

Supervision of Financial Institutions and Registration Requirements: Consultation for FIDLEG and FINIG - Part III

The Swiss government opened a consultation process for the draft bills of a Financial Services Act and a Financial Institutions Act.

These two projects will completely reshape the regulatory framework governing the Swiss financial markets. It includes new rules of conduct for financial intermediaries, a regulatory regime to prepare a prospectus in connection with public offerings of securities, registration obligations for client advisors and foreign service providers, licensing obligations for asset managers, as well as a comprehensive rules aiming to facilitate access to justice, including through a form of class actions.

The consultation process runs until 15 October 2014. The Federal Council plans to send the bill of the Financial Services Act and the Financial Institutions Act to parliament in Q2 2015.

In this third briefing on the draft bills, we examine the new supervisory regime for financial institutions and the registration requirements that apply to client advisors and foreign financial service providers.

Overview

In parallel to the draft FIDLEG, the FDF has also published a bill for a Federal Act on Financial Institutions (FINIG), which will consolidate the existing rules on banks, securities dealers, fund managers and asset managers for investment funds within a single act and expand its scope to all portfolio managers.

Licensing Pyramid

The regulatory philosophy underlying FINIG is to **move away from a sectorial approach** to regulation towards a **hierarchy of licences** which starts at the bottom with portfolio managers and escalates through asset managers, securities houses all the way to banks, allowing one side branch for fund managers.

Following this approach, all institutions are governed by **certain fundamental requirements** in terms of fitness of the directors and senior executives and organization, while **additional duties apply as the license allows a broader range of activities**.

At the bottom of the scale, **portfolio managers** are an entirely new type of financial institution, who provide professional investment advice and portfolio management. They are subject to a fairly light regime, which is described in further detail below.

The next stage is made of the **asset managers** or so-called **qualified portfolio managers**, who professionally manage assets of collective investment schemes or pension funds. To a large extent, this regime matches the Swiss version of the requirements applicable to AIFMs, which was introduced in connection with the last revision of the Collective Investment Schemes Act, with the particularity that an asset manager licence will also be required to manage pension fund assets.

At the next stage, the regime branches out with **fund managers** which are subject to a similar regime as the one they are currently subject to under the Collective Investment Schemes Act, on the one hand, and, **security houses**, which, in essence, will be subject to framework that mirror the one currently applicable to securities dealers on the other hand.

At the top of the pyramid, **banks** continue to be characterised by the accepting of deposits from the public or refinancing themselves from several unrelated banks to finance an undefined circle of persons or firms and are allowed to carry out financial activity.

Verification of Tax Compliance

Among the general obligations imposed on financial institutions, the draft FINIG proposes to **require all financial institutions** to verify whether funds provided to them are **subject to an enhanced risk that these assets were not taxed**, provided, however, that no duty to verify tax compliance exists

when the client is subject to taxes in a jurisdiction which accepts automatic exchange of information in tax matters. If such risk exists, the financial institution is required to determine whether **additional clarifications** are necessary based on the risks resulting from the specific facts and circumstances.

If the financial institutions must infer that the **assets are untaxed or will not be taxed**, they will be required to **turn down the client and refuse to accept the assets** (or terminate the relations if the suspicions relate to an existing client), if the client does not **prove that the assets were taxed** and it would not impose an undue burden to expect the clients to come clean with their tax obligations.

Licensing of Portfolio Managers

The major innovation of FINIG is the much discussed **licensing of portfolio managers**. Currently, portfolio managers are not subject to prudential licensing requirements or supervision. The only regulation of the profession applies through the anti-money laundering framework, which is largely delegated to self-regulatory organisations. Although FINMA has tried to stop the gap through its circular on minimum standards for self-regulation of portfolio management, which imposes a common framework applicable to all professional organisations involved with portfolio management, this regime is very open textured and allows for substantial differences in terms of enforcement policies.

In this context, FINIG envisages to subject **all portfolio managers**, including investment advisers with the authority to give instructions over an account, to a **licensing obligation**. It will be satisfied if

- the directors and senior executives are fit and proper,
- the portfolio manager has an appropriate organisation and
- the portfolio manager has either sufficient insurance coverage or has other forms of financial security.

By contrast, portfolio managers will **not be subject to extensive capital and liquidity requirements** like other financial institutions.

At this stage, it is uncertain who will exercise the supervision over portfolio managers. The draft FINIG proposes a choice between **direct licensing and supervision by FINMA** and a model with licensing and supervision by a **supervisory authority** (*Aufsichtsbehörde*), which will be, in turn, supervised by FINMA.

Registration Duties

Over and above the rules of conducts which apply to financial service providers, the draft FIDLEG also includes registration duties for **client advisors** and **cross-border service providers**.

In both cases, the registration does **not imply any ongoing supervision** by a regulator, but seeks only to ensure that client advisors and foreign firms **satisfy the statutory requirements at the outset**.

However, if they are found to have breached any duties under the draft FIDLEG, they **remain subject to enforcement action** by FINMA, including for client advisors a ban from any activity as a client advisor or as a person in a leading position of a licensed entity.

Registration Duties for Client Advisors

Over and above the rules of conducts which apply to financial service providers, the draft FIDLEG also includes rules for client advisors. Client advisors will need to have **appropriate education** including **continuing education** regarding the rules of conducts. More importantly, client advisors will need to be **registered with a newly created registration body** to carry out their duty.

Registration should be a relatively straight forward process, since client advisors will need to prove that

- a) they (i) were not convicted of any offence under the draft FIDLEG or any general economic offence under the Swiss Criminal Code and (ii) are not subject to a ban from an activity in the financial industry and
- b) they or their employer (i) has insurance coverage for professional liability or equivalent security and (ii) is member of an ombuds organization.

Registration Duties for Cross-border Services Providers

The draft FIDLEG also provides for a similar **registration obligation for foreign service providers** who exercise an activity that is subject to licensing obligations in Switzerland, namely provide financial services as a portfolio manager, an asset manager, fund management company, a securities house, or a bank.

This registration obligation will, however, **not apply** to foreign service providers who **already have an authorization** for their activity in Switzerland, e.g., for branches and representative offices, although it is not clear whether this applies only for activities carried out through such branches and representative offices.

Unlike client advisors, foreign service providers will be **registered with FINMA directly**. The registration will be contingent on them providing that

- a) they are licensed in their home jurisdiction to provide the services that are subject to licensing obligations in Switzerland and are subject to equivalent supervision;
- b) they have insurance coverage for professional liability or equivalent guarantees;
- c) they undertook in writing to provide FINMA with information on its business and clients in Switzerland; and
- d) FINMA and their supervisory authority entered into an agreement on the exchange of information.

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