Update

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New proposed Swiss legislation on financial services and financial institutions

The purpose of this Memorandum is to provide for an overview of the key findings which result from the consultation process, which was initiated by the Swiss Federal Council in June and ended in October 2014, following the publication of drafts of a new Swiss Federal Financial Services Act ("draft FFSA") and of a new Swiss Federal Act on Financial Institutions ("draft FAFI").

Object and background of the draft FFSA and of the draft FAFI

The publication on June 27, 2014 of the draft FFSA and of the draft FAFI is a response of the Swiss Federal Finance Department to the 2009 financial crisis in general and in particular to the "third country rules" provided for by the EU Financial Services Directive ("MIFID 2"). While the purpose of the draft FAFI is to provide for a "new legal framework" governing all financial institutions, the objective of the draft FFSA is to regulate financial services in Switzerland, whether performed in Switzerland or on a cross-border basis.

New Swiss architecture for financial regulations

The intent is to replace the current legal framework for financial services in Switzerland, which is based on "silos" with federal Acts governing each financial sector (such as the Swiss Banking Act, the Swiss Stock Exchange Act, the Swiss Insurance Act or the Swiss Collective Investment Schemes Act), with a new financial architecture based on a "horizontal" legislative framework. Under the proposed legislative framework, financial services and institutions will be governed in Switzerland by a general set of regulations on the supervision of financial services, which will be embodied in the FFSA, the FAFI and the new Swiss Financial Market Infrastructure Act ("FMIA"), the draft of which has been submitted to the Swiss Parliament and which we have addressed in our Newsflashes of April and September 2014. The new financial architecture of Swiss financial markets will not substantially impact the current Swiss Federal Act on Collective Investment Schemes ("CISA"), which had been revised, effective as of March 1, 2013, in order to satisfy the requirements of the "third country rules" of the AIFMD, among others. The new legislative framework currently proposes that the CISA, which will again be amended to focus on investment funds as products, coexists in parallel to the new rules of the FFSA and FAFI. As a result of this proposed coexistence, different rules, in particular rules of conduct, may apply to the offer of collective investment schemes and other financial instruments, such as structured products. During the consultation process, a number of participants have stressed the fact that the coexistence of the CISA alongside the FFSA and FAFI may compromise the ultimate goal of the new legislation which is to create a "level playing field" among financial products and services. Furthermore, this coexistence will trigger a number of delicate legal and practical issues, such as how the two sets of rules will coexist in cases where investment funds and other products and services are simultaneously offered and how actual or potential conflict of rules will be dealt with. For instance, potential conflicts of rules may arise inasmuch as "fund distribution" will still be governed by the CISA on the one hand, while on the other hand investment funds units will be characterised as "financial instruments" under the draft FFSA. Similarly, different rules of conduct may apply to the offer of investment funds, in the event that such offer is linked to the providing of investment advice. Furthermore, the relationship between prospectus requirements applicable to investments funds as opposed to those applicable to other financial instruments are not entirely clarified.

The European context

The main objective of the draft FFSA and the draft FAFI is to satisfy the third country rules imposed by MIFID 2. Indeed, AIFMD had introduced third country rules, which the Swiss legislator has addressed with the enactment of the revised CISA, which entered into force on March 1, 2013. Similarly, the third country rules of EMIR are addressed in the draft FMIA. While the CISA and the FMIA in all material respects satisfy the standards of AIFMD and EMIR and therefore meet the "EU equivalence test", the draft FFSA and the draft FAFI provide for a number of material differences with MIFID 2. Notable differences include in particular the absence of supervision of investment advisors and fund distributors, as well as different transparency rules on inducements. Different rules can be noted as regards verification of appropriateness for "execution only" transactions. Further, there is no differentiation between complex and non-complex financial instruments, and clients are classified based on different categorisation rules.

During the consultation process, the Swiss financial industry has requested that the legislator must ensure, wherever possible, that the EU equivalence test under the MIFID 2 is met in any case. Indeed, the satisfaction of the equivalence test by Switzerland and the conclusion of appropriate corporation agreements among the competent supervisory authorities will be one of the key prerequisites for Switzerland based professional investors to obtain access to the market in the EU. Such access is in our view a key element of the future of the Swiss financial industry.

The threat of a "Swiss finish"

While the draft FFSA and the draft FAFI differ from the MIFID 2 rules to provide for more flexible rules on a number of aspects, such as the absence of a prudential supervision over financial advisors and fund distributors, there are a number of points where the provisions of the draft FFSA and draft FAFI are more restrictive than the current MIFID 2 rules. The industry has expressed concerns that this will introduce a "Swiss finish" on a number of aspects, which may compromise the competitiveness of the Swiss financial market. Stricter rules are provided in particular for the distribution of collective investment schemes under the CISA and, furthermore, result from the absence of an express legal basis for the exemption of services provided on an unsolicited basis, the absence of an express exemption for intragroup services, the obligation to register client advisors in a new official register, the implementation of prospectus rules which are more stringent on a number of points compared to the requirements of the EU Prospectus Directive, and, finally, the introduction of a diverse bundle of rules which are meant to facilitate substantially the enforcement of civil claims by investors against financial institutions.

Relationship with non EU Countries

As the main focus of the draft FFSA and the draft FAFI is to answer the third country rules imposed by MIFID 2, the current drafts fail to provide for an answer as to how to deal with third countries, meaning those which are not members of the European Union. There are concerns relating to the adoption of a number of rules, including the third country rules on the basis of those imposed by MIFID 2 (for instance the conclusion of cooperation agreements on the model of the existing agreements entered into by ESMA with a number of third party countries under AIFMD). Financial services providers from other countries such as the United States or countries from South America or Asia may only be granted limited access to the Swiss market. Indeed, the replication of the EU model into the Swiss legal system is likely to introduce the same barriers as those which have been introduced by the EU towards third countries. This approach, while possibly tailored for the requirements of the EU, seems to fail to take into account the interests of Switzerland, which in the recent years has had a large number of new clients coming from members of non EU countries. For many Swiss financial institutions, the focus on non EU countries is even a strategic approach for Switzerland given the current isolating trends within the EU legislative framework. The current approach of the draft FFSA and the draft FAFI, as applied to the specific situation of Switzerland, may be counterproductive and lead to an isolation which does not satisfy the needs of the Swiss financial industry, especially since the latter has always been internationally oriented.

Cross-border services into Switzerland

Switzerland has always provided for a very liberal regime as regards cross-border provision of financial services by foreign providers into Switzerland (with the exception of specific constraints which apply to the distribution of collective investment schemes under CISA). Articles 34-36 of the draft FFSA proposes a change of paradigm by providing for an obligation for foreign services providers, which would be subject to an authorisation in Switzerland, to register, as a prerequisite to providing financial services in Switzerland. This registration will only be available to foreign services providers which are subject to an equivalent prudential supervision, and if cooperation agreements are entered into between FINMA and the competent authorities of the relevant countries. This may limit the provision of financial services on a cross-border basis by providers of third countries which are not members of the EU. By contrast, there will be no obligation to open a branch in Switzerland to provide cross-border services, including financial services rendered to retail clients. In this respect, the draft FFSA provides for a more flexible regime than the MIFID 2 regime.

Foreign providers offering services on a cross-border basis will have to comply with the Swiss market conduct rules, including the transparency rules on inducements and categorization of clients. This may lead to a situation where foreign providers will have to satisfy not only their domestic rules of conduct, but also the Swiss rules when rendering services to Swiss based clients.

Categorisation of clients

Articles 4-5 of the draft FFSA introduce categorisation rules based on the EU concept of “professional clients” and “private clients”. Professional clients include banks, insurance companies and other financial intermediaries within the meaning of the CISA, with a subcategory of “institutional clients” which corresponds to the EU category of “eligible counterparties”. All other clients are “private clients”. Depending on the categorisation, different market conduct and documentation requirements apply. The main difference to the MIFID 2 rules is the introduction of the requirement to establish a “professional treasury management” to meet the professional client test. In practice this additional requirement may lead to a narrower interpretation of the concept of professional clients compared to the EU rules. A further difference with the EU rules is that the existing client classification under the CISA, which makes a distinction between non-qualified investors and qualified investors (with a further differentiation between regulated qualified investors and non-regulated qualified investors), will coexist in parallel to the new client classification introduced by the draft FFSA. In this context, the financial industry has voiced concerns that “qualified investors” within the meaning of the CISA may not always qualify as “professional investors” as defined in the draft FFSA, which may lead to confusion and complications among financial advisors.

The draft FFSA provides, similar to the MIFID 2 rules, for the possibility for a “private client” to “opt-out” of the investors protection (allowing private clients to be categorised as professional clients, subject to certain conditions) or for a professional client to “opt-in” to the investors protection and to be treated as a “private client”.

Market conduct rules and Inducements

The draft FFSA introduces in Articles 6-20 market conduct rules, including the obligation to verify the appropriateness and suitability of financial services. A lack of appropriateness triggers an obligation to warn the client, while a lack of suitability prohibits the service provider to render that service. A significant difference with the MIFID 2 regime exists to the extent that there is no obligation to verify the appropriateness of financial services in the context of unsolicited requests. This exemption applies, by contrast to the EU laws, both to complex and to non-complex financial products.

The rules of the draft FFSA as regards permitted inducements and transparency rules differ from the MIFID 2 rules. On the one hand, they intend to integrate into the draft FFSA the most recent case law of the Swiss Supreme Court as regards the transparency and consent requirements for a financial institution to keep trailer fees. On the other hand, the Swiss rules on inducements are also intended to apply to an execution only context. Against the background that the most recent case law of the Swiss Supreme Court has been developed based on fiduciary duties where there is a general mandate relationship, the financial industry has stressed the fact that the extension of these contractual rules to an execution only relationship would not only unduly expand the case law of the Swiss Supreme Court, but also be more coercive compared to the inducements rules under MIFID 2. By contrast, while we understand that MIFID 2 will prohibit inducements in the context of discretionary asset management agreements, the draft FFSA does not prohibit the payment of inducements in the context of such discretionary asset management agreements (subject to compliance with the abovementioned transparency and consent requirements). The Swiss financial industry has voiced concern that codifying the case law of the Swiss Supreme Court into the FFSA may hinder the Swiss Supreme Court from further developing its case law and aligning it to international developments.

Prospectus requirements

The draft FFSA introduces in Articles 37-69 uniform prospectus rules which generally shall apply to all securities offered publicly into or in Switzerland or admitted to trading on a trading platform in Switzerland. The content and approval of the prospectus are inspired by the EU Prospectus Directive. The obligation to prepare a prospectus under the FFSA will be triggered by any public offering, be it primary or secondary. Similar to the EU Prospectus Directive, the draft FFSA provides for a number of exemptions from preparing a prospectus. The proposed prospectus rules also provide for an *ex ante* review and approval process by an independent authority. Further, the draft FFSA introduces an obligation to prepare a basic information sheet which will be necessary for any offering of securities (other than mere equity instruments) to retail investors in Switzerland and which has to be drafted in German, French or Italian.

Enforcing of rights of investors

The draft FFSA introduces in Articles 72-116 a change of paradigm in the enforcement of the claims of investors against financial institutions. In essence, the draft provides for the right of the client to obtain a copy of its file, although (such obligation already exists today under the accountability obligation imposed on any financial institution under the existing agency rules). The burden of proof as regards satisfaction of the information obligations would be shifted. A procedure before a mediation body to which all financial intermediaries would have to adhere is foreseen. In this context, the draft FSSA offers two options: either the creation of a specific arbitral tribunal, or alternatively, the introduction of a funding system to finance the litigation costs of investors. Further, some limited class actions would expressly be introduced into Swiss law. Such potential changes have raised major concerns from the financial industry. There is indeed a general view that there is no reason to create, for a specific industry sector (meaning the financial sector), more stringent consumer protection rules.

Criminal sanctions

Under the draft FFSA (Articles 119-121), both intentional and negligent breaches of the provisions regarding prospectuses and basic information sheets are subject to criminal sanctions (including *inter alia* the disclosure of incorrect information and omission of material information in the prospectus or the basic information sheet, and the breach of the obligation to prepare a prospectus or basic information sheet). Offering financial instruments to retail investors without the required basic information sheet and non-compliance with the market conduct rules of the FFSA will be subject to criminal sanctions as well. The proposed new sanction system has been criticized by the financial industry for being too severe and having a potential to harm the Swiss financial market. It could in particular deter foreign issuers from offering their financial products in Switzerland, which could result in a limited offer of financial products in terms of quantity and range available to investors in Switzerland.

Conclusions

The FFSA and the FAFI will have a fundamental impact on the Swiss financial industry and are likely to constitute a change of paradigm for both domestic players as well as for foreign financial institutions offering their services and products on a cross-border basis into Switzerland. The importance of the proposed changes has been well noted by the Swiss financial industry who has made a large number of comments and proposals in the context of the consultation procedure.

Following the consultation procedure which ended in October 2014, the Swiss government is expected to publish a formal Dispatch during the first quarter of 2015. This Dispatch will serve as a basis for the debates of the draft FFSA and draft FAFI in the two chambers of the Swiss Parliament. The debates are expected to occur in autumn 2015 or winter 2015-2016 at the earliest. The current expected date of the entry into force of the FFSA and FAFI is January 1st, 2017.

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

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