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ensure that the newly split process of (i) review/approval of the prospectus and (ii) admission to listing and trading will continue to be carried out efficiently and in line with market and issuers' needs.

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## Point of Sale Regulation – Consultation Draft of Financial Services Ordinance: Key Points

Reference: CapLaw-2018-58

The publication for consultation of the draft Financial Services Ordinance represents the last milestone on the road to the new financial services architecture in Switzerland. For all those who aim to optimize the details of the point of sale code of conduct, the consultation to the Draft-FinSO until 6 February 2019 is the last possibility to do so. Considering whether to provide comments to the Draft-FinSO is important because the ordinance specifies a number of key provisions of the FinSA on the point of sale duties. Hereinafter, is an overview of the most important proposed ordinance rules.

*By Sandro Abegglen / Luca Bianchi*

### 1) Introduction

The publication of the consultation draft Financial Services Ordinance (*Finanzdienstleistungsverordnung*, Draft-FinSO) on 24 October 2018 opens the last phase towards finalization of the Financial Services Act (FinSA). Market participants and other interested parties can provide comments to the draft until 6 February 2019. Consequently, there will be changes to the proposed text of the Draft-FinSO. Nevertheless, the published draft provides for a good indication of the definitive content of the FinSO, and, thus, of what the industry has to prepare for.

The purpose of this article is not to recapitulate an overview of the point of sale duties of the FinSA. The authors have already outlined those on other occasions (see CapLaw-2017-3, 2016-3 and 2014-5 or the publication *Switzerland's New Financial Market Architecture*). Instead, the article focuses exclusively on key points of the Draft-FinSO which are relevant for the point of sale.

### 2) Point of Sale Key Points of the Financial Services Ordinance Consultation Draft

The Draft-FinSO contains the following new aspects and clarifies the following key points:

- **Client segmentation:** The Draft-FinSO specifies that the client segmentation by a financial services provider (*i.e.*, the qualification of its clients as institutional, professional or private clients) applies throughout the whole relationship of a given client (article 4 (1) Draft-FinSO). However, according to the Explanatory Report to the Draft-FinSO of 24 October 2018 (the Explanatory Report, page 22) a client may have several client relationships with one financial services provider and can – depending on the relevant financial services – thereby be assigned to different client segments. The Draft-FinSO contains a transitory provision that allows the implementation of the new client segmentation within one year after the entering into force of the ordinance (article 103 Draft-FinSO), *i.e.*, until the end of 2020.
- **New threshold for the opting-out (up) of private clients:** The Draft-FinSO provides for specifications of the eligible financial assets that are required for the opting-out of a private client (HNWI) into the professional investor status, namely, bank deposits, securities and uncertificated securities (including collective investment schemes and structured products), derivatives, precious metals, life insurances with repurchase value, and claims on assets that are based on fiduciary relationships (article 5 (1) (a-f) Draft-FinSO). Direct investments in real estate no longer qualify as eligible financial assets (article 5 (2) Draft-FinSO), in contrast to the current rule in the Collective Investment Schemes Ordinance (CISO), and this seems to be a reaction to the reduction of the relevant threshold of assets of HNWI without knowledge and experience from currently CHF 5 million to only CHF 2 million by the parliament (cp. article 5 (2) (b) FinSA). Due to this decrease, consideration of direct real estate investments would have caused a major expansion of the circle of potential professional clients. According to the Explanatory Report (page 23), this was not the intention of the legislator.
- **Clarification of certain code of conduct duties:** The Draft-FinSO contains several provisions that further specify the conduct duties of financial services providers (article 6 et seq. Draft-FinSO; Explanatory Report, page 23 et seq.). In particular, it comprises details on the information duties, fee transparency (see lemma *Disclosure of (distribution) fees* below), conflicts of interests duties, and the required information on the considered investment product market universe.

If a client obtains financial services from various financial services providers, the code of conduct (especially, the information duties) applies to all of them.

Information on financial services and financial instruments must include their characteristics and functioning as well as the essential risks and duties that arise thereof for the clients (article 7 (1) (a) and (b) Draft-FinSO). Also, the financial services provider must clarify whether his service represents portfolio management, portfolio-related advice or mere transaction-related advice, or execution only services.

Conflicts of interests according to article 24 (a-d) Draft-FinSO include, in particular, situations where financial services providers:

- (a) draw financial advantages or avoid financial losses in breach of good faith at the expense of their clients;
- (b) have own interests which are conflicting the interests of their clients with respect to the outcome of a financial service rendered to its clients;
- (c) have a financial or other incentive to put the interests of certain clients ahead of those of other clients when rendering financial services; or
- (d) accept an incentive in the form of financial or non-financial benefits or services in breach of good faith from third-parties in relation to a financial service rendered to its client.

The new code of conduct rules (article 7-16 FinSA) must be implemented at latest with the end of the transitory period of one year after the entering into force of the Draft-FinSO (article 105 Draft-FinSO).

- **Assessment of appropriateness / suitability in the case of proxy relationships:** With respect to appropriateness and suitability tests in general, the Draft-FinSO clarifies, in line with the private law rules on imputation of knowledge of the agent to the principal, that in cases of proxy relationships the knowledge and experience of the *representative* must be considered (article 16 Draft-FinSO). The legislator presumes that in such a scenario it is the representative who takes the investment decisions for the represented party (Explanatory Report, page 26).
- **Assessment of financial situation / investment objectives:** For the assessment of the financial situation of the client in the context of a suitability test in particular, the financial services provider must evaluate the source and amount of the client's regular income, his wealth as well as his current and future financial obligations (article 17 (1) Draft-FinSO). For the assessment of the investment objectives of the client, the financial services provider must consider the time horizon, the purpose of the investment and the client's risk capacity and risk tolerance as well as investment restrictions, if any (article 17 (2) Draft-FinSO).
- **Disclosure of (distribution) fees:** Financial services providers are obliged to inform clients on the personally recommended financial service and connected risks and costs (article 8 (2) (a) FinSA). The information on costs comprises, in particular, information on the one off and recurring fees that arise with the sale or purchase of the concerned financial instrument (article 8 (1) FinSO). One time fees that must be disclosed include production costs that arise with the purchase of the financial

instrument, as well as related transaction costs such as, e.g., distribution fees; recurring fees include, e.g., management fees, advisory fees, or deposit fees (Explanatory Report, page 24). To the extent such information is included in the prospectus or the basic information sheet (KID), the information duty may be fulfilled by reference to these documents (article 8 (2) FinSO).

- **Criteria for best execution:** The financial services provider is obliged to define the criteria relevant for the selection of the execution venue which is to be chosen for the execution of client orders (in particular, the price, the speed, as well as the probability of the execution and settlement according to article 21 (1) Draft-FinSO). If the client has given an explicit instruction in this regard, the financial services provider must comply with it (article 21 (2) Draft-FinSO).
- **Organizational requirements and employee compensation:** The financial services providers must specify internal standards that are adequate relative to their size, complexity and legal form as well as the financial services offered (article 23 (1) (a) Draft-FinSO).

Generally, employee compensation must not create incentives to disregard legal duties or to engage in damaging behavior towards clients (article 23 (1) (c) Draft-FinSO).

In addition, feasible organizational measures for the prevention of conflicts of interests must be implemented as described in detail in article 25 (1) (a-g) Draft-FinSO. These include:

- (a) measures to recognize conflicts of interests;
- (b) barriers to or controls of the exchange of information to the extent contrary to the client interests;
- (c) functional separation of the organization and the management of employees (*i.e.*, Chinese walls) provided that their main tasks could cause a conflict of interest between clients among themselves, or between the clients and the financial services provider;
- (d) measures to avoid that employees, which are involved in providing different financial services at the same time, are assigned tasks that could impair the proper handling of conflicts of interests;
- (e) defining the compensation policy to the effect that variable compensation elements do not impair the quality of the financial services towards clients;

(f) the issuance of internal guidelines which enable the recognition of conflicts of interests between clients and employees and point out measures to avoid or resolve such conflicts of interests and regularly examine such guidelines; and

(g) enacting rules for the purchase and sale of financial instruments for the employees' own account.

With respect to organizational requirements the Draft-FinSO contains a transitory period of one year after the entering into force of the ordinance (article 106 FinSO).

- **Employee selection:** Employees must be selected diligently and obtain education and training on the code of conduct rules and the specific subject expertise required to fulfill their concrete tasks (article 23 (1) (b) Draft-FinSO). As there is no obligation to develop industry standards for the education and training, every financial services provider may define its own standards.

### 3) Point of Sale Duties vs. Product Transparency

Interesting legal questions arise regarding the relationship of the point of sale duties (especially, suitability, appropriateness, information duties, service transparency, or code of conduct) and the point of production duties (in particular, prospectus and KID duties). Both groups of duties are interlocked and complement each other. In addition, the cross-sectoral rules of the FinSA, respectively, FinSO must sometimes be applied in interplay with the sector-specific rules of the Banking Act (BA) or the Collective Investment Schemes Act (CISA) and the respective ordinances. While this task may not always prove simple, the combination of point of sale duties and point of production duties represents a well-designed regulatory framework that serves the adequate protection of investors, which constitutes a quality feature of “Swiss made” financial services and products.

### 4) Conclusion

In conclusion, the Draft-FinSO clarifies many point of sale-related provisions of the FinSA and overall is well drafted and balanced. However, certain amendments would be welcome, *e.g.*, on the difficult distinction between portfolio-based and transaction-based investment advice – it will be interesting to see how the industry and other interested parties will comment the Draft-FinSO.

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