

FINMA publishes its Ordinance on Financial Institutions

On November 12, 2020, the Swiss Financial Market Supervisory Authority ("FINMA") has published its Ordinance on Financial Institutions ("FinIO-FINMA"). The new FinIO-FINMA clarifies and regulates the details of professional liability insurance for portfolio managers, trustees and managers of collective assets, provides further details on the calculation of the de minimis threshold for asset managers of collective assets, and on risk management and internal control system for asset managers of collective assets. At the same time, FINMA also published a wide range of amendments to other FINMA ordinances and circulars, most of which seek to conform such ordinances and circulars to the Financial Services Act and the Financial Institutions Act. Among these amended ordinances and circulars, FINMA has published an amended circular on outsourcing, which now also covers asset managers of collective assets and fund management companies.

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1. Portfolio managers and trustees: Requirements concerning professional liability insurance

Pursuant to the Financial Institutions Act ("**FinIA**") portfolio managers and trustees are required to,

in addition to the minimum capital, maintain additional equity and/or to maintain a professional liability insurance. Such professional liability insurance may be used to offset up to 50% of the required minimum equity of portfolio managers and trustees.

The FinIO-FINMA sets out the requirements applicable to the professional liability insurance. These requirements apply only in instances where the portfolio manager or trustee wishes to (partially) offset its minimum equity requirement by way of a professional liability insurance. If the portfolio manager or trustee already meets these minimum equity requirements, it is free to maintain a professional liability insurance that does not meet the specific requirements of the FinIO-FINMA.

The requirements regarding professional liability insurance are based on those that previously existed with respect to the asset managers of collective investment schemes pursuant to the Swiss Collective Investment Schemes Act ("**CISA**"). The final version of the FinIO-FINMA differentiates, however, between professional liability insurance of portfolio managers and trustees and those of asset managers of collective assets.

The professional liability insurance must be taken out from a Swiss licensed insurance company, have a term of at least one year, have a termination notice period of no less than 90 days and cover the entire business scope (type of activities and geographical area) of the portfolio manager or trustee as set out in the organizational documents. The professional liability insurance must in particular cover financial losses that arise from any and all activities for which the portfolio manager or trustee is legally responsible, irrespective of whether such losses are caused as a result of negligence or gross negligence. The risks to be covered include, among other things, financial losses resulting from investment errors, including violations of contractual obligations or regulations as well as financial losses resulting from breaches of duty by employees of the asset manager or the trustee.

In case of termination or amendment of the professional indemnity insurance, the portfolio manager or trustee must inform FINMA immediately.

2. Managers of collective assets

a) Definition and calculation of the *de minimis* threshold

The provisions concerning the definition and calculation of the *de minimis* threshold in FINMA's Collective Investment Schemes Ordinance ("**CISO-FINMA**") have not been materially amended but have been transferred into the FinIO-FINMA. The term "managers of collective assets" now also encompasses managers of pension fund assets. Further, the existing provisions have been amended to include specific principles for the managers of pension fund assets. In this context, FINMA clearly stated that for those, both Swiss and foreign pension fund assets have to be considered when calculating the *de minimis* thresholds.

b) Risk management, compliance and ICS for managers of collective assets

The requirements that apply in respect of risk management, compliance and the internal control system ("**ICS**") were, for the most part, taken over from the CISO-FINMA.

FINMA, however, also introduced new rules with respect to liquidity management. These new rules require that institutions managing collective investment schemes evaluate and document – at regular intervals – liquidity and other key risks at the level of the individual collective

investment scheme, using various market scenarios. Such scenario analysis applies to open-ended collective investment schemes exclusively.

FINMA thus emphasizes the importance of ongoing liquidity management by the fund managers and also reflects the corresponding international recommendations. In particular, with the proposed amendments in the CISA in relation to the new Limited Qualified Investor Fund (L-QIF), references will be made to international standards, such as for example the "Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities" of the Financial Stability Board (FSB), or the "Recommendations for Liquidity Risk Management for Collective Investment Schemes" of the International Organization of Securities Commissions (IOSCO).

The provisions on risk management and ICS apply *mutatis mutandis* to fund management companies.

c) Professional indemnity insurance

As for portfolio managers and trustees, asset managers of collective assets must maintain either a certain amount of additional equity or a professional liability insurance. The FinIO-FINMA sets out the requirements that apply to such professional liability insurance. While these rules have largely been transferred from the CISO-FINMA, certain amendments have been made by FINMA. Contrary to the provisions previously set forth in the CISO-FINMA, the new FinIO-FINMA provides that the insurance coverage for an individual claim must correspond to at least 2% (formerly 0.7%) of the total assets of the collective investment schemes managed by the asset manager of collective investment schemes and the insurance coverage for all claims in a year must correspond to at least 3% (formerly 0.9%) of the total assets of the collective investment schemes managed by the asset manager of collective investment schemes.

In case of termination or amendment of the professional indemnity insurance, the manager of collective assets must inform FINMA immediately.

3. Representative offices of foreign fund management companies

FINMA's set of new rules did not provide further guidance on representative offices of foreign fund management companies. The specific issue relates to the fact that, based on the text of Art. 58 para. 2 FinIA, and despite resistance in the legislative process, foreign fund management companies are not permitted to set up representative offices in Switzerland. Asset managers of collective assets, on the other hand, are permitted to set up representative offices in Switzerland (subject to registration with FINMA). At this stage, it is to be expected that FINMA will, subject to further legislative changes, take a strict view on the admissibility of representative offices of foreign fund management companies, which intend to open such an office for their asset management business.

4. Entry into force and transitional provisions

The FinIO-FINMA will enter into force on January 1, 2021. Asset managers of collective assets and fund management companies that are already FINMA authorized will have to comply with the new FinIO-FINMA rules within 1 year after its entry into force, i.e. by December 31, 2021.

5. Changes to other ordinances and circulars

Together with the FinIO-FINMA, FINMA has also made a number of amendments to numerous ordinances and circulars. While a significant part of these amendments are of rather technical nature and made to conform such ordinances and circulars to the Financial Services Act ("**FinSA**") and the FinIA, FINMA also used the opportunity to make certain substantive amendments. Some of these more amendments are set out below.

a) Extended scope of FINMA's outsourcing circular

As part of its FinSA and FinIA overhaul of the outsourcing circular, FINMA extended the scope of such circular. It now also includes asset managers of collective assets and fund management companies. Previously, only banks and insurance companies were included in the scope of this circular. Portfolio managers and trustees will, however, not be subject to the rules of the outsourcing circular.

Due to the specific circumstances of asset managers of collective assets and fund management companies (e.g. frequent use of delegation of certain asset management tasks), we expect that FINMA will show more flexibility as regards the requirements applicable to such asset managers and fund management companies.

b) Changes to the CISO-FINMA

The CISO-FINMA is supplemented with new rules applicable to representatives of foreign collective investment schemes with respect to the duty to inform investors and the duty to notify FINMA.

According to Art. 66 CISO-FINMA, representatives of foreign collective investment schemes must disclose all costs incurred on the issue and redemption of units and in the administration of the collective investment scheme at least twice a month. In case of collective investment schemes where the right to redeem at any time is restricted, such disclosure shall be made at least once per month.

According to the new Art. 66a CISO-FINMA, representatives of foreign collective investment schemes must notify FINMA of the occurrence of specific events (e.g. in case of a combination or liquidation of a collective investment or sub-fund or in connection with a change of legal form).

c) Changes to FINMA's AML Ordinance

In addition to technical amendments reflecting the new rules and terminology of the FinSA and the FinIA, FINMA also made other amendments to its AML Ordinance that are not directly related to the FinSA and the FinIA. In particular, FINMA is lowering the client identification threshold values from CHF 5,000 to CHF 1,000 for exchange transactions in cryptocurrencies. In the explanatory report, FINMA justifies such change with the additional risks that are inherent to transactions in cryptocurrencies, such as the speed and ease of executing transactions. FINMA's lowering of the identification threshold is in line with international standards (FATF rules on Virtual Asset Service Providers) approved in mid-2019.

d) Amendments to the insolvency regime applicable to collective investment schemes

Following the entry into force of the FinIA, FINMA no longer has insolvency jurisdiction over asset managers of collective assets.



e) Extended scope of FINMA's market conduct circular

As a result of the new licensing requirements under the FinIA, FINMA has amended the scope of its circular on market conduct (FINMA Circular 2013/8). In addition to the previously covered financial institutions, asset managers of pension fund assets, portfolio managers and trustees are now also subject to the rules of the market conduct circular. Among other things, this includes the organizational requirements and the annual risk assessment to be undertaken by the relevant financial institutions.

f) Repeal of certain FINMA circulars

FINMA also announced that it would repeal its circular on distribution of collective investment schemes (FINMA Circular 2013/9), the circular on securities traders (FINMA Circular 2008/5) and the circular on securities lending and borrowing (FINMA Circular 2010/2). The FINMA Circular 2013/9 will be repealed due to abolishment of the "distribution" concept and replacement with the "offering" concept under the FinSA.

With respect to FINMA Circular 2010/2, the repeal is made given that securities lending is now subject to specific rules under the FinSA. FINMA, however, stated that it continues to apply its practice on required risk disclosure in connection with securities lending transactions.

Despite the repeal of FINMA Circular 2008/5, FINMA stated in its explanatory report that it intends to continue its practice regarding introducing brokers and the corresponding licensing requirement for representative offices, and will in the future apply such practice to representative offices of types of foreign financial institutions under the FinIA.

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

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