CapLaw
SWISS CAPITAL MARKETS LAW

No. 3/2020




CapLaw
SWISS CAPITAL MARKETS LAW

# Duty to Report under Article 74 FinIA – Planning Tool for FINMA or (Maybe) More?

Reference: CapLaw-2020-23

FinIA has consolidated the authorisation regime for all financial institutions (except for banks which remain to be regulated under the Banking Act) and has extended this regime to independent asset managers and trustees. Even though the new law provides for a smooth transitional period enabling financial institutions to cope with the new regulation, asset managers and trustees now falling under the new regime are or have been required to file a report with the Swiss regulator FINMA. This article outlines the duty to report and its consequences.

*By Matthias Lötscher / Pascal Zysset*

## 1) Introduction

The new Financial Institutions Act (FinIA) requires independent asset managers (IAMs) and trustees to obtain authorisation from the Swiss Financial Market Supervisory Authority (FINMA). In connection with the new authorisation requirement, parliament has introduced a duty to report under the transitional provisions.

Since FinIA entered into force, FINMA as well as various service providers active in the compliance sector held informational events in order to familiarise, in particular the IAMs and trustees, with the transitional periods, including the duty to report and the general licensing requirements. Quite a number of representatives of financial institutions have participated in these events and have – most likely – been informed on the following:

Under article 74(2) FinIA, financial institutions not required to obtain authorisation from FINMA under former law were obliged to report to FINMA within six months after entry into force of the FinIA. Furthermore, under article 74(3) FinIA, IAMs and trustees commencing their activities within a year after entry into force of the FinIA must report to FINMA immediately.

The legal concept of the report, in particular the legal consequences of failure to report, raises questions.

## 2) Aims and Objectives

It is questionable whether the report under article 74(2) and (3) FinIA serves to protect investors and proper functioning of the financial market, in line with the main thrust of the FinIA (article 1(2) FinIA) and of financial market regulation in general.

Investor protection cannot be the aim, as the report does not contain any investor-specific information and is not published in any form.

As the report form asks for planning information related to obtaining a FinIA authorisation, in our opinion the primary aim appears to be enabling FINMA to carry out sensible resource planning for the event of an inundation of applications for authorisation (in the case of the comparable provision, article 155 of the former Collective Investment Schemes Act (former CISA), the Federal Council (FC) has mentioned the purpose of taking stock of the situation, Dispatch to the Collective Investment Schemes Act of 23 September 2005, Federal Gazette 2005 pp. 6395 et seqq., p. 6489; similarly Swiss Banking Act (Banking Act), Final Provisions to the Amendment of 17 December 2004, para. 1, cf. BSK BankG-Maurenbrecher/Kramer, SchlB 2004 BankG N 1).

Of course the report may indirectly also serve a broader purpose such as protection of the FinIA system of supervision or the maintenance of public confidence in FinIA supervision. The FinIA provides for rather lengthy transitional periods with respect to the filing of the FINMA approval applications. Financial institutions that were active before FinIA entered into force (1 January 2020) must comply with the authorisation requirements imposed by FinIA and file an application with FINMA within three years of that date (i.e. until 31 December 2022). Financial institutions newly entering the Swiss market must comply with the authorisation requirements imposed by FinIA upon commencement of business, except for the requirement of having an affiliation with a Supervisory Organisation (SO). After FINMA's approval of an SO, they must affiliate with the SO and file an application with FINMA within a year after such approval. In both cases, the financial institutions may carry out their business, provided they are affiliated with a self-regulatory organisation (SRO) for AML purposes. Given these rather extensive transitional periods, the report may provide FINMA with information required to ensure surveillance of the financial institutions' SRO affiliation. However, taking into account that IAMs and trustees have been obliged to affiliate with an SRO for AML purposes already under former law, such a FINMA surveillance seems unlikely and contrary to the principle of self-regulation established and anchored with respect to AML surveillance.

In summary, protection of the FinIA system of supervision might be deemed supported with the duty to report but in no way constitute the ultimate purpose of this report. This broader purpose seems clearly subordinate to the purpose of resource planning, especially under consideration of similar report duties imposed in the context of previous legislative amendments and transitional provisions associated thereto.

In view of the above, in our opinion, the report under article 74(2) and (3) FinIA does not fundamentally help to protect proper functioning of the financial market. The reason for the provision, therefore, is predominantly FINMA's need to plan the use of

its resources, especially during the expected peak season by the turn of the year 2022/2023.

### 3) Deadline to Report

In assessing the deadline, one must distinguish the report to be submitted in accordance with article 74(2) FinIA by financial institutions already in business before FinIA entered into force on 1 January 2020 from the report to be submitted by institutions commencing business after that date in accordance with article 74(3) FinIA. Whereas IAMs and trustees already in business before 1 January 2020 had to submit the report by 30 June 2020, IAMs and trustees commencing business after 1 January 2020 must do so immediately ("*unverzüglich*") upon commencement of their activities, i.e. sometime in 2020.

The legal meaning of the vague but commonly used German term "*unverzüglich*" (English: immediately) requires some careful consideration. In the FinIA debate in the National Council (NC), FC Maurer defined "*unverzüglich*" as "ten days or so" (Official Bulletin 2017 NC p. 1321). This estimate is debatable considering the interpretation of other financial market law immediacy requirements (see for example article 29(2) of the Financial Market Supervision Act (FINMASA), article 13(6) Banking Act and article 96(4) CISA). It seems important to make it clear that "*unverzüglich*" (English: immediately) in German does not mean "*sofort*" (English: at once), but "ohne Verzug" (English: without delay)(see BSK FINMAG-Truffer, article 29 N 44). Even though the term "without delay" provides for some leeway, prudent IAMs and trustees will submit a report at the time activities are commenced.

### 4) Duty to Report and Addressee

#### a) Background

As indicated, article 74 FinIA differentiates between the financial institutions required to report in para. 2 and the financial institutions required to report in para. 3. Whereas para. 2 covers all financial institutions under the FinIA, para. 3 expressly only covers the IAMs and trustees in accordance with article 17 FinIA. The former is directed towards continuing activities and the latter towards commencing activities.

#### b) Financial Institutions Required to Report under Article 74(2) FinIA

The broad definition of the financial institutions required to report in article 74(2) FinIA covers not only IAMs and trustees but also and in particular the following financial institutions that so far have not required authorisation from FINMA:

– Managers of collective assets in accordance with article 24(1) (b) FinIA, i.e. pension fund managers;

– Trade assayers in accordance with article 42bis of the Precious Metal Control Act (PMCA);

– Branch offices of foreign financial institutions under article 52 et seqq. FinIA; and

– Representations of foreign financial institutions under article 58 et seqq. FinIA.

For the branch offices and representations, which by definition under article 2 FinIA – at any rate if they are Swiss entities – are not deemed to be financial institutions, article 93(4) of the Financial Institutions Ordinance (FinIO) reiterates the duty to report in article 74(2) FinIA.

It is open to question whether the duty to report covers financial institutions ceasing their activities within the transitional period. This question is primarily relevant for financial institutions active before FinIA entered into force. It seems clear that a report of financial institutions having ceased their activities before the lapse of the deadline to report, i.e. 30 June 2020, is, to say the least, hardly of any value and in our view clearly not required. The situation is different where a financial institution ceases its activities within the period between the deadline to report and the deadline to file an application with FINMA (i.e. 30 June 2020 - 31 December 2022). Article 74(2) FinIA does not link the report to a subsequent filing of an application with FINMA, neither explicitly nor implicitly. Furthermore, it seems to be realistic that financial institutions, even if planning to cease their activities, due to various reasons decide to remain operative. This leads to the conclusion that the duty to report applies irrespective of a financial institution ceasing its activities between 30 June 2020 and 31 December 2022. It is worthwhile noting that FINMA seems to be of the same opinion, as the FINMA report form requires written information until 31 December 2022 in case of a waiver to file an application (oddly enough in writing and not by means of its survey and application platform (EHP)).

### c) Financial Institution Required to Report under Article 74 (3) FinIA

As indicated, FinIA provides for a transitional period not only for financial institutions already in business before the FinIA entered into force but also for IAMs and trustees commencing activities within a year after FinIA entered into force. The wording is clear insofar that IAMs and trustees are the only financial institutions able to rely on this transitional period. The provisions of the ordinance do not provide for any extension corresponding to article 93(4) FinIO. For example, branch offices and representations of foreign financial institutions that are newly established or commence their activities in 2020 must go through the ordinary authorisation process before they can act for the foreign institution in Switzerland.

### d) Addressee of the Report

FINMA is the addressee of the report, for reports under article 74(2), those under article 74(3) FinIA as well as for those under article 93(4) FinIO. Responsibility within FINMA is that of Asset Management Division.

## 5) Report Form

FINMA provides a form that can be completed and submitted online on its EHP. Before submitting the report, the person required to report must register on the EHP and request a user account. Only when FINMA has provided the user details is it possible to complete the report form and send the report.

If the electronic transmission of the report is not possible for technical reasons, or due to lack of time (in the case the expiry of the deadline is imminent), under the general principles of administrative law, FINMA must also accept a report sent by mail. There is no legal obligation, neither in a federal act nor ordinance, to use a form in this case. Although the supervisory authority may favour the use of a form for practical reasons, the authority's insistence on submitting a form seems excessively formalistic and would be unlikely to be supported by the courts.

Once a report form has been submitted electronically, the EHP generates an automatic confirmation message which is sent to the email address previously indicated by the reporting institute.

## 6) Legal Consequences

The legal consequences of a failure to report remain vague and unclear. In particular, it is questionable whether a failure to report precludes the financial institution concerned from reliance on the transitional provisions and whether the absence of a report ultimately constitutes an obstacle to authorisation. The text of article 74(2) and (3) FinIA and article 93(4) FinIO does not contain any adverbs to link each first sentence (relating to the duty to report) to each second sentence (which refers to the application for authorisation). Article 74(3) FinIA differentiates between the authorisation requirements from the report as obligations *sui generis*, by using the conjunction "and" instead of an expression indicating inclusion (for example "such as" or "in particular"). Based on a grammatical interpretation, hence, there is no link between the duty to report and the authorisation requirements. Likewise, there are no indications in the wording that a report is a precondition for invoking the transitional provisions. FINMA also seems to take the view that the duty to report is separate, given the FINMA report form requires indication of an intention to apply for authorisation.

By contrast, the Federal Department of Finance (FDF) in its explanatory report on the FinSO and FinIO generically assumes that the transitional period is linked to the

"observance" of the transitional provisions (FDF, Explanatory report on the Financial Services Ordinance, the Financial Institutions Ordinance and the Supervision Organisation Ordinance of 6 November 2019, p. 114). The Dispatch to the FinSA and FinIA of 4 November 2015, Federal Gazette 2015 pp. 8901 et seqq., p. 9043 by usage of the adverb "*sodann*" (English: then) links potential reliance on the transitional provisions to the submission of a report within the relevant deadline. A historical interpretation – which carries considerable weight in the case of recent provisions – links the report with the other requirements, with the result that a failure to report would carry the significant repercussions of not being eligible to rely on the transitional provisions.

The aims and objectives of the report must lie outside the key principles of financial markets law – protecting investors and ensuring proper functioning of the financial market (article 4 FINMASA; cf. section 2) above). In our view, the report under article 74(2) and (3) FinIA as well as under article 93(4) FinIO allows FINMA to plan sensibly for a possible inundation of applications towards the end of 2022. This objective, however, does not under any circumstances justify any linkage between fulfilling the duty to report and being able to rely on the transitional provisions or being eligible for a decision on authorisation. Instead, for teleological reasons, a failure to report must be regarded as a simple breach of a provision of financial market law equivalent to an administrative regulation ("*Ordnungsvorschrift*").

Systematic interpretation demands the uniform application of the law within a subfield of the law. Consequently, the legal consequences should also be based on the other pre-existing transitional provisions of financial market legislation (for example article 155(1) of the former CISA, the Banking Act Final Provisions to the Amendment of 17 December 2004, paragraph 1 as well as on article 90(6) of the Insurance Supervision Act (ISA)). Strikingly, all these provisions, which serve as models, help FINMA to take stock of the situation or identify institutions requiring authorisation in future for the first time. None of the provisions are expressly set out as regulations on validity. In the case of article 155(1) of the former CISA, the duty to report was linked to the application for approval, but few additional conclusions can be drawn from this. In the case of the two other provisions mentioned, it is noticeable that the substantive transitional provisions are in each case set out in separate paragraphs, which indicates a certain separation of content and a qualification of the duty to report as a purely administrative regulation.

In summary, the legal consequences remain uncertain given there is leeway for different interpretations.

In our opinion, the wording and teleological considerations lead to the conclusion that the transitional provisions have no constitutive effect and should be regarded as merely administrative regulations. Although a historical interpretation is of importance with

respect to recent rules, it generally takes a generic approach to compliance with transitional periods, in particular requiring the application for authorisation to be submitted within the relevant deadline and SRO membership. In our opinion, a failure to report primarily brings strategic disadvantages in the authorisation process (before even submitting the application for authorisation, the applicant has already violated financial market law, which could at least have some practical influence on FINMA's attitude). Taking this view, FINMA would hardly be equipped with any enforcement measures, at most the restoration of legality (article 31 FINMASA) by forcing the respective financial institution to submit a report at this later stage. Applicants could steal FINMA's thunder by handing in such report on their own initiative in advance of being forced by FINMA by means of supervisory measures.

However, and by contrast, there is a hidden risk that the supervisory authority and the courts will weigh their interpretation differently and in the absence of a report take the view that the transitional regime does not apply. In such scenario an application for authorisation would have to be submitted immediately and no FinIA-relevant activity could be carried out until authorisation is granted. With the consequence of criminal sanctions according to article 44 FINMASA in case of non-compliance. Even though the authors are of the opinion that this scenario is rather unlikely, also here, handing in a belated report – of course before FINMA has initiated any enforcement measures – could be helpful and should be considered by financial institutions. We assume that FINMA allows for belated registrations and reports on its EHP and thus will generate automatic confirmation messages for belated reports as well. Such confirmation message could support financial institution's *bona fide* reliance on the transitional period.

## 7) Conclusion

For financial institutions seeking authorisation for the first time, reporting is now a common way for supervisory authorities to connect with new "clients" and gain an overview of how many and who they are. This "inventory" gives an indication of the amount of office work that will need to be done to deal with the applications for authorisation submitted.

Even though the authors are of the view that a failure to report will not have any negative consequences on financial institutions' ability to rely on the transitional periods nor obtaining authorisation, cautious financial institutions required to file until 30 June 2020 have filed a report within this deadline. IAMs and trustees commencing activities in 2020 must file the report without delay, but prudent financial institutions will do so right upon commencing their activities.

In case of failure to report, financial institutions are well advised to make up for such report.

However, irrespective of all the legal classifications, be it purpose or merely the consequences of a duty to report, FINMA's evaluation of the reports received by end of June will indicate whether the informational events have induced a general appetite to report and the interest shown at these events was also reflected in the number of reports received by FINMA.

*Matthias Lötscher (matthias.loetscher@walderwyss.com)*
*Pascal Zysset (pascal.zysset@walderwyss.com)*

## A new proxy adviser regulation in Switzerland?

Reference: CapLaw-2020-24

The Swiss Parliament has adopted a motion requiring the Swiss government to propose a new regulation addressing the conflicts of proxy advisers. The primary focus seems to be on ISS and to a lesser extent on Glass Lewis for their potential dual role in advising institutional investors on voting recommendations and listed companies on corporate governance and compensation. In the absence of a physical presence of these proxy advisers in Switzerland, it remains unclear how the required legislation could be effectively enacted.

*By Thomas U. Reutter / Annette Weber*

### 1) Proposal for new legislation in Switzerland

Thomas Minder, member of the Council of States submitted a parliamentary motion on proxy advisers on 23 September 2019. In this motion, the Swiss government was asked to propose legislation, for example by amending the Financial Market Infrastructure Act, to address the issue of conflicts of interests of proxy advisers. The legislation required by the motion should be designed to both disclose and avoid conflicts of interests of proxy advisers. It should also consider international developments on this topic. The motion was adopted by the Council of States on 3 June 2020 after being adopted by the National Council. Therefore, the Swiss government is tasked to provide a proposal how to regulate proxy advisers to mitigate conflicts of interests.

In the reasoning for the motion, Mr. Minder identified conflicts of interests of proxy advisers analyzing Swiss listed companies and offering advisory services to the very same companies on corporate governance and compensation. On a more polemic note, the motion also alleges that some proxy advisers recommend no votes for compensation systems of companies in order to be retained as advisers on a re-design of such systems by these companies. ISS, the big elephant in the room offering both proxy advice to investors as well as corporate governance advice to listed companies, was not specifically mentioned but seems to have been the primary target of the motion.