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Switzerland: Trends & Developments
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Trends and Developments

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Reverse Solicitation in Switzerland

Reverse solicitation designates the circumstances in which a financial intermediary provides certain services to a client upon the latter's request, without prior solicitation by the financial intermediary. Where the financial intermediary can rely on reverse solicitation, it generally avoids licensing requirements and regulatory duties.

The concept is not specific to Swiss law. For instance, EU law defines reverse solicitation in article 42 of MiFID II (EU Directive3 2014/65 of 15 May 2014) as a situation where a client "initiates at its own exclusive initiative" the provision of an investment service or activity by a financial intermediary. According to the European Securities and Markets Authority (ESMA), reliance on reverse solicitation implies that the financial service provider does not – either itself or through a related entity or an agent acting on its behalf – promote or advertise its services or activities, regardless of the communication means, including press releases, advertising on the internet, brochures, phone calls or face-to-face meetings.

Reverse solicitation also exists under Swiss law. It has assumed increased importance this year, with the coming into force of a new set of laws and regulations that aim to create a level playing field at the point of sale for all financial service providers, and to upgrade Swiss financial legislation so that it comes closer to the MiFID II standards.

This article provides a brief outline of this recent development in the Swiss financial services legislation. The evolution of the Swiss approach towards reverse solicitation is also described, from the previous legal framework to the new set of rules, ending with some considerations on the current transitional period.

Outline of the new legislation

Historically, the regulatory framework in Switzerland focused on the supervision of institutions (banks, securities firms, fund management companies and, more recently, financial market infrastructures) and the regulation of certain financial products – ie, collective investment schemes and structured products. The principles governing the provision of financial services were primarily derived from the provisions of Swiss contract law on mandate agreements. For instance, the restrictions on the payment of retrocessions to financial institutions arose from the general accountability duty of agents towards their clients. Certain succinct conduct of business rules were set out in the law governing the activities of securities firms – and banks when they act in such capacity – completed by self-regulations. Independent investment managers, who constitute a large portion of the Swiss financial centre, were not subject to such conduct of business rules.

After a relatively long period of preparatory work and discussions between representatives of the industry, scholars and regulators, new laws were adopted by the Swiss Parliament on 15 June 2018, which do the following:

- extend the scope of licensing requirements to the investment management industry;
- subject pure financial advisers (who have no discretionary authority over their clients' assets) to registration duties; and
- introduce a series of minimum requirements applicable to all financial service providers, including foreign institutions when they serve Swiss clients.

Alongside corresponding organisational requirements and information/reporting duties, these new conduct of business rules are set out in the Swiss Financial Services Act (FinSA), which came into force on 1 January 2020, together with implementing regulations.

As the new rules represent a major change in the approach of Swiss financial legislation towards the provision of financial services, a transitional period of two years has been granted for the regulated entities to adapt their procedures and satisfy the new requirements. That transitional period will end on 31 December 2021. From 1 January 2022, all financial service providers will have to comply with the new rules. Those institutions that have already taken the necessary steps may elect to apply the new rules by way of anticipation at any time during the transitional period, with such election being definitive (no way back).

Obviously, due to this major shift in the Swiss financial rules, the scope and definition of the reverse solicitation exemption have also evolved.

Reverse solicitation before the FinSA

Before the FinSA came into force, foreign financial service providers offering services in Switzerland were not caught by the Swiss supervisory framework, except under the somewhat limited scope of the Swiss Collective Investment Schemes Act of 23 June 2006 (CISA). The offering of open-ended and close-

ended collective investment vehicles was subject to the approval of the Swiss Financial Market Supervisory Authority (FINMA) if the circle of targeted investors included retail investors. There was a private placement exemption for foreign fund managers who chose to offer their products to qualified investors only – ie, such offer did not need FINMA approval. An offering to unregulated qualified investors, such as retirement benefit institutions (pension funds) with professional treasury management, or to high net worth individuals was, nevertheless, subject to the prior appointment of a representative and paying agent in Switzerland. That specific appointment requirement was introduced by way of a 2013 amendment to the CISA. It is at that time that the reverse solicitation exemption became more relevant, because the appointment requirement would fall away if the offer was made by way of reverse enquiry.

While the Swiss financial legal framework was – and still is – rather liberal compared to the applicable regulations in the European Union or the United States, the reverse solicitation exemption was described restrictively. Article 3(2)(a) CISA practically assimilated the reverse solicitation to execution only. Its implementing regulation (article 3(2)(b) of the Collective Investment Scheme Ordinance) stated that the possibility to rely on the reverse solicitation exemption was limited to circumstances where the respective fund manager or placement agent had not had (any) preliminary contacts with the investor. Practically speaking, the exemption would no longer be available after meeting with potential investors, even in a pre-marketing context, to present the activities and track record of the fund manager, for instance. This narrow definition generated criticism amongst scholars and professionals. Conversely, the distribution concept that triggered the need to appoint a representative and paying agent in Switzerland was so broadly defined that it further narrowed down the scope of the reverse solicitation exemption. Legal advisers would generally alert their clients to the restrictive scope of the exemption, insisting on the fact that reverse solicitation should be relied upon only exceptionally, and should definitely not be considered as a business model.

The offering of structured products was also regulated under the CISA and subject to similar limitations. However, the distribution to qualified investors was subject to a full private placement exemption, so that reverse solicitation has played a limited role in that context.

The FinSA regime

Under the FinSA, financial service providers are subject to enhanced conduct of business rules, the scope of which depends on the type of client concerned, and are accordingly required to classify their clients as either institutional, professional or retail clients. Professional clients include regulated financial intermediaries and insurance companies, central banks, large enterprises, public and private institutions (including pension funds) with professional treasury management, and professionally managed private investment structures. Retail clients comprise all investors that are not – or have elected not to be – considered as professional clients. A third category, called institutional clients, regroups a sub-category of professional clients (ie, the regulated institutions and the central banks) and national and supra-national institutions governed by public law, provided that they have professional treasury management. Qualifying high net worth individuals may opt out from the retail investor protection regime and elect to be considered as professional clients (elective professional clients).

A financial service provider may elect to treat all of its clients as retail clients and thus avoid the requirement to classify them into categories. It may also prefer to restrict the scope of its clients to professional and institutional clients. For the latter, the coming into force of the FinSA will have a limited impact, because conduct of business rules are not applicable if the investor is an institutional client or can be partially waived by the client if the latter is a professional, but not institutional, client. Conduct of business rules include the duty to verify the appropriateness of isolated investment advice and the suitability of investments recommended by a portfolio adviser or made under a discretionary management contract, but such duty does not apply when the investor is a professional client, unless there is doubt as to the level of skills and experience of such investor.

The CISA and the private placement exemption set out therein have been updated simultaneously with the adoption of the FinSA to take the new FinSA approach into account. The distribution concept, which was the key concept in the former version of the CISA, will lose all relevance at the end of the transitional period of two years. From 2022, the promoters of collective investment schemes will have to take into consideration both the FinSA rules, which may apply in connection with the placement of collective investment schemes (particularly foreign unregistered funds), and the revised CISA private placement exemption. Following strong lobbying from the Swiss investment fund industry, the definition of financial services under the FinSA has been extended to cover those activities relating to the acquisition of financial instruments (which includes the promotion of collective investment schemes). This explains why pure fund promoters will generally be treated as financial service providers under the FinSA, even if they target only institutional or professional clients. The private placement exemption has been slightly enlarged, in the sense that professional clients, other than elective professional clients, can be targeted without the need to appoint in Switzerland a representative and paying agent for the fund. The requirement to appoint such a representative will continue to apply when any type of publicity in respect of a foreign fund is addressed to elective professional clients.

Under this revised legal framework, the reverse solicitation exemption has accrued greater importance, as it enables foreign financial service providers not only to propose unregistered investment funds, but also to render services to retail investors, without being subject to FinSA requirements. Reliance on reverse solicitation will also permit the avoidance of the obligation for foreign funds to appoint a representative and paying agent when the scope of potential investors includes elective professional clients. The exemption is now defined in the Financial Services Ordinance, which is an implementing regulation of FinSA. Given that the distribution of collective investment schemes is generally deemed a financial service, the exemption applies under both the CISA and the FinSA.

The exemption applies to all financial services that are provided at the express initiative of the client, whether the financial service is granted on an isolated basis or in the framework of a pre-existing clientele relationship. In the latter case, this implies that the client relationship itself has been established at the express initiative of the client. The former condition of absence of prior contact with the potential client is not expressly set out in the regulation but continues to be relevant: the commentaries made by the Swiss Federal Finance Department on the Financial Services Ordinance expressly refer to the MiFID II reverse solicitation exemption. The Swiss approach therefore reflects the approach adopted in the European Union. These commentaries have also clarified that a response to a request for proposal made by a Swiss investor falls within the scope of the reverse solicitation exemption, as does an increase of an investment previously made by a client at their own initiative.

Transitional period

As mentioned, the former legal framework may apply until the end of 2021 to those financial service providers who do not elect to submit to the new regime by way of anticipation. Foreign fund promoters are, however, rather inclined to make such an election, if they target only professional clients, as it enables them to avoid the requirement to appoint a representative or a paying agent for their funds in Switzerland.

From a reverse solicitation perspective, the transitional period is in principle of little relevance. It may, as mentioned, apply to the provision of (unsolicited) new financial services under a pre-existing client relationship, provided that the relationship was established at the client's express initiative – in other words, if a client relationship is commenced at the client's initiative, then all financial services provided to the client under that relationship are covered by the exemption. This is a new aspect. The transitional period is, however, not a grand-fathering period – ie, client relationships initiated prior to 1 January 2020 are (or will be, from 1 January 2022) subject to the FinSA requirements unless the financial service provider can prove that they had been established at the client's initiative. In case of investigation, the financial service provider must be able to produce related evidence. For client relationships dating back to the period where Switzerland had a large cross-border exemption for financial services, there was no need to collect such evidence; it may be extremely difficult to retrieve it now.

Conclusion

The Swiss financial services legislation has been heavily amended and the scope of the reverse solicitation exemption has not been extended. While it may play an increased role considering the broader scope of the legislation, the exemption remains narrowly defined. Experience will show if it is relied upon widely by financial intermediaries.

Bär & Karrer is a renowned Swiss law firm with more than 170 lawyers in Zurich, Geneva, Lugano and Zug. The firm's core business is advising clients on innovative and complex transactions and representing them in litigation, arbitration and regulatory proceedings. Clients range from multinational corporations to private individuals in Switzerland and around the world. Most of the firm's work has an international component, and its extensive network consists of correspondent law firms that are all market leaders in their jurisdictions. The team has broad experience in handling cross-border proceedings and transactions.

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Frédéric Bétrisey has a long-standing practice in banking and finance. He advises banks and borrowers on all types of banking and finance transactions, including trade and commodity finance, acquisition finance, equipment financing, financial lease and syndicated lending. He also advises financial institutions on a variety of regulatory aspects and assists financial intermediaries in connection with their securities lending and derivative transactions. In recent years, Frédéric has also assisted originators, arrangers and trustees in connection with the securitisation of Swiss law receivables. He lectures courses in acquisition financing at the University of Fribourg, and in market abuse regulations at the Swiss Training Centre for Investment Professionals.

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