Symposium for Portfolio Managers and Trustees

17 February 2022
Programme

Welcome
Tobias Lux, FINMA spokesperson

Introductory remarks
Philip Hinsen, provisional Head of Asset Management division, FINMA

Framework for the authorisation process
Kenneth Ukoh, Asset Management division, FINMA

Findings and challenges on the path to the authorisation
Paolo Ader, Asset Management division, FINMA

Q&A session
Host: Tobias Lux, FINMA spokesperson

Suitability aspects in portfolio management
Simone Tobler, Markets division, FINMA

Focal points for trustees
Dorothée Ignatz, Asset Management division, FINMA

Q&A session
Host: Tobias Lux, FINMA spokesperson
Introduction

Philip Hinsen
Starting point: where are we now?

Data as of 31 January 2022

Source: Nirmal Purja /https://www.nzz.ch/panorama/bilderverbot-am-mount-everest
Framework for the authorisation process

Kenneth Ukoh
**Transition period and timeline**

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<th>Date</th>
<th>Event</th>
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<tr>
<td>31 December 2022</td>
<td>Financial institutions which are newly subject to an authorisation duty must fulfil the requirements of the FinIA and must submit an authorisation request to FINMA (Art. 74 para. 2 FinIA)</td>
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**It is the duty of the institution to meet the deadline**

- **Registration and drafting of the authorisation request in EHP**
- **Suggested deadline for transerral to an SO**
- **Submission of authorisation request to FINMA**
- **End of transition period**
  - Activities can be continued until FINMA’s decision if affiliated with an SRO
  - Missing the deadline results in unauthorised commercial activity

**Dates**

- 01.01.2022
- 30.06.2022
- 31.12.2022
**EHP survey – preview of the request wave**

**Key findings**

- EHP survey was sent to 2,500 registered institutions
- Return rate 66% (1'645)
- 1'224 / 74% institutions will be submitting their request to the SO by 30 June
- 1'351 / 82% institutions will be submitting a request by 31 December
- 222 / 13% institutions will not be submitting a request
- 72 / 5% institutions did not answer
Digital requests in the EHP

Key points

– As of 1 October 2021, you are required to use authorisation form version 2.0
– Submission is fully electronic and without signature
– Paper submissions will not be accepted
– Original documents must be kept by the institution
– The authorisation request and the corporate documents must be submitted in an official language. Other documents can be submitted in English.
– You can find visual aids online: https://www.finma.ch/en/authorisation/portfolio-managers-and-trustees/bewilligungsprozess/
SO affiliation procedure

Key points

- Early affiliation with an SO of your choice by 30 June 2022 at the latest
- Request needs to be assigned to the SO in the EHP and must not be "submitted".
- The SO will analyse the affiliation based on the authorisation request
- This pre-examination is based on FINMA's requirements
- The instructions given by the SO must be followed
- The SOs may not transmit incomplete requests
- Following the analysis, the SO will confirm the affiliation in writing
- Only following receipt of the written confirmation may the authorisation request be submitted to FINMA
FINMA authorisation procedure I

Key takeaways regarding the eligibility for approval

- Generally applicants display high willingness to cooperate
- Improvements requested by FINMA lead to some requests being withdrawn
- First authorisations granted to individual and small businesses

Authorisation requirements

Authorisation

✓ Complete request including SO affiliation
✓ Proof that authorisation requirements will be met
✓ Appropriate limitation and control of inherent risks
✓ Information and cooperation in the procedure

No authorisation

✗ Poor application quality / incomplete and inconsistent information
✗ Authorisation requirements not met
✗ No adequate risk management
✗ Violation of the duty to provide information and to cooperate
FINMA authorisation procedure II

Quality of the request as the determining factor for duration and cost

Costs

- Lowest amount: CHF 2,100
- Mean: CHF 7,400
- Highest amount: CHF 15,500

Duration of procedure (days)

- Quickest procedure: 18 days
- Mean: 167 days
- Longest procedure: 536 days
Findings and challenges on the path to the authorisation

Paolo Ader
FINMA's goals in the authorisation procedure

- FINMA creates an efficient, transparent and risk-oriented authorisation procedure while ensuring a level playing field.

- In doing so, FINMA applies a rigorous but fair assessment standard and thus contributes to portfolio managers' and trustees' respectful treatment of their clients.

- The authorisation functions as a seal of approval.
Proportionality of the risk-based authorisation procedure

Complex business model with high risks
- Largely independent senior management body
- Increased requirements for professional qualifications as well as adequacy of the organisation

Standard business model with significant risks
- Appropriate and appropriately qualified personnel for the business activity
- Business model must correspond to the financial possibilities as well as the operational organisation
- Principle of separation of risk control functions

Simple, low-risk business model
- Possibility of single-member companies
- Lean instruction and control system
High-risk business models

It is up to FINMA to define the term "high-risk business models".

The following circumstances are considered risky, even if they are below the threshold of Article 26 para. 2 FinIO:

- High volume of assets managed: AuM > CHF 1bn
- De minimis management of funds / pension assets
- Foreign custodian banks
- Client structures abroad
- Unlimited powers of attorney
- Conflicts of interest

In principle, separation of the control functions from the operating units.
# Findings pertaining to authorisation requests

## Internal documentation

- The **internal documentation** of financial institutions must be adapted to the effective organisation of the institution and the associated business models
- **Professional qualifications**: not only at the level of the executive board but also at the level of the governing body, the control functions and the other key functions (compliance and risk management)
- **Independence of the control functions** (especially compliance and risk management): if provided for or necessary, must be effectively implemented and also ensured in the case of deputies

## International clients and cross-border risks

- Understanding of **risks associated with cross-border activities** and adequacy of internal policies
- **Fragmented customer base** could lead to in-depth clarifications and comprehensive documentation being expected

## Financial guarantees

- **Detailed and precise calculation** of the financial guarantees based on the last balance sheet (if available, otherwise business plan)
Risk management measures

- Clear strategic and geographical alignment of the business model
- Focus on core competencies
- Relevant experience and professional qualifications of personnel
- Adequate personnel resources
- Effective system of instructions and controls with regard to risks
- Internal regulations on the avoidance and disclosure of conflicts of interest (transparency)
- Separation of risk and compliance from the operating units
- Senior management body largely independent of the executive board
Q&A

Tobias Lux, FINMA spokesperson
Suitability aspects in portfolio management

Simone Tobler
## FINMA on-site inspections and benchmarking

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**Institution’s suitability strategy**
- Design of overall suitability processes and assessment of whether they are appropriate for risk reduction.
- Is management involvement adequate?
- Existence of appropriate management reporting?

**Contractual relations**
- Point of sale controls
- Downstream controls
- Compliance & risk control integration
- Reports

**Risk profiles**
- Asset management
- Investment advice
- Execution only

**Product classification**
- Existence
- Content
- Regular updating
- Control of deviations

**Diversification**
- Method
- Risk aggregation

**Own investment funds**
- Requirements
- Control

**Risk information and inventory**
- Own volumes of PM, IA and EX-O funds

**Retrocessions**
- Process
- Documentation
- Control

**Training and development**
- Disclosure
- Waiver
- IA, PM, EX-O

- Specialist knowledge
- Behavioural requirement s
- Internal processes and systems

**Investment contract design**
- Appropriate content for the assessment of risk and compliance?
- Regular monitoring of risk concentration and reporting to clients.

**Product diversification**
- Are there any diversification requirements applied to PM and IA and how is risk aggregation performed at the portfolio level?

**Retrocessions**
- B) Waived or disclosed?
- Adequate transparency regarding calculation parameters.

**Front office staff and portfolio managers**
- Are employees trained in behavioural requirements/systems and internal guideline processes?
Contractual relationships (1/2)

➢ Topics:
  ▪ Separation of asset management, investment advisory and execution-only clients
  ▪ Compliance with the respective duties of conduct for these clients

➢ Findings:
  ▪ Need for action regarding suitability obligations, especially for investment advice (e.g. risk profiles, internal control system)
  ▪ Demarcation between execution only and investment advice not yet fully implemented
Contractual relationships (2/2)

Example 1: Distribution of financial service types by custody value for asset managers and banks:

Example 2: "Contact notes are not documented in such a way that it can be traced whether execution only or advice has been given and the client advisers have fulfilled the respective suitability obligations, especially if clients hold several custody accounts."
Use of in-house products (1/2)

Topics:
- Volume of in-house investment products in asset management and investment advisory services
- Minimisation and disclosure of conflicts of interest

Findings:
- In particular, there is a need for an **objectified selection process** for proprietary vs. third-party products, the right remuneration incentives, separation of functions between product management and sales
- Clients must be able to see the **extent** to which proprietary products are taken into account
- All (potential) **conflicts of interest**, including their causes, must be disclosed
Use of in-house products (2/2)

Examples:

Example 1: "The conflict of interest fact sheet does not disclose that certain investment solutions are limited to in-house products."

Example 2: "The administration contract provides for the possibility of investing part of the discretionary mandate funds in collective investments managed by (...). However, our random sampling identified cases where the entire assets of the business relationship were invested in in-house funds."

Example 3: "In the basic contract documentation, reference is made to information on the institution's website for the disclosure of conflicts of interest."

Example 4: The reason for conflicts of interest is not disclosed (e.g. that the institution manages financial instruments and receives a management fee for this, which is charged directly to the financial instrument).
Retrocessions (1/2)

➢ Topics:
  - Retention of third-party compensation (brokerage fees, discounts, etc.)
  - Minimum content and medium of advance information on third-party compensation

➢ Findings:
  - Many institutions continue to retain retros despite declining trend
  - Transparent information on ranges is "key" for valid advance waiver
  - In the case of asset management and portfolio-related advice, retros must be disclosed as a percentage/range of custody assets (see Federal Supreme Court decision 4A_355/2019 of May 13 2020)
Retrocessions (2/2)

Examples:

Example 1: Based on a table with different percentages for individual asset classes (e.g. funds, structured products), clients cannot correctly assess the amount of third-party compensation and compare it with the amount of the management fee.

Example 2: "A mere reference to the website with the overview of compensation in the investment business does not ensure [sufficient information about the scope of retrocessions]."

Example 3: The ranges must be defined in such a way that clients can make a meaningful assessment of the compensation. A generic bandwidth of 0-3% is not suitable for this purpose.

Example 4: "The Bank retains the commission without prior agreement with the client, or without having drawn the client's attention to such a particular clause in the contract."
Focus topics for trustees

Dorothée Ignatz
Introduction

− Activity as trustee is newly subject to prudential licensing and supervision

− FINMA's risk-based authorisation approach also takes into account the specifics of trustees

− Definition of trustee-specific business models with increased risks as well as expectations for appropriate risk management

− Clarification of the authorisation requirements for trustees on core aspects such as minimum substance, organisational requirements as well as due diligence and fiduciary duties
Business models with increased risks: trustee-specific risks

Responsibility for corporate decisions or maintenance of non-bankable assets. Trustee can be sued for breach of trust.

Trust laws vary. Furthermore, trustees must consider legal implications for beneficiaries when making distributions.
Business models with increased risks: expectations of trustees

- **Specific knowledge** in the management of assets or **transfer to qualified third parties**
- **Access to specialists** from the relevant jurisdictions
- **Recording the risks** in the risk analysis and **formalising the controls** in the ICS
- **Fundamental independence of risk management** and operational activities
Requirements for minimum substance

Empty structures are not eligible for authorisation

- At least **one qualified managing director** - in the case of extended management, all members must be **employed on the basis of an employment contract**.

- **The role of qualified managing director cannot be delegated**. However, it is possible for a qualified managing director to work for several financial institutions (conflicts of interest must be adequately considered)

- Financial institutions must have **staff that are appropriate to their business** and appropriately qualified

- **No umbrella authorisation**, authorisation can only be granted at the institution level

Outsourcing requirements with regard to the minimum substance

- **Essential tasks may be delegated** if this **does not affect the appropriateness** of the company's organisation

- Essential tasks that are typically delegated: **asset management** and **trust accounting**
Trustee-related duties of care and loyalty

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<th>Retention of due diligence and fiduciary duties in the internal directives</th>
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<td>– <strong>Written</strong> trust instrument</td>
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<td>– <strong>Preservation</strong> of value and earmarked use of the trust assets</td>
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<td>– Investment of the trust assets in <strong>accordance with the applicable trust law</strong> and in accordance with the provisions of the deed of creation</td>
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<tr>
<td>– Act exclusively in the interest of the <strong>beneficiaries</strong> and <strong>avoid conflicts of interest</strong> in accordance with the applicable trust law</td>
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<tr>
<td>– In <strong>accordance with the applicable trust law</strong> and the <strong>provisions of the instrument of incorporation</strong>, to act impartially towards beneficiaries</td>
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**Trustee-related organisational requirements**

| Specification of organisational requirements in the internal directives  |
| (Art. 24 para. 4 FinIO) |

- **Separation of the trust assets**

- **Access to specialists** (lawyers specialising in trusts, tax experts, asset managers, accountants)

- Ensuring that, in accordance with the applicable trust law and the provisions of the deed of creation, entitled parties can be provided with information on trust assets, business activities and claims / entitlements (in principle, trust accounting is required)

- **Availability of current contact details of parties involved** (settlor, beneficiaries, protector, etc.)
Q&A

Tobias Lux, FINMA spokesperson
Should you have further questions regarding the topics discussed at the symposium, you can contact assetmanagement@finma.ch