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NEWSLETTER 03 2019

LSFIN – LEFIN: Actions to be taken

Enforcement ordinances have just been voted, the financial intermediaries concerned by the new set of regulation LEFin / LSFin will have to be compliant with these new rules

Various measures have to be assessed, with an impact both on structures, participants and relationship management processes. Without discussing the specific point of affiliation disclosed in a previous newsletter (see Newsletter n°02), it is useful to distinguish actions in relation with financial intermediaries' organization, with members and with control to implement.

The main objective of this newsletter is not to exhaustively list measures to be taken but it is more to emphasis on main actions to be considered in relation with financial intermediary's activity, type of his relationships and considering the size of his company. To synthetize, we grouped wealth:

a) The « Smalls », meaning independent wealth managers and trustees with a limited size, organized all around the company's manager / partner. The company has less than 5 employees (Full Time Equivalent / FTE) and a gross income of less than CHF 2 mios.
b) The « Mediums », meaning independent wealth managers and trustees, generally organized around one or more managers / partners. The company has between 5 and 10 employees (FTP) and a gross income of less than CHF 5 mios.
c) The « Larges », meaning independent wealth managers and trustees with a higher size, the company has several partners and managers, and has more than 10 employees (FPT) with a gross income of more than CHF 5 mios.

The specific of topic of « Securities issuance » and others activities in relation with LPCC regulation is not covered by this newsletter.

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1) Organizational measures

	Steps to take	"Smalls"	"Mediums"	"Larges"
For authorization	Plan internal directives defining: - company's organization, - scope of practice, - geographical area of practice, - risks exposure, - risks hedging measures.	X	X	X
	Affiliate to a mediation organism	X	X	X
	Information about significant subsidiary (10%)	X	X	X
	Information about potential activities developed abroad	X	X	X
	Proof of irreproachable activity for qualified persons (identification, CV, criminal record extract, professional references,…)	X	X	X
	Authorization request for each activity developed (wealth management, trustee,…)	X	X	X
For governance	At least one qualified executive	X	X	X
	A formalized continuation plan a minima compliant with authorization criterias	X		
	Qualified executive must have to sign jointly		X	X
	Top management (directors) in charge of oversight and controls have to be independant with executive in charge of operating management	N/A[1]	N/A[1]	X
	Set up an internal audit department			X[2]
	Split between risk management and control activities / operating management activities [3]	N/A[1]	X	X
For training	Qualified executives should have at least 5 years of professional experience in wealth management, trust or asset management	X	X	X
	Complete 40 hours of continuous training in relation with activities developed (with an university degree, a professional or a specific certification such as CAS,...)	X	X	X
	Complete continuous training courses (in accordance with specifications definite by the Supervisory Body)	X	X	X
For the company	Register to the commercial register for any kind of authorized entities	X	X	X
	Subscribe to a liability insurance for civil responsability: - at least KCHF 500/year, - from 2 to 4 advisors CHF 1.5 mio, - from 5 to 8 advisors CHF 3 mios, - > 8 advisors CHF 10 mios. The insurance could be replaced by an equivalent blocked warranty	X	X	X
	Minimum share capital of CHF 100'000 or equivalent (net equities, shareholders current accounts postponed, bank guarantees,...)	X	X	X
	At least 25% of fixed expenses covered by net equity or any equivalent guarantee	X	X	X
	Complete a prudentiel audit in accordance with provisions and frequencies defined by the SB (realised by the an external auditor, by the SB's auditors, annually or on a multi-year period till 4 years)	X	X	X
	Audit of company's financial statements, a priori on the same frequency as prudential audits, in order to certify financial accounts (gross income, fixed expenses and net equity)	X	X	X

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(1) With some exception or specific risk identified during the process of authorization or a posteriori by the SB. Specific risks considered are:

- management of relationships domiciled in an high risk country form AML or corruption
- management of relationships domiciled in a non-signatory country for AEOI with Switzerland
- wealth management for PEP
- wealth management of values deposited outside of Switzerland
- branch or subsidiary abroad
- clientele concentration
- wealth management inside a fund non regulated by a prudential supervision or through a domicile structure
- wealth management with a general or unlimited power of attorney
- use of leveraged financial instruments
- management of too many relationships compared with the available staff

(2) On FINMA's request

(3) See following comments

➔ Regarding point 3 and the specific question of segregation between « control » activities with wealth management tasks, several options seem to be offered by the regulator. For operating considerations, controls and risk management (Compliance in a broad sense) are the responsibility of top management and so, of a qualified executive. This function includes preventive and detection control. For technical reasons and due to the internal organization chosen, the company may delegate this function to one or more employees under the responsibility of the qualified executive.

Likewise, when considering smaller entities or bicephalous organization or without any particular risk, a segregation of controlling functions between qualified executives must also be developed. An example is given in the ordinances commentaries. One executive could supervise the Compliance activity if he is not in charge of portfolios' management. In the opposite, the executive in charge of portfolios' oversight could only proceed to specific controls related to AML duties (transactions monitoring, cross border check…). The monitoring of portfolios will then be dedicated to the first executive.

In the same way, we could imagine that a cross-check would be created. Then, the Compliance function will be completed by the two qualified executive but their controls would be limited to portfolios not directly managed by them. Their own portfolios would then be controlled by their partner. The main objective is to permanently ensure the « 4 eyes principles ».

➔ Rules for net equities and other accounting threshold are defined at article 29 and following OEFin. Financial data must be established in accordance with Code of obligations (CO) standard presentation of financial statements. For overindebtness entities, postponed debts and loans have to be considered for only 80% of their value in net equities calculation.

For ratio controls and other financial data, the regulator did not modify specific CO rules for statutory audit. There is no new obligation to get a legal auditor with this new regulation. Nevertheless, figures have to be controlled!

Therefore, prudential auditors will probably have to check compliance ratios and integrity of financial data during their audit with the frequency decided by the SB.

This point will have to be clarified because it creates a lot of problem about its feasibility and it does not seem to be in compliance with a lot of professional standards of auditing. The regulator put the stress on his willingness of pragmatism and his objective to reduce costs induced by the reform by creating the opportunity for a four years audit period. But, it does not seem to be technically possible, for example, to certify net equities amounts (which represent the accumulation of previous years' results) only for the year when prudential audit is performed. Furthermore, when the company already has a statutory auditor different from prudential auditor, the prudential auditor needs to check the controls done by the statutory auditor and the adequate financial statements disclosure. Once again, if there are some discrepancies, some trouble might probably appear. Some decisions and clarifications on these points are expected.

2) Actions to be taken for wealth management considerations

If the new regulations involve a lot of organizational changes, it will be the same for wealth management and all the rules for services providers. These changes will concern services providers for wealth management, issuers of financial instruments or trustees.

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	Duties	Consequences	Deadlines
Clients' classification	Clients have to be sorted by nature: - private clients, - professional clients, - institutional clients	Due to their own nature, the checking level and information level to release is different. Client classification is the main step for wealth management activity because it determines for the future of the relationship the level of duties to perform. Without any qualification, all clients will be considered as private clients.	Two years from 01.01.2020, financial intermediaries will have to choose the starting date of implementation of the new rules during this transition period, All new rules have to be applied at the same time.
Formalization of basic documentation	Clients' classification will require a specific formalization, with detailled information for the client about the involvments of its classification and potential waive of a status (opting out[1]) .	New formulars have to be prepared, those documents will allow: - To validate legal nature of clients, - To identify their activity, their knowledge and experience about financial environment, - To sort them into specific classes, - To formalize any potential "opting out" for qualified clients, after a mandatory information about the consequences of this waiver.	Immediatly considering the short term transition period.
Legal informations for services provided	Financial intermediaries have to detail and to provide to the client with offer of services : - legal informations about his company, - risk information about financial instruments, - services offered, - any link with third parties regarding the services offered, - selection process of financial instrument. In case of financial instrument recommandation, the related legal information must be made available for the clients.	The commercial offer is generally disclosed in the mandate, hence information have to be repeated in a new contrat or in a specific appendix. As long as these information are available for the client with sufficient time before signing the mandate. It supposes that this timing must be documented and the exact duration has to be defined by the SB. For risk information about financial instruments, we assume that the regular ASB brochure will be sufficient for traditionnal wealth activities. In any cas of particular activity / financial instruments, a specific information should be necessary. Relationships with third or related parties and providers concern transactions that could have an impact on services costs[2] or which could generate a conflict of interests.	Two years from 01.01.2020, financial intermediaries will have to choose the starting date of implementation of the new rules during this transition period, All new rules have to be applied at the same time.
Contract information related to services offered	Clients have the right of being regularly informed and receive regular feedbacks. On clients' request the financial intermediary have to inform about : - results for services provided, - allocation, evaluation and evolution of the portfolios, - global costs in relation with services provided. The form of the reports will be homogenized and defined by the Federal Council.	This point comes to reinforce current wealth management legal framework rules and disposals about reporting for clients. A minimum standard has still to be defined but the report will probably need to include usual banking documents (performance report), a presentation of services provided and results obtained, as well as direct and indirect costs / inducements (recurring or not), related to the services offered.	Two years from 01.01.2020. However, for transparence issues and efficiency, financial intermediaries may find advantageous to develop now reporting templates.
Check appropriateness and/or adequacy	Wealth managers must have to assess appropriateness and adequacy of financial services provided. The appropriateness is assessed when the provider offer one-shot advices or recommandation. The adequacy must be assessed when the provider offer services on the global wealth (or at least on the assets under management) of the clients. These controls are not necessary when the services offered are performed without any advice / execution only, but only if the financial intermediary has communicated to the client that no check is performed. These checks, as well as legal and contractual information presented above should be excluded by professional clients. This waiver to be valid has to be formally documented (express waiver).	As presented in the previous point, these obligations represent a reinforcement of wealth management framework rules already applied by most of the wealth managers and an extension to advisor activities. The check of the appropriateness will consist in controlling and documenting for each isolated transaction, the knowledge and experience of clients about the considered financial product. The check of the adequacy consists in controlling financial environment of the clients, investment objectives and their knowledge and experience (investment strategy and risk profile for current regulation). The documentation should provide: - nature and amount of regular income of the clients and his present and future engagements, - investment strategy in terms of duration, objectives (conservation, growth,...) and his risk appetite, - potential investment restriction.	Two years from 01.01.2020, financial intermediaries will have to choose the starting date of implementation of the new rules during this transition period, All the new rules have to be applied at the same time.
Management conflicts of interest	The company need to document processes developed for identifying and regulating conflicts. The financial intermediary also need to create a wage policy which preserve client's interests. The company also have to put in place processes for authorization and followp up employees personal accounts dealing.	All these controls have to be documented in company's internal directives and to be communicated to all its employees. These rules also supervise inducements from 3rd parties. There is no significant change comparing with current wealth management legal framework rules. Inducements are still authorized: - if the client express waive inducement after an appropirate information (type of inducement and scale, calculation criterias and range) - if all inducements are cashed back to clients.	Already valid for inducements. All other items (employees supervision, internal directives) have to be implemented within 2 years.

[(1)] *Opting out, high net worth private clients could waive to be considered as private client only and to opt for professional clients' rules. A client could be considered as a high net worth private client if:*

- *he has sufficient experience and knowledge of financial environment and products and if he has a referring wealth over than CHF 500'000.-*

or

- *he has a referring wealth of more than CHF 2 mios.*

Real estate is not considered in the definition of referring wealth.

Additionally, professional clients could opt to be considered as institutional clients.

To summarize, professional clients represent all financial intermediaries submitted to AML regulation (banks insurance companies,….) plus all the entities (private or public) with a professional cash management and all the « big company » (company which met 2 thresholds on the following 3 total of balance sheet over CHF 20 mios, total turnover over CHF 40 mios or more than CHF 2 mios of net equities).

As opposite, institutional or professional clients could opt in and ask to be considered as pertaining to the lower category.

3) A latent need for juridical assistance

As mentioned before, organizational and wealth management changes are expected. One point is clear; the new regulation will require an increased level of documentation.

The first step consists in correctly defining its own organization and its controlling function but also to document this analysis in detailed internal directives.

The second step must be to develop a set of documentation for clients classification with the objective of formalizing clients' acceptance of their class after an informed decision and after the check of the appropriateness and adequacy of the services provided by the financial intermediary.

At this stage, it is difficult to assess if existing documentation could be completed (by addendum) for the purpose of this new regulation or if financial intermediaries have to redo all the documentation. However, it is quite sure that no help is expected from SB. Supervisory bodies have for only function to control financial intermediaries and it is different from the previous system of SRO, when those entities were also used as professional instances. In the same way, in a prudential audit the auditor is not allowed to support his clients in order to establish documentation because he will then be considered as non-independent and potentially concerned by a forbidden situation of self-control of its own advices which is not allowed by professional standards.

We wish that the former SRO will continue to exist and to act as a professional instance, association for his new and existing members. We expect that they will communicate templates to provide support in this compliance process. If not, a large part of these actions will have to be done under the supervision of a legal advisor. As usual, CF Compagnie fiduciaire is ready to accompany financial intermediaries in this transition and to make his network available to help you in this compliance process.