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Liberalization of the Point of Sale– Amendments to the FIDLEG Bill's Point of Sale Duties Proposed by the Council of States

Reference: CapLaw-2017-03

After having been discussed throughout 2016 in various sessions of the Economic Affairs and Taxation Committee of the Swiss Federal Council of States (WAK-S), on 14 December 2016 the new Federal Financial Services Act (*Finanzdienstleistungsgesetz*; FIDLEG) was finally resolved on by the Federal Council of States (SR). Compared to the bill of the Federal Council (the Swiss government), the SR resolved on a number of amendments that will, in certain areas, substantially liberalize the proposed regulatory regime to be complied with at the point of sale. Starting this year, the bill is now before the other chamber of Swiss parliament, the Swiss National Council (NR), and it will be interesting to see to what degree the NR will follow the SR's approach. The enactment of the bill is still anticipated at the earliest in 2018. The present article focuses on important amendments to the FIDLEG bill as suggested by the SR.

By Sandro Abegglen / Luca Bianchi / Edi Bollinger

1) Introduction

As expected, the SR followed its preparatory commission (WAK-S) when deliberating the FIDLEG bill and resolved on a number of important curtailments to point of sale duties of financial services providers when compared to the government's bill. Apart from a general position to only accept the new regulation if it is "liberal in approach and design" and relatively simple to implement, a certain more relaxed stance vis-à-vis the question of whether the new Swiss regulation will be equivalent with EU's MIFID II may have driven the decision making of the SR members. It remains to be seen whether the NR will approve such a liberal course in all respects, in particular, as there are certain amendments where the SR's bill (at least according to the letter of the law) provides for a very liberal regime.

Further, it is a clear message to the government that certain aspects of the legislation will be addressed at the level of the formal statute, the rationale being to prevent potentially too strict concretization of the act at the level of the ordinance to FIDLEG.

This article does not aim to give an overview of the FILDEG's point of sale duties (for such overview, see Sandro Abegglen and Luca Bianchi in CapLaw-2016-3) but focuses on important amendments to the FIDLEG bill as suggested by the SR in December 2016.

2) Amendments to the Federal Council's FIDLEG Draft concerning the Point of Sale

The SR resolved on the following important amendments to the Federal Council's draft of FIDLEG:

- ***Client segmentation:*** The SR proposed a few amendments to the contemplated client segmentation regime of the FIDLEG, including the sensible introduction of a new professional client category of "large undertakings" (with a concept and content very similar to the related category under MIFID) and, importantly for Switzerland as major private banking center, a concretization that private investment structures with a professional treasury unit (created for wealthy private clients) shall always be regarded as professional clients. Moreover, and also to be considered against the private banking needs, the SR now wishes to define the requirements for high-net-worth individuals (HNWI) within the FIDLEG statute itself. The respective proposal is that an HNWI may opt-out/up to professional investor status whenever it has a net worth of at least CHF 2 million, it being understood (and in stark contrast to MIFID) that no specific experience or know-how is required. This proposal is all the more remarkable when considering that the corresponding threshold under the Collective Investment Schemes Act (CISA) is currently CHF 5 million.

- ***No super-opting-in (down) / amended opting-out (up)***: The SR resolved to restrict the opting-in (opting-down) as well as to liberalize the opting-out (opting-up) possibilities. In particular, and indeed rather astonishingly, institutional clients shall not have the freedom to super-opt-down anymore to the level of private clients. The sensibility of such amendment is questionable given that an institutional client, based on the freedom of contract principles, may continue to request to be treated as a private client under civil law. Whether or not a financial services provider will agree to such request mainly seems to be a commercial question and a matter for the financial services firm and not for the law to decide. Further, retirement benefits institutions with a professional treasury shall, in turn, be able to opt-up, *i.e.*, to choose to be classified as institutional client, which is the equivalent of MIFID's eligible counterparty.

- ***General exclusion of code of conduct duties vis-à-vis institutional clients***: Furthermore, and quite remarkably, the SR resolved that the entire set of code of conduct duties under the FIDLEG shall not apply in relation to institutional clients (or eligible counterparties as per MIFID's terminology). Such a general carve out of the code of conduct duties seems to be questionable to the extent it concerns fundamental rules, such as best execution. It is not conceivable how the management of an institutional client may accept (*e.g.*, a broker-relationship) a relationship where the broker does not promise best execution, not to speak of institutional clients, such as fund management companies and pension plans that, by virtue of their own

regulation and fiduciary duties, must insist on their counterparty complying with certain elementary code of conduct principles. It may be that the SR did not fully appreciate the impact of its pertinent deviation from the Federal Council's draft that, in line with MIFID II, had provided for a differentiated carve out. Such a critical assessment seems justified by the contradiction that, according to the SR's bill, the entire conflict of interest regulation, which is a concept interlinked with the duty of loyalty, shall *not* be carved out. Finally, and certainly less likely to cause differences with the NR, the SR resolved that professional clients, in addition to the possibility to opt-up to the institutional investor status subject to certain conditions, shall be entitled to waive the application of certain code of conduct duties.

– ***Appropriateness / suitability***: While the Federal Council had proposed that a financial services provider must advise against the purchase of certain financial instruments where they are considered not appropriate or suitable for such client, the SR now decided on a mere warning requirement instead. It remains, however, unclear whether a financial services provider may still proactively offer respective financial instruments. The SR further clarified with regards to the appropriateness test that the requested experience and know-how shall refer to the financial service as such, and not to the individual transaction or instrument, an amendment that seems to make a lot of sense for discretionary mandates, but less so for investment advisory situations where it remains the client who has to take the (informed) investment decision.

– ***Duties of due diligence and loyalty***: Driven by the safe harbor concept described in the next paragraph, and likely also by a misunderstanding with regards to the true scope of the duty of loyalty (it had always been clear and would not have changed under the Federal Council's bill that the duty of loyalty does not apply in true counterparty situations), the SR decided to delete altogether the (regulatory) duties to act with due care and in the interest of the principal (duty of loyalty). Under civil law, however, compliance with those duties will, of course, still be required.

– ***Safe harbor***: The SR resolved that the compliance with the FIDLEG's (regulatory) point of sale duties should ensure automatic compliance with corresponding civil law duties, and based on a statement of a member of the SR, non-compliance with FIDLEG will not automatically result in a violation of civil law duties. This concept is welcome as it ensures a sensible coordination of civil and regulatory laws (and was the likely reason to exclude the arguably too general duty of loyalty from the FIDLEG as otherwise the "frontier" of the safe harbor would remain unclear). However, the SR's wording contains room for improvement by the NR (*e.g.,* with regards to an explicit exclusion of the *e contrario* argument that non-compliance with regulatory duties will automatically be a civil law violation). Furthermore, the question of

how the safe harbors will be applied or handled where regulatory duties do not apply should be addressed (*e.g.*, for client segmentation reasons).

– ***Limitation of the duty of information***: While the Federal Council's bill had provided for a duty of (specific) information about the risks and costs of an offered financial service, the SR decided that such an information duty shall only apply in case of "personally recommended services". A potential reading of such a qualification would seem to suggest certain "personal recommendations". This seems all the more astonishing as in such situations *investment advice* is pertinent that will anyway exceed the pure information duties. And also here, civil law may not follow such limitation of the duty to ensure that the investor may take his decision on an informed basis.

– ***Basic information sheet (Basisinformationsblatt; BIB):*** The BIB will have to be made available to private clients whenever financial instruments other than shares, straight bonds, or plain-vanilla notes (*i.e.*, bonds or notes without a derivative character) are offered. The SR decided that with respect to multi-underlying products a single BIB shall be sufficient (and no additional BIBs for all the underlyings of such product are required). Furthermore, the SR held that in case of investment advice provided – on the client's initiative – amongst absentees, the client may agree that it is sufficient for the financial services firm to hand out the BIB only after completion of the transaction (*i.e., ex post*).

– ***Inducements – broader scope of application***: In deviation from the Federal Council's bill that followed more closely the transparency approach of MIFID II, the SR resolved that any payments in connection with any financial services, and not only in connection with investment advice etc., are to be made transparent as inducements. Also, the SR amended the bill by introducing the duty to obtain an informed, valid waiver in case the inducements are to be kept by the recipient, a duty that traditionally has been regarded as pure civil law in character. This leads to a stricter inducement regulation when compared to the current situation under Swiss law and (with regard to the scope of application) also when compared to MIFID II.

– ***Exclusion from FIDLEG of insurance policies with investment character***: In deviation from the "same business, same rules" concept, the SR decided that FIDLEG shall not apply to financial services in respect of life insurance policies with (also) investment character; *i.e.,* such policies and their distribution will remain governed solely by the insurance regulation, which is expected to be further bolstered in the coming years.

– ***No explicit professional education standards***: In rather surprising contrast to the Federal Council's draft, the SR resolved to dispense with any and all explicit regulation (at the statute-level) on standards of adequate qualification and education of

client advisors, and of the corresponding responsibility of the firms. Such a seemingly lax attitude with regard to professional qualification and education may warrant reconsideration by the NR, taking into account the importance of the (international) private banking and the increasing importance of the asset management industry for Switzerland. This seems all the more true as the industry will not have problems to cope with reasonably high standards, given that the relevant educational level in Switzerland is very high.

– ***Criminal offences***: Besides the regulatory duties at the point of sale (and respective regulatory measures), financial services providers and their employees may, potentially, also be penalized with criminal sanctions in case of non-compliance with certain regulatory duties. In this respect, according to the SR, financial services providers being supervised and licensed within the meaning of the Financial Market Supervision Act (FINMASA) as well as their employees shall be explicitly carved-out from being subject to the criminal offences stipulated under the FIDLEG, meaning that FIDLEG's duties will only be enforced criminally vis-à-vis the non-FINMASA licensed investment advisors. The underlying rationale is that the latter are not within the reach of regulatory measures that in fact often prove more effective than criminal sanctions. It remains to be seen, however, how the NR will deal with the SR's proposal of a so-to-speak "preferential" criminal law treatment of FINMASA-regulated versus non-regulated players.

3) Excursus: Regulation of the Digital (FinTech) Point of Sale

The digitization of the point of sale for financial services and products is a current reality and continuously becoming more important. As such, the (conduct) duties that must be fulfilled at the point of sale under the FIDLEG or the other Swiss financial market regulation, including, but not limited to the rules for digital onboarding under the Swiss anti-money laundering (AML)-regulations (see CapLaw-2016-21), will, naturally, also apply to such digital point of sale.

However, the appropriateness or suitability assessments, the information or documentation duties, or the registration duties as foreseen in the FIDLEG will represent challenges for many FinTech companies and their products and services. Thus, an appropriate specific regulation of the digital point of sale and for innovative FinTech business models is welcomed (see CapLaw-2017-02 and CapLaw-2016-31). For such, the traditional pragmatism of the Swiss legislator and regulator will be helpful.

4) Conclusion and Outlook

The SR has proposed substantial amendments to the regulation of the point of sale, many of which are welcome as they are liberal in approach and design (putting aside issues of equivalency). Some of the changes, however, and as discussed, deserve to

be annotated with, mainly technical, question marks. Also for this reason, the law-making process of FIDLEG will remain exciting now that the bill is about to be treated by the NR.

As regards FinTech, there is reason to believe that the Swiss regulatory landscape will be adapted to enable the provision of innovative digital financial services and products.

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Update on the Key Information Document Requirement

Reference: CapLaw-2017-04

In CapLaw-2016-5, Enrico Friz outlined in detail the new duty of manufacturers of financial instruments to produce a key information document (KID, *Basisinformationsblatt*) for all financial instruments. This duty shall be implemented by the Financial Services Act (FinSA) which will likely be set into force during the course of 2018 and is currently being debated in the Swiss Parliament. The Council of States has, with rather minor amendments, approved the draft FinSA produced by the Federal Council in December 2016. The National Council will discuss the FinSA in one of its upcoming sessions. This contribution summarizes the changes to the FinSA in respect to the KID proposed by the Council of States compared to the Federal Council's draft FinSA outlined in CapLaw-2016-5.

By Thomas Müller

1) Partially revised Framework

Generally speaking, but with some important exception, the Council of States has not amended the duty to produce a KID and the content of the KID. A KID will have to be produced for all types of financial instruments offered to retail clients. Given that insurance companies shall now be excluded from the scope of the FinSA, the definition of financial instruments has been partly revised. Redeemable life insurance policies with price-dependent benefits and settlement values as well as capital redemption operations and tontines are no longer deemed as financial instruments under the FinSA.

Accordingly, no KID will have to be produced for life insurance policies. In addition, the Swiss Council of States has amended the list of financial products exempt from the KID requirement. Under the previous draft FinSA, no KID would be required for the offering of equity instruments, such as shares, participation certificates and dividend rights certificates. The new draft FinSA now also excludes debt instruments without