

Supervision of Trustees in Switzerland

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Requirements for Trustees under the Financial
Institutions Act (FinIA) and the Financial Services Act
(FinSA)

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Introduction

- Swiss Financial Services Act (FinSA) and the Swiss Financial Institutions Act (FinIA) will introduce a **new regulatory framework** governing the Swiss financial markets
 - New rules of conduct for financial service providers, incl. client segmentation
 - Registration duty for client advisors of financial services providers who are not licensed by FINMA
 - Obligations to prepare a prospectus
 - Subject portfolio managers and **trustees to ongoing prudential supervision and require them to obtain a licence from the Financial Market Supervisory Authority FINMA**
- The FinSA and FinIA were enacted by the Swiss Federal Assembly on 15 June 2018.
- The drafts of the implementing ordinances were presented for consultation.
- The acts and ordinances are expected to enter into force on 1 January 2020.

Who is subject to prudential supervision?

Definition of Trustee under FinIA - Overview

Trustees are persons acting on a commercial basis who, based on an instrument creating a trust in the meaning of the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition, manage or have the power to dispose over assets [Sondervermögen, patrimoine distinct] for the benefit of beneficiaries or for a specific purpose.

(article 17 (2) FinIA)

- Persons acting on a **commercial basis**
- Based on an **instrument creating a trust** in the meaning of the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition
- **Manage or have the power** to dispose over assets
- For the benefit of the beneficiaries or for a specific purpose

Who is subject to prudential supervision? Definition of Trustee under FinIA – Based on a Trust

Trustees are persons acting on a commercial basis who, based on an instrument creating a trust in the meaning of the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition, manage or have the power to dispose over assets [Sondervermögen, patrimoine distinct] for the benefit of beneficiaries or for a specific purpose.

(article 17 (2) FinIA)

Trust = trust under the Hague Convention

- Voluntary trusts evidenced in writing (article 3 HCT; ≠ statutory trusts, constructive trusts)
- Trusts created *inter vivos* or on death (article 2 (1) HCT)
- Law applicable to the trust is irrelevant
- Type of assets are irrelevant (not limited to trusts over financial assets)
- Location of the assets is irrelevant

N.B. the definition of a trust under the Hague Convention and the definition of a trustee under the FinIA do not hinge on whether the trust is created for the benefit of beneficiaries or a specific purpose

Who is subject to prudential supervision?

Definition of Trustee under FinIA – Manage or Power to Dispose

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Trustees are persons acting on a commercial basis who, based on an instrument creating a trust in the meaning of the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition, manage or have the power to dispose over assets [Sondervermögen, patrimoine distinctif] for the benefit of beneficiaries or for a specific purpose. (article 17 (2) FinIA)

All persons who "**manage or have the power to dispose**" over the trust assets **under the instrument** creating the trust

- not necessarily limited to the trustee under the law applicable to the trust (or the definition of the Hague Convention)
 - management authority or power to dispose does not need to be exclusive
 - authority does not need to be comprehensive

A contrario:

- **Not mere "protectors"** or other persons with, e.g., veto rights, right to appoint a trustee, inspection rights, information rights, consultative rights, advisory position, under the trust deed
- **Not other persons** who have the power to manage or dispose over the assets based on a contract or another instrument, e.g. **portfolio managers, investment advisors, corporate directors, foundation board members**

N.B. no automatic license for trustees to act as portfolio managers and vice-versa (article 12 draft FinIO)

Who is subject to prudential supervision?

Definition of Trustee under FinIA – Commercial Basis

Trustees are persons acting on a commercial basis who, based on an instrument creating a trust in the meaning of the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition, manage or have the power to dispose over assets [Sondervermögen, patrimoine distinct] for the benefit of beneficiaries or for a specific purpose.

(article 17 (2) FinIA)

Persons acting on a commercial basis

- Persons regardless of the legal form (individuals, partnerships, registered partnerships, corporates)
- "an independent economic activity pursued on a permanent, for-profit basis" (article 3 FinIA)
- Portfolio managers and trustees are deemed to act commercially (article 11 (1) draft FinIO):
 - **Gross turnover** from the activity of at least **CHF 50'000** per calendar year;
 - Onboard **20 contractual partners** (sic!) that are not limited to one-of transactions or ongoing relationship with 20 contractual partners in a calendar year;
 - Unlimited power to dispose of **third-party assets** worth more than **CHF 5 million** at any given time; or
 - Transactions of a total **volume of CHF 2 million per calendar year.**

Who is subject to prudential supervision?

Definition of Trustee under FinIA - Exemptions

Exemptions under the FinIA:

- Persons, who exclusively manage assets of persons with whom they have **business or family ties** (article 2 (2)(a) FinIA);
 - **Business ties**: entities who exclusively service assets of the same group of companies
 - **Direct family members, + side-lines** up to three degrees, **spouses** and registered partners, **co-heirs, god-children**
 - + exemption for **single-family offices** controlled by the family and exclusively managing assets controlled by the family (but not multi-family offices)
- Persons who manage assets under an **employee participation plan** (article 2 (2)(b) FinIA)
- **Occupational pension funds and employer-sponsored foundations and employers**, who manage such assets (article 2 (2)(f) FinIA)
 - Incl. foreign employee trust funds

N.B. "Trustee" is a protected designation. It can only be used in a name or corporate purpose by licensed persons.

Who is subject to prudential supervision?

Definition of Trustee under FinIA - Exemptions

Exemptions under the FinIA:

- No specific exemption for **private trust companies**: trustee for a single family.
- Structuring possibilities:
 - Private trust company under the **exemption for single family office** BUT the private trust company is generally not controlled by the family
 - Private trust company as a **non-profit organisation** (article 3 FinIA)
 - BUT is it possible to charge the trust fund the costs and expenses of the private trust company (without a margin)?
 - BUT is it possible to pay the officers and employees?
Are the officers and employees, under such circumstances, regulated trustees?
Employees are not independent.
Are the directors and officers independent under article 3 FinIA?

Who is subject to prudential supervision?

The "short" answer

Regulated Trustees

- Typical trustees:
 - Swiss professional trustees
 - Swiss corporate trustees
 - Attorneys (in Switzerland) who act as trustees for clients *ad personam*
- Atypical trustees:
 - Trusts with a foreign trustee, that is effectively managed in Switzerland (!)
 - Swiss security trustees under financing agreements (but generally banks)
 - Swiss escrow agents holding assets "in trust"

Out of scope

- Foreign trustees based abroad, without a permanent presence in Switzerland
- Trustees acting for family members
- Single family office acting as trustee for members of the family
- Administrators of underlying companies
- (Corporate directors)
- (Foundation board members)

Who is subject to prudential supervision?

Definition of Trustee under FinIA – Regulatory Cascade

- **Banks, Securities firms, and collective asset managers** (but not fund management companies) are automatically authorised to act as trustees (article 6 FinIA)
- **Portfolio managers** need a separate license to act as trustees (article 12 (1) draft FinIO)
- **Licensed trustees** need a separate license to act as portfolio managers (article 12 (2) draft FinIO)
Portfolio management = power to dispose over assets under the FinSA of clients on the basis of a contract
 - Covers both discretionary portfolio management and investment advice with power to execute
 - N.B. uncertain to what extent a portfolio management agreement/investment advice agreement in connection with trust assets will be exempted
 - Not corporate directorships (or foundation members).
- **Licensed trustees** (and portfolio managers) are licensed financial intermediaries for AML-purposes

Licensing Requirements

Corporate Governance

Licensing Requirements

- **Qualified shareholder** (incl. shareholders holding more than 10% of the votes or capital) must have a good reputation and ensure their influence will not be exercised at the expense of prudent and reliable management (article 11 (3)FinIA)
- **"Fit and proper" requirement** (*Gewährsertfordernis, garantie d'une activité irréprochable*) for the financial institution, members of the board and executive management (article 11 (1) FinIA)
- As a matter of principle, at least two members of management, or at least a business continuity arrangement.
- General business continuity requirements (including through an external BCP-Partner)

Licensing Requirements

Corporate Governance

"Fit and proper" requirement (*Gewährserfordernis, garantie d'une activité irréprochable*)

Members of the board and executive management will require a **good reputation** and **requisite qualifications** for their function based on the activity and investment activity (article 11 (2) FinIA)

- At least **five years of professional experience** in portfolio management or connection with trusts (article 18 (1)(a) draft FinIO)
- **Training** that is equivalent to the professional experience applicable for regulatory auditors (article 18 (1)(n) draft FinIO)(!), i.e., among others, pursuant to article 4 of the Federal Act on the Oversight of Auditors
 - **Certified auditor** (expert-comptable)
 - Accountant, tax expert, and at least five years of professional experience
 - **(Swiss) University degree** in business administration, economics, law and 12 months professional experience or
 - Equivalent **foreign diploma** and **appropriate knowledge of Swiss law**, subject to a treaty or reciprocity
 - Knowledge of the law(s) applicable to the trust (?)

Licensing Requirements Organisation

Appropriate organization

- **Effective risk management**, to identify, measure, manage and monitor all essential risks (articles 9 (2) and 21 (1) FinIA)
- **Effective internal controls**, including to ensure compliance with laws and regulations as well as internal policies and procedures (articles 9 (2) and 21 (1) FinIA)
- **Risk management and internal controls** need to be independent from revenue generating activities (article 19 (2) draft FinIO), unless
 - the trustee has less than five employees or generates a turnover of less than CHF 1.5 million and
 - the business model does not have high risks
- **Internal audit** (if the annual turnover exceeds CHF 10 million and the scope of the activity makes it necessary; article 19 (3) draft FinIO)
- Personnel must be **appropriate for the activity and duly qualified** (article 15 (2) draft FinIO)
- Stringent regulation of **outsourcing** (article 14 FinIA)

Licensing Requirements

Statutory and Regulatory Capital

Licensing Requirements

Statutory and Regulatory Capital

- Fully paid-in share capital of CHF 100,000 (similar contributions with other business organisations (article 22 (1) FinIA)
- Appropriate level of own funds or professional liability insurance (article 22 (2) and 23 FinIA)
 - a quarter of the fixed costs in the last annual financial statements, up to CHF 10 million (article 23 (1) and (2) FinIA)
 - 50% of the own fund requirements can be met through an appropriate professional liability coverage (article 24 (2) draft FinIO)

Affiliation with

- a supervisory organisation (article 7 (2) FinIA) and
- an ombudsman organisation (article 16 FinIA) – BUT who is the client?

Duties of Trustees Under the FinIA

The trustee manages the separate fund, ensures its value is maintained and employs it for the specified purposes.

(article 19 (2) FinIA)

- Act in the best interest of the beneficiary with the requisite skills, care and loyalty (*Gewissenhaft*) (article 16 (4) (a) draft-FinIO)
- Takes appropriate organizational measures to avoid conflicts of interest or exclude any prejudice at the expense of the beneficiary (article 16 (4) (b) draft-FinIO)
- No obligation to hold trust assets on separate accounts, as long as the bank or securities firm allocates the assets to each individual "client" (article 16 (2) *cum* (4) draft-FinIO)
- Take requisite measures to avoid losing contact with clients and having dormant accounts (article 16 (3) *cum* (4) draft-FinIO)

and everything else based on the fit and proper requirement...

Duties of Trustees

Under FinsA?

Trustees as financial services providers?

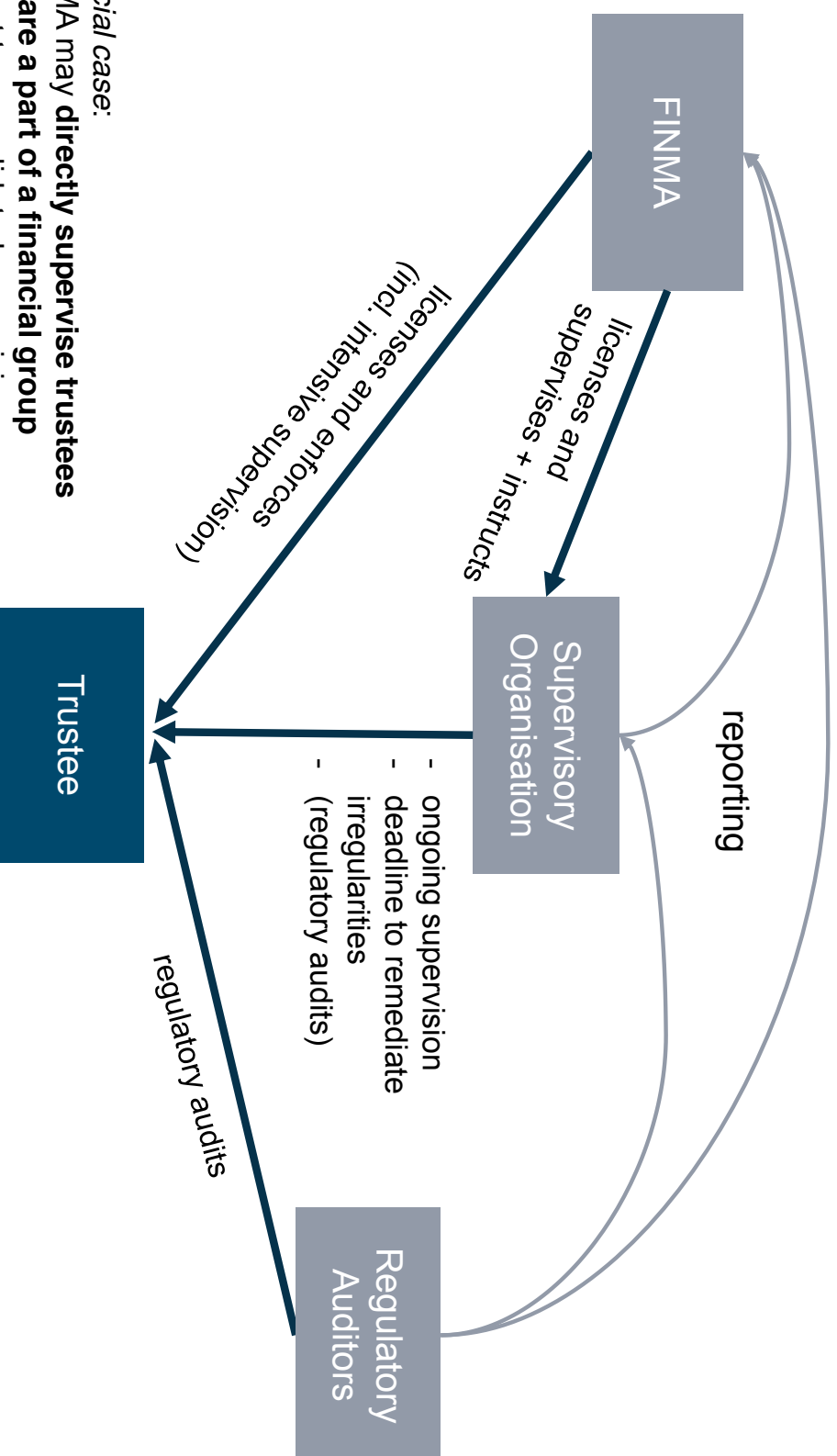
- Persons providing portfolio management services are financial services providers
 - portfolio management includes all activities entailing the investment of assets on behalf of clients **under a power of attorney**
 - ≠ trustees who act as legal owner of the managed assets are not financial services providers for FinsA purposes

Trustees/trust as clients of financial services providers

- **Trustees are institutional clients** under the FinsA (article 3(3)(a) *cum* (4) FinsA): low level of protection, but may opt-in to acquire professional client status
 - Does this segmentation apply to the trustee when it acts on behalf of the trust?
The trustee is the contracting party, even when it acts on behalf of the trust
- Does this segmentation apply to a company held by the trust?
 - Undertakings with a professional treasury (article 3 (3)(g) FinsA) (?)
 - Private investment structures with professional treasury operations created for high-net-worth individuals (article 3 (3)(i) FinsA) ?
 - = professional clients, but may opt-in to acquire retail client status
 - = HNW1 on a look-through basis (?)

Supervision of Trustees

Two-tiered supervisory model



Special case:
FINNMA may directly supervise trustees that are a part of a financial group subject to consolidated supervision, as part of such consolidated supervision

Supervision of Trustees

Two/three-tiered supervisory model

Supervisory model (article 61 (1) FinIA)

- **FINMA** is responsible for licensing trustees and taking formal enforcement action
- **Supervisory organisation** is responsible for the ongoing prudential supervision (article 61 (2) FinIA)
 - **monitor compliance with the licensing requirements** under the FinIA (and with the rules of conduct under the FinSA)
 - deadlines to remedy irregularities (article 43b (2) FINMASA), and
 - reporting serious irregularities and non-remediated issues to FINMA (article 43 (3) FINMASA)
- Regulatory audits will be carried out by the supervisory organization or by a regulatory auditor
 - (annual) prudential audits (article 62 (1) FinIA)
 - audit cycle can be reduced to an audit every four years, provided the trustee files a report on compliance with applicable laws and regulations (article 62 (2) FinIA)

Supervisory organization

- private organisations licensed and supervised by FINMA (article 43a (2) FINMASA), who are also allowed as a **self-regulatory organization (SRO)** monitoring compliance with anti-money laundering duties if recognised as such by FINMA (article 43a (3) FINMASA)

Foreign Trustees

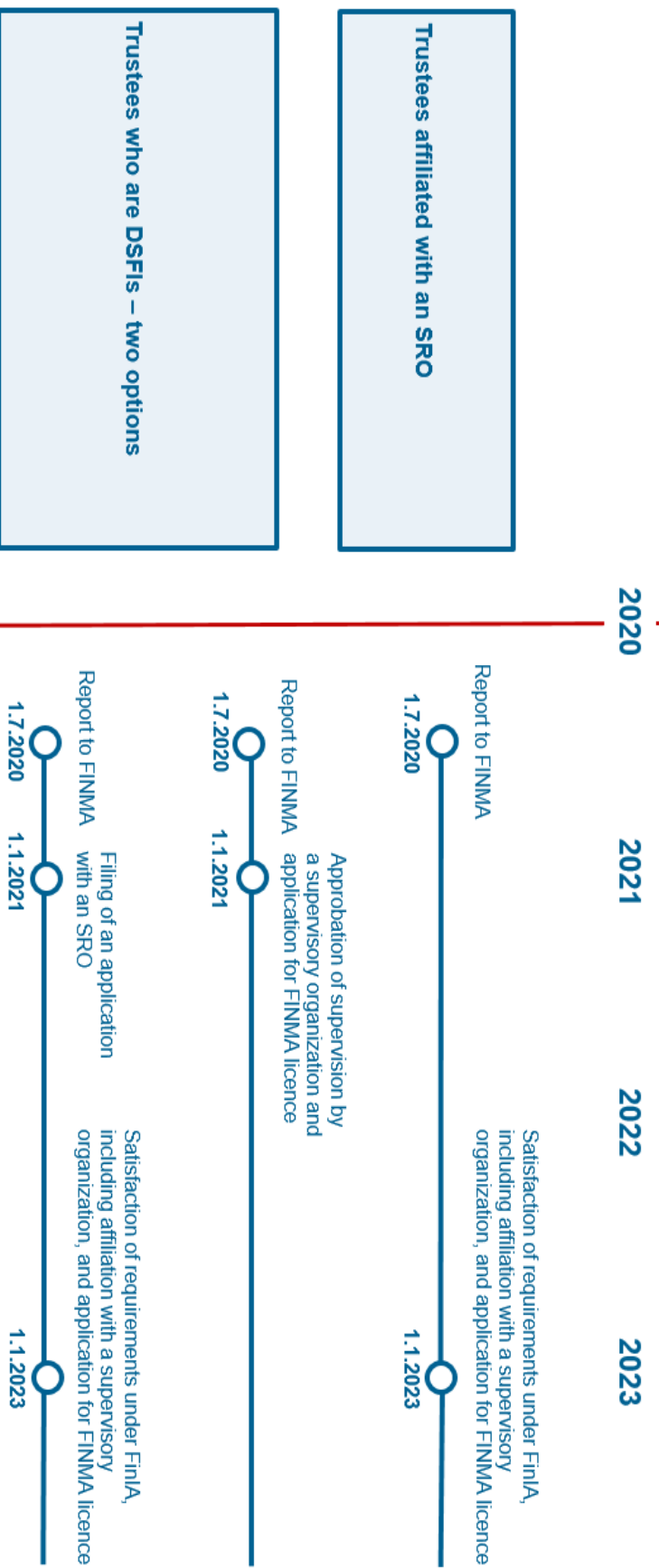
Cross-border Services and Licensing Requirements

- General licensing requirements apply only **to (Swiss) trustees acting in or from Switzerland**
 - Trustees domiciled/incorporated in Switzerland (article 2 (1) draft FinIO), regardless where the settlor, beneficiary, trust assets, etc. are domiciled/located
- **Foreign trustees must be licensed by FINMA**, if they have a physical presence in Switzerland, i.e. if they engage persons in Switzerland who, on a permanent commercial basis, in or from Switzerland:
 - perform **trustee activities** in the name of the **foreign trustee (branch)** (article 52 (1) FinIA) or
 - **work for the foreign trustee** in another manner, namely by forwarding client orders to it or representing it for **marketing** or other purposes (**representative office**) (article 58 (1) FinIA)
 - act **de facto as a branch** or representative office of a foreign trustee; persons carrying out an activity in Switzerland without having formally established a branch or representative office or persons permanently helping the foreign trustee to carry out essential aspects of its activities in or from Switzerland
- Foreign trustees that do not have a permanent physical presence in Switzerland are not subject to licensing requirements

Pro memoria: Client advisors of foreign providers of financial services will be subject to the registration requirement

Fate of DSFIs and Transitional Regime

Status of directly subordinated financial intermediaries (DSFIs) under the Anti-Money Laundering Act to be abolished and trustees to be subject, for AML purposes, to the ongoing supervision by the **supervisory organisation** and to the supervision of **FINNMA**





Outlook

Predictions and Open Questions

A few predictions:

- **Expect** a standardized approach to licensing proceedings (standardized approach applicable to collective investment schemes, rather than the bespoke approach applied to banks and securities dealers)
- **Expect** focus on organisational requirements (risk management and compliance function + internal audit) as well as on qualifications and professional experience of members of management
- **Expect** FINMA more intensely to intervene on AML

Outlook

Predictions and Open Questions

A few open questions:

- How will FINMA and the supervisory organisations interact?
- How will the supervisory organisations and FINMA address the (limited) regulatory duties of trustees?
 - Will they defer to the law applicable to the trust or will they create a Swiss regulatory law of trusts?
 - What will they (and the Ombudsman) do when Swiss mandatory law conflicts with the law applicable to the trust (family law or inheritance law)?
 - Will FINMA issue guidance ("circulars") on the substantive duties of trustees?

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