



A long way to investor protection Vol. II

**National Council and Council of States reached
agreement on FinSA and FinIA**

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The political process aiming to introduce stronger investor protection rules and a level playing field for the different kind of Swiss financial service providers goes back a long way. In June 2014 the Swiss Federal Council launched the consultation on both the Financial Services Act (FinSA) and the Financial Institutions Act (FinIA). The consultation caused an intense political discussion, which resulted in major adjustments in the two legislative bills between the consultation draft and the dispatch, which was finally published in November 2015.

Now, almost 4 years later, this political discussion is finally approaching the finishing straight. On 12 June 2018, the National Council discussed the last remaining differences between the two parliamentary chambers in the FinSA and FinIA legislative package and managed to reach an agreement.

From the consultation draft to the dispatch

In many aspects, the provisions of the initial consultation draft were still very close to the provisions prescribed by the European MiFID II, which was enacted in the EU as of 3 January 2018. In particular, the focus was on topics such as client categorization criteria, suitability and appropriateness, retrocessions, prospectus requirements and education requirements for financial service providers. This, among other reasons, was motivated by the hope that Swiss financial intermediaries could gain EU market access by implementing equivalent requirements. However, MiFID II did not foresee free access to the EU market based just on equivalency, so there was a significant amount of industry criticism, which found the proposed new legislations too strict and too far reaching. As a result, the subsequent dispatch moved away from many of the key principles introduced by MiFID II and suggested looser legal requirements compared to the initially proposed consultation draft. This included amongst many other changes the removal of the concept of independent advice and the abolition of the reversal of the burden of proof regarding information and disclosure duties.

The parliamentary discussions and its hot topics

After the Council of States treated the bill as first council in December 2016, the debate in the National Council followed in September 2017. In March 2018, the Council of States discussed the differences between its version and the version of the National Council and eliminated many of the existing differences. However, some controversially debated differences relating to client categorization, prospectus liability, grandfathering and the right to revoke consumer contracts remained. The parliamentary discussion of the remaining differences was continued in the summer session 2018 and a back and forth between the Councils followed. In particular, the following controversial differences need to be mentioned.

Client categorization criteria

As already known from the fund industry, also FinSA foresees stricter information duties and conduct rules for financial service providers for different client categories. The Swiss Federal Council proposed to have two main client categories, namely, private investors and professional investors including institutional clients as a sub-category. While the client categories itself did not given rise to much discussion, the Federal Council additionally proposed to have the right to define further client categories as "professionals". The Council of States was against this standard as they feared a dilution of investor protection. In the summer session, however, the National Council finally agreed to delete the right of the Federal Council.

Education requirements for financial service providers

It was also discussed whether to define industry-specific minimum standards for education requirements for financial service providers to the very last of the discussion. The FinSA foresaw minimum standards to ensure that client advisors have sufficient knowledge of the services they offer as well as the relevant conduct rules. While the Federal Council and the National Council were in favor of minimum standards, the Council of States preferred to eliminate this provision. In its last discussion, the National Council gave in and followed the proposal of the Council of States to eliminate minimum standards.

Prospectus liability and reversal of burden of proof

The two chambers intensely discussed the reversal of burden of proof from the very beginning. While the dispatch of the Federal Council initially proposed that every party involved in the preparation of the basic information sheet is liable unless it proves that it is not at fault, the National Council proposed to leave the burden of proof with the damaged client. As the Council of States did not follow this proposal, the National Council proposed a new wording for the planned prospectus liability. This wording is a compromise between the Federal Council's initial version (constituting a reversal on the burden of proof in favor of the client) and the former version proposed by the National Council. The new wording proposed by the National Council features a liability for onerous information in prospectuses

and basic information sheets if the producer did not apply the required diligence in compiling these. On 4 June 2018, the Council of States followed the proposition of the National Council.

Fulfillment of duties according to civil law

The proposed provision stating compliance with the supervisory requirements of the FinSA also means the deletion of the fulfillment of the civil law requirements. Initially, both chambers of Parliament were in favor of such a provision. However, the legislators came to understand that, technically speaking, the introduction of such a provision is rather complicated and might cause some unwanted effects.

Information duties

Under FinSA it was also discussed whether financial service providers should have an initial information duty to inform clients on any significant changes. While the National Council was in favor of deleting this duty, the Council of States wanted to retain this provision as initially proposed in the dispatch of the Federal Council. On 4 June 2018, the Council of States followed the proposition of the National Council regarding limited information duties. Henceforth, financial service providers will not have to inform customers if, for example, the investment risk of a financial instrument changes significantly retrospectively.

Right to revoke consumer contracts concluded away from business premises

Another important element to protect the consumer is the right to revoke consumer contracts concluded away from business premises according to Article 40 Swiss Code of Obligations. While the majority of the National Council was in favor of excluding banking contracts and contracts on financial services from the right to revoke consumer contracts concluded away from business premises, the Council of States was against changing the existing law regarding this provision. As a compromise, the Council of States accepted a limitation and proposed a new wording. Accordingly, the provisions shall not apply to insurance contracts and legal transactions concluded by financial institutions and banks within existing service contracts according to FinSA. This part is of particular importance since the right to revoke the contract (e.g. an order to invest in a certain financial product) would result in a de-facto put-option for the client to step back from his investment.

Grandfathering

The dispatch of the Federal Council for the FinIA proposes a grandfathering clause for independent asset managers who have been performing their activity for fifteen years or more. The Council of States was in favor of this grandfathering clause, while the National Council wanted to delete this exception. Towards the end of the summer session, the Council of State followed the National Council's proposition to delete the grandfathering clause. As a result, independent asset managers who have been performing their activity for fifteen years or more will still need to apply for a license under FinIA. The relevance of the grandfathering clause was in any case controversial. As it can be assumed that depository banks would have imposed additional requirements on the cooperation with external asset managers which in practice would have forced them to apply the license provisions according to FinIA.

Consequences and recommended next steps

Now that all open points regarding the FinSA and the FinIA have been clarified and a political consensus could finally be reached, we recommend that Swiss banks and external asset managers assess the impact of these regulations on their business models. Key questions will include potential new licensing requirements and the impact of the new rules on revenue streams and core processes along the entire client life-cycle, including for instance client categorization or service offering. Furthermore, institutions should identify, evaluate and take key strategic decisions in order to plan a concrete implementation of the Acts' provisions.

Performing a regulatory impact assessment is a good way to address all of these topics. This is also relevant for banks who have already implemented MiFID II principles in their Swiss organization.

The still outstanding ordinances to the two legal acts will be essential for the actual implementation. A consultation draft for the ordinances is expected in autumn 2018. However, financial service providers are well-advised to start their FinSA/FinIA projects soon.

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