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Position Paper regarding selected Aspects of the Financial Services Act (FinSA)

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With the entry into force of the Swiss Financial Services Act (FinSA) as of 1 January 2020, new regulatory duties and requirements for Swiss and foreign financial service providers which are active in Switzerland or serve Swiss clients proactively on a cross-border basis were introduced. However, the practical application of the new law revealed that various newly introduced legal terms and concepts of the FinSA require more specific explanation and some statements made in the course of the implementation process require clarification.

The authors of this position paper are practicing lawyers working with various Zurich based law firms who regularly exchange views on new legal developments and share their experience in the application and implementation of the law. The views and positions expressed in this position paper are those of the individual contributing authors and not those of the respective law firms or other market participants.

1) Introduction – Subject Matter and Scope

Traditionally, Swiss financial market laws have provided for a rather liberal regulatory regime for the provision of financial services, which has been true in both the inbound cross-border as well as the domestic context. The Swiss Financial Services Act (**FinSA**), which came into force as of 1 January 2020, marked a paradigm shift in this regard and introduced new regulatory duties and requirements for Swiss and foreign financial service providers which are active in Switzerland or serve Swiss clients proactively on a cross-border basis. The newly implemented notion of financial services within the meaning of FinSA, inter alia, includes the "*acquisition or disposal of financial instruments*" as well as the "*provision of personal recommendations on transactions with financial instruments (investment advice)*".

A personal recommendation on transactions with financial instruments may either occur on a stand-alone basis, i.e., without taking into account the client portfolio, in which case it is referred to as "transaction-related advice", or under consideration of the client's portfolio, in which case it is referred to as "portfolio-related advice". However, if no personal recommendation is given to a potential investor, (i.e., if no recommendation is addressed to a specific client considering his or her needs), then no investment advice would be rendered to such an investor.

The term "*acquisition or disposal of financial instruments*" shall include any activity undertaken directly towards a particular client specifically aiming at the acquisition or disposal of financial instruments. According to the explanatory report of the Federal Department of Finance, dated 24 October 2018 and published in relation to the FinSA's implementing ordinance, the Financial Services Ordinance (**FinSO**), "marketing of" or "brokerage services in relation to" financial instruments would typically fall within the scope of this provision and therefore qualify as a financial service. The second explanatory report of the Federal Department of Finance relating to the FinSO, dated 6 November 2019, however, also clarifies that the acquisition or disposal of financial instruments between regulated financial intermediaries shall not be considered as a financial service since the purpose of the legislation would be to protect the end client at the point of sale unless the financial intermediary is acting on its own behalf.

The authors of this position paper are of the view that the definition of certain legal terms and concepts newly implemented by the FinSA and the FinSO, such as financial services and brokerage, require more specific explanation and some statements made in the course of the implementation process require clarification, e.g. pure brokerage of financial instruments on behalf of the issuer of such financial instruments towards potential investors would *not qualify* as financial service pursuant to FinSA.

For any financial service provider proactively providing its services on a cross-border basis into Switzerland, a good understanding of, inter alia, the terms "financial instruments" and "financial services" implemented by the FinSA is crucial to safely navigate Swiss financial regulation. This position paper aims at resolving certain ambiguities of the new law. It has no claim of a comprehensive interpretation of the FinSA, the FinSO and the further implementation measures by the Swiss financial regulator FINMA and the self-regulatory bodies but reflects the interpretation of certain main topics by the authors only.

2) Financial Instruments

2.1) General

With regard to the substantive scope of the FinSA, "financial services" in the sense of article 3 lit. c FinSA have to relate to "financial instruments" in the sense of article 3 lit. a para. 1 to para. 7 FinSA. This list is exhaustive and covers the following:

1. equity securities (including, without limitation, securities that are convertible into equity securities);
2. debt securities (including, without limitation, notes and bonds);
3. shares or units in collective investment schemes;
4. structured products;
5. derivatives as defined in article 2 lit. c of the Financial Market Infrastructure Act (**FMIA**);

6. deposits, where the repayment or interests depend on an underlying or a market price (structured deposits), except for deposits with interest linked to an interest benchmark; and

7. other debt instruments structured with fungible terms (*Anleihensobligationen*).

Examples of assets/transactions that do not qualify as financial instruments for the purposes of the FinSA include the following:

– cash deposits or precious metals other than deposits mentioned under 6. above (see also article 3 para. 1 FinSO);

– commodities other than derivatives on commodities as underlyings falling under 5. above;

– participation in equity of an undertaking not qualifying as securities (*Effekten*), e.g. partnership interests; and

– cryptocurrencies (i.e. digital assets that are not the digital representation of any rights that can be exercised against an issuer or a third party).

Some questions require further consideration when interpreting the scope of FinSA-covered financial instruments.

2.2) Derivatives pursuant to Article 2 lit. c FMIA

Derivatives in the sense of article 3 lit. a para. 5 FinSA are defined by reference to article 2 lit. c FMIA. Such instruments are contracts (i) with a value depending on one or more underlyings, as resulting from the terms of the contract, provided that (ii) it is not a spot transaction.

For the purposes of this definition, note that transactions settled on a T+2 basis or within the relevant settlement cycle for spot transactions are excluded from the definition of a derivative and therefore do not qualify as "financial instruments" in the sense of article 3 lit. a para. 5 FinSA either. In line with the definition of spot transactions pursuant to the Financial Market Infrastructure Ordinance (**FMIO**), this would in our view also be true for rolling spot transactions, which are rolled without a pre-existing obligation to do so.

The FMIO excludes some derivatives from the definition of article 2 lit. c FMIA, i.e. those referred to under article 2 para. 3 lit. b and c FMIO. These derivatives are therefore also excluded from the definition of "financial instruments" in the sense of article 3 lit. a para. 5 FinSA.

Some derivatives within the meaning of article 2 lit. c FMIA are not subject to the obligations of articles 93-117 FMIA. This exclusion applies to physically settled derivatives on commodities as underlyings, provided they are not traded on a trading venue in the sense of FMIA or an organized trading facility. While these instruments are derivatives in the sense of article 2 lit. c FMIA, the question arises whether they should be excluded from the definition of a "financial instrument" in the sense of the FinSA. We believe that this should be so, because the exclusion from the obligations of article 93-117 FMIA was defined by reference to the scope of "financial instruments" under MiFID.

Other derivatives in the sense of article 2 lit. c FMIA (e.g. physically settled FX forwards and swaps) are exempted from only some of the obligations of articles 93-117 FMIA. These derivatives in our view qualify as financial instruments in the sense of the FinSA.

Additionally, any derivatives exempted from the obligations of articles 93-117 FMIA but falling under any of the categories of article 3 lit. a para. 1 to para. 7 FinSA other than para. 5 (e.g. structured products) would of course be qualified as "financial instruments" in the sense of the FinSA.

2.3) Digital Assets

While cryptocurrencies do not fall into any of the categories of article 3 lit. a para. 1 to para. 7 FinSA, this may be the case for other tokens, in particular asset tokens and possibly also utility tokens or hybrid tokens combining elements of different token categories (with regard to the classifications made by FINMA, reference is made to the FINMA guidelines on ICOs of 16 February 2018, as supplemented in respect of stable coins on 11 September 2019). These other tokens may be issued as DLT-rights in the sense of the new article 973d CO (as in force since 1 February 2021) or other uncertificated rights held in a distributed ledger (e.g. if issued under foreign law).

We believe that a "substance over form" approach should take place in respect of such tokens. Accordingly, the token should in our view be classified as a "financial instrument" in the sense of the FinSA, where the rights represented in the token fall into one of the categories of article 3 lit. a para. 1 to para. 7 FinSA (see also FINMA guidelines on ICOs of 16 February 2018, as supplemented on 11 September 2019). For this analysis, the "same business, same rules" approach taken by FINMA and the Swiss legislator should be considered. Therefore, if such tokens neither qualify as securities (*Effekten*) within the meaning of article 3 lit. b FinSA nor fall under any category of financial instruments as set forth under article 3 lit. a FinSA, then they are out of scope.

3) Financial Services for Clients

3.1) End Clients as Recipients of Financial Services

With regard to the definition of "financial services" in the sense of article 3 lit. c FinSA, the question may arise as to what extent issuers can be classified as financial service providers.

In relation to article 3 para. 2 FinSO, the explanatory report of the Federal Department of Finance relating to the FinSO of 6 November 2019 clarifies that the activity must be directed to the end clients directly in order to fall under the definition of "financial services" in the sense of article 3 lit. c FinSA. Hence, on the side of the recipients of financial services, only *end clients* are covered by the legal purpose of investor protection. However, the (end) client is neither defined in the law nor in the ordinance nor in the materials.

An end client is a client who obtains the financial service for himself, i.e. for his own account. As a result, prudentially supervised financial service providers are not deemed to be end clients if they purchase a financial service for the account of a third party (so-called *vostro business*). On the other hand, they are also deemed to be end clients if they purchase a financial service for their own account (so-called *nostro business*). The recognisable intention to resell to third parties not yet specified at the time of the financial service (usually clients) is sufficient in order for the prudentially supervised financial service providers not to be considered as the end client.

3.2) Issuers and Underwriters

On the basis of the aforementioned concept of end clients being the recipients of financial services, an issuer who interacts with an underwriter or with a distributor or other financial intermediary (i.e. not with the end investor / end client directly) could not be classified as a provider of "financial services" in the sense of article 3 lit. c FinSA.

Furthermore, the activity of an underwriter is excluded pursuant to article 3 para. 3 lit. b FinSO from the definition of providing "financial services" in the sense of article 3 lit. c FinSA. We take the view that this applies not only to an underwriting activity in a primary market offer, but also to an underwriting activity in a secondary market offer, even if the interaction of the underwriter is not with the issuer, but with selling investors holding the securities. We take the view that the underwriter acts in this context as a counterparty, not as a financial service provider of the seller or of the buying investor.

Likewise, the issuer who offers its own financial instruments to potential recipients (whether it be through brokers or not, or through a public offer or not) does not perform a financial service under FinSA. Rather, the issuer is acting in its own interest and not in the interest of the potential recipient (buyer of financial instruments). Acting "in the interest of a client" is however a pre-requisite for a financial service in the sense of article 3 lit. c FinSA.

3.3) Pure Brokerage (*reine Vermittlung*)

Pure brokerage of financial instruments *for the issuer* of such financial instruments towards potential investors (*reine Vermittlung*) – irrespective of the type of financial instruments under article 3 lit. b FinSA – does not qualify as a financial service pursuant to article 3 lit. c FinSA.

If the pure brokerage services (*reine Vermittlung*) are provided *for and in the interest of the potential recipient* (meaning the "end client" under the FinSA) of the financial instrument however, e.g. the broker is engaged by the potential recipient (i.e. "end client") to find interesting investment opportunities for the recipient, then such services qualify as financial services in the sense of the FinSA.

Accordingly, only if the broker (also) acts in the interest of the potential recipient ("end client"), the brokerage activity qualifies as a financial service under the FinSA. For example, if the broker is engaged by the issuer and accepts subscriptions from potential investors for which the broker (or the relevant department of the broker) does not provide any services related to the respective financial instrument(s), such acceptance of subscriptions does not qualify as financial service under the FinSA. This is also in line with the explanatory report of the Federal Department of Finance relating to the FinSO dated 6 November 2019, according to which the law regulates the legal relationship between a financial service provider and *its clients*.

The above concept applies regardless of the type of financial instruments at issue. The legislators intended to introduce a product-independent concept for the provision of financial services.

3.4) Reverse Solicitation

Based on the reverse solicitation exemption, financial services provided to clients in Switzerland by foreign financial service providers are not covered/governed by the FinSA if (i) the entire client relationship or the individual/specific financial services have been requested by clients on their express initiative, (ii) the relevant specific financial service has not been advertised or solicited by any other means to the relevant client prior to such client's enquiry, and (iii) the service in question does not go beyond the scope of the original request.

Therefore, the reverse solicitation results in a narrow exemption. Reverse solicitation is not a business model in the sense that the market can by systematically worked – the purpose of the exemption is not to simplify market access for foreign financial service providers.

The client's inquiry must relate to a specific financial service, financial instrument or type of financial instrument; mere general inquiries about the company or persons are not sufficient. To comfortably rely on the reverse solicitation exemption, the original request of the client should therefore be documented by the financial service provider; *ex post* confirmation by the client is generally not sufficient but is probably only circumstantial evidence. If a client relationship was entered into on the initiative of the client, all financial services that fall under this client relationship (i.e. this requested service) are covered by the reverse solicitation exception (e.g.: individual advisory services in the case of an advisory relationship, or individual investment decisions and related acts in the case of an asset management relationship; but not: "recommendation" of an asset management relationship in the case of an existing advisory relationship). The extension of, i.e. the provision of further, financial services that are not requested by the client is not possible based on reverse solicitation.

Client relationships entered into prior to the entry into effect of the FinSA can be continued under the FinSA if they have been the result of reverse solicitation and would not be subject to the FinSA and its requirements.

3.5) Relevance of Definition of Client

3.5.1) Client / Counterparty

Clients in the context of FinSA are individuals, legal entities, partnerships and other legal entities formed under foreign law, with the dispatch to the Financial Services Act of 4 November 2015 (**Dispatch**) citing the trust as an example of the latter. In our view, with regard to clients of a financial service provider, there is no reason to treat the trust differently than under the previous practice to article 3 Anti-Money Laundry Act (**AMLA**) and the Automatic Exchange of Information and Foreign Account Tax Compliance Act (**FATCA**), which is why the trustee should also be treated as a contractual partner and thus as a client with regard to the provision of a financial service.

According to the Dispatch, a person approached for the *potential provision* of a financial service should already be considered a client of the financial service provider, i.e. without an agreement having already been concluded between the financial service provider and the client. However, in our view, the term "financial service", the legal wording of the introductory sentence of article 3 lit. c FinSA ("Financial services: the following activities provided to clients") as well as the activities clearly and conclusively listed in article 3 lit. c FinSA preclude such a broad interpretation of the term "client" by the Dispatch in the absence of a legal basis. The mere contacting of potential clients with a view to promoting financial services is not itself a financial service, but only when the financial services are contractually agreed and/or effectively provided.

It does not matter in what form the contractual relationship between the financial service provider and the client is concluded (i.e. FinSA may apply before the onboarding of the client is documented).

As proprietary trading transactions lack any elements of interest protection, the involved transaction parties do not qualify as clients within the sense of FinSA. Such proprietary trading transactions are often seen in connection with OTC derivative transactions under an ISDA Master Agreement or Swiss Master Agreement.

3.5.2) Client Segmentation

3.5.2.1) Client Segmentation Duty

Pursuant to article 4 para. 1 FinSA, financial service providers must assign clients to whom they provide financial services to one of the following three client categories or segments: retail clients, professional clients and institutional clients. Alternatively, according to article 4 para. 7 FinSA, financial service providers may refrain from client segmentation, provided they treat all clients with the highest level of protection of the retail client.

At least based on the duty of information and clarification of the financial service provider towards its client, the client probably has the right to information about its client status pursuant to article 4 FinSA vis-à-vis its financial service provider at any time, but at least always before the conclusion of a contract or before the provision of a (financial) service.

The Swiss legislator has explicitly not granted the Federal Council any competence to designate further categories of professional clients at ordinance level. In this sense, the listing of professional clients is of an exhaustive nature.

The status as a professional client is linked to more or less clearly verifiable criteria, which must in principle be met on an ongoing basis. However, financial service providers should not be required to continuously monitor whether the criteria for the client qualification are still met. Thus, in the absence of any indications to the contrary, the financial service provider may rely on the initial information credibly provided by, or available with respect to, the client and the client relationship.

The financial service provider may carry out a segmentation according to foreign law such as MIFID II, although it remains responsible for determining whether and to what extent this is to be considered as equivalent to the FinSA.

3.5.2.2) Multiple Relationships and Client-Representing Third Parties

A client may have several client relationships with a financial service provider, each of which must be segmented separately and for each of which the opting-in/out rule applies separately. If, pursuant to article 4 para. 1 FinSO, assets are owned by several clients, these clients have to be categorized in the client category with the respective highest level of client protection.

Pursuant to article 4 para. 2 FinSO, clients acting through an authorised person may agree with the financial service provider in writing or in another form demonstrable via text that their allocation to a segment is based on the knowledge and experience of that person. Thus, upon explicit declaration by the client, an attribution of the knowledge and experience of the authorised person takes place. This can be used, for example, by retail clients or SPVs that use prudentially supervised external asset managers or are represented by other prudentially supervised financial institutions.

3.5.2.3) High-Net-Worth Retail Clients and Private Investment Structures

In our view, the category of high-net-worth retail clients is designed for individuals and, except where individuals act through private investment structures created for these individuals, not for companies. It is precisely for companies that the category of "large company" was created pursuant to article 4 para. 3 lit. h FinSA. However, a more liberal approach may be taken in practice by market participants, according to which companies may also qualify as high-net-worth retail clients within the meaning of article 5 FinSA. As a result, companies would also be able to declare an opting-out. In any event, the wording of the FinSA and the FinSO as well as the materials would not exclude such interpretation.

While the wording of the law requires a combination of personal education and professional or comparable experience, we are of the view that the "education" requirement and the "experience" requirement are to a certain extent interchangeable and, therefore, a high degree of education may compensate for a lack of experience – and vice versa. Under the old Federal Act on Collective Investment Scheme (**CISA**), FINMA defined "comparable experience", for example, as the case where the investor has executed an average of 10 transactions of significant size per quarter on the relevant market during the four preceding quarters (FINMA-Circ. 13/9 n 16, not in force anymore). In our view, this also applies under the FinSA, although the criterion of the "relevant market" is likely to become more important due to the wider range of financial instruments covered under the FinSA. Otherwise, it remains in the reasonable discretion of the financial service provider to interpret the criteria of sufficient training as well as professional and comparable experience of the clients.

Since professional qualification is in principle imperishable, a one-off declaration or proof should be sufficient in this respect. However, the required minimum assets are subject to fluctuations over time (see above section 3.5.2.1).

The term private investment vehicle is not defined in FinSA. However, according to the previous literature on the old CISA, a private investment structure is understood as "transactions" in which one or more – for the present purposes "wealthy" – retail individual(s) (e.g. a family), usually as settlor, founder, policyholder or premium payer, dedicate portions of assets to a special purpose and therefore contribute them to an investment structure. In doing so, these typically do not pursue an operational purpose, but rather focus – often without a market presence – on the discretionary organisation of the management of the assets dedicated to it and are therefore usually considered domiciliary companies pursuant to article 6 para. 2 et seq of the Anti-Money Laundering Ordinance (**AMLO**).

The legal form can be contractual or corporate, with foundations, institutions or companies domiciled in offshore jurisdictions, trusts, insurance wrappers or specially structured investment products (e.g. single-investor funds) often being used.

3.5.2.4) Opting-Out/-In

The following comments in the Dispatch on the obligations of the financial service provider in the event of an opting-out requirement by a high-net-worth retail client are likely to apply to all opting-out options:

a) the financial service provider must inform clients of the consequences, in particular the risks of such a waiver of protection under the specific opting-out (duty of clarification and information);

b) in the event of a waiver, it must also inform the client that he is obliged to report any changes in circumstances to the financial service provider (obligation to report changed circumstances);

c) as soon as the financial service provider learns of new facts or changes, it must clarify the new circumstances again and determine whether the requirements for an opt-out are still given (duty to clarify changed circumstances).

The Swiss legislator incomprehensibly limited the opting-in possibilities for institutional clients explicitly in such a way that they cannot be considered retail clients. This makes little sense, because if a financial service provider waives client segmentation, it must treat all clients – and thus also institutional clients – as retail clients.

3.5.3) FinSA Client / Investor according to CISA

Under the old CISA, potential investors were also covered by the term "investor", e.g. in relation to advertising, distribution, contract initiation and the acquisition of units. In our opinion, this broad interpretation of the investor concept including the potential investor should no longer be applicable with the entry into force of the FinSA, because the concept of qualified investor refers to the professional client under the FinSA, the distribution regime has been abolished and the concepts of advertising, offer, financial service provider and financial service are now regulated uniformly across sectors in the FinSA.

The transitional provision in article 103 FinSO concerning the two-year transitional period for the introduction of client segmentation only relates to client segmentation under FinSA, but not to the one under CISA. Thus, the adjustments to client segmentation under CISA already started to apply as of 1 January 2020.

4) Further Selected Aspects

4.1) Definition of "Acting on a Commercial Basis" (*Gewerbsmässigkeit*)

Only those persons who provide financial services according to the FinSA on a commercial basis (*gewerbsmässig*) qualify as a financial service provider in the sense of the FinSA. The definition of "acting on a commercial basis" is defined by article 3 lit. d FinSA as an independent economic activity pursued on a permanent, for-profit basis (*selbständige, auf dauernden Erwerb ausgerichtete wirtschaftliche Tätigkeit*).

Acting on a commercial basis in this regard must relate to the activity of performing financial services in the sense of the FinSA. It is not sufficient if the respective person performs other activities which qualify as commercial activity, but which are not related to financial services in the sense of the FinSA.

Although the Dispatch states that acting on a commercial basis may be assumed if financial services "for more than 20 clients" (see page 8947 of the Dispatch) are provided, the activity must still be carried out on a for-profit and permanent basis. Hence, the mere fact that financial services have been rendered to more than 20 clients of the service provider is not yet sufficient to qualify as acting on a commercial basis (*Gewerbsmässigkeit*) in the sense of the FinSA and hence does not yet qualify as a financial service provider under the FinSA.

4.2) Requirement for "Best Execution"

4.2.1) Legal Nature: Supervisory Law

Unlike the predecessor provisions of article 11 of the old Federal Act on Act on Stock Exchanges and Securities Trading (SESTA) and articles 20 and 22 of the old CISA, the conduct of business requirements for "best execution" under article 18 FinSA is purely supervisory law and, in particular, not a double standard provision (supervisory law/civil law).

4.2.2) Applicability to Secondary Market (principle)

The rules of the FinSA on the allocation and execution of orders do not in our view apply to primary market transactions (market on which the initial offer/sale of a newly issued financial instrument takes place) – to the extent that they constitute a financial service at all. Rather, financial institutions continue to be allowed to follow allocation principles established in the Swiss market.

4.2.3) Addressed to Financial Service Providers in their Activities vis-à-vis End Clients

The provision of article 18 FinSA applies by its wording to all persons in their function as financial service providers. Several intermediaries (e.g. third-party brokers) are regularly involved in the execution of a client order.

The following is true for external asset managers in particular: In connection with the acquisition and sale of financial instruments, external asset managers are obliged to ensure that intermediaries who are commissioned by them to execute investment decisions comply with article 18 FinSA. As a rule, the external asset manager may rely on the execution policy of the intermediary complying with the legal requirements and that the intermediary adheres to such policy. Therefore, applying appropriate selection criteria with respect to a custodian bank (which is involved in the execution) is critical. We take the view that external asset managers do not have to take article 18 FinSA into account when recommending a custodian bank to the client, since this activity is not a financial service within the meaning of the FinSA.

4.2.4) Applicability to Client Orders in Connection with the Provision of Financial Services

According to article 18 para.1 FinSA, financial service providers must ensure compliance with the best execution obligation "when executing the orders" of their clients. The wording of the provision, when read in isolation, opens up a very broad material scope. However, the subject matter of the FinSA of interest here is limited to the provision of financial services (see also above sections 1, 2.1 and 4.1). The scope of article 18 FinSA therefore only covers the execution of client orders which qualify as financial services to *clients*, and the relevant financial services are the acquisition or disposal of financial instruments as well as the acceptance and transmission of orders for *clients* (article 3 lit. c para. 1 and article 3 lit. c para. 2 FinSA).

4.2.5) Best Possible Result in Financial, Temporal and Qualitative Terms

Financial service providers must ensure that the best possible result in financial, temporal and quantitative as well as qualitative terms is achieved in the execution of their clients' orders (article 18 para. 1 FinSA). In our view, the best execution obligation in article 18 FinSA is satisfied if the financial service provider *strives to achieve* the best possible overall result for its clients, taking into account, within the limits of the client instruction, all relevant circumstances (in particular market environment, diverging client interests, etc.). – Cf. on best execution in the EU: "This overarching requirement should not be interpreted to mean that a firm must obtain the best possible results for its clients on every single occasion" (ESMA, Questions and Answers, On MiFID II and MiFIR investor protection and intermediaries topics, December 4, 2019, 18).

Also, the best execution obligation does not impose any substantive requirements on the product range of the financial service provider, namely on the selection and quality of the financial instrument to be acquired or sold. Execution takes place after the selection (and is separate from it).

In contrast to the EU, the FinSA does not require the client to agree to the financial service provider's execution policy.

4.2.6) Legitimate Reliance

Under MiFID I, the European Commission introduced the four-fold trading relationship test (Four-Fold Test or Legitimate Reliance) in connection with the execution of orders from retail and professional clients under EU law. This test remains in place under MiFID II. It enables investment firms to check whether a client may legitimately rely on the execution circumstances to ensure that his order is executed in accordance with best execution principles. The test is based on the following four questions: (1) Did the initiative for the transaction come from the client? (2) Does the client have the opportunity, based on existing market practice, to obtain price quotations from different suppliers (i.e. to shop around)? (3) Is the relative price transparency of the financial instrument requested by the client high and available on the market? (4) Does the information provided to the client by the investment firm and the contractual arrangements between the parties indicate that some or all of the best execution principles are not applicable? If all the answers to these questions are in the affirmative, it is less likely that the (usually professional) client may legitimately rely on compliance with the Best Execution Principles. The Federal Council has expressly refrained from introducing the four-fold test because the "complicated and also not easily communicable regulation" is not compatible with Switzerland's principle-based regulation. However, this does not exclude that the test is also applicable under the regulation of article 18 FinSA, and we take the view that it in fact is.

4.3) Specialties and Challenges with Client Advisor Registration

4.3.1) Inbound Cross-Border Aspects

The FinSA also applies to non-Swiss financial service providers if they provide their financial services to clients in Switzerland (with the exception of "reverse solicitation", see section 3.4 above). A client in Switzerland is a client that is either:

- an individual that is permanently resident in Switzerland;
- a legal entity that is incorporated in Switzerland;
- a Swiss branch of a non-Swiss legal entity.

Non-Swiss branches of Swiss legal entities should not be considered as "clients in Switzerland". The same should apply to individuals that are merely temporarily in Switzerland, e.g. for purposes of vacation or a business trip or conferences.

Providing financial services is in many jurisdictions a regulated activity and non-Swiss financial service providers are therefore often already subject to financial services rules and regulations in their respective home jurisdiction. Thus, the question arises whether a non-Swiss financial service provider can rely on its home country conduct and organizational rules and requirements, instead of applying similar rules laid out in the FinSA. While the FinSA does not provide for an explicit substituted compliance regime (in fact, such a substituted compliance regime was removed from an early draft of the legislation), it was the clear intention of the Swiss legislators that the FinSA should not exceed comparable requirements and rules under the European laws and regulations (in particular MiFID II). Accordingly, to the extent that a non-Swiss financial service provider complies with MiFID II (and the relevant national implementing laws) when servicing clients in Switzerland, such non-Swiss financial service provider should, for the most part, also meet the requirements of the FinSA. This is particularly true for a client segmentation that is equivalent to the FinSA rules (such as, for the most part, MiFID II, which is explicitly mentioned in the explanatory materials as an equivalent standard).

In consideration of the above, it is worth noting that the FinSA provides for a number of Swiss features and differences compared to other regulations, such as MiFID II. Therefore, non-Swiss financial service providers will have to nonetheless analyze their existing policies and procedures in light of the requirements of the FinSA. This is of particular importance because non-compliance with certain specific FinSA requirements and features may result in enforcement action or criminal proceedings. These specific Swiss features also apply to non-Swiss financial service providers:

– *obligation to disclose compensation received from third parties (e.g. retrocessions, kickbacks and similar payments)*. Such payments need to be either handed over to the client or the client explicitly must waive claims to such payments;

– requirement to *affiliate with an ombudsman service*, provided the non-Swiss financial service provider offers its services to retail clients and/or opting-out professional clients (such as high-net worth individuals);

– requirement to *register client advisors with a Swiss client advisor register* (subject to certain exemptions).

In terms of the afore-mentioned requirement to register the client advisors, the FinSA provides for an exemption for foreign financial service providers that are prudentially supervised in their respective home jurisdiction and that offer their services exclusively to professional clients or institutional clients (see also section 4.3.2 below). As for the requirement of a "prudential supervision", the FinSA neither specifies this term nor stipulates any equivalence or appropriateness requirements. Considering the type of Swiss financial institutions that would be considered as prudentially supervised (the lowest level of supervision being that of portfolio managers or trustees), "prudential supervision" generally requires that the relevant foreign financial service provider is:

– subject to ongoing supervision (as opposed to a mere one-time registration without ongoing obligations);

- subject to basic minimum capital and organizational requirements; and
- supervised with respect to capital and other organizational requirements as well as compliance with applicable rules of conduct.

The term "client advisor" is limited to the individual actually maintaining the client relationship (i.e. individuals that have meaningful client-facing interactions). Individuals in a mere supporting function (such as middle and back office) are not considered "client advisors". The same applies to experts with specific area of expertise, provided they are brought in by the individual that is otherwise responsible for maintaining the client relationship. Where there is no such individual (e.g. where a financial service is exclusively rendered through a digital platform), no client advisor registration is required. In particular, the client advisor registration obligation should not be seen as a "back-door" registration obligation for any non-Swiss financial service providers.

If a financial service provider has a client advisor that meets the above criteria, then such a client advisor needs to be registered in the Swiss client advisor register prior to providing financial services to a client in Switzerland. Using a chaperone (i.e. an already registered client advisor) does not free the client advisor from its registration obligation, provided such chaperone is not otherwise involved in maintaining (in a meaningful way) the client relationship.

4.3.2) Exemption for Foreign Financial Service Providers subject to Prudential Supervision

An exemption from the client adviser registration duty applies to client advisors of foreign financial service providers that are prudentially supervised in their home jurisdiction, if such client advisors render their services in Switzerland exclusively to professional and institutional clients (article 28 para. 2 FinSA and article 31 FinSO; see also section 4.3.1 above).

In defining the exemption (or, rather, the delegation of the power to the Federal Council to enact an exemption by way of an ordinance), the FinSA refers to "professional and institutional clients within the meaning of article 4 FinSA". According to article 4 FinSA, professional clients include, in particular, regulated financial intermediaries, central banks, large companies and certain entities with professional treasury operations ("*per se* professional clients"). Clients that do not qualify as professional clients are considered to be retail clients. A subset of professional clients and certain additional client types qualify as institutional clients. Further, pursuant to article 5 FinSA, high-net worth individuals and their private investment structures have the right to opt out of the retail client regime and elect instead to be treated as professional clients ("opting-out professional clients" or "elective professional clients").

The wording of article 28 para. 2 FinSA raises the question as to whether the full scope of professional clients including opting-out professional clients is intended to be covered by the rule. The view taken in this position paper is affirmative, *i.e. client advisors of prudentially supervised foreign financial service providers that serve a client base in Switzerland composed exclusively of institutional clients, per se professional clients and opting-out professional clients in line with the requirements of the FinSA are exempt from the obligation to register in the client adviser register*. The requirements of the exemption must be fulfilled at the level of the individual client advisor, not with respect to the entire client base of the foreign financial service provider.

We note that this view has been challenged in an FAQ published by the three admitted Swiss client adviser registration bodies, who interpret the exemption more narrowly such that client advisors serving opting-out professional clients would need to be registered and only the service provision to institutional and *per se* professional clients would be exempt. FINMA has "taken note" of the FAQ in its English language version.

There are various arguments supporting the view taken in this position paper, in particular the following:

- article 28 para. 2 FinSA was introduced in the course of the parliamentary deliberations. At no point in the discussions in the Swiss parliament was any distinction between opting-out and *per se* professional clients discussed for the purposes of this provision. Furthermore, while the Federal Council could conceivably have limited the scope of the rule when implementing the exemption in the FinSO under the power delegated to it, it did not do so in any way;

- the extraterritorial scope of the client adviser registration requirement (and other provisions of the FinSA) is an uncommon and unusual concept in Swiss financial regulation and Swiss law in general. Where there are ambiguities in the law, a restrictive interpretation limiting the extraterritorial application must be favoured. Therefore, the reference in article 28 para. 2 FinSA to professional and institutional clients "within the meaning of article 4 FinSA" must be understood as a general reference to the client classification system, the *sedes materiae* of which is in article 4 FinSA. Article 5 FinSA merely builds on that system, setting out the eligibility conditions under which a retail client may declare an opting-out. However, once such declaration is made, the client is for all intents and purposes – a professional client in the sense of article 4 para. 1 lit. b FinSA (conversely, a professional client having opted into the retail client regime must be considered a retail client also for the purposes of the client adviser registration exemption, again even though the opting-in right is set out in article 5 para. 5 FinSA);

- *per se* and opting-out professional clients are also otherwise treated equally in all respects (or, rather, not distinguished between) under the FinSA, in particular when it comes to the duties of diligence to be observed by financial service providers and their client advisors. This is in line with the legislative intention of including an opting-out right in the first place. One area where a distinction between *per se* and opting-out professional clients is made is for the purposes of determining whether a financial service provider is required to join an ombudsman's organization (article 77 FinSA). However, compared to the client advisor registration exemption, the ombudsman rule is drafted more narrowly at the level of the FinSA itself – exempting only financial service providers that exclusively serve professional and institutional clients pursuant to article 4 para. 3 and 4 FinSA – and is available to both domestic and foreign financial service providers without regard to their regulatory status. This is an important distinction, as the exemption from the client advisor registration duty is available for client advisors of foreign prudentially regulated financial service providers only, ensuring a level of client protection by way of reliance on the foreign regulatory regime.

No registration requirement applies to client advisors of FINMA-licensed branches of foreign banks or foreign financial institutions. With regard to FINMA-licensed *representative offices* of foreign banks or foreign financial institutions, draft amendments have been proposed to the Banking Ordinance (**BankO**) and the Financial Institutions Ordinance (**FinIO**) which would state that if financial services within the meaning of the FinSA are rendered out of the representative office, the relevant client advisors have to be registered in a Swiss client advisor register if they provide financial services to *retail clients*. While the amended provisions are not final yet, they do show a continuation of the line of thinking pursuant to which the provision of financial services to *retail clients* (and not to opting-out professional clients) is the key trigger for the registration duty as applicable to client advisors of foreign financial services providers.

Given the statements in the FAQ and the fact that FINMA "took note" of it, foreign prudentially regulated financial service providers should carefully consider their approach depending on the composition of their Swiss client base and should continue to monitor the developing legal practice in Switzerland.

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