

A practical guide for independent wealth managers and trustees in the coming new environment of financial services in Switzerland

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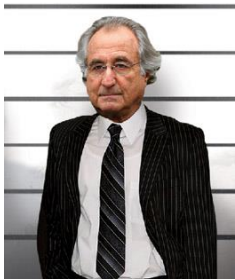


Plan

1. Background and overview of the Financial Services Act (FinSA) and Financial Institutions Act (FinIA)
2. Trustees and Portfolio Managers under the new FinIA
3. New supervision system and costs
4. Rules of conduct for wealth management under the new FinSA
5. Conclusion

1. Background and overview

Origin and aims



Madoff case



Financial crisis



Lehman collapse



International regulations
and access to EU markets

Investor losses



International developments



Interdisciplinary regulation of financial products
and financial services

1. Background and overview

Origin and aims

“Aside from creating uniform competitive conditions and strengthening the competitiveness of the financial centre, the FinSA serves primarily to improve client protection”


Word count in the Federal Council’s dispatched on to the drafts:

5 x «competitiveness»



24 x «client protection»

1. Background and overview



| | |
|----------------------|--|
| March 2010 | FINMA Distribution Report |
| February 2012 | FINMA Position Paper on Distribution Rules |
| March 2012 | Federal Council instructs Federal Department of Finance to develop a consultation draft |
| February 2013 | Publication of a hearing report on the key thrusts of potential regulation |
| March 2013 | Comments by interested parties (over 50 submissions) |
| June 2014 | Presentation of consultation drafts of FinSA and FinIA and start of consultation procedure |
| October 2014 | Closing of consultation procedure |
| 4 November 2015 | Presentation of revised drafts and Federal Council's dispatch |
| February 2016 | The Parliament decided to treat the drafts but also required the Federal Department of Finance to provide significant overhaul proposals. |
| 2017 / 2018 | Entry into force of FinAS and FinIA is expected in 2017 the soonest but most probably in 2018. |

1. Background and overview

Architecture of Swiss financial market regulations

Supervision

(organisation & competencies)

- *Relation Authority ↔ financial institutions*

FINMASA, NBA (stability of the system)

Infrastructure of financial markets

(rules for market participants)

- *Guarantee of a functioning market*

SESTA, FMIA

Institutions

(authorised forms & requirements)

- *Conditions of authorization*

FinIA, BA, SESTA, LSA, LLG

Financial Services

(product & distribution)

- *Relation Financial institutes ↔ client*

FinSA, SESTA, AMLA, CISA

Source: Translation from FDF presentation 2016

2. Trustees and Portfolio Managers under FinIA

Scope of application

Art. 2 FinIA

Financial institutions (...) are as follows, irrespective of their legal form :

- a) Portfolio managers*
- b) Trustees*
- (...)*

- Trustees are newly considered as financial institutions (they were not mentioned in the previous consultation drafts)

2. Trustees and Portfolio Managers under FinIA

Definitions - Portfolio manager

Article 16 para 1. FinIA

A portfolio manager is a person...

... mandated to manage assets...

... on a commercial basis...

... in the name of and on behalf of clients or who may dispose of clients' assets in any other manner (art. 16 para 1. FinIA)

- Investment advisers providing only investment advice are not concerned by FinIA (they are however subject to FinSA's requirements)

2. Trustees and Portfolio Managers under FinIA

Definitions - Trustee

Article 16 para 2. FinIA

A trustee is a person who...

... on a commercial basis...

... manages or disposes of a separate fund...

... for the benefit of a beneficiary or for a specified purpose...

... based on a restricted grant given namely in the instrument creating a trust within the meaning of the Hague Convention of 1 July 19859 on the Law Applicable to Trusts and on Their Recognition.

- Definition based on to the Hague Convention (art. 2, par. 2, lit c) to avoid undue extension of scope, e.g. to persons who create and manage companies on a fiduciary basis.

2. Trustees and Portfolio Managers under FinIA

Tasks

Article 17 FinIA

The portfolio manager manages individual portfolios.

The trustee manages the separate fund, ensures its value is maintained and employs it in a restricted manner.

Portfolio managers and trustees may also provide the following services in particular:

- a. investment advice;*
- b. portfolio analysis;*
- c. offering of financial instruments.*

2. Trustees and Portfolio Managers under FinIA

Particularities of a Trustee

Article 17 FinIA para. 2

The trustee manages the separate fund, ensures its value is maintained and employs it in a restricted manner.

- The Trustee must comply with
 - The same FinIA requirements applicable to portfolio managers
 - The provision of the Trust (Trust deed, etc.)
 - The foreign law applicable to the trust

- Impact on the guarantee of irreproachable business conducts, organization and due diligence duties of the Trustees

2. Trustees and Portfolio Managers under FinIA Requirements

- Duty to obtain authorization from the competent supervisory authority (Art. 4 FinIA)
- Transitional provisions (Art. 70 FinIA)

As a financial institution newly subject to an authorization, Trustees and Portfolio managers shall upon entry into force of FinIA

- Report to the supervisory authority within 6 months
 - Satisfy with the requirements of FinIA and submit an authorization within 2 years
- Grandfathering clause: Portfolio managers can be exempted from prudential supervision if
- they have at least 15 years of activity, and
 - confine themselves to serving existing clients

2. Trustees and Portfolio Managers under FinIA

Requirements

- **Organizational requirements (Art. 8 FinIA)**
 - Appropriate corporate form and internal organization
 - Appropriate internal control system (ICS) : Identify, measure, control and monitor its risks, including legal and reputational risks
 - Minimal organization requirements to be set by the Federal Council
- **Organization form as sole proprietorship, commercial enterprise or cooperative (Art. 17 FinIA)**
- **Obligation to be listed in the commercial register (Art. 17 FinIA)**
- **In particular for Trustees : organizational measures to prevent that the assets of the trust get mixed with the assets of the Trustee**

2. Trustees and Portfolio Managers under FinIA

Requirements

- Guarantee of irreproachable business conduct (Art. 10 FinIA)
 - Good reputation
 - Expertise in the specific field of activity

- Concerned persons
 - The financial institution itself
 - Persons responsible for the administration and management
 - Qualified participants (10% of share capital/votes or significant influence)

- In particular for Trustees:
 - Trustee must have sufficient expertise (e.g. requirements of the law applicable to the trust)
 - Trustee's activity is recognized as a specialized activity (e.g. a Bank acting as Trustee would have to set up a separate legal structure with special qualified personal)

2. Trustees and Portfolio Managers under FinIA

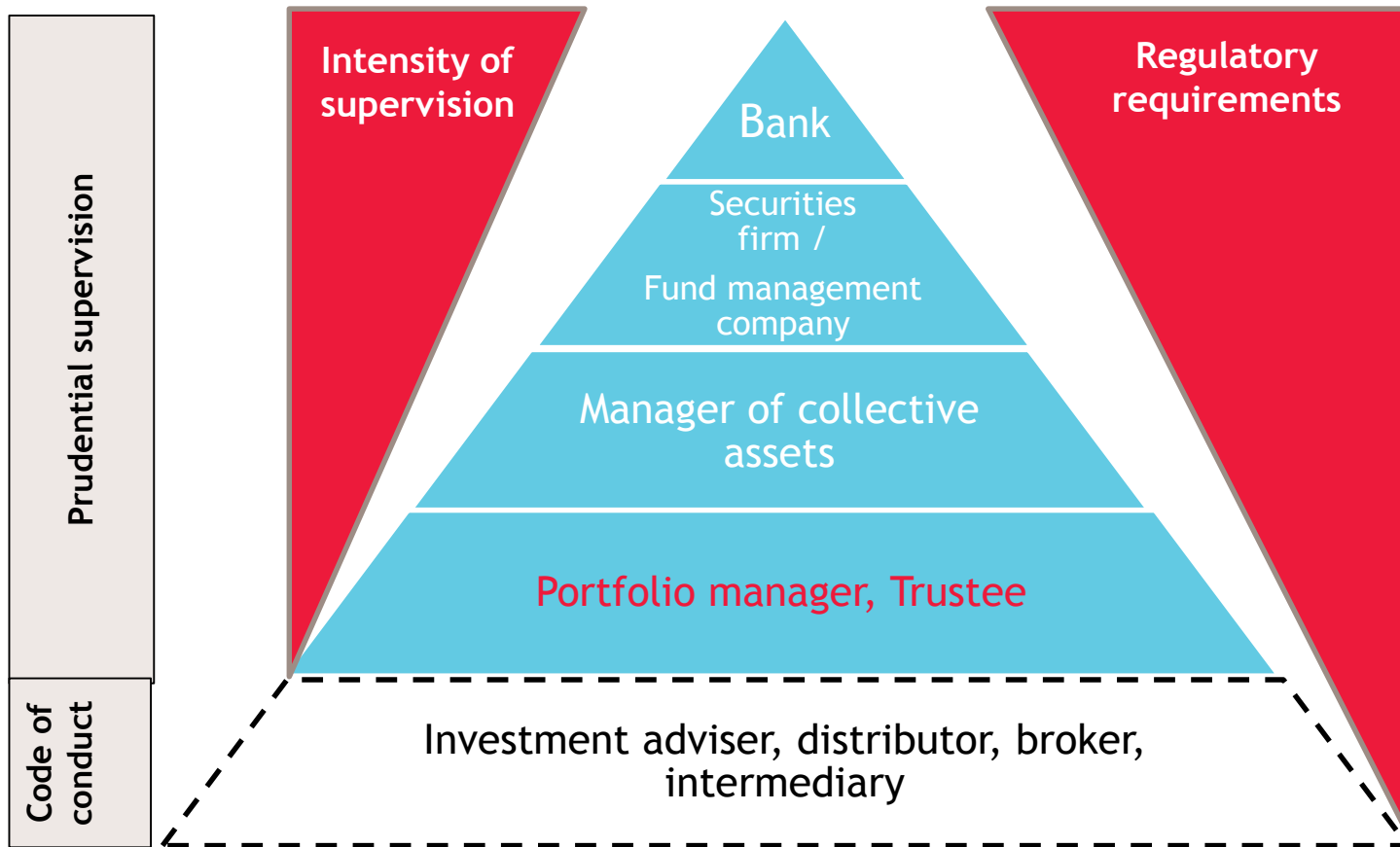
Requirements

- Respect at all times of authorization conditions (Art. ° 6 FinIA)
- Notification /prior to the authorization in case of changes of relevant facts (Art. ° 7 FinIA)
- Effective place of management in Switzerland (Art. ° 9 FinIA)
- The terms “portfolio manager” and “trustee” may only be used only with the corresponding authorization (Art. ° 12 Fin IA)
 - International treaties exemptions are reserved
 - Protected by criminal provisions against confusion and deception

2. Trustees and Portfolio Managers under FinIA Requirements

- Adequate collateral or professional liability insurance (amount to be set by Federal Council's ordinance)
- Duty to provide information and to report in case of delegation of significant functions (Art. 60 FinIA)
- Respect of professional confidentiality (Art. 65 FinIA)
 - Willfull violation : custodial sentence up to 3 years or monetary penalty
 - Negligence : fine up to CHF 250'000

3. New supervision system



Source: FDF

3. New supervision system

Competent supervisory authority (Art. 57 FinIA)

- Portfolio managers are supervised by one (or several) **Supervisory Organization(s)** regulated by the FINMASA (art. 43a ss FINMASA)
- The Supervisory Organization (SO) will be an autonomous and independent Swiss based organization under FINMA's supervision
- The model of the SO is based on the US semi-public Financial Industry Regulatory Authority (FINRA)
- Market participants are expected to propose one or more SO, if not or if the SO is inadequate, supervision will be performed by FINMA

3. New supervision system

Competent supervisory authority (Art. 57 FinIA)

- The Supervisory organization is competent for:
 - Granting authorizations to Trustees and Portfolio managers
 - Issue circulars in its field of supervision (with FINMA approval)
 - Control the activity of the concerned financial institutions (in particular through external or direct audits)
 - Use supervisory measures, including sanctions against concerned financial institutions

- Prudential supervision including Anti-money laundering supervision

- Decision of the Supervisory organization are to be judged before the Federal Administrative Court or the Federal Supreme Court, FINMA is informed and invited to make a statement

3. New supervision system

Frequency of controls

Intensity of supervision

- Controls based on risks
 - Type of activity
 - Types of products
 - Activity in Switzerland, abroad or worldwide
- Frequency of Audits
 - 1 to 4 years
 - **Portfolio managers and Trustees (art. 58 FinIA)**
 - Manager of collective assets
 - Fund management companies
 - Securities firms
- In the intermediary years
 - Compliance Report

Source: FDF

3. New supervision system

Expected costs (based on a study of ZHAW)*

Initial cost* (between CHF 70'000 and 130'000 depending on the size and complexity)

- Initial measures to comply with the authorization requirements
- Advisory and control fees during the application process (65% of the costs)
- Fees for the authorization control by the supervisory authority

Recurring costs*

- Compliance measures
- Prudential audit the years when such audit is required (between 20'000 and 60'000)
- Annual fees of the supervisory authority

*Source : Dispatch p. 176 ss. referring to a recent ZHAW study based on Portfolio managers

4. Rules of conduct under the new FinSA

Scope

Trustees and Portfolio managers and their employees are subject to FinSA rules of conduct if they provide financial services or financial instruments (Art 2. FinSA)

- Financial instruments contain in particular : equity securities, units of collective investments schemes, bonds, etc.

- Financial services encompasses in particular :
 - Administration of assets (portfolio management)
 - Provision of personal recommendations on transaction with financial instruments (investment advice) - **broader than FinIA!**

4. Rules of conduct under the new FinSA

Requirements

- Basic training and continuous professional development duty for all client advisers
 - Code of conduct and expertise to perform their activity
 - Sector specific minimum standards to be set by the market

- Client segmentation: A distinction is made between retail clients and professional clients, as well as institutional clients as a subgroup of professional clients.
 - Possibility to switch between segments (opting system).
 - HNWI can opt-in to be treated as professional clients.

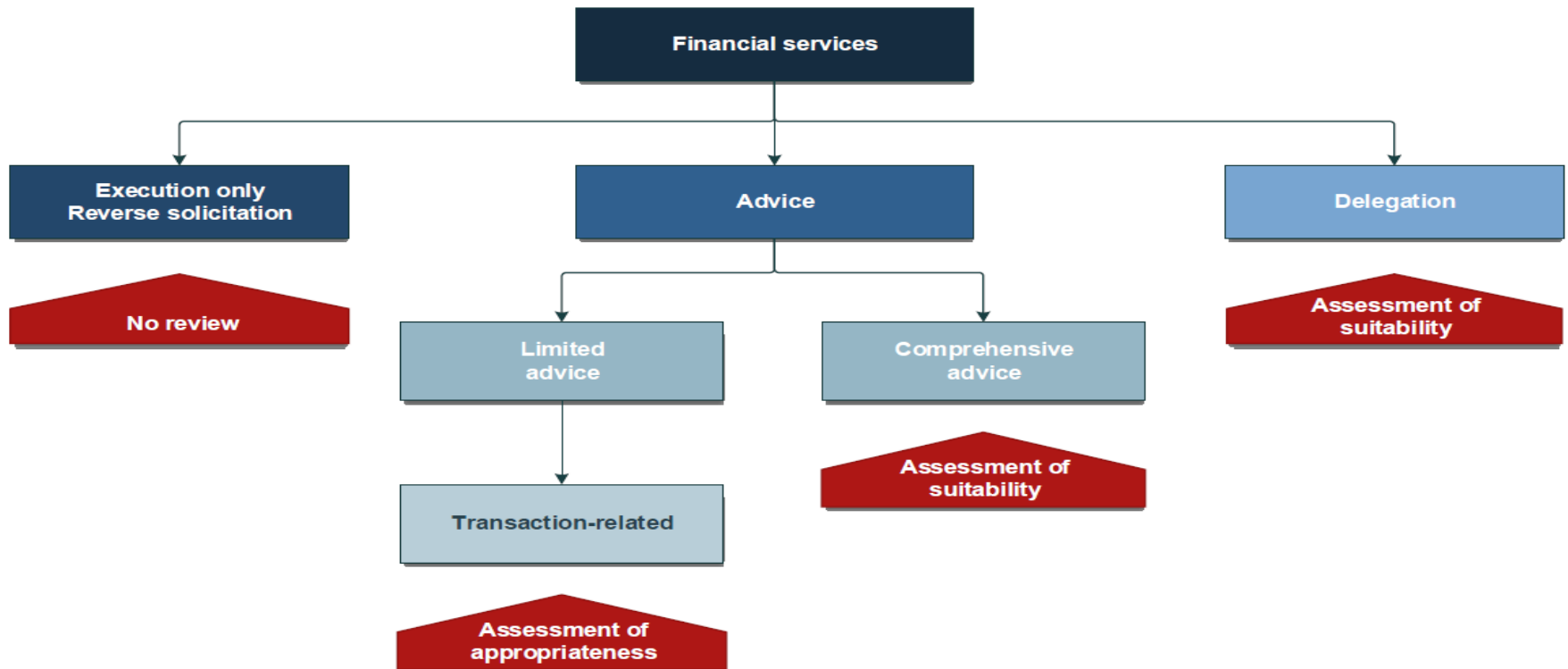
- Extensive duty to Provide Information
 - Financial service provider
 - Offered services and products
 - etc.

4. Rules of conduct under the new FinSA Requirements

- **Modular clarification duty (Appropriateness & Suitability)**
 - Execution only and reverse solicitation
 - Transaction related investment advice
 - Entire client portfolio related investment advice and asset administration
- Professional client are supposed to have
 - Sufficient knowledge and experience
 - Financial capacity to absorb risks
- No Appropriateness & Suitability test for Institutional clients

4. Rules of conduct under the new FinSA

Suitability and appropriateness test



Source: FDF

4. Rules of conduct under the new FinSA

Suitability and appropriateness test

Suitability test

- Client's overall financial situation and objectives
- Client's knowledge and experience

Appropriateness test

- Client's knowledge and experience

If the tests are not fulfilled:

- Giving additional information may fulfil a possible lack of knowledge
- Warning of customer that evaluation is not possible
- Advise client against the requested service/instrument and document

4. Rules of conduct under the new FinSA

Documentation duties

General

Agreed services
gathered information

Warnings relating to
suitability/appro-
priateness test

Performed services

Investment advice and asset management

Clients's needs

Reasons for every recommendation
that led to the purchase/sale of a
financial instrument

5. Conclusion

- Introduction of FinSA and FinIA in 2017 the earliest, but most probably in 2018 with possible important amendments by Parliament
- Major changes and complexification of the regulatory environment for all providers of financial services and products
- Trustees and Portfolio managers are the most impacted with the submission to a new prudential supervisory regime
- Complexity and cost of Compliance measures and supervision will lead to new solutions
 - Concentration of actors
 - Platforms dedicated to Compliance and back office services

5. Questions?

Thank you!

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