January 2018

Newsletter No. 120

New Outsourcing Rules for Banks, Securities Dealers and Insurers

The Swiss Financial Market Supervisory Authority (FINMA) has published a new Circular 2018/3, which will replace its current Circular 2008/7 on Outsourcing. As one of the main modifications, the new Outsourcing Circular will not only apply to banks and securities dealers, but also to insurance companies. Moreover, the rules on data protection and banking secrecy contained in the current Circular 2008/7 have been removed to avoid duplications and divergences with the separate legislation in these areas. This new Outsourcing Circular will enter into force on 1 April 2018. The new Outsourcing Circular is available on FINMA's website in English, German, French and Italian.

walderwyss attorneys at law

New Outsourcing Rules

The new outsourcing rules to be implemented by the new Circular 2018/3 Outsourcing – banks and insurers **(New Outsourcing Circular)** are the result of a lengthy consultation process in which many stakeholders participated. FINMA has made various amendments to the original draft. In particular: (i) the transition period for banks and securities dealers to adapt pre-existing outsourcing agreements has been extended from two to five years; (ii) self-assessment by the financial institutions on whether an outsourcing is subject to the circular has been emphasised; and (iii) the treatment of intra-group outsourcing has been slightly reviewed and now stipulates a principle-oriented approach.

By Jürg Schneider
Dr. iur., Attorney at Law
+41 58 658 55 71
juerg.schneider@walderwyss.com

By Thomas Müller
Dr. iur., LL.M., Attorney at Law
+41 58 658 55 60
thomas.mueller@walderwyss.com

Application of the New Outsourcing Circular

The current Outsourcing Circular applies exclusively to banks and securities dealers. The scope of the New Outsourcing Circular now includes insurance companies and Swiss branches of foreign insurance companies as well. Fund management companies, SICAVs, asset managers of collective investment schemes and representatives of foreign collective investment schemes remain out of scope but are subject to specific outsourcing rules in the FINMA Collective Investment Schemes Ordinance. Nevertheless, FINMA has applied principles of the current Outsourcing Circular on an informal basis to outsourcing arrangements on these entities as well and we expect that FINMA will continue this practice as regards the New Outsourcing Circular. It would in any event not be legitimate to apply stricter outsourcing rules on fund management companies, SICAVs, asset managers of collective investment schemes and representatives of foreign collective investment schemes than on other regulated entities subject to the New Outsourcing Circular.

Outsourcings Falling under the New Outsourcing Circular

Outsourcing falling under the New Outsourcing Circular is defined as commissioning a service provider to perform all or part of a function that is significant for the business activity of the institution. Functions are significant if they have a material effect on compliance with the aims and regulations of the financial market legislation. It will have to be determined in each individual case whether a function is significant. In doing so, differences between the institutions have to be taken into account. Contrary to the current Outsourcing Circular, the New Outsourcing Circular does no longer provide for an illustrative (but not exhaustive) list of activities falling under the circular and activities outside of the circular.

Outsourcing of significant functions is permissible for banks and securities dealers without the need for an authorisation from FINMA. In relation to insurance companies, however, the outsourcing of significant functions and the partially admissible outsourcing of control functions are considered relevant to the business plan and therefore require authorisation from FINMA.

The New Outsourcing Circular still follows a quite liberal approach and allows outsourcing of all significant functions, except for some which are regarded as core tasks of the board of directors and the management or which relate to decisions on the commencement and termination of business relationships. In addition, there are some newly imposed rules on category 1 to 3 institutions (larger and more important banks and securities dealers) which are required to have an autonomous control body in the form of a separate risk control and compliance function. For category 4 and 5 institutions (smaller, less important banks and securities dealers) the appointment of a responsible member on the executive management level is sufficient. Furthermore, operational risk management and compliance tasks may be outsourced in all supervisory categories.

Outsourcing Abroad

Under the New Outsourcing Circular, the requirements for outsourcing abroad have been adapted. From the date of entry into force of the New Outsourcing Circular, it will be necessary for the institution to guarantee that the institution, its audit firm and FINMA will be able to assert and enforce their rights of inspection and audit information. Further, the restructuring or resolving of the institution in Switzerland should not be hindered. Finally, all information required for the purpose of restructuring and resolving must be accessible in Switzerland at all times. In our view, access from Switzerland to the information stored outside of Switzerland would suffice this requirement.

For the sake of completeness, it can however be noted that, in addition to the foregoing requirements, outsourcing abroad may be subject to additional restrictions and requirements under separate laws and regulations (data protection law, banking secrecy, FINMA circular 2008/21 Operational Risks Banks, etc.).

Organisational Measures and Written Agreement

In order for FINMA to be able to comply with its supervisory obligations, institutions will be expected to take organisational measures such as keeping an inventory list of the outsourced functions in Switzerland and abroad. This list shall contain a description of the outsourced function and indicate the service providers (incl. subcontractors), the service recipient and the unit responsible within the service provider. Furthermore, diligent selection, instruction and supervision of the service providers will be required, taking into account and assessing their professional skills as well as their financial and human resources.

As under the current regime, outsourcing must be based on a written agreement with the service provider. The written agreement with the service provider shall in particular name the parties and describe the functions, include provisions regarding control, instruction and inspection rights and safety requirements and contain measures to ensure implementation of the requirements set out in the circular. It must be noted that the use of subcontractors that perform significant functions must be made subject to the institutions' prior approval and the obligations and guarantees of the service provider which are necessary to comply with the New Outsourcing Circular must be imposed on the subcontractors.

Data Protection and Banking Secrecy Requirements

Another change has been made with regard to the data protection requirements contained in the current Outsourcing Circular, which have been completely removed from the New Outsourcing Circular in order to avoid duplication and possible divergences with current and future data protection law(s) and to ensure a strict differentiation between the supervisory requirements of financial market regulation and the obligations under civil law. For banks and securities dealers this in particular means that, contrary to the current Outsourcing Circular, the New Outsourcing Circular does no longer grant their clients an extraordinary termination right if their personal data is disclosed abroad in the context of an outsourcing and the New Outsourcing Circular also forfeits information rights granted under the current Outsourcing Circular, such as information in general form about outsourcing and information by separate letter before client personal data is transferred abroad in the context of an outsourcing.

References to banking secrecy have also been removed from the New Outsourcing Circular.

However, as already mentioned, data protection legislation and banking secrecy continue to apply in parallel to the New Outsourcing Circular and must be complied with.

Intragroup Outsourcing

Outsourcing within the group will no longer benefit from exemptions but will in essence have to comply with the same requirements as external outsourcing. Group affiliation will only be taken into account regarding the selection, instruction and supervision or the agreement with the service provider and only if the risks typically associated with outsourcing do not exist or if certain requirements are either not relevant or met in some other way.

Responsibility

The institution is not released from its responsibility for the outsourced function. It remains responsible to FINMA for the performance of outsourced functions in the same way as it would if it performed them itself.

No Specific Provisions on Outsourcing "to the Cloud"

As under the current Outsourcing Circular, the New Outsourcing Circular does not specifically or separately address outsourcing "to the cloud". The same requirements apply.

Entry into Force and Actions Required

For Banks and Securities Dealers

Upon entry into force on 1 April 2018, the New Outsourcing Circular will directly apply to all outsourcing agreements of banks and securities dealers which will be entered into or modified after 1 April 2018. Any pre-existing outsourcing relationships (even if not altered) must be adapted to meet the requirements of the New Outsourcing Circular by 1 April 2023 at the latest.

As new outsourcing relationships and/or altered outsourcing relationships of banks and securities dealers must immediately comply with the New Outsourcing Circular. Any new outsourcing structure and any alterations of existing outsourcing relationships have to be checked against and implemented in accordance with the New Outsourcing Circular.

Furthermore, despite a rather long transition period, it is recommended for banks and securities dealers to already start reviewing their existing outsourcing relationships and verify if and to what extent they will have to be adapted in order to comply with the New Outsourcing Circular at the end of the transition period at the latest.

For Insurance Companies

For insurance companies the New Outsourcing Circular shall apply to initial authorisations of a business plan which includes an outsourcing structure as of its entry into force on 1 April 2018. Existing outsourcing structures have to comply with the New Outsourcing Circular as soon as the insurance company submits or communicates an amended business plan to FINMA for approval. Any change of a business plan thus requires a review and potential restructuring of the existing outsourcing solution. This has to be kept in mind should an insurance company intend to amend its business plan after 1 April 2018.

Walder Wyss Ltd.
Attorneys at Law

Phone + 41 58 658 58 58
Fax + 41 58 658 59 59
reception@walderwyss.com

www.walderwyss.com