The New Swiss Federal Intermediated Securities Act – What Secured Parties Should Be Aware Of

On January 1, 2010, the new Swiss Federal Intermediated Securities Act (FISA) will enter into force. From that day forward, security interests in intermediated securities will only be valid if created in accordance with the terms of the FISA. In addition, the FISA may affect the rights of secured parties under security interests created prior to January 1, 2010.

Background

Under traditional Swiss law, the transfer of securities either follows the principles of property law – in the case of certificated securities – or the principles of the law of obligations – in the case of uncertificated securities. The new Swiss Federal Intermediated Securities Act (FISA), which enters into force on January 1, 2010, introduces a new category of rights: intermediated securities (Bucheffekten). Under the FISA, all intermediated securities are treated the same, irrespective of whether the underlying securities are in certificated or uncertificated form.

In its message of November 15, 2006 regarding the FISA (Botschaft), the Federal Council stated that intermediated securities have both the features of an object (Sache) within the meaning of the Swiss Civil Code (CC) and the features of a claim (Forderung) within the meaning of the Swiss Code of Obligations (CO). This statement raises the question: to what extent are the pre-FISA principles of Swiss law, such as the principles of accessoriness or causality, applicable to the new rights category of intermediated securities? Also, do the terms of the FISA addressing security interests in intermediated securities create a new form of security interest or do they simply govern the perfection of a security interest which is based on the existing categories of pledge (Pfand) and security transfer (Sicherungsübereignung).

What are Intermediated Securities?

According to Art. 3 and 4 FISA, intermediated securities are fungible (vertretbare) claims or membership rights vis-à-vis the issuer that are credited to a securities account (Effektenkonto) of an intermediary (Verwahrungsstelle). For purposes of the FISA, an intermediary must be a regulated entity, such as a bank, securities dealer or insurance company.

Following the entry of uncertificated securities in a main register (Hauptregister) and the lodging of certificates representing certificated securities with an intermediary, the act of crediting fungible claims or membership rights to a securities account with an in-
intermediary turns these claims or membership rights into intermediated securities under the FISA. Once such claims and membership rights are intermediated securities, any disposition (in particular, a transfer of, or the creation of a security interest in, the intermediated securities) are subject to the provisions of the FISA.

Applicable Law in an International Context

Certain amendments to the Swiss Private International Law Act (PILA) will become effective at the same time as the FISA. The new Art. 108c PILA states that the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (the Hague Convention) is applicable to conflict of law issues relating to intermediated securities and the creation of security interests therein, even before the Hague Convention itself enters into force.

According to the Hague Convention, the relevant parties (i.e., the investor and the intermediary or two intermediaries, as the case may be) may choose the applicable law in their account agreement, provided that the intermediary has a place of business (as defined under the Hague Convention) in the jurisdiction chosen by the parties at the time of the agreement. If the parties have chosen Swiss law, the transfer of, or creation of a security interest in, intermediated securities will be governed by the FISA. In addition, since the transfer of, and creation of security interests in, intermediated securities are governed by the new Art. 108c PILA, the limitations of Articles 102, 105 and 145 PILA will no longer apply. Articles 102, 105 and 145 PILA govern the choice of law in respect of outright transfers of security, pledges and assignments and state that a choice of law is permitted, but may not be invoked against third parties.

Security Interests in Intermediated Securities

Under the FISA, a security interest in intermediated securities may be created in two ways: (i) by a transfer of the intermediated securities to the account of the secured party (Sicherungsnehmer) (Art. 24 FISA); or (ii) by an irrevocable agreement between the security provider (Sicherungsgeber) and the intermediary holding the intermediated securities, that the intermediary will follow the directions of the secured party (Art. 25 FISA). The parties have three options when defining the object of security. The object of the security may be: (i) certain intermediated securities themselves, (ii) the intermediated securities that are credited with a certain account, or (iii) the intermediated securities credited with a certain account up to an agreed upon value.

In addition, the FISA provides for an additional method of granting a security interest in intermediated securities to the intermediary holding such intermediated securities. Any such security interest may simply be created by an agreement between the intermediary and the account holder (Art. 26 FISA).

It is worth noting that the FISA also recognizes the creation of a security interest in uncertificated intermediated securities by the assignment of the intermediated securities for security purposes (Sicherungszession), which is the method of creation under existing Swiss law. However, since a security interest created by assignment will rank behind any security interest created or any other disposition under the FISA (Art. 30 FISA), regardless of when created, security interests in intermediated securities should always be created in accordance with the provisions of Art. 24-26 FISA rather than by assignment.

Security Interests by Transfer

For the creation of a security interest by transfer, Art. 24 FISA requires (i) the security provider to instruct the intermediary to transfer the intermediated securities to the secured party’s account; and (ii) the credit entry (Gutschrift) of the intermediated securities to
the securities account of the secured party. The secured party can verify the perfection of the security by checking whether the intermediated securities have been credited to its account. Because the security provider is not in a position to verify that the security has actually been perfected, closing mechanics in secured financing transactions need to be adapted.

**Security Interests by Control Agreement**

Art. 25 FISA introduces a new concept to Swiss law: the creation of a security interest over intermediated securities by an irrevocable agreement between the security provider and the intermediary holding the intermediated securities (control agreement) that such intermediary will follow the secured party’s instructions without the need for any prior approval by, or consent of, the security provider.

In this case, in contrast to a security interest created by transfer, the intermediated securities remain credited to the securities account of the security provider. As account holder, the security provider may still dispose of the securities, which in view of the provisions of good-faith acquisition contained in the FISA may become an issue for the secured party. From a secured party’s perspective, this right should be restricted or eliminated in the control agreement and the security agreement between the security provider and the secured party.

As a novelty, it will now also be permissible under a control agreement to only determine a maximum of value of intermediated securities in an account which shall serve as security. This new option raises the question of whether it is sufficient if only the relative value of the object of the security is determinable (e.g., twenty per cent of a secured claim) or whether that maximum value must be expressed by reference to a fixed amount.

**Security Interests granted to the Intermediary**

According to Art. 26 FISA, the security provider may grant a security interest to the intermediary holding the relevant intermediated securities by way of an agreement. The agreement does not have to meet any specific requirements or be in a particular form, and may also be contained in the intermediary’s general terms applicable to the securities account. An intermediary may wish to amend its general terms, since the FISA (as opposed to the CC) does not specify if ancillary rights are also covered by the security and who will exercise voting rights of shares.

Further, Art. 21 FISA gives the intermediary a right of retention (Rückbehaltungsrecht) over the intermediated securities held with it. The terms of this right of retention are similar to those of the right of retention under Art. 895 CC.

**Transitional Provisions**

After a transition period of 12 months upon entering into force of the FISA, i.e., from January 1, 2011 on, security rights established in accordance with the FISA are higher ranking in relation to any security rights that are created under the current law and do not meet the requirements of the FISA. As an example: If today a security provider pledges uncertificated securities held with an intermediary to the benefit of a Party A, and on January 1, 2010 he grants a security interest in the same securities to Party B according to Art. 25 FISA, the security interest of Party B prevails, if Party A does not obtain, until December 31, 2010, a security interest in the intermediated securities that conforms with the requirements of the FISA. It will, however, be difficult for Party A to transform its pledge over the uncertificated securities into a FISA-conforming security interest if the security provider is uncooperative, in particular if the security agreements entered into before January 1, 2010 do not contain an obligation of the security provider to maintain the security.

**Two Particular Issues**

We like to draw your attention to two further issues that should be taken into account when drafting a security agreement over intermediated securities:
Pursuant to Art. 8 FISA, the account holder can ask for delivery of the intermediated securities at any time if the securities are in certificated form, or the account holder has a right to demand certification. As a result of the delivery of the certificated securities, the securities will no longer qualify as intermediated securities, and the FISA is no longer applicable. In such a situation, a secured party that has been granted a security interest in intermediated securities prior to their delivery to the account holder faces the risk that the security interest established under the FISA will no longer be valid and that a valid security interest has not been created under the CC or CO. We therefore recommend to include a provision in the control agreement and the respective security agreement that the security provider is not entitled to demand delivery of the intermediated securities.

Another issue may arise in connection with a security granted under the Art. 25 FISA. Should the security provider’s intermediary change, the secured party may entirely lose its security interest under the control agreement entered into between the security provider and the old intermediary, unless a control agreement is also entered into between the security provider and the new intermediary granting an equivalent security to the secured party. Further, all control agreements should be drafted so that a change of the intermediary is subject to the approval by the secured party.

Need for Action?

As consequence of the FISA’s entry into effect, a lot of paperwork will need to done. Existing security rights, most importantly in uncertificated securities held with an intermediary, will need to be reviewed and, if necessary, adapted to the system provided for by the FISA until December 31, 2010. Additionally, parties planning to establish security rights in intermediated securities after January 1, 2010 should weigh the pros and cons of the different FISA security rights and should evaluate which kind of security right to establish.

Finally, however, the result will be a more flexible system for providing security rights in intermediated securities providing for insolvency proof security rights for the benefit of secured parties.

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If you have any questions or require further information or advice, please contact your regular contact at Homburger or one of the members of the Financial Services Practice Group.

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