

Update

Newsflash June 2019

Portfolio Managers under the New Swiss Financial Institutions Act

On 15 June 2018, the Swiss Parliament adopted the new Swiss Financial Institutions Act ("FinIA" or the "Act") and the new Swiss Financial Services Act ("FinSA"). The new legislation, which is expected to enter into force on 1 January 2020, will have a significant impact on Swiss and foreign portfolio managers active in Switzerland. This newsflash summarizes certain key points that will affect portfolio managers.

1. Current Regime

Under the current regime, independent portfolio managers, i.e. portfolio managers which are not authorized as banks, securities dealers or asset managers of collective investment schemes, are not subject to a comprehensive prudential supervision. As financial intermediaries under the Anti-Money Laundering Act ("AMLA"), they are supervised only in relation to their compliance with anti-money laundering obligations. The AMLA obliges financial intermediaries, including independent portfolio managers, to register with, and become a member of, a self-regulatory organisation ("SRO") or submit to the direct supervision of the Swiss Financial Market Supervisory Authority (FINMA). At present, no other authorisation or licensing requirements apply to independent portfolio managers.

2. New Regime

Once FinIA enters into force, Swiss portfolio managers and certain foreign portfolio managers active in Switzerland will be required to obtain a

FINMA authorisation to carry out their activities. The new Act introduces a "split supervision" for portfolio managers, exercised by FINMA and by supervisory organisations ("SO") authorised by FINMA.

FINMA will be in charge of granting portfolio manager licenses and will also be empowered to impose sanctions and revoke licenses. However, the day-to-day supervision of portfolio managers will be entrusted to the SOs. It is expected that there will be several SOs, given that a number of the existing SROs are looking to apply for such status in order to supervise portfolio managers that are currently affiliated to them.

Under the new regime, FINMA will cease its direct supervision of independent portfolio managers as regards compliance with the AMLA.

3. Scope

FinIA defines a "portfolio manager" as someone, based on a mandate agreement, can dispose on a

professional basis of a client's assets, acting in the name of and for the benefit of the client.

According to the draft implementing ordinance ("**Draft-FinIO**"), an activity is considered to be undertaken on a professional basis if any of the following thresholds are exceeded:

- › gross turnover exceeding CHF 50,000 per year;
- › business relationships with more than 20 contracting parties;
- › power to dispose over third party assets having a valuation exceeding CHF 5 million; or
- › transactions with a total volume in excess of CHF 2 million per year.

These thresholds follow the rules already set out in the current Swiss Anti-Money laundering Ordinance and accordingly, as a rule, portfolio managers that are currently subject to the Swiss anti-money laundering obligations will also be subject to the licensing requirements under the FinIA.

4. Exemptions

The FinIA and the Draft FinIO provide for certain exemptions. One of them provides that portfolio managers who exclusively manage the assets of persons with whom they have "economic" or "family" ties are not subject to the Act and therefore do not require a license. In this respect, the Draft FinIO further specifies what is considered as "economic" or "family" ties (and lists the relevant family relationships). This exemption allows, for example, single family offices to continue to operate without the need for a license. Multi-family offices, on the other hand, cannot benefit from this exemption as they manage assets of a number of unrelated clients. Further, the FinIA and the Draft-FinIO also exclude from the licensing requirements persons that are acting based on a statutory mandate (e.g. legal guardians).

The final FinIO, which is expected to be published in November 2019, should provide for further clarification and hopefully for an extension of the scope of the exemptions.

5. Licensing Requirements

FinIA sets out the requirements that Swiss portfolio managers must meet in order to obtain a license from FINMA. These standards are generally in line with those already in place for Swiss regulated financial institutions, but take into account the specificities of the business of Swiss portfolio managers on a risk-based approach, including in particular:

- › The place of effective management of portfolio managers must be in Switzerland;
- › "fit and proper" requirements with respect to the board of directors, senior management and qualified participants (i.e. each direct or indirect holding of 10% or more of the voting rights or the capital);
- › Swiss portfolio managers must comply with the minimum capital requirement of CHF 100,000;
- › Portfolio managers must maintain an adequate collateral or professional liability insurance;
- › Portfolio managers must have a minimum eligible equity equal to one quarter of their fixed annual costs;
- › Portfolio managers have to implement appropriate internal organization, in particular as regards risk management and internal control mechanisms depending upon the size of the business;
- › Duty to notify FINMA of activities conducted outside of Switzerland; and
- › Affiliation requirement with an SO and an ombudsman body.

Some of these requirements (management composition and risk management, internal controls and compliance) are summarized in more detail below.

5.1 Management composition

Unlike certain other financial institutions (such as banks or securities firms), portfolio managers are not required to set up a two-tiered management structure. FINMA may, however, on a case-by-case basis require certain portfolio managers to put in place a two-tiered management structure with a board of directors

and an executive management. According to the Draft-FinIO, portfolio managers may become subject to such additional FINMA requirements if they have annual gross revenue of CHF 5 million or more or if required in light of the type and nature of their business.

As a rule, the management of a portfolio manager must be composed of at least two "qualified" individuals. An individual is qualified within the meaning of the FinIA if such individual has an adequate education and sufficient professional experience when taking over the management of a portfolio manager. The Draft-FinIO further specifies the requirements in terms of education and professional experience in line with FINMA standards used for similar institutions as follows (with FINMA having the power to grant exemptions on a case-by-case basis):

- › professional experience in portfolio management of at least 5 years;
- › relevant education in the area of portfolio management; and
- › obligation for ongoing training.

The Draft-FinIO also requires portfolio managers to set in place appropriate business continuity procedures that ensure the functioning of the management in case of a prolonged absence or death of a qualified individual.

5.2 Risk management, internal controls and compliance

A portfolio manager will have to implement an adequate risk management and effective internal controls, including a compliance function. As a rule, risk management and compliance functions have to be independent from the asset management business. Taking into account that internal control systems and compliance can be quite a burden for smaller companies, the Draft-FinIO provides for certain exemptions. More specifically, a portfolio manager does not need to have a risk management and compliance function that is independent from the business, if it has:

- › annual gross sales of less than CHF 1.5 million or no more than 5 employees; and
- › a business model without increased risks.

On the other hand, where a portfolio manager has annual gross sales exceeding CHF 10 million, FINMA may require such portfolio manager to put in place an independent internal audit.

The risk management and compliance functions may be delegated to qualified third parties. Such delegation will be subject to the general delegation rules applicable to other financial institutions, including the requirements to have the necessary technical knowhow and internal procedures to adequately supervise the delegated functions and to document the delegation in the portfolio manager's organization documents.

6. Requirements for the provision of financial services

FinSA further contains various rules of conduct inspired by, but with notable differences to, MiFID II that are applicable to financial institutions providing financial services in or from Switzerland. A portfolio manager will have to comply with the duty to provide information about itself and the risks associated with financial instruments. He will have to conduct an appropriateness and suitability review, document in an appropriate manner the financial services agreed with the clients and the information collected about them, and act in compliance with the transparency and best executive requirements set out under FinSA.

These rules of conduct apply with regard to transactions of portfolio managers with private clients, but not with regard to institutional clients. Professional clients may explicitly waive the application of the rules of conduct concerning the duties regarding information, documentation and accountability.

7. Foreign Portfolio Managers

Foreign portfolio managers fall within the scope of FinIA if the place of effective management is in Switzerland, if they exercise their business activity predominantly in or from Switzerland or if they employ staff in Switzerland on a permanent basis.

The setting up by a foreign portfolio manager of a Swiss branch requires a prior authorization

from FINMA and affiliation with an SO. FINMA will grant such authorization if the applicant can notably demonstrate that it:

- › is properly organized to operate its business;
- › has sufficient financial resources;
- › has personnel that is qualified to operate a branch office in Switzerland; and
- › is subject to appropriate supervision in its home jurisdiction and that the relevant supervisor does not object to the establishment of the branch office.

Representative offices of foreign portfolio managers in Switzerland will also be subject to a new prior authorization regime from FINMA.

Foreign portfolio managers rendering their services on a pure cross-border, i.e. without permanently employing staff in Switzerland, will not need a FINMA license. However, they will have to comply with the new requirements under the FinSA, and their staff providing the relevant financial services to their clients in Switzerland (so-called client advisers) have to register in a new register of advisers in Switzerland and will have to meet the requirements for such registration (please refer to our March 2019 Newsflash on that topic).

8. Delegation

A portfolio manager may delegate activities (e.g. administration, compliance, accounting), but it should at all times ensure that it has sufficient human resources and technical know-how to properly elect, instruct and supervise third party agents. Certain activities can only be delegated to third parties that themselves hold the relevant license.

Portfolio managers will therefore need to review their current organisation and delegation or outsourcing arrangements they have put in place, to ensure that they comply with the new regime.

9. Timing

FinIA is currently expected to enter into force on **1 January 2020**. The implementing ordinance is

expected to be published in November of this year.

Existing portfolio managers will need to notify FINMA of their intention to apply for a license before **30 June 2020**. Within the same time frame, branches and representative offices of foreign portfolio managers will have to notify FINMA of their existence. All of them are granted with a three year transitional period to obtain an authorisation. During such period, they may continue their activities. Portfolio managers subject to the direct supervision of FINMA as financial intermediaries within the meaning of AMLA will no longer be required to be affiliated to an SRO according to Article 24 AMLA to the extent that within one year of the entry into force of the FinIA (a) they receive approval from an SO that they can be subject to it and (b) they apply for a license with FINMA.

Portfolio managers starting business operations within one year from the entry into force of FinIA must notify FINMA and immediately comply with the licensing requirements. They will however have to register with an SO and apply for a license with FINMA within one year after an SO has been recognized by FINMA. In the meantime, they may continue their business pending licensing provided they remain affiliated with an SRO for AML purposes.

Swiss and foreign portfolio managers are advised to assess whether they fall within the scope of FinIA. If so, they will need to take the appropriate steps to ensure compliance with the licensing requirements. As mentioned above, the licensing requirements impose various financial and organizational obligations. The final text of implementing ordinance will hopefully provide further clarifications.

Similarly, foreign portfolio managers are advised to assess whether their activities conducted in or from Switzerland qualify as a branch or a representative office.

Please do not hesitate to contact us in case of any questions

Legal Note: The information contained in this UPDATE Newsflash is of general nature and does not constitute legal advice. In case of particular queries, please contact us for specific advice.

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