

30.06.2015

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Watch out, holders of bearer shares – FATF is coming

Dear Sir or Madam,

Recently Switzerland tightened its money laundering regulations again, following a recommendation by the Financial Action Task Force (FATF, a working group of the OECD to fight money laundering), and as a result of the usual international pressure in such cases. The media covered this law revision extensively because of the originally planned ban on cash transactions above CHF 100'000. Even if the cash ban in its intended form was removed from the new legislation and other points were diffused by parliament, the law revision will have serious consequences for private stock corporations with bearer shares, and – in a somewhat reduced form – for all other private stock corporations and limited liability companies. Meanwhile, it has been reported that the new regulations already becomes effective on 1st July 2015, with a transition period of six months for some aspects. This means there is an urgent need for action for all private companies (respectively for those not listed on the stock market) to create the necessary structures in time. Below we would like to give you an overview of the issue at hand.

What problems do bearer shares create?

While companies issuing named shares have a so-called share register, and shareholders need to register every time they buy shares and only become shareholders once entered in the share register, no such structures exist with bearer shares. As all shareholder rights are embodied in an anonymous piece of paper and shareholders are entitled to pass this paper on to anyone, the company does not know the holders of bearer shares.

From the point of view of combating money laundering, this anonymity is a problem. Should dirty money turn up in a company, the law enforcement authorities could probably take measures against the board of directors, but not even the directors can say for sure who owns the company and who thus could be profiting from dirty money. Equally, large amounts of illegal money could be deposited in a company and then transferred without any paper trail by a handover of shares.

Which new obligations apply for bearer shares?

The legislator may have foregone the complete elimination of bearer shares, but de facto they are now on an equal footing with registered shares. The company must now keep a register of all its bearer shares.

Within a month after having acquired bearer shares the shareholders are required to give the company their full names and addresses, prove the possession of the bearer shares (e.g. by physically showing the original share certificate) and identify themselves (in case of individuals, for example, with copies of ID or passport, just as with opening a bank account). The company registers all these details and is required to keep all these documents created accessible in Switzerland for at least 10 years after each shareholder's withdrawal.

The shareholder on the other hand is required to inform the company of any changes of name or address within a month.

As there is no mandatory identification for holders of named shares via copy of ID or passport or similar, the transparency regulations for bearer shares have become even tighter than for named shares!

Generally, the Board of Directors is obliged to keep the share register accurately. If the company, for whatever reasons, does not want to know who its shareholders are, this obligation can be transferred to a financial intermediary subject to the money laundering regulations, following a decision of the general assembly.

Which further obligations apply for corporations and LLCs?

For all kinds of shareholdings, including participations in LLCs, there is now an obligation to determine and document the beneficial owner if at least 25% of the shares are held. These beneficial owners are the individuals (one or several persons) who are behind all holdings, intermediate companies, fiduciary arrangements and so on, and are in reality the actual economic beneficiaries of the assets. To put it simply, a private investor who invests his or her own money will declare himself or herself as beneficial owner; the fiduciary, however, needs to declare his or her client or financial backer, and the investment holding needs to declare its own private shareholders or, should it belong to another holding company, the shareholders of that company, etc.

Should the threshold of 25% be reached, the shareholder needs to register the full names and addresses of the economic beneficiaries, and additionally all later alterations must also be registered. The company, on the other hand, keeps a register with all this information and stores all documents that have been received, accessible in Switzerland, for at least 10 years after the withdrawal of each shareholder.

What are the possible sanctions?

The law provides that failure to provide information can lead to a cessation of membership rights and even to forfeiture of proprietary rights. Thus a shareholder who has failed to register in time can neither exercise his or her voting rights at the annual general meeting nor is entitled to receive dividends, to just name the most important rights. De facto, he or she will be treated like someone who is not a shareholder. Should the registration, occur too late, all rights will be reinstated from the date of registration onwards, and the shareholder will be considered as such from then on.

Particularly severe is the forfeiture of the dividend: although the shareholder is entitled to receive dividends accrued after the late registration; however, any previously decided dividends are irrevocably forfeited, and any payments of such dividends are against the law.

The final version of the law does not provide any criminal sanctions for violation of the registering requirements, for neither the shareholders nor for the board of directors who is obliged to keep the share register and directories. Nevertheless the board of

directors must ensure that only shareholders who are entitled to exercise their rights can and shall do so. Should the board fail to keep the share register correctly, and therefore shareholders illegally attend the annual general meeting or even receive forfeited dividends, then it risks facing civil lawsuits to challenge the decisions of the general meeting, or liability lawsuits for damaging the company.

Which periods of transition apply?

The change in law comes into effect as per 1st July 2015, and the new regulations will immediately apply for all new share purchases. For existing shareholders and partners that do not acquire new securities, a period of transition of six months applies for the forfeiture of proprietary rights (i. e. for passively receiving dividends without participation at the annual general meeting), until 1st January 2016.

Then at the very latest all shareholders and partners need to have registered, and all share registers and directories need to be fully up-to-date and documented.

How best to proceed?

As bearer shares are now treated more strictly than named shares, their last advantages have been eliminated, and you should now seriously consider whether to convert your capital into named shares. The new law even provides some simplifications to do so. Should you intend to go down that road, you need to change your statutes with the notary.

You should also introduce the structures for the keeping of the share registers and the list of beneficial owners. You can use the previous registers for named shares as template for the new records of bearer shares; however, they possibly might need to be expanded to include the additional information required. You also need to determine how to proceed with identifying the shareholders, and where and how you store the resulting documents.

Now you should inform your shareholders and partners what information you require from them and support them with the relevant registration. As owner of an SME you generally are either majority shareholder or minority shareholder with a substantial holding, thus subject to the 25% rule. So please remember registering your own information correctly and have it entered in the company's documents.

For the future please remember that any changes among the shareholder base requires demanding the relevant information, and even any change of address or name must be correctly registered and documented.

Finally it has become more important than ever to ensure that only the right (correctly registered) shareholders are invited to the annual general meeting and that only correctly registered shareholders receive dividends. If in doubt, ask to have the original bearer shares presented. Should you find this to be too cumbersome, then you have yet another reason to move over to paperless named shares.

Conclusion

Compliance is far from being a businessman's favourite topic. Nevertheless you should be treating these new regulations seriously from the first day, and actively introduce the required structures. As long as you have no changes in your shareholder base, it is a one-time manageable effort that helps avoid a lot of hassle and liability claims particularly when – for whatever reasons – you are required to present these documents to anyone.

artax is here to help you, both as competent contact for these issues and as financial intermediary subject to money laundering regulation.

Kind regards

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