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Swiss Book Entry Securities Act ("BESA") And Related Changes Enter Into Force On January 1st 2010

Introduction

The current Swiss law on securities is still based upon the concept that a security is a certificated instrument such that the rights evidenced by the certificated instrument can only be exercised or transferred together with the certificated instrument. Possession of the certificated instrument is legitimating the exercise of the rights evidenced by such instrument and transfer of possession of the instrument is a precondition for the transfer of the rights evidenced by the instrument.

What once was intended to facilitate the transfer and trade of the rights evidenced by such certificates became increasingly a burden and costly factor for the transfer and trade of fungible securities traded on exchanges. Today, most securities are immobilised and deposited with a central custodian and both the transfer and exercise of the rights evidenced by such securities no longer require possession or physical transfer of the certificate from one person to the other. Registered shares, investment fund units and money market papers traded on the Swiss Stock Exchange are no longer certificated at all.

The legal concept used in Switzerland with collective custody was to create a so called modified and unstable co-ownership interest of the holders in the pool of fungible securities deposited with the central custodian or – as the case may be – in the global certificate. This somewhat artificial legal construction was required in order to make the solution insolvency proof in case of insolvency of the central custodian. The BESA foresees an amendment of the existing law to provide for an explicit legal basis for this co-ownership structure.

Uncertificated securities were introduced in Switzerland with the enactment of the Swiss Securities Trading Act ("SESTA"). Art. 2 lit. a SESTA defines uncertificated securities as rights not represented by certificates suitable for mass trading with the same function as certificated securities. However, there were no provisions governing the transfer of book entry securities. Under the existing Swiss law, uncertificated securities have no proprietary aspect but are treated as claims and other rights which are solely transferred by way of assignment. Most importantly, there is no good faith acquisition of such rights by way of assignment. First in time governs the priority.

Foreign jurisdictions have dealt with the decertification of securities by way of special laws such as France, Luxembourg, Belgium as well as in the United States of America (UCC Article 5). On an international level, the Hague Convention on the Law Applicable to Indirectly Held Securities was finalized and signed by the United States of America and also Switzerland. In the European Union the settlement finality directive and financial collateral directive are intended to create more certainty and to reduce the risk of the participants in a settlement and clearing systems.

The increasing competition of the securities market around the world and the need for efficiency and legal certainty in an international environment called for a revision of the existing Swiss substantive law for an amendment of the Swiss conflict of law rules for indirectly held securities. The BESA, which was approved in parliament in fall 2008, will enter into effect on January 1st, 2010. An unofficial translation of the BESA and the other changes to be introduced to the Swiss law is attached hereto.

Basic Framework of the Draft Book Entry Securities Act

The new law moved away from the concept of the modified unstable co-ownership interests (which, however, receive an explicit legal basis) and introduces the book entry security as a new and

distinct legal subject having a proprietary aspect. According to the definitions of the law, a book entry security is a fungible pecuniary or membership right against an issuer, credited to a securities account, transferable in accordance with the BESA and which right is enforceable against the custodian and third parties.

The creation of book entry securities is based upon two steps, (1) the deposit of a global certificate or certificated fungible securities with a custodian or the entry of uncertificated securities in the main register of a custodian and (2) the credit of the book entry securities to the account holder's securities account.

Limited Application of the BESA

The BESA does not mandate the immobilisation of securities with a custodian or the decertification. Consequently, the BESA provides for means permitting the introduction of securities to an indirect holding pattern as well as for their exit. The law applies only to securities deposited with a custodian as defined by the law. Under the new law, transfer of title as well as security interests depend upon registration in privately kept registers. This dependency was thought to be acceptable, where the custodians are subject to adequate regulation and supervision.

Use of Third Party Custodians

Indirect holding patterns have significant advantages over direct holding patterns, in particular in terms of efficiency and reduction of transaction costs. On the other side, indirect holding patterns have specific risks emanating from the use of third party custodians. In particular, a customer's claim against a custodian may not be covered by a sufficient number of disposable securities held with such custodian. Therefore, the BESA requires custodians to keep available sufficient disposable book entry securities to meet the account owners' claims.

Rights from Custody of Book Entry Securities

The BESA contains detailed rules regarding the rights of the account owners against the custodian maintaining the securities account. An account owner must exercise its rights exclusively against the custodian maintaining the securities account for the account owner. Likewise, creditors of the account owner will have to exercise their rights – if any – against such custodian. This also applies to attachments of securities. Book entry securities are disposed of exclusively by instructions from the account owner to the custodian, who will have to make the necessary bookings in the account.

Most importantly, an account owner's book entry securities are insolvency proof in case of the custodian's insolvency. The book entry securities are to be segregated and do not form part of the insolvency estate. In case there is a shortfall, the custodian's own book entry securities of the same kind will be segregated and, if there remains a shortfall, the account owners will share into the shortfall pro rata. Finally the BESA also governs the right of the custodian to make use of the book entry securities and the right of retention.

Disposal and Transfer of Book Entry Securities

One of the most important parts of the BESA deals with the disposal and transfer of book entry securities. A transfer of book entry securities may require one or several bookings in the multi tier holding pyramid, which may not necessarily take place simultaneously.

According to the BESA, the credit of book entry securities to the securities account with the custodian is decisive for the acquisition and transfer of indirectly held securities in an indirect holding pattern. Security interests can also be created by irrevocable agreement between the account owner and the custodian, pursuant to which the custodian is instructed to honour the instructions of the secured party without any further consent of the account owner. This will facilitate the perfection of security interest in favour of third parties. For a security interest of the custodian in the account owner's book entry securities held by such custodian, an agreement in writing suffices.

Since the credit to the securities account is decisive, the BESA also governs the preconditions for the cancellation of erroneous credits or debits as well as good faith acquisitions of book entry securities. Finally, the law also governs the liquidation of collateral and the liability of the custodians towards the account owners.

Right of Self Entry and Private Liquidation of Collateral

The BESA explicitly provides for a right of self entry of the secured party for book entry securities traded on a representative market and for private liquidation of

the collateral. The secured party may either sell the securities and apply the proceeds against the secured obligation or take ownership of the collateral and apply the value of the collateral against the secured obligation. This right survives the insolvency of the provider of the collateral and remains unaffected by restructuring or protective measures of whatever nature.

Increased Certainty in Insolvency

In connection with the BESA, also the Swiss Bankruptcy Act will be amended by a new Art. 287 para. 3, which provides that security interests cannot be challenged as a voidable preference, where book entry securities traded on a representative market are provided as collateral and where the debtor had a prior obligation to provide additional collateral in case the value of the collateral decreases or the secured obligation increases. Such transaction can, however, be challenged as intentional fraudulent conveyance, provided it can be demonstrated that the transaction was intended to defraud other creditors.

Conflict of Law Rules

The existing conflict of law rules in order to determine the law applicable to the transfer of rights to securities in an indirect multi tier holding pattern did not provide for sufficient certainty. In particular, different provisions are governing the transfer of title and the pledge as well as certificated and uncertificated securities. This uncertainty placed Switzerland at a competitive disadvantage in an international environment. Therefore, Switzerland has signed the Hague Convention on the Law Applicable to Indirectly Held Securities on July 5, 2006, together with the United States of America.

The Convention will enter into force with its ratification by at least three signatory states. The draft of the amendment to the Swiss Private International Law Act which also enters into effect on January 1st, 2010 provides for the direct application of the Convention and, therefore, the Convention will become national law upon the enactment of the changes, irrespective of the number of ratifications of the Convention at that time. With this change Switzerland will adopt the place of the relevant intermediary approach and become a PRIMA (place of relevant intermediary) jurisdiction.

The Hague Convention determines which law is to govern proprietary aspect of a securities transaction where such securities are held with an intermediary. This encompasses the legal nature and effects against the intermediary and third parties, resulting from a credit of securities to a securities account; the legal nature and effects against the intermediary and third parties of a disposition of securities held with an intermediary, perfection of disposition, priority rights, duties of an intermediary in case of conflicting interests, requirements for realisation of an interest in securities, extension of disposition of securities in respect of dividends, income, other distributions etc,. (*see* Art. 2 para. 1 Hague Convention).

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