

# GUIDELINES

## Banks & Financial Services Providers

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## FinSA – Strengthening Investor Protection

The new Financial Services Act (FinSA or the Act) aims to improve investor protection. It contains a comprehensive catalogue of regulatory rules of conduct and organisational rules as well as the obligation – with its associated cost implications – to join an ombudsman's office. Client advisers not working for a supervised Swiss financial service provider must now be entered in a client advisers registry. The recently published Financial Services Ordinance gives concrete form to the legal provisions.

### 1. Introduction

The FinSA will enter into force together with the Financial Institutions Act (FinIA) on 1 January 2020. While the FinIA lays down authorisation requirements and other organisational requirements applicable to financial institutions, as well as their supervision (see separate guidelines), the FinSA stipulates uniform regulatory provisions on the provision of financial services and the offering of financial instruments. The FinSA also contains rules designed to make it easier for clients to enforce their rights against financial service providers. The FinSA is a regulatory framework whose content is specified in greater detail in the Financial Services Ordinance (FinSO or the Ordinance). Many obligations set out by the FinSA and thus stated now in regulatory law, have already existed based on civil law and, for regulated financial market participants, also based on the relevant FINMA requirements. In the future, regulatory and civil obligations will coexist and influence each other, which may in particular affect civil liability.

These guidelines deal exclusively with the rules of conduct and organisational rules for financial service providers and their client advisers when providing financial services. They show who qualifies as a financial service provider and client adviser according to FinSA and outline the most important obligations resulting from this qualification as well as the sanctions regime for enforcing the Act.

### 2. Financial Service Provider

#### 2.1. Definition

The Act defines the financial service provider as a provider of financial services on a commercial basis for clients in Switzerland.

It covers legal entities and natural persons who provide the following services:

- Asset management
- Investment advice
- Execution-only services
- Any activity targeted directly at certain clients and specifically aimed at the acquisition or disposal of a financial instrument
- Granting of Lombard loans or the granting of other loans where the financial service provider knows that the loan is used to acquire financial instruments.

These services must always relate to *financial instruments*. The latter essentially include equity and debt securities (securities), bonds, derivatives, structured products and holdings in collective investment schemes. The individual categories cannot always be clearly distinguished from each other. Financial services within the meaning of the FinSA are provided to investors. For this reason, advisory services in the corporate finance area or issuing business are not considered financial ser-

VICES. Group companies exclusively performing financial services for other companies within the same group are not considered financial service providers.

## 2.2. Supervised and Unsupervised Financial Service Providers

On the one hand, financial service providers can be supervised financial market participants, such as banks, securities firms, fund management companies, insurance companies and now also asset managers. On the other hand, the term also includes unsupervised financial service providers who provide financial services for their clients on a commercial basis, such as pension fund and investment advisers. Commercial activity occurs when the financial service provider engages in an independent commercial activity for profit on an ongoing basis. This is presumed if the financial service provider provides financial services to more than 20 clients or advertises providing financial services.

## 2.3. Financial Services in Switzerland and Out of Switzerland

Swiss financial service providers are subject to the FinSA regardless of whether they provide services for clients in Switzerland or abroad. Foreign financial service providers are in principle subject to the FinSA if they serve clients in Switzerland. This is the case if the foreign financial service provider operates at least one de facto branch or representative office in Switzerland or sends client advisers to Switzerland on road shows on a given number of days. In cases of doubt, a full analysis of the applicability of the FinSA must be carried out. If a foreign financial service provider provides financial services at the request of a Swiss client (reverse solicitation), these services are not considered to have been provided in Switzerland.

## 3. Client advisers

### 3.1. Definition

The FinSA also covers individual client advisers in the context of the provision of financial services. These are natural persons who provide financial services for clients, such as investment advice, on behalf of a financial service provider or in their own capacity as a financial service provider.

Employees of financial service providers who have no contact to clients or who support the provision of financial services only in a subordinate manner, are not considered client advisers.

### 3.2. Obligation to Register

Client advisers of domestic financial service providers who are not supervised and client advisers of foreign financial service providers must, as a rule, have themselves entered in a client advisers registry for their activities in Switzerland.

Exempt from the obligation to register are client advisers of foreign financial service providers who are subject to prudential supervision abroad, provided they perform their services in Switzerland only for professional or institutional clients.

To be entered in the client advisers registry, client advisers must have sufficient knowledge of the FinSA rules of conduct and the specialist knowledge required for their activities. The completed training and continuing education courses in this context are listed in the client advisers registry. In addition, a client adviser must prove that they or the financial service provider for whom they work have taken out professional liability insurance or equivalent financial security and are affiliated with an ombudsman's office.

## 4. Obligations to be Implemented by Financial Service Providers

### 4.1. Client Segmentation

Each financial service provider must classify its clients into one of three categories: private client, professional client or institutional client. This requirement does not apply if all clients are treated as private clients.

Furthermore, under certain conditions (awareness of investment risks and/or personal fortune above certain thresholds), wealthy private clients may request to be classified as professional clients, or certain professional clients as institutional clients (so-called opting out). Here, the financial service provider must make the private clients aware of the consequences of their waiver of the increased level of protection linked to this reclassification. On the other hand, institutional clients can request to be considered professional clients, or professional clients can ask to be considered private clients (so-called opting in). The financial service provider must also inform its clients of that possibility.

The classification of a client into a specific segment will affect the duties of conduct the financial service provider must fulfil towards the client, as stated below, and to what extent they must be fulfilled. For example, the disclosure requirement and assessment duty as well as the documentation requirement and accountability do not apply to institutional clients. Professional clients may explicitly waive the provisions regarding the financial service provider's disclosure and documentation requirement, as well as accountability. They can, however, not waive the assessment duty, where the assessment in this case will not have to be conducted to the same extent as for private clients.

### 4.2. Rules of Conduct

#### Assessment Duty

For portfolio-related investment advice and asset management, the financial service provider must inquire about the financial situation (risk-bearing capacity) and the investment objectives (duration and purpose of the investment, risk tolerance and investment limitations) as well as knowledge and experience of the client with a view to the contemplated financial services (suitability test). Based on the information obtained, the financial service provider must draw up a risk profile and, based on that, determine the investment strategy together with the client.

For transaction-related investment advice, the financial service provider must determine the knowledge and experience of the client and assess whether the client understands the way the financial instruments to be recommended work and what risks they involve (appropriateness test).

For execution-only relationships, there is no need on the part of the financial service provider to conduct any appropriateness and suitability test, but the client must be informed accordingly.

If the financial service provider could not assess the appropriateness or suitability of a financial instrument or the financial service in question for lack of information, it must notify the client accordingly. If it considers a financial instrument or service to be inappropriate or unsuitable, it must advise the client against it. The financial service provider must document the performance and result of the appropriateness and suitability tests, including the recommendations and warnings to clients derived from the tests.

### *Disclosure Requirements*

The FinSA imposes comprehensive disclosure requirements on financial service providers, which are intended to increase transparency for clients. The disclosure includes, first of all, general information about the financial service provider, its field of work and supervision status, the ombudsman's office and the general risks associated with financial instruments. Where clients receive recommendations on specific financial services, such as investment advice or asset management or certain financial instruments, precise information must be provided on their respective functions, risks and costs. Clients must always be informed about existing commercial relationships with third parties resulting in conflicts of interest, and about the market supply of the financial service provider's own and third-party products considered when selecting financial instruments. Where appropriate and feasible, the information may be given in standardised form on paper or electronically. That information must be permanently available for evidentiary purposes and distinguishable from advertising. The disclosure requirement does not apply to institutional clients and may be waived by professional clients.

### *Documentation Requirement, Accountability and Duty to Return Records*

Under the FinSA, financial service providers are subject to extensive documentation requirements and accountability to clients. In particular, they must document any information collected on clients and the financial services agreed upon with them, the fulfilment of important disclosure requirements and the financial services performed for clients. When investment advice is provided, the documentation requirement goes even further and must also include the reasons for each recommendation. The financial service provider must render account on these documents and other aspects to clients upon their request. Clients are also entitled at any time to be given within 30 days of the request a copy of the client file and all other documents relating to them and prepared within the scope of the business relationship. Already now, the documentation of the client relationship is often of crucial importance in liability proceedings filed by clients. Clean documentation can protect against unjustified claims; the lack of documentation, on the other hand, tends to have a negative effect. This should be taken into account when implementing the documentation requirement, all the more since the Act does not provide any specifics on the content of the documentation.

### *Obligations to Be Observed When Processing and Executing Client Orders*

Client orders must be processed and executed according to the principle of good faith and the principle of equal treatment and of best execution. In addition, the requirements for the permissibility of securities lending with client portfolios are laid down by law.

### **4.3. Organisational Rules**

The organisational rules under the FinSA apply to both supervised and unsupervised financial service providers. The requirements and obligations derived from the Act vary according to the size, complexity, legal form of, and services offered by, the financial service provider. This means that a rather small asset manager does not have to meet the same requirements as any of the larger banks.

### *Adequate Organisation*

Financial service providers must ensure an adequate operating organisation. The organisation must be set up through internal guidelines (directives, regulations, job descriptions, checklists, etc.) in such a way as to guarantee compliance with the FinSA provisions. In addition, financial service provider must ensure that the employees have the necessary skills, knowledge and experience to perform their work. These requirements apply similarly to the outsourcing of activities to third parties, who must be carefully selected, instructed and monitored. Unsupervised financial service providers must ensure that their client advisers are registered in the client adviser registry.

### *Avoiding Conflicts of Interest*

Financial service providers must avoid conflicts of interest when providing financial services to the best of their ability. FinSO provides a non-exhaustive list of typical scenarios that may lead to conflicts of interest. Financial service providers need to take organisational precautions to identify, prevent or resolve potential or actual conflicts of interest. This also includes internal directives, which must be reviewed regularly. If discrimination against a client cannot be prevented or can be prevented only with disproportionate effort, this must be disclosed to the client in a comprehensible form. The FinSO contains a catalogue of frowned upon behaviours (churning, front running, etc.), which are inadmissible in any event.

### *Compensation by Third Parties*

The FinSA provides that financial service providers may not accept compensation from third parties (retrocessions and the like) in connection with the provision of financial services unless that compensation is fully passed on to the client or if the client has expressly waived that compensation after having been advised of it in advance. The information provided to the client must include at least the calculation parameters and bandwidths when the amount of the compensation cannot be determined in advance. Upon request, the financial service provider must disclose the amounts actually received.

## **5. Joining an Ombudsman's Office and Financial Participation**

At the latest upon taking up business, each financial service provider must join an ombudsman's office. This affiliation comes with financial obligations and duties towards the client (participation in mediation).

## **6. Sanctions**

The sanctions regime for violating the obligations under the FinSA is two-pronged. On the one hand, FINMA may take regulatory measures against financial service providers and their bodies and employees under its supervision. On the other hand, the FinSA provides for certain consequences under criminal law in the event of breaches of duty by unsupervised financial service providers.

### **6.1. Regulatory Sanctions upon Non-Compliance with FinSA Obligations**

FINMA's regulatory instruments against supervised financial service providers include the restoration of orderly conditions, declaratory orders, the publication of regulatory orders, the confiscation of

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assets and even the revocation of the authorisation, if necessary. Persons holding positions of responsibility and client advisers of supervised financial service providers may face prohibitions against exercising the profession or professional activities in the event of serious violations of the FinSA.

## 6.2. Sanctions Under Criminal Law for Violating Certain FinSA Obligations

Financial service providers who are not supervised, i.e. the persons in charge, are liable under criminal law to a fine of up to CHF 100,000 if the following criminal offences have been satisfied:

- false statements or withholding essential facts when fulfilling their disclosure requirements;
- breach of the assessment duty (performing the appropriateness and suitability tests);
- violation of the provisions on the surrender of compensation from third parties.

Client advisers exercising their activity without registration risk, in the event of wilful misconduct, a prison sentence of up to three years or a monetary penalty.

## 7. Effects on Civil Liability

In future, there will be parallel regulatory and civil duties of conduct and organisational requirements, although their content will not be completely identi-

cal. For example, there is no differentiation between transaction- and portfolio-related investment advisory in civil law. The extent of assessment and disclosure requirements under civil law depends on the circumstances of each individual case.

It is to be expected that the comprehensive regulatory adoption of investor protection provisions under the FinSA and the FinSO will have relevant effects on civil liability. This is in particular the case when the detailed stipulation of regulatory obligations affects the parallel civil obligations of financial service providers and makes those more concrete. This appears to occur most likely when it comes to disclosure requirements and organisational rules, which might lead to an increase in liability risks.

Yet the question might at times arise to what extent regulatory exemptions must also be considered under civil law. What needs to be clarified, for example, is whether and to what extent a client's advance waiver of disclosure requirements or a limited suitability test as provided under the FinSA for professional clients is permissible also for the parallel civil disclosure and assessment requirements. As long as this has not been clarified, scenarios like these involve civil liability risks, in particular if the classification of the client is based on its opting out, which occurred solely because of the scope of that client's assets but not also due to that client's knowledge and experience.

## 8. Transitional Provisions

What	Deadlines
<b>Client segmentation</b>	The obligation of client segmentation must be fulfilled <b>within two years</b> of FinSO entering into force.
<b>Rules of conduct</b>	The disclosure requirement, assessment duty, documentation requirement and an accountability under the FinSA must be fulfilled <b>within two years</b> of the entry into force of the FinSO.
<b>Organisational rules</b>	The requirements regarding the organisation under the FinSA must be fulfilled <b>within two years</b> of the FinSO entering into force.
<b>Ombudsman</b>	Financial service providers must have joined an ombudsman's office <b>within six months</b> of the FinSA entering into force. If there is no pertinent ombudsman upon FinSA's entry into force, the period for affiliation will not begin to run until the ombudsman has been recognised by the Federal Department of Finance or set up by the Federal Council.
<b>Entry in the client adviser registry</b>	Client advisers must apply with the registration office for entry in the register <b>within six months</b> of the FinSA entering into force. If there is no pertinent registration office upon FinSA's entry into force, the period for applying will not begin to run until the registration office has been approved by the FINMA or designated by the Federal Council.
<b>Required knowledge of client advisers</b>	Client advisers must meet the requirements for the required knowledge <b>within two years</b> of the FinSO entering into force.