Homburger

The Provision of Financial Services in Switzerland – Introduction

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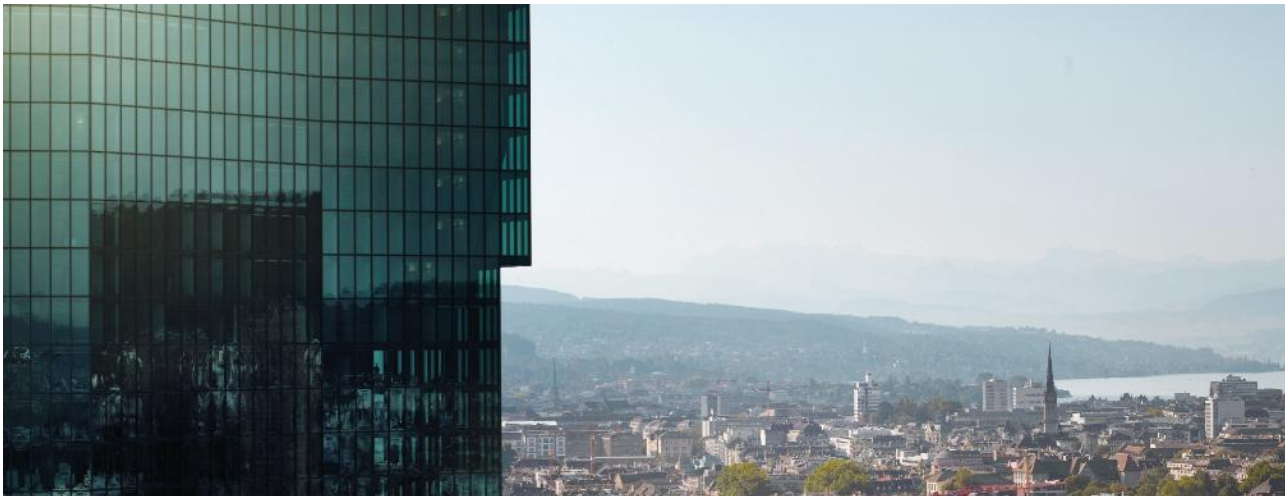

Cross-border Financial Services into Switzerland – Be Prepared

New conceptual approach, new regulatory definitions. What is relevant to Swiss and foreign financial service providers? This is the first of a series of bulletins discussing the new concept for the provision of financial services into Switzerland.

It is currently expected that on January 1, 2020, the Financial Services Act (FinSA) will enter into effect. The FinSA will not only implement MiFID-type conduct rules and organizational requirements for local financial service providers, but for the first time will also introduce regulatory requirements applicable generally to the cross-border provision of financial services. While the draft of the implementing ordinance is still under consideration and certain of the regulatory duties and consequences thereunder are subject to phase-in, Swiss and foreign financial service providers are well advised to now carefully analyze the FinSA's scope of application and its consequences for their service offerings and organization.

I. Scope of Application

As outlined in our Bulletin of September 17, 2018, the Financial Services Act of June 15, 2018 (**FinSA**) will significantly change the Swiss regulatory regime on financial services. The FinSA aims to promote a level playing field among Swiss financial service providers and their foreign competitors and to enhance the protection of local clients by regulating the provision of financial services to customers in(to) Switzerland. In order to understand whether foreign (financial) service providers are affected by such change, it is therefore key to understand the FinSA's scope of application from a subject-matter, personal and geographical perspective.

Financial Services

Under the FinSA, financial services are limited to specific and enumerated services related to financial instruments. Services not related to financial instruments are not covered in the first place. The list of financial services in the FinSA is similar to the one set forth in Annex I of MiFID II in some parts, but notably does *not include* services such as dealing on own account, underwriting of financial instruments and|or placing of financial instruments on, or without, a firm commitment basis, or operation of an MTF or OTF. Investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments do not constitute a financial service within the meaning of FinSA, either. Neither does the list include most of the ancillary services under MiFID II, with the exception of the granting of loans to an investor to allow transactions in financial instruments, where the firm granting the loan is involved in the transaction. We also believe that corporate finance advice, M&A advice or similar services where the investment in financial instruments is only a means to a different end (*e.g.*, the optimization of the capital structure or the purchase of an enterprise) should generally not be deemed financial services.

Provided to Customers

All such services only qualify as a financial service pursuant to the FinSA if they are provided on a professional basis and to "customers". This means that for instance the mere sale of a financial instrument to a counterparty would not be a financial service. In our reading of the law, services rendered to parties other than investors acting on their own behalf are not rendered to "customers" within the meaning of article 3 lit. c FinSA. This also means that services qualifying as financial services that are rendered to issuers of financial instruments, for example, or to asset managers or other financial intermediaries themselves acting as service providers to the ultimate investors, are not provided to relevant customers and do not fall within the scope of the FinSA.

Portfolio management, investment advice, trade execution and other financial service provided by foreign investment firms are subject to the FinSA irrespective of whether the client qualifies as a retail or as a professional customer. Conversely, the conduct rules of the FinSA do not apply to cross-border business with institutional clients, *i.e.*, Swiss-licensed banks and insurance companies, the Swiss National Bank and national and international public law entities with professional treasury (*e.g.*, the CERN).

In Switzerland

First, foreign services providers need to assess whether the customer served are deemed to be "in Switzerland".

Domicile or Residence

Financial services provided to customers domiciled and resident outside of Switzerland are not subject to the FinSA. Accordingly, if a non-Swiss financial service provider renders a relevant service to a client domiciled outside of Switzerland who, coincidently, is in Switzerland when he or she gets contacted, the FinSA should not apply. Conversely, servicing foreign domiciled clients from client advisors based in Switzerland and servicing Swiss domiciled or resident clients from abroad is geographically in scope.

Reverse Solicitation

A reverse solicitation exemption will safeguard that unsolicited contacts of a foreign financial service provider by Swiss customers themselves do not inadvertently trigger the requirements under the FinSA. However, the draft Financial Services Ordinance (**FinSO**) is ambiguous as to whether and under what circumstances a foreign investment firm may rely on the exemption if the scope of the

client relationship evolves beyond the scope of the initial client request. The current draft of the FinSO seems to suggest that the initial reverse solicitation covers future transactions under the same type of service (*e.g.*, portfolio management) but not beyond (*e.g.*, Lombard credit).

Cooperation by Several Service Providers

Next, foreign services providers need to check whether they become subject to the FinSA by joining forces with either a Swiss financial service provider or with another foreign financial service provider who has Swiss customers. In our view, the scope of application of the FinSA is only triggered if, first, there is direct client contact and, second, the involvement reaches a certain level of independence or substance. Hence, as a general rule, only client facing activities may trigger the application of the FinSA but not, for example, mere back-office, execution or settlement activities that involve no interaction with the client.

Situations where several units of the same group or several service providers jointly provide services to Swiss resident or domiciled clients and perform client facing activities need special attention. A certain substantial connection to the Swiss service provider or the financial services provided to the Swiss customer is needed in our view: Where a foreign service provider renders a financial service to a Swiss customer independently, it is subject to FinSA even if the relevant service (*e.g.*, advising in connection with a hedging transaction or transmission of orders in relation to certain bonds) is embedded in a broader service offer of the Swiss investment firm. The same holds true if the foreign service provider performs a client-facing function that contributes significantly to the financial service provided to the Swiss client. For example, repeatedly advising the Swiss client on the U.S. securities in the portfolio otherwise managed and booked in Switzerland would be subject to the FinSA. Conversely, mere supporting activities do not justify the FinSA's application to the foreign financial service provider as such, provided that the point-of-sale conduct rules set out in the FinSA are complied with in substance at all times. Examples for such supporting services would be a one-off participation in a conference call where investment proposals by a London-based specialist are discussed between the client and the Swiss investment firm, or the occasional preparation of proposals which are included in the advice submitted to the client by the client advisor of the Swiss investment firm. Similarly, with respect to mere booking services or locations, if a client is not domiciled or resident in Switzerland, the mere fact that the client relationship is booked in Switzerland should not justify the application of the FinSA as long as he or she is served comprehensively by a foreign branch.

We also believe that (1) a foreign financial service provider cannot rely on chaperoning or a similar technical involvement of a Swiss financial service provider to eschew the scope of the FinSA and (2) not only the responsible client relationship manager, but also other specialists or employees with client contact, depending on their role, will have to themselves be registered in the register of client advisers (see below).

II. Consequences of FinSA's application

Once it is established that the FinSA applies, certain legal and regulatory consequences are triggered. Insofar as "special statutory regulations" apply, such rules override the FinSA's regulations on conduct and organization as *lex specialis*. While the legislative history clearly mentions Swiss banking regulations, Swiss insurance regulations and the rules of the Swiss Collective Investment Schemes Act, it is not entirely clear whether equivalent foreign special statutory regulations also prevail and can be relied on. Foreign financial service providers will be well-advised to analyze whether such foreign rules apply to them and whether they also cover the duties under the FinSA.

Duties under the FinSA

FinSA's regulatory duties include the following:

- *Duty to register* the individuals who actually perform financial services on behalf of the (foreign) financial service provider in a new register of client advisers;
- *Duty to categorize* their clients in private clients, professional clients and institutional clients;
- Duty to comply with expanded *conduct rules*;
- Duty to comply with certain *organizational requirements*, including by disclosing or passing on fees, commissions and other remuneration or financial benefits received by financial service providers from third parties in connection with the provision of financial services, except where waived.

The next series of bulletins will provide more information on these duties.

Consequences of a Breach – why bother?

If the FinSA applies and financial service providers do not comply with certain of their duties thereunder, this may trigger charges under criminal law. Namely the intentional violation of informational duties, of appropriateness or suitability checks, and of the duty to pass on financial benefits from third parties for which receipt by the financial service provider has not been waived, can lead to a fine. Additionally, if the financial service providers are subject to prudential supervision in Switzerland, a breach of duties can have regulatory consequences.

According to some legal scholars, violation of the FinSA's duties can also lead to civil law liability. We do, however, not share these views insofar as they refer to a direct contractual liability.

III. Outlook

We expect that the final FinSO will clarify all or most of the issues described herein. We actively monitor the further legislative process and will inform on any relevant developments.

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