

Briefing November 2018

Inbound Cross-border Financial Services under FinSA and FinIA

On 15 June 2018, the Swiss parliament adopted the Swiss Financial Services Act (FinSA) and the Swiss Financial Institutions Act (FinIA). On 24 October 2018, the Swiss Federal Council opened a consultation process regarding the three ordinances implementing these acts, the Financial Services Ordinance (FinSO), the Financial Institutions Ordinance (FinIO) and the Supervisory Organisation Ordinance (SOO), which will last until 6 February 2019. The two acts are expected to enter into force together with the ordinances on 1 January 2020 and will introduce an entirely new regulatory framework governing the Swiss financial markets. FinSA will affect both Swiss providers and providers based outside Switzerland, which currently offer financial services or products to Swiss clients on a cross-border basis. Foreign financial service providers will be required to either register their client advisers in a newly established register of advisers or establish a regulated branch or subsidiary in Switzerland.

In this briefing, we outline how these acts will affect foreign financial service providers. In particular, we present the subject matter and territorial scope of FinSA, the registration duties applicable to foreign financial institutions and client advisers as well as organizational measures applicable to them and transitional periods.

Subject matter: Financial Services

FinSA applies to **financial service providers**, defined as persons providing financial services commercially in Switzerland or for clients in Switzerland, regardless of whether they qualify as a financial institution under FinIA or as a bank under the Federal Act on Banks and Saving Banks, subject to certain exemptions, such as, among others, pension funds (including employer sponsored pension funds), employers who manage the assets of their pension funds, as well as insurance

companies and insurance brokers falling within the scope of the Insurance Supervisory Act. Persons providing financial services are subject to the act only if they do so on a commercial basis. FinSA defines a **commercial activity** as an independent economic activity pursued on a permanent, for-profit basis.

According to the legislative materials, the **term financial services is defined broadly**, and covers all activities that could lead to the acquisition of a financial instrument by a client. Financial instruments

are in turn defined to include equities (incl. participation certificates, dividend rights certificates, convertible bonds) and debt securities, derivatives, units in collective investment schemes, structured products, and certain types of deposits.

In particular, FinSA regulates the following **types of financial services**:

- acquisition or disposal of financial instruments,
- receipt and transmission of orders in relation to financial instruments,
- administration of financial instruments (portfolio management),
- provision of personal recommendations on transactions with financial instruments (investment advice),
- granting of loans to finance transactions with financial instruments.

The term '**financial services**' is, therefore, likely to encompass many lines of business that were until now largely unregulated, including portfolio management and investment advice. In particular, while market research and financial analysis will not be covered under the definition, since they will not lead to personal recommendations, it is not certain whether corporate finance services, e.g. underwriting, advisory services in connection with capital market transactions or mergers and acquisitions, will also be included in the definition. Similarly, it is not yet clear whether issuers of financial instruments, potentially even corporate issuers, will be deemed to be engaging in the professional sale of financial instruments.

Territorial Scope: Services 'in Switzerland' or 'for Clients in Switzerland'

FinSA applies to financial services providers who provide their services (1) in Switzerland or (2) for clients in Switzerland. FinSA marks a departure from the current regime by **extending the scope** of Swiss

financial market regulation from activities carried out 'in or from Switzerland' to include activities carried out for clients 'in Switzerland'. In other words, whereas inbound cross-border services were largely out of scope under the current regulations, providing financial services to clients in Switzerland on a cross-border basis will be subject to FinSA.

According to the legislative materials, '**in Switzerland**' refers to financial service providers (1) domiciled or incorporated in Switzerland, or (2) foreign financial service providers which have established a branch or a representative office, including a *de facto* branch or representative office, in Switzerland. It therefore applies to Swiss financial service providers, which must apply FinSA regardless of whether they provide financial services **for clients in Switzerland or abroad**.

Foreign financial service providers, on the other hand, will be subject to FinSA when they provide financial services '**for clients in Switzerland**'. Therefore, FinSA will clearly apply when a foreign financial service provider offers its services in Switzerland to clients domiciled in Switzerland. This means that if a client adviser travels to Switzerland to meet a client in Switzerland, FinSA will apply. By contrast, the draft FinSO states that **FinSA will not apply** extraterritorially if a Swiss client takes the initiative to engage a financial service provider abroad, by travelling to such foreign country or contacting the financial service provider directly abroad.

Application of the Rules of Conduct and Organizational Measures to Foreign Financial Service Providers

Rules of Conduct

If a foreign financial service provider is subject to FinSA, it will be required to comply with the requirements of FinSA when dealing with clients in Switzerland. A foreign financial service provider will therefore be required as part of the onboarding process to **classify the client** as a retail, professional or institutional client and subsequently comply with the **information duties**, as well as meeting the **appropriateness or suitability requirements** under FinSA if it provides investment advice or portfolio management

services. Furthermore, it will also be subject to the **record-keeping and accountability obligations** under FinSA.

These obligations will apply in parallel with any other foreign rules applicable to the financial service provider, without any option to rely on equivalence or substitute compliance. Foreign financial service providers will therefore, at the very least, need to engage in a thorough analysis to determine whether they need to adjust their client segmentation and rules of conduct to comply with the requirements of FinSA.

Organizational Measures

More importantly, the organizational rules under FinSA will also apply to foreign service providers subject to the act. In addition to a general requirement to have an appropriate organization, FinSA provides that financial service providers may appoint employees and third parties to carry out their services if such persons possess the **necessary skills, knowledge and experience** for their work and have the requisite authorization and/or registration in Switzerland. Furthermore, the financial service provider is required to instruct and supervise such persons carefully.

In this context, both the delegation of activities to third parties and cooperation with intermediaries and distributors will be deemed to constitute the involvement of a third party and will trigger the application of the organizational duties under FinSA.

Chain of Providers

In addition to the organizational requirements, FinSA provides for certain obligations in situations where financial services are delivered through a chain of providers: Under these rules, a **financial service provider that mandates** another financial service provider to supply financial services for clients **remains liable** for the completeness and accuracy of the client information and for complying with the rules of conduct as set out in FinSA.

Therefore, the financial service provider that delegates the execution of a financial service to another financial service provider, including a foreign financial service provider, must **ensure that the requirements of FinSA are complied with**, even if the service

provider further down the chain is not directly subject to FinSA. Practically speaking, this requirement implies that foreign investment firms who execute orders on behalf of Swiss financial service providers, such as introducing brokers who pass on transaction orders, will be asked to comply with the Swiss record keeping and accountability obligations as well as the Swiss best execution requirements.

By contrast, FinSA allows the mandated financial service provider to assume that the financial service provider instructing it has complied with its duties under FinSA, provided that they are both subject to FinSA. This provision is, however, without prejudice to the information and conduct obligations which the mandated financial service provider may have to fulfil subject to other laws with regard to its own relationship with the client.

Licensing and Registration Duties

Registration Duties for Client Advisers

FinSA introduces a **new registration duty** for (1) client advisers of Swiss financial service providers not subject to prudential supervision, as well as (2) client advisers of **foreign financial service providers**. Therefore, if a foreign financial service provider provides financial services to clients in Switzerland, its client advisers will need to be registered in the register of advisers, regardless of the domicile or place of work of the client adviser. This new register will be maintained by a dedicated Registration Body licensed by the Swiss Financial Market Supervisory Authority (FINMA).

This obligation applies, as a matter of principle, regardless of whether the client adviser is **dealing with retail or professional clients**. The draft FinSO only exempts client advisers of prudentially supervised foreign financial service providers which are part of a financial group that is legally subject to the consolidated supervision of FINMA from the duty to register if the services they provide in Switzerland are exclusively for professional or institutional clients.

The term '**client advisers**' is defined as natural persons who perform financial services on behalf of a

financial service provider or in their own capacity as financial service providers. This definition includes (1) **employees of financial service providers** who perform financial services for clients, e.g. employees of a bank who carry out transactions in financial instruments for clients of the bank or advise them on the investment and (2) **natural persons who as financial service providers themselves provide financial services personally** (without being an employee of a financial service provider or producer of a financial instrument).

By contrast, employees of financial service providers who have no contact with clients or who support the provision of financial services only to a minor extent, e.g. by sending product documentation in response to a client's expression of interest, arranging an appointment for a client with its client adviser, or supervising the technical processes of electronic customer portals or websites of the financial service provider, **are not client advisers**.

In this context, it remains to be seen how persons who have a contact with clients under the direct and ongoing supervision of a client adviser, such as a financial analyst providing specialist advice in a meeting conducted by a client adviser will be treated.

In order to be registered in the **register of advisers**, client advisers will need to prove that:

- a) they have sufficient knowledge of the code of conduct set out in FinSA and the necessary expertise required to perform their activities,
- b) they (i) were not convicted of any offence under FinSA 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
- c) they or their employer (i) has insurance coverage for professional liability or equivalent security, and (ii) is affiliated to a Swiss ombudsman's office.

By contrast, the registration will not imply any ongoing supervision by a regulator and only seeks to ensure that client advisers are aware of their regulatory obligations and treat clients fairly.

Licensing Duties for Foreign Financial Institutions

If a foreign bank, securities firm, or collective asset manager has a permanent physical presence in Switzerland, it will continue to require a license as a branch or a representative office depending on the nature of its activity, whereby existing licenses will automatically be grandfathered into the new regulatory framework.

A change may, however, be triggered for portfolio managers and trustees. Indeed, as a novelty under FinIA, professional portfolio managers and trustees will require an authorization from FINMA to carry out their activity. As a consequence of this new licensing requirement, **foreign portfolio managers and trustees** will also require an authorization from FINMA if they have a physical presence in Switzerland.

A foreign financial institution is deemed to have a **physical presence in Switzerland** by engaging persons in Switzerland who, on a permanent and commercial basis, in or from Switzerland:

- a) perform asset management or trust activities, portfolio management for collective investment schemes or occupational pension schemes, securities trading, conclusion of transactions, or client account management in the name of the foreign financial institution (**branch**), or
- b) work for them in another manner, namely by forwarding client orders to them or by representing them for marketing or other purposes (**representative office**).

The above also applies if a foreign financial institution carries out an activity in Switzerland without having formally established a branch or representative office (**de facto branch**). Moreover, persons who permanently help the foreign financial institution to carry out essential aspects of its activities in Switzerland or from Switzerland are also deemed to be a *de facto* branch.

Therefore, foreign portfolio managers and trustees that have a permanent physical presence in Switzerland should carefully review their arrangements to determine whether they will be subject to a licensing obligation, even if this presence has a limited activity

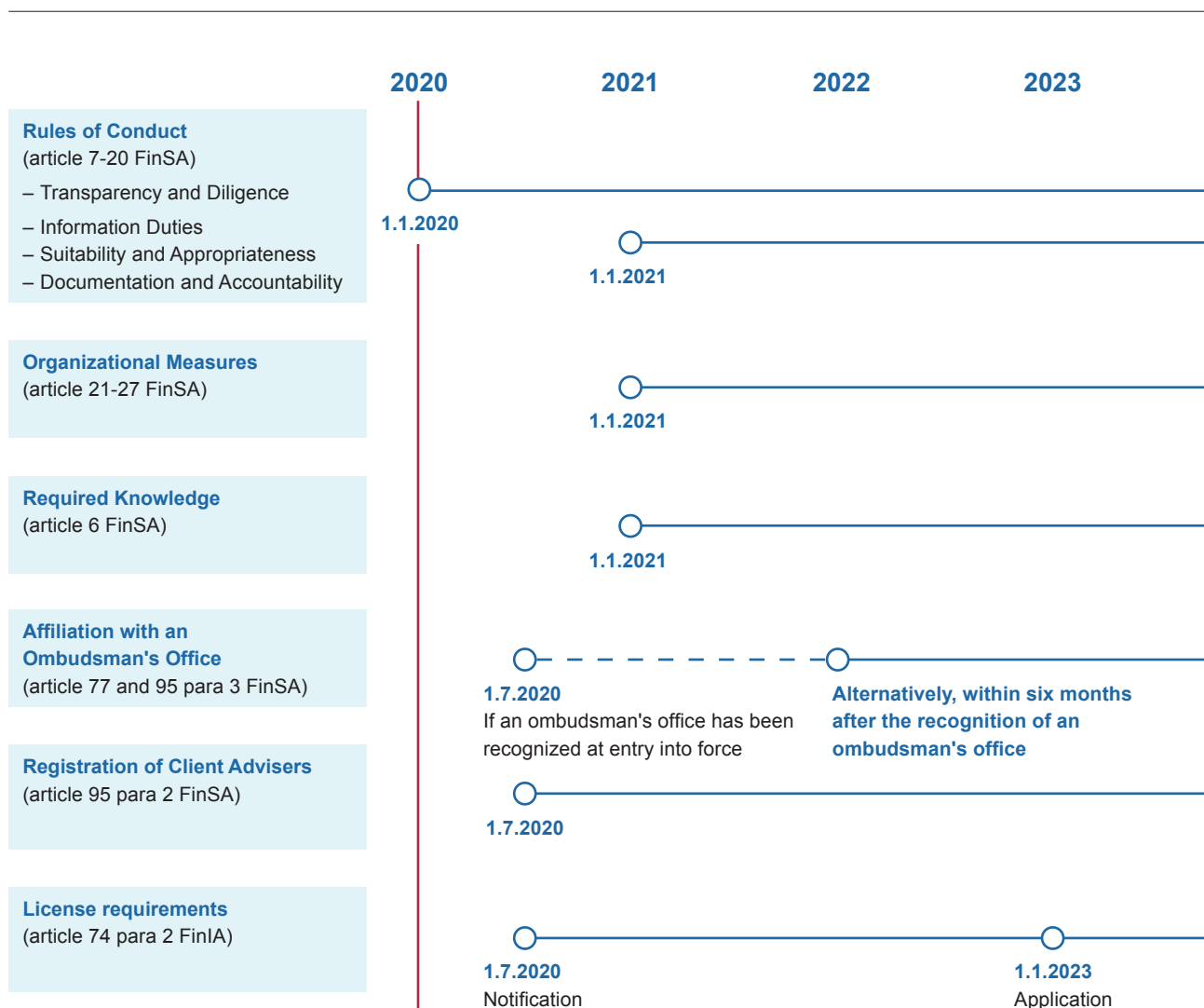
in Switzerland and only engages in marketing or essential back-office operations.

Outlook: Entry into Force and Transitional Periods

Overall, FinSA and FinIA are likely to have a substantial impact on foreign financial service providers who provide their services to clients in Switzerland.

Foreign financial service providers should therefore carefully review their processes and determine whether they are appropriate and adjust them to ensure that they will comply with these requirements when the obligations become effective.

It is currently expected that FinSA and FinIA, together with their implementing ordinances, will **enter into force on 1 January 2020** with the following transitional periods:



- Transparency and diligence duties forming part of the rules of conduct under FinSA apply **immediately** upon entry into force.
- The other rules of conduct (information duties, suitability and appropriateness duties, and documentation and accountability duties) and the organizational measures according to FinSA apply **within one year** from the entry into force.
- Compliance of client advisers with the requirement of appropriate qualifications, knowledge and experience applies **within one year** from the entry into force.
- Financial service providers must affiliate to an ombudsman's office **within six months** from the entry into force if such ombudsman's office already exists, or within six months after the recognition of such by the Federal Department of Finance.
- Client advisers must register themselves **within six months** from the entry into force.
- License requirements for foreign financial institutions according to FinIA apply as follows:
 - Notification of FINMA of the requirement to obtain a license **within six months** from the entry into force, and
 - Filing of a license application with FINMA **within three years** from the entry into force. However, upon the entering of FinIA into force until the granting of the license, asset managers and trustees may only continue their business if they have become a member of a self-regulatory organization.

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