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Switzerland: Trends & Developments
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Trends and Developments

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Asset Managers and Trustees under the New FinIA Supervisory Regime

The Swiss Parliament adopted, along with new financial services legislation, the Financial Institutions Act (FinIA) in June 2018 in order to enhance Switzerland's competitiveness in wealth management and to level the playing field for financial institutions. In force since January 2020, FinIA has introduced a new licensing regime for asset managers and trustees. In the new regime, regulated asset managers and trustees are required to be affiliated with a supervisory organisation (SO) that is itself licensed by the Swiss Financial Market Supervisory Authority (FINMA). Although the SO will oversee the regulated asset managers and trustees on a day-to-day basis, FINMA is the chief supervisory authority and has the authority to take any necessary regulatory actions towards these regulated entities and each SO at any time.

Active asset managers and trustees – other than banks, securities firms and collective asset managers, which were already regulated by the FINMA before 2020 – had a six-month period following the implementation of the FinIA to inform FINMA of their intention to continue operating under the new supervision regime. Consequently, asset managers and trustees were eligible to seek affiliation with an SO licensed by FINMA if they had reported to the FINMA by 30 June 2020 and to submit a licensing application to the latter until the end of a statutory transition period that ends on 31 December 2022. It is permissible for such asset managers and trustees to continue their activities until a decision is made concerning their application.

The purpose of this article is to define the scope of the new licensing requirements set out in the FinIA, outline these requirements and the authorisation process, and provide an overview of the current situation and the consequences faced by active asset managers and trustees who do not apply for a licence by the applicable deadline (31 December 2022).

Asset managers and trustees subject to an authorisation

Under the FinIA, asset managers are defined as persons or entities acting on a commercial basis who are empowered on the basis of a mandate to professionally dispose of assets in the name – and on behalf – of clients. The definition encompasses all types of asset managers, not only those who have discretionary mandates (ie, those who acquire, dispose, or manage financial instruments), but also investment advisers who are able to execute transactions on behalf of their clients. While the issuance of personalised recommendations concerning transactions in financial instruments is also covered by the above definition, the management of other assets, such as direct investments in real estate or art collections, is not.

A trustee is defined as a person or entity acting on a commercial basis who, by virtue of an instrument creating a trust under the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and their recognition, professionally manages – or is able to dispose of – assets for the benefit of the beneficiaries or for a specific purpose based on the instrument. This definition does not include protectors – unless they have

the power to dispose over the trust's assets – nor directors or officers of companies held by a trust.

Irrespective of their legal form, asset managers and trustees as defined above who operate in or from Switzerland, including Swiss branches and representative offices of foreign asset managers and trustees, qualify as financial institutions according to FinIA and require a FINMA authorisation.

General authorisation conditions

As a reminder, in order to obtain – and maintain – a FINMA authorisation, asset managers and trustees must fulfil the following requirements:

- be affiliated with an SO licensed by FINMA (Article 7(2) FinIA);
- satisfy, together with its directors and senior management, the fit and proper requirement and ensure an irreproachable conduct of business (Articles 11(1) and (2) FinIA);
- ensure that their qualified shareholders, being shareholders holding more than 10% of the capital or the votes, have good reputation and do not exercise their influence at the expense of prudent and reliable management (Articles 11(3) and (4) FinIA);
- have a management body comprising at least two persons who are duly qualified for their task (one person may suffice, pursuant to Article 20 FinIA, if the FINMA has received proof that business continuity is warranted);
- maintain an appropriate internal organisation, including a suitable risk management system and an effective internal control structure to ensure compliance with legal and internal provisions (Articles 9 and 21 FinIA);
- be effectively managed from Switzerland, provided that entities that are part of a financial group subject to appropriate consolidated

supervision may apply the general guidelines and decisions of the group in connection with the consolidated oversight (Article 10(1) FinIA);

- dispose of a fully paid-in share capital of CHF 100,000, plus adequate guarantee or professional liability insurance coverage (Article 22 FinIA); and
- dispose of an appropriate level of regulatory capital. In order to limit the compliance burden, the regulatory capital requirements for asset managers and trustees are set at a quarter of the fixed costs as reported in the last annual financial statements, up to a maximum of CHF 10 million (Article 23 FinIA). Insofar as it covers the risks inherent in the business model, the net professional indemnity insurance may be used as regulatory capital up to 50% of the required capital amount (Articles 22(2) and 23 FinIA; Article 31 FinIO).

Authorisation process and supervisory regime

Asset managers and trustees interested in applying for a licence must register (together with an authorisation coordinator) on FINMA's survey and application web platform (EHP).

Upon completion of such registration, which can take up to two weeks, asset managers and trustees can prepare their application files and apply for affiliation with one of the SOs. As of December 2022, the following institutions had been licensed as OS by the FINMA.

- AOOS - Schweizerische Aktiengesellschaft für Aufsicht, in Zurich.
- FINcontrol Suisse AG, in Zug.
- Organisme de surveillance des instituts financiers OSIF, in Geneva.

- Supervisory Organisation for Financial Intermediaries & Trustees SOFIT, in Geneva.
- OSFIN Organisation de surveillance financière, in Neuchâtel.

Affiliation with an SO is a mandatory preliminary step for an asset manager or a trustee to apply for a FINMA licence. To obtain such affiliation, asset managers and trustees are required to provide the relevant SO with a complete FINMA application file and remain available for any adjustment or improvement.

As mentioned above, Swiss asset managers and trustees who started their activities before the coming into force of FinIA (on 1 January 2020) must file a licensing application with the FINMA before 31 December 2022 in order to remain eligible to continue their activity on a commercial and professional basis beyond that date (see Article 19 FinIO). This deadline applies to the filing of applications with the FINMA. Although there is no specific deadline for the affiliation with an SO, considering that the affiliation with an SO is a prerequisite to the filing of the licensing application, FINMA recommended that asset managers and trustees seek their affiliation at the latest by 30 June 2022 in order to allow for sufficient time to make any adjustment or improvement to their application and obtain their affiliation with an SO, before submitting their application to FINMA prior to the end of the transitional period on 31 December 2022.

Risk-based authorisation approach

FINMA handles licensing requests based on risk: while applications submitted by simple business models may be handled in a standardised manner, those submitted by asset managers who have more complex and risk-bearing models may be dealt with more rigorously.

For instance, pursuant to Article 26(2) FinIO, asset managers and trustees with more than five full-time work positions or an annual gross income of more than CHF 2 million must have an independent (of revenue-based activities) risk management in place to qualify for an authorisation, unless they do not have high risks in their business model.

FINMA may also require that asset managers or trustees that have ten or more full-time work positions or annual gross earnings higher than CHF 5 million appoint an independent body responsible for governance, supervision and control (equivalent to a board of directors in a company limited by shares), if the nature and scope of the company's activities so demand (Article 23(2) FinIO). The independence criterion is met if the majority of the members of that body are not part of the company's management.

Asset managers and trustees must set out guidelines for the basic principles of risk management and define their risk tolerance according to their activity and structure. Asset managers and trustees can entrust their risk management to a qualified external entity.

According to FINMA, a business model is deemed high-risk – regardless of the asset manager's annual gross income threshold – in particular in case of:

- management of retirement benefit institutions' assets that do not exceed the *minimis* threshold;
- use of foreign custodian banks, because of risks of money laundering (in particular money originating from tax fraud), non-equivalent prudential supervision and shell banks;
- heterogeneous foreign client structure (from many different countries) or client structure

- focused on a specific foreign region (especially when such region entails a significant money laundering risk);
- use of financial instruments with potential conflicts of interest: risk due to lack of information to clients with regard to potential conflicts of interest arising from the use of their own investment instruments (eg, funds, actively managed certificates) in the context of asset management, advice or structuring; risk due to lack of transparency with regard to so-called “double dipping” of fees; and risk of fraud;
- unlimited power of attorney granted to the asset manager by certain clients (as opposed to powers of attorney limited to portfolio management, which exclude the right to withdraw or transfer assets except for investment in other financial instruments);
- large volume of assets under management (AuM > CHF 1 billion); and
- receipt of inducements from third parties (eg, retrocessions), which involves civil and criminal law risks if the clients are not comprehensively informed on such inducement and have not waived any right to claim for the transfer of such inducement to the client’s benefit.

According to FINMA, some of the general measures which contribute to managing and reducing the above listed risks are as follows:

- the adoption by the manager of internal guidelines and regulations which define and take into due consideration the risks associated with the involvement of foreign custodian banks, cross-border financial services and inducements and provide for adequate measures with regard to prevention and transparency of conflicts of interest;
- segregation of the risk and compliance functions from the operational units; and

- the presence of client advisors with appropriate experience and professional qualifications and continuous education and training.

Overview of the current situation

In its guidance published on 11 August 2022, FINMA indicated it had received 689 complete licence applications as of 31 July 2022. Of these, 365 asset managers and 11 trustees had been granted authorisations, while the remaining 313 applications were still being reviewed by FINMA. The authorised SOs informed FINMA that they had received 765 applications by 30 June 2022, which indicated that most asset managers and trustees adhered to FINMA’s recommended deadline for submitting affiliation requests to SOs of their choice. According to FINMA, the costs and the time needed to process an application depend on the quality and complexity of the application. The average processing time for an application is 108 days (which includes the time required by institutions to make necessary adjustments or improvements) and the average licensing (administrative) fee was CHF 5,674.

In light of the fact that 1,535 institutions submitted their applications by the deadline and are presently undergoing the licensing process – or have already obtained their licences – and that 661 other institutions have already informed FINMA that they will not be submitting licence applications, approximately 400 institutions had not yet submitted affiliation applications – or a licence application – by 31 July 2022. The institutions that had reported to the FINMA in the first semester of 2020 but will not submit an application before the end of 2022 have to cease operations by that date, unless they merge into another institution that has duly applied for the licence or transfer their clients to such an institution.

Once the affiliation confirmation by an authorised SO is obtained and the licence application filed with FINMA within the deadline of 31 December 2022, asset managers and trustees may continue their activities beyond the transitional period until FINMA has made its decision. Those who have not filed an application by 31 December 2022 and continue their activities within the same structure might be considered in breach of FinIA as from 1 January 2023.

Forecasts for 2023

FINMA, in its guidance published on 4 May 2022 and 11 August 2022, stated that asset managers and trustees should take the necessary steps in time to affiliate with an SO and apply for a licence with FINMA.

Further, it also called on asset managers and trustees who have not yet applied for authorisation to do so immediately and reminded them that if they miss the deadline, they will not be eligible for a possible deadline extension under Article 74(4) of the FinIA.

Finally, asset managers and trustees who did not intend to submit a licence application because they intended to cease their activity or because they were – or, by 1 January 2023, would be – no longer engaged in an activity requiring a licence were being asked to inform FINMA in writing of their decision stating their reasons.

FINMA has already opened investigations and warned latecomers that, if they continue to operate on a professional basis – intentionally or negligently – without having duly submitted an application by 31 December 2022, FINMA will take supervisory measures (by placing such institutions on its public warning list) and will file a criminal complaint with the Federal Department of Finance.

Conclusion

To conclude, while it is true that new regulations in the financial sector have certainly altered the practice of asset managers and trustees by requiring them to comply with new regulations, FINMA has assisted and guided such institutions in achieving authorisation, particularly by means of its communications on the subject. The length of processing time and the cost of the authorisation procedure are reasonable and depend largely on the quality of the applications and the cooperation of the institutions.

However, it seems that, despite an ample transitional period, the majority of asset managers and trustees have waited until the last few months before the deadline to file their licensing applications with FINMA.

Therefore, it is not surprising to see from FINMA's communications that it will be quite strict with institutions that fail to comply with requirements within the deadline, which may result in a hard time or even a liquidation proceeding.

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Bär & Karrer Ltd is a well-known Swiss law firm with more than 200 lawyers located in Zurich, Geneva, Lugano, Zug and Basel. The firm's core business is advising clients on innovative and complex transactions and representing them in litigation, arbitration and regulatory proceedings. The firm's clients include multinational corporations as well as individuals in Switzerland

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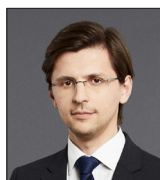
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Frédéric Bétrisey has a long-standing practice in banking and finance. He advises banks and borrowers on a wide range of banking and finance

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