



GENEVA COMPLIANCE GROUP

# FINANCIAL SERVICES AND INSTITUTIONS

## FINIO AND FINSO PROJECTS

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# 01

### Editorial

We are pleased to be back in touch with our readers with this special issue on the draft of the Swiss Financial Institutions Ordinance (FinIO) and on Financial Services (FinSO).

Expected with impatience and even anxiety by financial service providers (in the new terminology), these two projects should not give rise to hope or disappointment, in that they do not revolutionize the current system governed by the laws. At most, this can be seen more clearly in terms of the conditions for organising and authorising financial intermediaries and in terms of information obligations towards clients.

SOLUTION offers a brief summary of the two packages FinIA/LEFin and FinSA/LSFin with a zoom on the draft ordinances. This is an exciting subject and so will be the implementation of these new rules. The entire Geneva Compliance Group team is at your disposal to further develop this subject or to assist your company in the transition towards 2020.

On October 24<sup>th</sup> 2018, the Federal Council published the FinIO and FinSO projects. These texts complete the system set up in 2018 with the Financial Institutions Act (FinIA) and the Financial Services Act (FinSA) and are in line with the decrees. These texts are scheduled to enter into force on the 1<sup>st</sup> of January 2020.

The FinIA and the FinIO contain the licensing, organisational and supervisory provisions governing the activity of financial institutions. The FinSA and the FinSO regulate the requirements for providing financial services and offering financial instruments to clients.

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## FinIO

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In terms of authorisation, organisation and supervision, the changes made by the FinIA and the FinIO mainly concern independent asset managers (IAMs) and trustees who have not previously been subject to the FINMA.

The request for authorisation from the FINMA must contain the following elements:

- the organisation, in particular the management and control of the company and risk management;
- the location of effective management;
- the guarantee of an irreproachable activity;
- the tasks and their possible delegation;
- minimum capital and guarantees;
- shareholders' equity;
- the mediation body;
- the supervisory body and the audit company.

The organisation of the IAM or trustee will need to precisely define the scope and geographical scope of its activities, corresponding to the company's financial resources and organisation, so that the main risks can be detected, assessed, monitored and remediated.

IAM and trustees must have adequate risk management and effective internal control (Compliance). The FinIA states that these tasks cannot be carried out by a person involved in the activities it supervises, while the draft ordinance specifies that they do not have to be independent, provided that certain thresholds are not exceeded (companies with no more than five employees or with annual gross income of less than CHF 1.5 million) and that the business model presents little risk. In any case, the possibility of outsourcing the Compliance function to a qualified partner is confirmed by the draft ordinance.

The Federal Council's explanatory report gives an unclear example of how two or more managers of a company could divide the tasks of management and control between them:

*«La répartition précitée pourra par exemple être effectuée selon les modalités suivantes: un dirigeant qui assurera également le suivi des clients, mais ne sera pas chargé de surveiller le portefeuille pourra surveiller les risques et effectuer des contrôles, tandis qu'un dirigeant également chargé de surveiller le portefeuille pourra remplir des tâches relevant de la compliance dans les domaines du blanchiment d'argent et des affaires transfrontalières.»*



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Written in "*français fédéral*", this example seems confusing to us as it stands to define an internal organization that exempts it from meeting the independence criterion set out in art. 21.3. FinIA. The consultation period will prove to be useful in providing a better understanding of how art. 19.2. of the FinIO project will be applied. By way of comparison, the MiFID Delegated Regulation is no more precise on the subject, stating that an investment firm may be exempted from certain risk management and internal control obligations providing it can demonstrate that, taking into account the nature, scale and complexity of its activity as well as the nature and range of its investment services and activities, the obligations in question are not proportionate and that its compliance verification function continues to be effective; the assessment must be regularly reviewed.

As part of the guarantee of irreproachable business activity, the application for authorisation must contain the following for natural persons directly or indirectly holding 10% of the capital or voting rights (qualifying holdings):

- nationality, domicile, qualifying holdings in other companies and ongoing judicial or administrative proceedings,
- a signed curriculum vitae,
- work certificates and references,
- an extract from the criminal record and the prosecution register.

For companies, it will be necessary to include the articles of association, an extract from the Trade Register, a description of the activities, structure and financial situation and an indication of any legal proceedings in progress.

The minimum capital must amount to 100,000 CHF and be fully paid up in cash.

Shareholders' equity must constantly amount to at least one quarter of the fixed costs of the last annual accounts, up to a maximum of CHF 10 million. The FinIO defines as fixed costs personnel expenses, operating expenses, depreciation of fixed assets and expenses due to value adjustments, provisions and losses. On the other side of the balance, equity refers mainly to share capital, reserves, retained earnings and unrealized reserves.

Finally, the asset manager or trustee must be affiliated to a mediation and supervisory body and appoint an audit firm approved by the Association of Swiss Auditors (ASR). Companies have already organized themselves as OS in French-speaking and German-speaking Switzerland, nevertheless the FINMA has not published an official list to our knowledge.

During transitional period, asset managers and trustees will have 6 months from the 1<sup>st</sup> of January 2020 to register with the FINMA and three years to meet the obligations mentioned above and obtain an authorisation.

## FinSO

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The FinSA and the FinSO apply to financial services provided on a professional basis in Switzerland or to clients in Switzerland.

In order to be able to provide financial services, financial service providers will have to fulfil organisational obligations, namely to have internal requirements adapted to their size, services and risks to ensure the selection and continuous training of employees and to exclude any financial incentives that could lead to a conflict with clients' interests. These aspects will have to be contained in binding operational processes and subject to internal controls.

Among the organizational measures affecting clients, financial service providers will have to classify clients as private, professional or institutional clients. A private client will benefit from the highest level of legal protection while a client identified as a professional or institutional client will benefit from less protection, as the latter is considered to have better knowledge and experience in relation to the provision of financial services or financial instruments.

High net worth private clients and the private investment vehicles set up for them may declare that they wish to be considered as professional clients (so-called opting-out), provided that the client has the knowledge, professional experience and a fortune of at least CHF 500,000. A private client with a fortune of at least CHF 2 million can also opt out without further requirements. The FinSO clarifies the definition of assets by excluding direct investments in real estate and claims relating to social insurance and occupational pensions from the calculation of assets.

In regard to the verification of suitability and adequacy as part of an investment advisory or asset management service, the FinSO provides little detail, except for the explicit mention that the financial service provider takes into account the adequacy of the client's experience and knowledge, its financial situation including the origin and amount of its regular income, its current and future assets and financial liabilities, its investment objectives taking into account the indications provided on the duration and purpose of the investment, its risk capacity and its risk appetite as well as any investment restrictions.

In terms of information for customers, the FinSA and the FinSO have extensive obligations. Financial service providers will have to communicate to customers their addresses and contacts, the authorisation they have, the names and addresses of the supervisory authority and the supervisory body to which they are affiliated. The characteristics and functioning of financial services will also have to be communicated to clients as well as their main rights and obligations.



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The provision of information about risks, costs, economic relations, order execution and conflicts of interest is also part of the transparency and diligence obligations towards clients. Cost information should be provided before the service is provided (*ex ante*) and include information on one-time and recurring costs. At the client's request, the financial service provider shall also provide details of the costs in the form of a report (*ex post*).

Finally, the FinSO contains an important section about information sheets and prospectuses applicable to issuers of financial instruments.

Among the topics not covered by the FinIO project, it is interesting to note the absence of a provision concerning the content or minimum standard of training for client advisors. After the Swiss Parliament, it is the Federal Council's turn to relinquish this point. If the project remains as it is, the question will be whether the FINMA will decide to establish a standard or whether the assessment of the level of training will remain the assessment of the providers themselves.

The FinSA/FinIO transition period is of one year starting from the entry into force of the law and the ordinance.

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