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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 an update on the new Swiss legislation on financial services and financial institutions. The Swiss Parliament has indeed enacted on June 15, 2018 the Swiss Federal Financial Services Act ("FFSA") as well as the Swiss Federal Act on Financial Institutions ("FAFI").

1. Introduction

In November 2015, the Swiss Federal Council published the draft FFSA and FAFI as a response to the 2009 financial crisis and with a view of meeting international standards, including the recognition of the so-called "equivalence" under the "third-country rules" provided for by MiFID II.

The purpose of this new Swiss legislation was also to review fundamentally the regulatory framework for financial services in Switzerland. The purpose of the FAFI is to create a new supervisory regime governing all financial institutions, by introducing in particular a new prudential supervision over independent asset managers and trustees. The purpose of the FFSA is among others, to regulate financial services in Switzerland by introducing specific rules of conduct regardless whether the services are performed in Switzerland or on a cross-border basis.

During the parliamentary debates, the Council of States and the National Council have discussed and amended various aspects of the draft FFSA and FAFI initially published by the Swiss Federal Council. Both chambers of the Swiss Parliament have now agreed on all provisions of the FFSA and the FAFI. The new legislation is considered final, subject to a potential referendum which is however very unlikely.

2. Objectives and scope of application of the FFSA

The stated objectives of the FFSA are (i) to enhance the protection of the clients of financial service providers, (ii) to create a "level playing field" for the provision of financial services across all financial service providers and, thereby, (iii) to reinforce the reputation and the competitiveness of the Swiss financial market place.

To this effect, the FFSA, on the one hand, requires a transparent, loyal and diligent provision of financial services (Art. 7 et seq. FFSA) and, on the other hand, introduces the new concept of the "offer" of financial instruments (Art. 35 et seq. FFSA).

The FFSA's scope of application will extend to (i) any provider of financial services as well as (ii) so-called client advisors, which are the individuals who actually provide financial services within a given institution or on their own. During the parliamentary debates, a qualifying element has been introduced to the notion of provision of financial services in that it needs to be conducted on a "professional basis" so as to fall under the FFSA. A professional activity is an economic activity that is conducted on an independent basis in view of generating regular income. The relevant thresholds for determining the notion of "professional basis" will be defined in the implementing ordinance.

Any financial service provider will have to comply with rules of conduct and organizational requirements. For client advisors, there are additional obligations, namely to follow specific training programs and, as a rule (except where an exemption applies), to register with a specific register (see below para. 4).

3. Notion of "Financial Services"

In line with the rules under the European legislation, the FFSA in Article 3 lit. d defines the services which are considered to be "financial services" for the purposes of the FFSA, namely purchase and sale of financial instruments (including "execution only" transactions), reception and transmission of orders relating to financial instruments, the grant of loans for the purpose of investments in financial instruments, the asset management with respect of financial instruments as well as the provision of financial advice, i.e. the issue of specific and personal recommendations relating to financial instruments (without any discretionary authority to take investment decisions).

By contrast, the granting of loans not linked to investments in financial instruments, as well as custody services or the opening of accounts without any financial advisory or asset management activities, are not deemed "financial services" and are as such not covered by the FFSA. Such activities may be covered by other Swiss legislation, in particular the Swiss Banking Act.

4. Register of Client Advisors

The FFSA introduces the obligation of client advisors to register with a specific register, if such client advisor is not employed by a financial institution which is subject to prudential supervision of Swiss Financial Market Supervisory Authority ("**FINMA**") (Articles 28 to 34 FFSA). This obligation also extends to client advisors of foreign financial service providers, unless the Swiss Federal Council provides for an express exemption. Client advisors of foreign financial service providers subject to prudential supervision shall be exempt provided they exclusively provide financial services in Switzerland to professional investors. Any exemption will be however subject to reciprocity requirements, which are at this stage uncertain and will depend on international political factors.

The registration in the client advisors' register will comprise the filing of information on the education of the client advisors, the entering into a third party liability insurance or the provision of other financial guarantees, the obligation to adhere to an organization for the mediation of conflicts as well as filing various other information/documents relating to the "fit and proper nature" of the relevant client advisor.

5. Client classification

The FFSA does not provide for a definition of the term "client". This term is expected to include also any prospects. The term client will, hence, typically cover any person to which a financial service provider actually provides or intends to provide financial services, as specifically defined by the FFSA. Except where a financial service provider considers that all his actual or potential clients are so-called "private clients", a financial service provider has to take appropriate organizational measures in order to categorize those actual or potential clients. The client classification determines among others the rules of conduct that the financial service providers will have to apply in relation to each category of client.

In an analogous manner to the European legislation, the categories of clients include "private clients", which are all those clients which are neither "professional" nor "institutional clients". Affiliates of a financial service provider are not considered "clients" (Art. 4 para. 6 FFSA).

The concept of institutional investors includes all financial intermediaries prudentially supervised in accordance with the Swiss Banking Act, the FAFI, the Swiss Insurance Supervision Act or the Swiss Collective Investment Schemes Act ("**CISA**"). Similarly, foreign counterparties that are subject to an analogous prudential supervision abroad are also considered institutional clients, as are central banks.

The concept of professional clients pursuant to Article 4 para. 3 and 5 FFSA includes institutional clients and, among others, Swiss pension funds, companies with a professional treasury as well as private wealth holding vehicles, subject to certain additional requirements.

The FFSA introduces a regime for the opting-in and opting-out across these three client categories, which is more flexible than the one provided under MiFID II. As an example, private clients as well as their private wealth holding vehicles, which have financial assets exceeding CHF 500'000, and have sufficient knowledge about the risks of investments as a result of their personal training and professional experience (or similar experience in the financial sector), may "opt-out" and be considered as "professional clients".

Notwithstanding the introduction of the three client categories, the FFSA has not abolished the category of so-called "qualified investors" provided in Article 10 para. 3 CISA. As a consequence, the notion of "qualified investors" will remain relevant in the context of assessing whether a specific collective investment scheme can be offered to a particular client. Under the revised CISA, all professional clients as well as all private clients having entered into a discretionary asset management agreement or a long term advisory agreement, will be recognized as being qualified investors without need for a specific opting-out declaration. By contrast, not every investor, who is a qualified investor, for example as a result of a discretionary asset management agreement or an advisory agreement, will *per se* be considered as professional client.

6. Rules of conduct

a) Principle

Under Article 7 FFSA, all financial service providers, whether prudentially supervised or not, will have to comply with the rules of conduct introduced by the FFSA. These rules include, in an analogous manner to MiFID II, an up-front obligation of information (Art. 8 to 9 FFSA), an obligation to verify whether a financial instrument/service is appropriate and adequate (Art. 10 to 14 FFSA), a documentation obligation and accountability requirement (Art. 15 to 16 FFSA) as well as transparency and due diligence requirements for the execution of client orders, including "best execution" (Art. 17 to 19 FFSA).

These rules of conduct are not applicable to financial services rendered to institutional clients. Further, during the parliamentary debates, flexible rules regarding the waiver of the rules of conduct by professional clients have been introduced.

b) Information of clients

Under Art. 8 and 9 FFSA, financial service providers have to up-front inform their clients (in a manner analogous to MiFID II, albeit less detailed), in particular, on (i) their regulatory status, (ii) the general risks linked to the financial instruments which are offered as well as (iii) the specific risks linked to the services which are personally recommended to the client and (iv) the related cost. Also, economic ties with third parties, which include group companies, in relation to the financial services and instruments which are offered, must be disclosed. The FFSA does not, however, provide in this context for any specific rules on benefits derived from investment research contrary to MiFID II. Benefits derived from investment research will likely have to be addressed under the rules governing conflicts of interests (see para. 7 below). The information submitted has also to include whether the financial service provider offers third party financial instruments ("open platform") or whether only financial instruments of that financial service provider are offered.

The FFSA is also more flexible than MiFID II in relation to the obligation to hand over documentation to the clients. An obligation to make available a so-called Key Information Document (*feuille d'information de base* / *Basisinformationsblatt*) ("**KID**"), which is the Swiss equivalent of the European Key Information Document (KID) under the EU PRIIP Regulation, is only triggered in case of a personal recommendation of financial instruments to private clients. Contrary to the rules applicable within Europe, no KID shall be made available in case of "execution only" transactions. Similarly, the prospectus must only be made available upon request where a personal recommendation is made to private clients. Neither a prospectus nor a KID must be made available where financial instruments are bought under a discretionary asset management agreement.

The information can be provided in a standardized manner, either physically or in a digitalized form, before the conclusion of the financial services agreement or the provision of financial services.

c) Appropriateness and suitability

The obligation to verify whether a financial instrument/service is appropriate or adequate applies only in the context of advisory or discretionary asset management services. Contrary to MiFID II, no verification of the adequacy and appropriateness of a financial service/instrument is required in the context of "execution only" transactions. Furthermore, the FFSA distinguishes between advisory services linked to an individual transaction, which only triggers the obligation to verify the appropriateness of that transaction, as opposed to a global advisory service taking into account the entire client portfolio, which triggers, in addition to the verification of the appropriate character, also the adequacy of the financial instruments or services for the specific client.

d) Accountability requirement

The FFSA also provides, as a result of the parliamentary debates, for a flexible obligation to account towards clients pursuant to Art. 15 to 16 FFSA. Financial service providers have to document in an appropriate manner the financial services which have been agreed, whether the verification of the appropriate or adequate character of an instrument/service has been made, the financial services actually provided and the need and reasons for a recommendation made to a client. By contrast to MiFID II, a financial service provider has only to account to a client upon demand of such client and within a timeframe agreed with that client. There is no compulsory obligation to account for the cost in pre-determined intervals, unless agreed otherwise between the client and the financial service provider.

e) Transparency and diligence requirements for order execution

The transparency and diligence requirements for the execution of orders, in particular best execution requirements, are now expressly embodied in the FFSA. It is expected that the best execution rules as further specified in the implementing ordinance will, in substance, be similar to those of MiFID II, but with less procedural burdens and transparency requirements. In particular, there will be no obligation to publish on an annual basis the most frequently used platforms.

7. Organizational requirements

An important aspect of the FFSA are the organizational requirements which will apply not only to the prudentially supervised but to any financial service providers. Therefore, any individual or entity providing financial services will have to take adequate measures and establish appropriate governance and internal procedures to ensure a fit and proper organization, including as to the training of the employees, the delegation of tasks as well as the disclosure of conflicts of interests and the transparency in relation to the possible payment of retrocessions.

The transparency in relation to conflicts of interests will also include the disclosure of conflicts linked to group companies. As mentioned before, any investment research received which may trigger an actual or potential conflict of interests, will have also to be considered under the provisions regarding conflicts of interests.

The disclosure of retrocessions required is based on the current case law of the Swiss Supreme Court on the obligations derived from a mandate relationship. Under the FFSA such disclosure will however apply irrespective of the presence of a mandate relationship, i.e. including in case of "execution only" transactions. Receiving retrocessions is allowed as long as the recipient specifically discloses those retrocessions, obtain the client's consent and renders account at the request of the client.

8. Offer of financial instruments

The new uniform concept of an offer of financial instruments relates to situations where a specific financial instrument is offered in view of a purchase or subscription of that instrument by an investor. As such, all relevant details must be available in order for that investor to take an investment decision.

The concept of the offer is in particular relevant for the purpose of the registration in Switzerland with FINMA of non-Swiss collective investment schemes. Indeed, the relevant test under the CISA for the registration with FINMA of non-Swiss collective investment schemes will be the offer to non-qualified investors. This new concept will replace the existing one of "distribution" pursuant to Article 3 CISA. The precise scope of application of the concept of the offer of collective investment schemes will have to be specified in the implementing ordinances.

9. Prospectus and KID

a) Prospectus requirements

The FFSA introduces uniform prospectus rules which apply to any securities offered publicly into or in Switzerland or admitted to trading on a trading venue in Switzerland. First time issuers will be required to submit the prospectus for approval 20 calendar days prior to commencement of the envisaged offering or admission to trading, all other issuers at least 10 calendar days. The *ex ante* review and approval of the prospectus will be conducted by a new regulatory body which will be licensed by FINMA and vested with administrative powers. Special rules apply to the offering of collective investment schemes.

b) Exemptions from prospectus requirements

The FFSA provides for a number of exemptions from the prospectus requirements largely in line with the new EU Prospectus Regulation. The list of exempted transactions includes, inter alia, offerings limited to professional clients, offerings addressed to less than 500 private clients and *de minimis* offerings of CHF 8 million or less over a period of 12 months. There are also exemptions from the prospectus requirements with respect to the admission of trading. For example, the admission to trading of equity securities (without a concurrent public offering in Switzerland) which over a period of 12 months account for less than 20% of the equity securities of the identic class already admitted on the same trading venue does not require a prospectus.

c) Prospectus liability and criminal liability

In line with the current prospectus regime, the burden of proof for establishing that a person when making incorrect, misleading or incomplete statement in a prospectus acted without the necessary duty of care remains with the claimant (and not with the defendants as originally proposed by the Swiss Federal Council). Conversely, wrong or misleading forward-looking statements in a prospectus can only lead to prospectus liability if such statements were made against better knowledge or without a disclaimer in the relevant prospectus.

The FFSA introduces criminal liability pursuant to which the intentional disclosure of incorrect information and omission of material information in a prospectus or a KID as well as the intentional offering of financial instruments to retail investors without the required KID will be subject to criminal sanctions.

d) KID requirements

Finally, the FFSA introduces an obligation to prepare a KID which will be necessary for any offering of securities, other than equity securities and debt instruments without derivative elements, to private clients in Switzerland, similar to the European KID.

10. New supervision regime over financial institutions

a) Concept

While the purpose of the FFSA is to provide for a level playing field for the provision of financial services and for the offer of financial instruments, the FAFI provides for a uniform authorization and ongoing supervision regime of financial institutions, namely securities houses (formerly referred to as securities dealers under the Swiss Stock Exchange Act), fund management companies, independent asset managers, trustees, asset managers of collective assets (i.e. of pension funds and collective investment schemes). The supervision is tailored to address the risks inherent to the activities of each financial institution. Accordingly, the conditions for the authorization will vary depending on the business model of each such financial institution.

As for the FFSA in relation to the notion of financial service provider, a qualifying element has been introduced in the parliamentary debates to the notion of financial institution in that it needs to conduct its services on a “professional basis” so as to fall under the FAFI. The concept of “professional basis” should be defined in the FAFI implementing ordinance in the same manner as for the purposes of the FFSA.

It is noteworthy that Swiss banks as well as Swiss insurance companies will not be governed by the FAFI, but will remain under the Swiss Banking Act and by the Swiss Insurance Supervision Act.

In order to achieve a level playing field, the FAFI sets out general authorization conditions which are intended to apply to all financial institutions, whatever their authorization regime. Ultimately, this will ensure a prudential supervision by FINMA over all such financial institutions. These general authorization conditions are supplemented by specific authorization requirements, tailored to each category or supervised financial institutions.

Generally, the corporate governance requirements apply across all financial institutions, in particular in terms of the guarantee of an irreproachable activity (Art. 11 FAFI) in respect of both the persons in charge of the management of the financial institution as well as the qualified shareholders, holding 10% or more of the share capital or of the voting rights.

Furthermore, detailed requirements apply regarding the delegation and the outsourcing of activities across the categories of financial institutions (Art. 14 FAFI).

b) Independent asset managers and trustees

One of the most salient features of the FAFI is the prudential supervision introduced over independent asset managers and trustees. The activities of an independent asset manager is defined by the FAFI as the asset management of client portfolios based on an investment authority (Art. 17 FAFI).

The supervision over independent asset managers as well as over trustees has been structured in the course of the parliamentary debates as a two level supervision. In order to ensure a prudential supervision in line with international standards, FINMA will be in charge of the supervision of the independent asset managers and trustees, including the authorization and the power to issue sanctions in case of enforcement proceedings. However, the day-to-day supervision of such financial institutions will be entrusted to supervisory organizations (*organismes de surveillance / Aufsichtsorganisationen*) licensed by FINMA. A few professional associations active in the financial sector and self-regulatory organizations in the context of the prevention of money laundering are considering to apply for such status.

The supervision over trustees, also a novelty in Switzerland, may rise issues, in particular for those trustees which do not actually perform financial services, but delegate the entire provision of financial services to a bank or an asset manager. Also, rendering trustee services will imply an extension of the original FINMA license if an independent asset manager seeks to act as trustee.

The regulations provided by the FAFI are tailored to the size and the risk profile for each financial institution. Accordingly, specific governance requirements, including the independence of the management from the board of directors, should only be imposed when the gross revenues of an independent asset manager or trustee exceeds certain thresholds.

c) Manager of collective investment schemes and of pension funds

Managers of collective investment schemes will be regulated under the FAFI in a manner which is in substance equivalent to the supervisory regime provided for under CISA in line with EU AIFMD standards. In addition, asset managers of pension funds and analogous organizations, including investment foundations, will require a license under the FAFI. In substance, the organizational and governance requirements should remain identical to the current ones. The specific organizational requirements, as well as the rules of conduct derived from the Swiss Pension Funds Act, including transparency requirements, will continue to apply and will not be replaced or rendered obsolete as a result of the enactment of the FFSA and FAFI.

11. Other consequences

The enactments of the FFSA and of the FAFI lead to significant changes to the CISA, whose content will generally be limited to the provisions specifically governing the products, i.e. collective investment schemes. However, provisions relating to the rules of conduct applicable to these products (Art. 20 CISA) as well as the provisions regarding the custodian banks and the representatives of foreign collective investment schemes will remain in the CISA.

The new legislation will also entail modifications to a number of other legislative acts, namely the Swiss Federal Financial Market Infrastructure Act.

12. Level-two regulation; Timeline

The Swiss Federal Finance Department is now finalizing the drafts of the implementing ordinances of both the FFSA and the FAFI and will proceed with the formal consultation process, expected to occur from October 2018 to February 2019.

This “level two regulation”, mainly the implementing ordinances to the FFSA, FAFI and CISA, as well as the implementing ordinances of FINMA to these acts (if any), will further specify many key provisions of the new legislation.

The most likely date for the entry into effect of the FFSA and the FAFI is currently January 1st, 2020.

Most of the transitional provisions to implement the new rules, which are key for the financial industry, will be defined in the implementing ordinances. These ordinances will be finalized only shortly before the entry into force of the FFSA and FAFI.

In this context, it is expected that the Swiss Federal Finance Department will provide for a number of transitional provisions, including for the implementation of the rules of conduct under the FFSA and the classification of clients.

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

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