

NEW FINANCIAL SERVICES ACT: UPDATE ON REQUIREMENTS FOR FINANCIAL SERVICES PROVIDERS

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This blog is part of a series of several briefings on the new Financial Services Act (FinSA). On 6 November 2019, the Swiss Federal Council approved the implementing Ordinance of the FinSA (FinSO) which contains changes from the initial draft, some of them with significant importance. In this blog, we will look at new requirements to which financial services providers will be subject under the FinSA and highlight certain important points brought by the FinSO.

The FinSA and the FinSO will enter into force on 1 January 2020. The purpose of the FinSA is to impose similar requirements to financial services providers thereby creating a level playing field, in addition to improving client protection. Under the current system, there is no framework applicable to financial services and instruments in general, but different rules apply depending on the specific financial services providers or financial instruments.

The FinSA will significantly change the Swiss regulatory landscape and will impact both Swiss providers and providers based outside Switzerland which offer financial services or instruments to Swiss investors on a cross-border basis. The requirements of the FinSA should generally be aligned with the Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (MiFID II). Nevertheless, differences will subsist and even MiFID II compliant firms shall review and analyse their duties under the FINSA. In addition to setting new requirements for financial services providers, the FinSA will introduce a comprehensive prospectus and key information document regime.

The FinSA does not address licensing requirements and the need to obtain an authorisation of the FINMA, which is dealt with in other statutes such as the Banking Act, the Financial Infrastructure Act, the Collective Investment Schemes Act, the Insurance Act and the new Financial Institutions Act.

1. Does the FinSA Apply to You?

The FinSA will apply to any person or entity providing "financial services" in or from Switzerland, including on a cross-border basis. The definition of financial services, which encompasses a range of different activities, is therefore key to understanding who will be subject to the FinSA. The following activities are considered "financial services":

- i. the sale and purchase of financial instruments;
- ii. the reception and transmission of clients' orders on financial instruments;
- iii. the management of financial instruments (asset and wealth management);
- iv. the provision of personal recommendations regarding financial instruments (advisory activities); and
- v. the grant of loans to transact in financial instruments if the relevant financial services provider participates in the transactions or is aware that the loan will be used to transact in financial instruments.

Marketing and promotion activities of financial instruments to Swiss investors will, depending on the circumstances, be included in the scope of financial services, since they may be considered as sale and purchase of financial instruments even in the absence of any advisory relationship. In this regard, the FinSO defines the sale and purchase of financial instruments as any activity directed at a specific client which aims specifically at selling or purchasing a financial instrument. The explanatory notes to the FinSO suggest that certain marketing and promotion activities may therefore be out of the scope of the FinSA if for instance they are not carried out towards a specific client but between financial intermediaries. Determining whether an activity amounts to a financial service will on occasion require a case-by-case analysis.

What constitutes a financial instrument further participates in defining the scope of the FinSA since financial services must be rendered in connection with financial instruments. They are defined as (i) any equity or equity-linked securities, (ii) bonds and other debt securities, (iii) units of Swiss or foreign collective investment schemes, (iv) structured products, (v) derivatives and (vi) deposits of which the value or the interest rate depends on a risk or a market price, except where the interest rate is linked to an interest rate index.

Certain activities, which are specified in the FinSO, are expressly excluded from the scope of the FinSA, such as: (i) corporate finance and M&A advisory services, (ii) the placement of financial instruments, including with underwriting, (iii) financings in connection with corporate finance and M&A advisory services or the placement of financial instruments and (iv) the provision of financial services by an entity part of a group to its affiliates.

The question whether an activity is a financial service has important practical consequences since those providing financial services will be subject to the requirements of the FinSA, in particular the classification of clients, the obligation to comply with the code of conduct, the organisational

requirements, the affiliation with a mediation office and the registration with the client advisors register, if applicable.

2. How Does the New Client Classification Works

Financial services providers will need to categorise both their current and prospective clients into one of the following three categories: (i) institutional clients, (ii) professional clients or (iii) private clients.

The following investors/clients will be considered institutional clients:

- i. Swiss financial intermediaries and insurance institutions regulated by the FINMA;
- ii. foreign financial intermediaries and insurance institutions subject to a prudential supervision; and
- iii. central banks.

The following investors/clients will be considered professional clients:

- i. public entities, pension funds and corporate entities with professional treasury operations;
- ii. companies which reach or exceed two of the following thresholds (balance sheet of CHF 20 million, turnover of CHF 40 million and equity of CHF 2 million);
- iii. private investment structures with professional treasury operations set up for high net worth individuals; and
- iv. certain high net worth individuals and their private investment structures who/which request to be treated as professional clients provided that they meet certain net asset and, as the case may be, knowledge/experience requirements (so-called opting out).

Private clients comprise all clients which/who do not qualify as institutional or professional clients.

There are bridges between the different categories so that clients can to a certain extent choose more or less protection. Institutional clients may request to be treated as professional clients. Professional clients may request to be treated as private clients. Certain professional clients may request to be treated as institutional clients.

The classification of clients has practical consequences since the type of clients will in particular determine which requirements of the code of conduct apply or may be waived by the client.

In addition, funds marketed to Swiss investors will be subject to different requirements depending on the type of clients targeted. The requirements applicable to the fund (i.e. at the product level) will still be governed by the Swiss Collective Investment Act (CISA), which will keep the categorisation between qualified investors and non-qualified investors. To align the client categorisation of the FinSA with the investors' categories under the CISA, institutional and

professional clients will be considered as qualified investors and private clients as non-qualified investors.

3. Which Requirements Will Apply to Financial Services Providers?

The FinSA introduces a code of conduct, organisational requirements, a new client advisors register and mediation proceedings.

Generally speaking, the code of conduct will in particular require from financial services providers that they comply with:

- i. information and disclosure obligations, including the provision of a prospectus and key information document under certain circumstances;
- ii. appropriateness and suitability tests;
- iii. record keeping duties; and
- iv. clients' records delivery obligations.

The FinSA provides that transactions with institutional clients are not subject to the requirements mentioned above and that professional clients will be able to waive the disclosure and record keeping requirements.

The organisational requirements will in particular relate to the following:

- i. a general duty of good faith and equal treatment of clients in executing clients' instructions;
- ii. best execution requirements;
- iii. the obligation to have an adequate organisation ensuring compliance with the requirements of the FinSA, as well as the prevention and management of conflicts of interests;
- iv. qualifications, knowledge and experience requirements for employees and advisors;
- v. due diligence and monitoring requirements when appointing third party providers; and
- vi. retrocessions related disclosure and repayment obligations.

Client advisors will need to be registered in a newly created client advisor register.

Client advisors employed by Swiss financial services providers subject to the supervision of the FINMA or by foreign financial services providers subject to a prudential supervision and who target institutional and professional clients only will not need to register. In other words, individual advisors, advisors of unsupervised entities and advisors of foreign financial services providers subject to a prudential supervision but who target private clients will need to register.

All financial services providers will need to be affiliated with a designated mediation office and will be subject to mediation proceedings.

4. Will Foreign Funds Need to Appoint a Representative and a Paying Agent?

Under the old regime, a foreign fund must appoint a representative and a paying agent as part of the requirements for the fund to be distributed to qualified investors (except if the fund is distributed only regulated to financial intermediaries and insurance institutions). Distribution to non-qualified investors also requires the appointment of a representative and a paying agent, in addition to obtaining the approval of the FINMA, but we are not discussing here the distribution to non-qualified investors.

The regime is to a large extent discontinued with respect to qualified investors. A representative and a paying agent will only be required if the fund has as investors, or is marketed to, high net worth individuals (i.e. private clients who meet the specific net asset and, as the case may be, knowledge/experience requirements and who request to be treated as professional clients).

However, the transitional period provisions extend the regime beyond 1 January 2020 under certain circumstances. It is important to mention that financial services providers will have 2 years to implement the code of conduct and the organisational requirements. Until all financial services providers marketing a specific fund to Swiss qualified investors have switched to the new regime and comply with the code of conduct and the organisational requirements, the fund will need to have a representative and a paying agent (except if the fund is distributed exclusively to regulated financial intermediaries and insurance institutions). In addition, other statutory and self-regulatory requirements of the old regime will continue to apply during the 2 year transition period to financial services providers until they are compliant with the requirements of the FinSA. Hence, although the new regime comes into force on 1 January 2020, the transitional period rules mean that funds may be required to continue to appoint a representative and a paying agent.

In addition, the Collective Investment Schemes Ordinance will be amended so that a representative and a paying agent will be necessary for advertising a foreign fund.

5. When Do the New Rules Apply?

The FinSA will enter into force on 1 January 2020 subject to transitional periods, which vary depending on the requirements.

Financial services providers benefit from a 2 year transitional period to classify their clients and to implement the code of conduct and to organisational requirements. Financial services providers may choose to switch to the new regime at any time before the expiry of the transitional period.

Until they switch to the new regime and comply with the code of conduct and the organisational requirements of the FinSA, they remain subject to certain statutory and self-regulatory requirements currently applicable to their activities or status.

As mentioned above, a foreign fund distributed to Swiss qualified investors will need to keep or to appoint a representative and a paying agent until all financial services providers distributing the fund are compliant with the FinSA, and such financial services providers will need to comply with current statutory and self-regulatory requirements until they apply the requirements of the FinSA.

The affiliation to a mediation office will need to be completed within 6 months from the date on which a mediation office is recognised by the FINMA. Other requirements such as those regarding the use of clients assets and the obligation to deliver clients' records enter into force immediately.

In any case and despite the transitional period, it is advisable to seek legal advice prior to carrying out any activity in Switzerland or towards Swiss investors.

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