to prevent circumvention of the AEOI through the interposition of a passive entity. The standard also sets out clear guidelines on the identification of the beneficial owner of the account.

- **the scope of financial institutions required to deliver this information**

The financial institutions subject to the reporting duty include not only banks and custodians, but also investment companies and certain life insurance companies.

- **how the information is to be gathered**

The AEOI standard provides for differing due diligence obligations for existing accounts and new accounts. This is due to the fact that the gathering of information from existing account holders is deemed more difficult and time-consuming than in the case of an account opening.

SPONTANEOUS EXCHANGE OF INFORMATION

For Switzerland, the spontaneous exchange of information will be a new instrument when dealing with other contracting states. The Swiss authorities are required to spontaneously transmit information that is in their possession to the competent foreign authority if they suspect that the information is foreseeably relevant to the other contracting party. This may be the case, for example, if a taxpayer receives a tax reduction or tax exemption that would lead to a tax increase or taxation by another contracting state.

In contrast to the AEOI, there is no agreement in advance with one or more contracting parties that information (e.g. periodic interest earnings) will be routinely transmitted at regular intervals.

OUTLOOK

Not all of the provisions of the MCAA and the common reporting standard are sufficiently detailed und thus directly applicable. Therefore it is necessary to enact the Federal Act on the International Automatic Exchange of Information in Tax Matters (AEOI Act) first.

The consultations on both bills will run until April 21, 2015. The Federal Council's dispatches for the attention of Swiss Parliament are expected in summer of 2015, with Parliament to deliberate on the bills in the fall of 2015. Based on this timeline, it should be possible for the legal principles to come into force as from the beginning of 2017, even with a possible referendum. §

Natalie Peter