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Financial Market Infrastructure Law
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FinTech
Information Technology Law
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Intellectual Property Law
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Litigation & Arbitration
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Financial Institutions Act – Effects on Independent Asset Managers and Trustees

The new Financial Institutions Act (FinIA or the Act) will enter into force on 1 January 2020. This Act regulates the supervision of financial institutions, which now also include independent asset managers (IAM) and trustees. The recently published Financial Institutions Ordinance will provide more clarity about the new legislation. These guidelines are meant to give an overview of the most important effects of the FinIA on IAM and trustees and the deadlines for implementation they must observe.

1. Introduction

The FinIA will enter into force together with the Financial Services Act (FinSA). While the FinSA primarily lays down regulatory requirements relating to conduct and organisation for financial service providers for providing their services (see separate guidelines), the FinIA stipulates authorisation requirements and other organisational requirements applicable to financial institutions, as well as their supervision. The FinIA is a regulatory framework whose content is specified in greater detail in the Financial Institutions Ordinance (FinIO).

Financial service providers conducting asset management transactions in any way without a banking licence are considered financial institutions under the FinIA. Along with securities firms (Wertpapierhändler) (formerly: securities dealers), they include fund management companies (Fondsleitungen) and managers of collective assets (Verwalter von Kollektivvermögen) – regulated already and not to experience major changes under the FinIA – and now also all asset managers acting on a commercial basis, in particular IAM and trustees.

Financial institutions require an authorisation by the Swiss Financial Market Supervisory Authority (FINMA)

and are then subject to what is known as 'prudential supervision'. This means that compliance with the authorisation requirements and duties relating to conduct and organisation imposed on financial institutions under applicable financial market legislation is monitored on an ongoing basis. FINMA exercises its prudential supervision of IAM and trustees with the involvement of the relevant supervisory organisation (SO). A SO is not a federal authority, and that means that FINMA specifically retains the authority to enforce regulatory sanctions.

Enforcement of the FinIA is not ensured by regulatory sanctions alone. The Act also provides for various penal provisions, in particular to protect professional secrecy, which now also applies to IAM and trustees.

2. Asset Managers and Trustees Are Subject to the FinIA

2.1. Asset Managers

Relevant Criteria

Under the Act, the term asset manager is thus linked to two criteria: (i) the power to make dispositions of clients' assets, and (ii) the commercial activity.

The power of disposition of assets must result from an order given by the client for that purpose. What

this refers to is the power to manage assets granted to the financial service provider. If financial service providers who do not provide discretionary asset management services, have their clients grant them power to manage assets so that they can, for example, implement investment decisions made by their clients in dealings with the custodian bank in their capacity as pure investment advisers, then they fulfil that criterion. According to the legislation, what counts is the power to make dispositions of the client's assets. If a power to manage assets is in place, this will automatically include the power to make dispositions.

The second criterion, commercial activity, is fulfilled according to the FinIO when a financial service provider either:

- yields gross income of more than CHF 50'000 per year;
- maintains a business relationship with more than 20 contracting parties per year, or enters into a business relationship with more than 20 contracting parties, which is not limited to one single business transaction; or
- has the power of disposition of third-party assets in excess of CHF 5 million.

Financial service providers who meet both criteria (power of disposition of clients' assets and commercial activity), qualify in principle as asset managers under Art. 17 para 1 FinIA, and are therefore considered financial institutions. Asset managers of collective capital investments and asset managers of pension funds who do not reach the thresholds set out in Art. 24 para 2 FinIA are also considered asset managers under the Act and not managers of collective assets.

Special Cases

For reasons of legal certainty, FinIA and FinIO contain various provisions that clarify the factual and geographical aspects of borderline cases about subjection to the Act.

- **Factual borderline cases:** The Act provides for a list of exceptions applicable to financial service providers not subject to the Act, which is specified in the FinIO. Exempt is, for example, anyone who exclusively manages assets of affiliated entities or related persons linked by family ties. Affiliated entities include specifically group companies as well as pension funds, foundations and investment vehicles affiliated with a group. Related persons linked by family ties include primarily relatives and persons in inheritance relationships (e.g. community of heirs), as well as, in principle, single-family offices. Further exempt are persons who manage assets exclusively in connection with employee participation plans (ESOPs); lawyers and notaries for activities subject to professional se-

crecy; persons who manage assets under an order governed by statutory provisions (e.g. advisers, executors of wills, receivers in bankruptcy, and creditor's trustees under the Swiss Debt Collection and Bankruptcy Act), as well as pension funds. This list is not exhaustive. Activities covered by this list of exceptions are not to be considered when determining whether an activity is carried out on a commercial basis.

- **Geographic borderline cases:** In cross-border transactions, the activity of the financial service provider in question must be analysed precisely to determine whether or not it is subject to the FinIA. The Ordinance provides that only financial service providers operating in or from Switzerland are subject to the Act. Thus, the location of the financial provider's place of business will determine this question. In everyday practice though, this raises tricky questions of delimitation that must be clarified case-by-case.

2.2. Trustees

Foreign trusts are legally recognised in Switzerland by the Hague Trust Convention. The business activity as a trustee has not been regulated until now, apart from the provisions of the Anti-Money Laundering Act (AMLA) to be complied with. But this will change upon the introduction of the FinIA. Trustees will be placed alongside the IAM under the obligation of obtaining authorisation by FINMA and will be subjected to prudential supervision by a SO.

Anyone who, on a commercial basis and through a declaration of trust, manages or disposes of fund assets in favour of the beneficiaries or for a specific purpose, is a trustee. The second relevant criterion, the commercial activity, is, as a rule, the same as for asset managers, i.e. it only applies if the thresholds for business volume under the FinIO have been attained. In the case of trustees, the amount of assets under management is not relevant because these are not third-party assets under civil law.

3. Consequences of Being Subject to the FinIA

3.1. Obligation to Obtain Authorisation

Types of Authorisation

Anyone who fulfils the requirements as an asset manager or a trustee in accordance with the FinIA requires an authorisation for that purpose from FINMA. Managers of collective assets who also take care of individual clients do not require an additional authorisation as asset managers. That said, asset managers who also wish to act as trustees do require an additional licence for this purpose. The same applies the other way around. Transitional provisions apply to asset managers and trustees who have already been practicing as such at the time the FinIA enters into force on 1 January 2020 (more on this under Section 4 below).

Authorisation Requirements for IAM and Trustees

There are numerous authorisation requirements, detailed in the Act and the Ordinance. They can be broken down as follows:

- **Organisational Requirements**

This includes, among other things, the issuing of rules on corporate governance, regulations on the legal form, composition of the management board, rules on the power to sign, setting up an appropriately equipped risk management system and an effective control system. Besides this, the financial institutions must, in fact, be managed from Switzerland and join an ombudsman's office. Finally, the Act also stipulates the conditions for transferring tasks to third parties and the international business of financial institutions. Along with this, asset managers and trustees must provide proof that they have subjected themselves to a SO.

- **Financial Requirements**

Asset managers and trustees must show a minimum capital of CHF 100'000 (in cash and paid in full). At least one quarter of the fixed costs of the last annual accounts up to a maximum amount of CHF 10 million must always be available as own funds. They must also provide appropriate security or take out professional liability insurance.

- **Personal Requirements**

The persons responsible for administration and management must possess the specialist qualifications required for their activities, meet the requirements for proper business conduct, and enjoy an excellent reputation. Moreover, proper business conduct must not be jeopardised by persons holding qualified participations (specifically shareholders).

The management of an asset manager or a trustee must, as a rule, consist of at least two qualified persons. What qualifies them is their education and professional experience. According to the FinIO, a person is considered qualified enough if, when upon taking over management, he or she has at least five years' professional experience in asset management for third parties or as part of a trust, as applicable, and can provide proof of adequate education and training. In addition, these skills must be maintained through regular continuing education. Substitution rules must also be in place in the event that any of the qualified managing directors is prevented from exercising their duties.

Authorisation Procedure

Anyone who fulfils the legal authorisation requirements as an asset manager or a trustee is legally entitled under the Act to be granted that authorisation. The FinIO contains a list of topics on which the request for authorisation must include information and documents. FINMA specifies in detail

all documents that must be submitted, and may do so by way of guidance documents, sample forms and the like.

3.2. Prudential Supervision

Ongoing Review of Compliance with Applicable Law

Asset managers and trustees are supervised by FINMA with the involvement of a SO, with the ongoing supervisory activity being performed by the SO.

As part of the ongoing audit, asset managers must in principle prove annually that they comply with the authorisation requirements and other organisational requirements under the FinIA, with the duties of care under the AMLA and the duties relating to conduct and organisation under the FinSA, as well as – if they exercise an activity subject to the Collective Investment Schemes Act (CISA) – with the obligations set forth under CISA.

Trustees managing trust funds are not performing financial services under FinSA. They will only have to comply with the obligations set forth in the FinSA if they exercise the related secondary activities. But they too must comply in any event with the requirements of FinIA and AMLA.

To keep the audit costs for asset managers and trustees as low as possible, the SO may set the audit frequency at no more than 4 years according to a risk-based approach. In that case, the asset manager or trustee must submit a report to the SO in those years in which no periodic audit is conducted that its business activities conform to the statutory provisions. This report may be submitted in a standardised form. However, asset managers and trustees are also subject to at least the annual accounting rules under the Swiss Code of Obligations (CO), regardless of their legal form.

Reporting Obligations

Independently of the ongoing audit, financial institutions must notify FINMA of any changes to the facts on which the authorisation was based. If the changes are crucial, FINMA's prior authorisation must be obtained before continuing any activity. This is the case, for example, if the changes relate to organisational and corporate documents, major personnel turnover, changes to minimum capital and own funds, and incidents having an impact on proper business conduct (such as institution of criminal proceedings).

3.3. Instruments of Supervision and Sanctions

Regulatory Instruments of FINMA up to Revocation of Authorisation

FINMA has various regulatory instruments and sanctions at its disposal to enforce financial market legislation. These regulatory instruments can now also be directed against asset managers, trustees, and their governing bodies, as well as against certain categories of employees (employees responsible for trading



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in financial instruments and client advisers). They cover a broad spectrum and range from the mere determination that a breach of duty has occurred, the confiscation of profits obtained through serious breaches of duty, to the revocation of the financial institution's authorisation, as well as prohibitions imposed on individual bodies or employees against exercising the profession or professional activities.

Criminal Provisions

If the activity of a financial institution is carried out without authorisation, those responsible are

threatened either with imprisonment for up to three years or a monetary penalty, and in the event of negligence, with a fine of up to CHF 250'000. Anyone who uses the terms "asset manager", "trustee", "manager of collective assets", "fund management company", or "securities firm" in business relations without having received the required authorisation is liable to a fine of up to CHF 500'000.

Article 69 of the FinIA stipulates professional secrecy for financial institutions, i.e. now also applicable to asset managers and trustees. The violation of the provision is criminally punishable.

4. Transitional Provisions

Financial service providers	Deadlines to be observed
Existing IAM / trustees	IAM and trustees who subordinated themselves directly to FINMA based on the AMLA (Directly Subordinated Financial Intermediaries; DSFI) or affiliated themselves with a recognised self-regulatory organisation (SRO), must report to FINMA within six months of the entry into force of the FinIA using FINMA's Data Collection and Application Platform ("EHP", https://www.finma.ch/de/finma/extranet/erhebungs-und-gesuchsplattform/).
SRO-affiliated IAM / trustees	They must comply with the requirements of the FinIA within three years of its entering into force and submit a request for authorisation together with their subjection to SO. They are allowed to continue their activities until a decision on the authorisation has been made.
IAM with DSFI status	They need not join an SRO if they have been approved for subjection to the SO by the latter within one year of the entry into force of the FinIA and have submitted a request for authorisation with FINMA. But they also could proceed in stages and simply join an SRO within one year of the entry into force of the FinIA, and then submit their request for authorisation while subjecting themselves to a SO within three years of the FinIA entering into force.
New AMI / trustees	If they start operating within one year of the entry into force of the FinIA, they must register with FINMA immediately and comply with the authorisation requirements from day one of their activities. Proof of a SO must not yet be submitted at this point. They must join the relevant SO no later than one year of that SO's approval by FINMA and submit a request for authorisation . They have a right to carry out their activity until the decision on the authorisation has been made provided that they are affiliated with an SRO and are supervised by the latter.