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Financial Services Act and Financial Institutions Act: what changes to expect for independent asset managers?

Since the 2008 financial crisis, the regulators have been reviewing the financial services regulation in order to, among other things, reduce systemic risks and enhance investor protection. On 27 June 2014, the Federal Council has therefore launched the much-anticipated consultation on the Financial Services Act ("FSA") and the Financial Institutions Act ("FIA"). The consultation will end on 17 October 2014.

The two draft statutes pursue different objectives. The FSA primarily aims at enhancing protections offered to customers whilst providing them with additional means in case of disputes. The FIA on the other hand aims at regulating, in one uniform piece of legislation, the supervision of all financial services providers offering, in any form, asset management services.

This newsletter describes the main changes that will ensue from this new legislation for the activity of external asset managers ("EAM") and their business model.

Authorisation and supervision of the EAM

1. Authorisation

Pursuant to the draft FIA, the EAM will require an authorisation from the regulator to exercise their activities and register with the commercial registry. For the purpose of obtaining such authorisation, the EAM will need to dispose of, among other things - and aside from the assurance of proper business conduct -, an adequate organisation as well as internal rules. Therefore, internal directives as well as compliant asset management agreements will need to be put in place.

In addition, the FIA provides for financial guarantees and/or professional liability insurance as an authorisation requirement.

The current draft legislation does however not make any further specifications as to the required organisational structure or amount of financial guarantees. Indeed, the draft does not indicate whether the conditions currently applicable to managers of collective investment schemes in terms of organisation and financial guarantees will also apply to the EAM (e.g. the requirement of a risk manager and risk officer, minimum number of persons at the board of directors and management level, minimum capital requirement of CHF 200'000). These elements are expected to be specified at a later stage through ordinances and/or circulars.

It should however be noted that in order to protect acquired rights, the draft legislation plans to introduce a grandfathering clause for existing EAM. They will be exempt from the authorisation requirement if they have sufficient experience (minimum 15 years) and do not accept any new clients. The usefulness of such clause however remains questionable, as few EAM are likely to willingly renounce serving new clients.

The authorisation requirement furthermore only applies to those EAM, who manage their clients' assets, and not to those exercising a purely advisory activity. The draft statutes do however not provide for a clear delimitation between the activities of asset management and investment advice.

2. Supervision
According to the draft FIA, the EAM, who are defined in the legislation as "non-qualified" asset managers (contrary to the managers of collective investment schemes and of pension institutions), will in future be subject to prudential supervision. To this end, two options are being proposed at the consultation level: the EAM will be subject to either (i) the direct supervision of FINMA, or (ii) the supervision of a specially created independent supervisory organisation that in turn would be subject to FINMA's supervision. In the latter case, the supervisory organisation will also be responsible for anti-money laundering supervision.

Duties as a client advisor

1. Registration duty of client advisors
In future, all client advisors, i.e. all individuals liaising with clients to offer them a financial service, and, therefore, also the EAM, will need to register with a registry comparable to the one for attorneys or for non-tied insurance intermediaries. For that, the EAM will first need to have taken out professional liability insurance and be affiliated to a mediation body.

In addition, contrary to what is the case for the authorisation requirement, the duty of registration with the advisors' registry also applies to those EAM, who act exclusively as investment advisors.

2. Training and development
Further to the aforementioned duty of registration, the FSA provides that the client advisors must have "sufficient" knowledge of the rules set out in this statute as well as of the technical knowledge required for the exercise of their activity.

The purpose of these requirements is to motivate the client advisors to regularly update their know-how by attending development courses. The draft legislation does however not specify the number, frequency or type of courses to attend.

Independence and retrocessions

1. Independence
In future, the EAM will only be allowed to call themselves "independent" subject to very strict conditions. Influenced by the MiFID Directive, the FSA stipulates that a service may only be qualified as independent if the EAM takes into account a sufficient number of financial instruments available on the market and if it does not receive any benefits from third parties in exchange of the provision of this service or if the benefits are forwarded to the clients.

2. Retrocessions
In order to clear any possible doubts that may have remained subsequent to the various development of the jurisprudence on retrocessions, the new legislation now sets out the strict conditions under which the EAM may accept benefits from third parties. The FSA therefore reiterates the requirements of a prior express waiver from the client as well as of a disclosure of the type and scope of these benefits, both conditions having to be satisfied prior to the provision of the financial service or the conclusion of the agreement. In case this information cannot be given in advance, the EAM needs to inform the client of the calculation criteria and the order of magnitude of the benefits expected to be received from third parties.

Suitability and appropriateness test as well as duty of documentation

Today, the FINMA 2009/1 circular as well as the various codes of conduct of the self-regulatory organisations already provide for the duty of the EAM to ensure that the investments effected are at all times in line with the clients' risk profiles and their investment objectives and limits.

The draft FSA specifies the rules of conduct applicable to the EAM in respect of the suitability and appropriateness test for the proposed financial services and instruments. In particular, the FSA introduces, for customer protection purposes, a new duty of documentation requiring the EAM to keep a written record of the checks performed in this respect. It is important to note that these duties of verification and documentation will be applicable both in the context of an asset management mandate and in that of an investment advisory relationship.

Generally speaking, the EAM will therefore need to draft a number of documents that they will have to provide their clients with. In particular, they will need to record in writing (i) the risk profiles of the clients, (ii) their investment objectives and (iii) the various services agreed and provided as well as (iv) the motives that have led to recommending a particular financial service/instrument over another. Despite the exact content of this new documentation not yet being specified in the FSA, this duty is expected to increase the administrative workload of the EAM.

Distribution of collective investment schemes

The new classification of clients provided for in the FSA (professional versus private clients) is likely to have positive implications for the EAM in relation to the notion of distribution of collective investment schemes. Indeed, according to our interpretation of the draft statutes, the EAM should qualify as professional clients so that – contrary to the current situation – any marketing of collective schemes addressed to them would a priori no longer be considered as distribution.

Tax compliance

In order to fulfil in particular the requirement of an assurance of proper business conduct, the EAM will, according to the FIA, need to check whether there is a high risk of the assets under management not being tax compliant. If, after having checked this, the EAM has reasons to believe that the concerned assets are not tax compliant, he/she will be under the obligation to refuse to enter into, respectively will need to terminate the existing business relationship. Note that this check is required only for clients from states with which Switzerland has not entered into any treaty on automatic exchange of information in tax matters.

Clients' civil law claims

The draft FSA introduces new customer protection enhancing provisions. The report of the Federal Department of Finance for instance indicates that any breach of the rules of conduct set out in the FSA will have a "transmission effect on the civil law relationship" between the EAM and its clients. Furthermore, the reversal of the burden of proof in favour of the client, as provided for by the FSA, constitutes a major change. In case of dispute, it will therefore be up to the EAM to prove that he/she complied with the statutory duties of information and explanation, or else the client will be deemed not having executed the transaction at issue.

Conclusions

Even though some uncertainty remains, in particular regarding the type of supervision to which the EAM will be subject or the applicable requirements in terms of organisation or financial guarantees, the EAM must soon prepare for these regulatory changes and, where applicable, reconsider their business model. Areas of consideration could for instance include their organisation, remuneration model, line of services or possible mergers.

One however needs to bear in mind that all financial services providers will be concerned by this draft legislation, so that the EAM will always be able to maintain their current competitive edge, this being particularly their independence of advice, availability, tailor-made service and continued relationship monitoring.

Contact

The content of this newsletter is for information purposes only and does not constitute a legal advice or opinion. Should you require specific advice in this matter, please get in touch with your usual contact at ALTENBURGER LTD legal + tax or with one of the below authors of this newsletter.

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