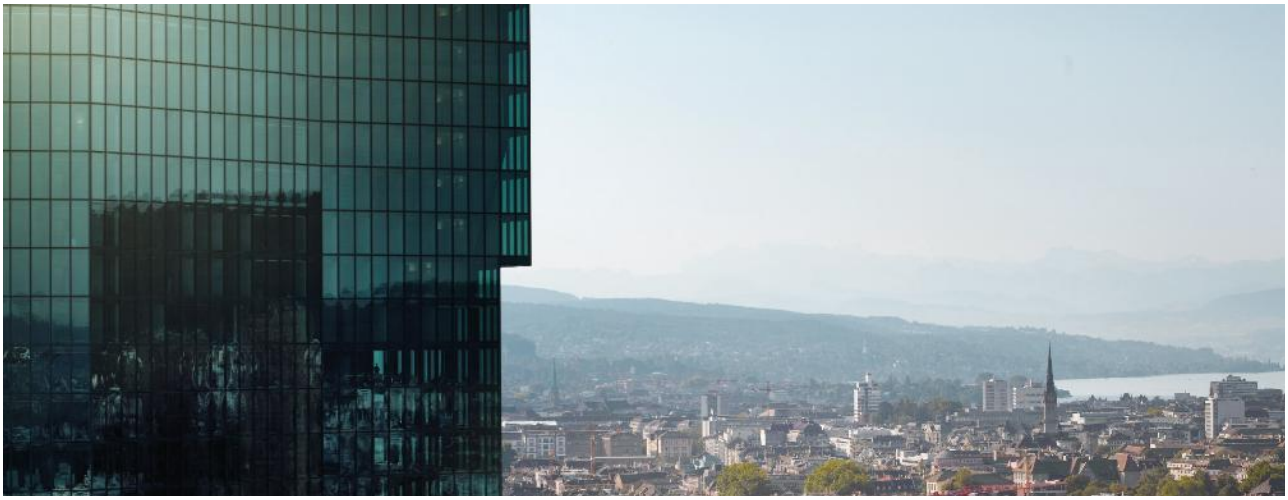

Cross-border Financial Services into Switzerland – Organizational Requirements

New Framework – What are the implications for the organization of foreign financial service providers? This is the second of a series of bulletins discussing the new concept for the provision of financial services into Switzerland.

A cornerstone of the new Financial Services Act of June 15, 2018 (FinSA) are the new requirements on the organization of financial service providers. As the provision of cross-border financial services into Switzerland generally falls within the scope of application of the FinSA, these requirements are also relevant for foreign financial service providers. This bulletin provides an overview on important key elements of the new organizational requirements and specifically aims to identify the need for action for foreign financial service providers.

I. Introduction

As outlined in our Bulletin of June 28, 2019, the Financial Services Act of June 15, 2018 (**FinSA**) will introduce a comprehensive set of regulatory requirements on the organization of financial service providers. In particular, the new rules comprise:

- *General organizational requirements* (Article 21-27 FinSA);
- *Duty to register the client advisers* (Article 28-34 FinSA); and
- *Criminal provision regarding benefits received from third parties* (Article 89 lit. c FinSA).

II. General Organizational Requirements

Preliminary Remarks on Scope of Application
Under the FinSA, financial service providers must abide by certain general organizational requirements. While the wording of the FinSA does not

distinguish between foreign and Swiss financial service providers, we believe the legislator did not intend to generally impose Swiss organizational regulations on financial service providers domiciled abroad. Furthermore, due to the principle of territoriality, such rules could not be enforced by the Swiss Federal Market Supervisory Authority FINMA (**FINMA**) on foreign financial service providers that provide their services on a mere cross-border basis (but see paragraph IV. below as to criminal sanctions).

Appropriate Organization

If the general organizational requirements of the FinSA are applicable, the financial service provider must adopt an appropriate organization and internal regulations to ensure the fulfilment of its duties under the FinSA. For instance, it shall not pay any compensation to its employees that creates an incentive to disregard its obligations.

Foreign financial service providers may be subject to organizational regulations in their home jurisdiction which conflict with the rules under the FinSA. However, the act does not regulate how such conflicts shall be resolved. That said, in our view, for financial service providers with an OECD home country supervisor, such foreign rules should be considered as *lex specialis* and, hence, override the rules on appropriate organization set out in the FinSA.

Staff

Financial service providers must ensure that their staff possess the necessary skills, knowledge and experience to perform their work. As a consequence, regular training for employees will have to be carried out. However, in our reading of the law, these requirements should apply to foreign financial service providers only with respect to the staff actually rendering financial services to Swiss clients that fall within the scope of the FinSA (see also our Bulletin of June 28, 2019).

Delegation and Outsourcing

Pursuant to the provisions on outsourcing and delegation, financial service providers may appoint third parties to carry out their services only if such parties possess the necessary skills, knowledge and experience and have the requisite authorization and|or registration. In addition, they must instruct and supervise such party carefully. As with the requirements for the staff, we believe that these obligations are only applicable to foreign financial service providers if the outsourcing or delegation in any way affects in-scope financial services rendered to Swiss customers.

Furthermore, in case a financial service provider (for example, an external asset manager) mandates another financial service provider (for example, an account bank) to supply financial services for clients ("chain of service providers"), the former remains liable for completeness and accuracy of the client information as well as for complying with the rules of conduct. There is no clear rule on whether or not the aforementioned provision shall also apply in case the mandated service provider down the chain is not subject to the FinSA. However, we believe that the spirit of the law commands that a financial service provider may not exempt itself from compliance with applicable rules of conduct of the FinSA by simply delegating financial services to another service provider, regardless of whether or not the latter is subject to the FinSA.

Conflicts of Interest

Under the FinSA, financial service providers are also obliged to take appropriate organizational precautions to prevent conflicts of interest or, where a conflict of interest cannot be avoided, to disclose this fact to the client. The Financial Services Ordinance (**FinSO**), the final version of which is expected on or around November 6, 2019, will further specify the actions required. Currently, it is not entirely clear whether the rules of FinSA and FinSO on dealing with conflicts of interest solely apply in relation to Swiss clients. Yet, given that these rules primarily aim to protect the interest of clients in

Switzerland, they should in our view not affect the organization of the relevant financial service provider in its entirety, unless the interests of Swiss customers are concerned.

Rules on Inducements

In light of the fact that the rules of the FinSA are largely modeled to reflect the principles established so far by the Swiss Federal Supreme Court with respect to Swiss contract law, there are notable differences compared to the respective duties under MiFID II. Notably, under the FinSA, financial service providers may accept benefits from third parties if they have expressly informed the clients of benefits and the clients have waived such benefits in advance. MiFID II, on the other hand, generally prohibits accepting and retaining benefits from third parties when providing portfolio management and|or independent investment advisory services. Another difference between the two regulatory frameworks concerns the scope of information needed for a client to waive benefits from third parties. Under both FinSA and MiFID II, financial service providers must disclose the existence, nature and amount of the benefits or where the amount cannot be ascertained the method of calculating. However, unlike MiFID II, the FinSA allows financial service providers to inform their clients also of the expected ranges of the benefits.

III. Requirement to Register Client Advisers

Client advisers of foreign financial service providers may carry out their activities in Switzerland only after entry in the register of client advisers. In our view, this applies only if the client advisers' involvement reaches a certain substance (see also our Bulletin of June 28, 2019). According to the draft FinSO, this registration requirement should apply irrespective of whether the financial services are provided to private, professional or institutional clients. Only where the financial service provider, which the client adviser is working for, is subject to prudential supervision abroad and part of a financial group that is subject to consolidated supervision by FINMA no registration is required. This narrow exemption has been widely criticized in the consultation and we expect that the registration duty will only apply to foreign service providers serving private clients.

In order to be registered client advisers must fulfil certain requirements. In particular, they must (i) have sufficient knowledge of the rules of conduct under the FinSA and other applicable regulations as well as the necessary expertise for their services, (ii) have taken out a professional indemnity insurance or provided equivalent financial guarantees and (iii) prove that the financial service provider they are working for is affiliated to an ombudsman. The purpose of such ombudsman is to settle disputes between clients and the financial service provider in mediation proceedings. In case of a change in the circumstances underlying the registration requirements, the registered client adviser as well as the foreign financial service provider are obliged to notify the registration body.

IV. Sanctions in case of Non-Compliance

Currently, it is not entirely clear what sanctions, if any, could be imposed if a client adviser is not registered. Generally, violations of the organization requirements under the FinSA will not trigger charges under criminal law. A fine of up to CHF 100,000 may, however, be imposed in the event of non-compliance with rules on inducements. By imposing criminal sanctions, violations of said rules may be enforced against foreign financial service providers even in the absence of regulatory consequences.

V. Need for Action

Foreign financial service providers are well advised to assess whether they provide any in-scope financial services to Swiss clients and, if so, identify the staff involved in the rendering of such services. As

a next step, service providers should take necessary measures to comply with applicable registration requirements, including ensuring that client advisers have sufficient knowledge of the rules of conduct under the FinSA as well as the necessary expertise for their service. Compliance with the registration requirement, combined with the necessity to educate client advisers and other relevant individuals on the Swiss regulatory framework may lead institutions providing financial services to Swiss clients to establish a "Swiss desk".

In addition, foreign financial service providers should analyze whether their organization, including arrangements on delegation and outsourcing, are compliant with the requirements prescribed by the FinSA.

Finally, if a foreign financial service provider intends to accept and retain benefits from third parties, it must prepare to inform its clients in accordance with the requirements of FinSA. In particular, it may not assume that compliance with the relevant rules under MiFID II will be considered sufficient.

If you have any queries related to this Bulletin, please refer to your contact person at Homburger or to:

Stefan Kramer
Dr. iur., LL.M., Attorney-at-Law
stefan.kramer@homburger.ch
T +41 (0)43 222 16 35

Benjamin Leisinger
Dr. iur., LL.M., Attorney-at-Law
benjamin.leisinger@homburger.ch
T +41 (0)43 222 12 96

Benedikt Maurenbrecher
Dr. iur., MBA, Attorney-at-Law
benedikt.maurenbrecher@homburger.ch
T +41 (0)43 222 15 14

Homburger AG
Prime Tower
Hardstrasse 201
CH-8005 Zurich

T +41 43 222 10 00
F +41 43 222 15 00
www.homburger.ch