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Update

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Update on the new Swiss legislation on financial services and financial institutions

The purpose of this Newsflash is to provide for an update on the proposed new Swiss legislation on financial services and the supervision of financial institutions. This new legislation will be embodied in the Swiss Federal Financial Services Act ("FFSA") and the Swiss Federal Act on Financial Institutions ("FAFI"). After the debates in the Council of States as first chamber of the Swiss Parliament to approve the two new acts, the draft FFSA and FAFI will be analysed by the Commission on Financial Affairs of the National Council on January 23, 2017.

1. Background

The FFSA and the FAFI are a response of the Swiss Federal Council to the 2009 financial crisis in general and, furthermore, to international developments in financial regulations, as developed in the context of the IOSCO. The FFSA and the FAFI are also a response to the so-called "third country provisions" of MiFID II and MiFIR.

The objective of the FFSA is to provide for a new legal framework on the provision of financial services in Switzerland, including when such services are provided on a cross-border basis from abroad into Switzerland. In the context of such cross-border services, the rules of conduct deriving from the FFSA will apply in addition to any other regulatory provisions, such as those resulting from MiFID II and MiFIR, which may be applicable to foreign financial services providers.

The objective of the FAFI is to provide for a new legal framework governing the supervision of all financial institutions, with the exception of banks and insurance companies which have been carved out from the FAFI and remain regulated by specific legislation tailored to their needs. In particular, asset managers, other than fund managers, which are already today prudentially supervised under the Swiss Federal Collective Investment Schemes Act ("**CISA**"), will be subject to a new prudential supervision.

2. A Point on the Enactment Process

The FFSA and the FAFI were submitted by the Swiss Federal Council to the Swiss Parliament on November 4, 2015, after a consultation process in 2015 which had led to many substantial amendments to the initial draft laws.

The Council of States as first chamber of the Swiss Parliament debated the new laws on December 11, 2016. As a result of the debates in the Council of States, a number of amendments have been made to the drafts initially submitted by the Swiss Federal Council. On this basis, the two draft acts will be submitted to the National

Council (as second chamber of the Swiss Parliament to approve the new laws) and, on January 23, 2017, the Commission on Financial Affairs of the National Council will hold a hearing to discuss the draft FAFI and FFSA.

Following this hearing, the Commission on Financial Affairs of the National Council is likely to decide not to take a formal resolution on the remaining open points, but to postpone those resolutions to the next hearing of the Commission before submitting the drafts for debates in the National Council, not later than in the summer session.

Upon the agreement of the Council of States and the National Council on all provisions of the FFSA and the FAFI, the new legislation will be final. This will allow the Swiss Federal Financial Department to proceed with the formal consultation process on the implementing ordinances to the FAFI and the FFSA which will specify many key provisions of the new legislation.

The earliest likely date of the entry into effect of the FFSA and of the FAFI is currently July 1, 2018 or in case the work at the Parliament takes more time January 1, 2019. Most of the transitional deadlines to implement the new rules, which are key for the industry, will be defined in the implementing ordinances.

3. Key Issues

a) High level Comparison with EU Rules

One of the objectives of the FFSA and of the FAFI is to satisfy the so-called "third country provisions" embodied in MiFID II and MiFIR. While the recent Swiss financial legislation had (i) addressed, following AIFMD, the European third country rules with the enactment of the revised CISA, and (ii) largely taken into account EMIR within the context of the Swiss Federal Law on Financial Infrastructures ("**FMIA**"), it is to be noted that the current drafts of the FFSA and the FAFI provide for some differences with the provisions of MiFID II and MiFIR.

This being said, a key alignment with international standards is the introduction by the FAFI of a prudential supervision over independent asset managers and trustees. This prudential supervision is based on a "two tier supervisory regime", where FINMA is responsible for licensing the independent asset managers and trustees, with a right to impose sanctions and fix minimum requirements, including as to corporate governance, but where the ongoing (day to day) supervision is delegated to privately organised and FINMA-licensed supervisory organisations. This system benefits from a wide consent within the Swiss financial industry and is a positive element of the new legislation.

One of the most notable differences with other legal regimes remains the absence of any prudential supervision or authorization requirement over fund distributors and investment advisors.

The draft FFSA provides also for other differences as compared to MiFID II, which are more technical in nature and should therefore, in our analysis, not lead to material obstacles for any equivalence recognition under MiFID II and MiFIR. These technical differences include the following:

- Trailer fees and rebate payments are allowed, provided that specific and detailed transparency and consent requirements are met.
- There is no difference made on "inducements" paid in the context of "independent" advisory services as compared to "dependent" advisory services.
- The obligations to verify the adequacy and suitability are more limited in nature as compared to MiFID II. These duties are restricted to a "transaction based advice", where such advice is not rendered in respect of an entire portfolio or under a discretionary asset management agreement.
- There is, in respect of all investors' categories, no obligation to verify the adequacy and suitability in the context of "execution only" transactions or "reverse solicitation" situations.
- Where a transaction is not adequate or suitable, the draft FFSA provides only for an obligation to "warn" the client and to document the

warning. No prohibition to execute the transaction as opposed to MiFID II would apply.

› The rules as regards the "opting out" of private clients to professional investors are more flexible than under the MiFID II regime.

› Less stringent obligations on the information and documentation of clients apply as compared to MiFID II, namely as to the content, timing and form of such information.

› There is under the draft FFSA no obligation to record telephone conversations or electronic communications.

› There is no obligation for product providers to proceed with a "target market analysis".

› The draft FFSA foresees much more flexible rules for the market access by foreign financial service providers for cross-border offers of services into Switzerland with no authorization or registration obligation for client advisors of prudentially supervised foreign financial service providers. The draft FFSA provides only for an obligation to register client advisors with a recognized register in Switzerland if the cross-border offer is made by a non-prudentially supervised foreign financial institution.

b) Prospectus Liability - Criminal Sanctions

In addition to introducing uniform prospectus rules that generally shall apply to all securities offered publicly into or in Switzerland or admitted to trading on a trading platform in Switzerland, the draft FFSA also provides for a new set of criminal sanctions that will apply in parallel to the already existing civil law prospectus liability rules. More specifically, the intentional disclosure of any incorrect information (irrespective of the materiality of such information) and omission of material information in a prospectus or a basic information sheet are proposed to be subject to criminal sanctions. Further, the intentional offering of financial instruments to retail investors without the required basic information sheet as well as the intentional violation of certain duties under the conduct rules are proposed to be subject to criminal sanctions. The draft FFSA as passed by the Council of States proposes that the financial service providers which are prudentially supervised in Switzerland be carved-out from being subject to criminal sanctions under the FFSA.

c) Revised Client Segmentation and Opting in and Opting out Regime

The current FFSA draft, as passed by the Council of States, introduces two new types of professional clients, being the large undertakings (similar to the large undertaking category under MiFID II) and the private investment structures with professional treasury management set up for high-net worth individuals. Further, the current FFSA draft proposes that the conduct rules under the FFSA shall not apply on institutional clients (such as banks or insurance companies), while professional clients may waive the application of certain duties under such conduct rules. Finally, the draft FFSA brings some further changes to the opting in and opting out regime, i.e., institutional investors can only opt-in into the professional client category (but not into the retail client category), while pension funds may choose to opt-out of the professional client category into the institutional client category.

d) Distribution of Funds

The concept of the "distribution of funds", which was introduced by the CISA in 2013, will be entirely abolished and covered by the general concept of the offer of financial instruments under the FFSA. As a consequence, the specific authorisation regime for fund distributors under the CISA will be abolished. However, fund distributors will have the obligation, as any other financial service provider, to the extent that they are not prudentially supervised, to register their client advisors with a formal register in Switzerland. It is expected that the register will contain not only the name and address of such providers, but also information on their organisation and the key persons in charge. The key elements of this information may be in essence similar as the one which is currently provided for the authorisation as a fund distributor. Subject to final parliamentary debates, the current requirement to appoint a Swiss representative and paying agent, where a

distribution of foreign funds is made exclusively to non-supervised qualified investors, should be substantially reduced as a result of the suppression of that obligation where a placement of funds is made to non-supervised qualified investors (e.g. pension funds, industrial enterprises or independent asset managers) other than *opt-in* qualified investors (e.g. HNWI).

4. Conclusion

The new legislation embodied in the forthcoming FFSA and FAFI is, in substance, a "soft" replication of the EU MiFID rules, introducing in a number of instances a touch of "Swiss flexibility". As a result of the differences of the future Swiss legislation with in particular the rules under MiFID II and MiFIR, Swiss financial institutions may have to implement procedures to ensure compliance not only with the provisions of the FFSA and FAFI when operating on a cross-border context or servicing international clients, but also with rules applicable in the relevant foreign jurisdiction(s). Given the international nature of the clients of the Swiss financial institutions, this is likely to trigger substantial operational challenges. It is to be noted that the FFSA does not provide for any "substituted compliance" regime which would allow Swiss financial institutions to satisfy their obligations under the FFSA by complying with the MiFID II and MiFIR rules.

Please do not hesitate to contact us if you have any questions.

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