Authorisation process for portfolio managers and trustees: Status and initial practical experiences

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With the entry into force of the Financial Institutions Act (FinIA) and the Financial Services Act (FinSA) on 1 January 2020, new regulations apply regarding authorisation requirements and conditions for the provision of services by portfolio managers and trustees. Since then, independent portfolio managers and trustees have required authorisation to carry out their activities.

The deadline for submitting an application for authorisation, 31 December 2022, is approaching and the authorisation process has already begun for some applicants. FINMA recently published information on its initial experiences in the authorisation process with portfolio managers and trustees. This legal update is intended to provide an overview of the status of authorisations granted and applications for authorisation submitted, and also to share initial practical experience gained regarding the new applications for authorisation. For information on the authorisation requirements for independent portfolio managers, please refer to our legal update of 1 December 2020.

Status of the authorisation process

To date, FINMA has received 95 applications for authorisation and has authorised 36 portfolio managers, of which only one authorisation was granted to an independent portfolio manager. All other license holders are group companies under FinIA. Pursuant to Art. 74 para. 2 and para. 3 FinIA, independent portfolio managers and trustees who were already active in that capacity prior to the entry into force of FinIA had to report to FINMA by 30 June 2020. Independent portfolio managers who commenced their activities by the end of 2020 had to report to FINMA immediately upon commencement of their activities. Based on these notifications, it is possible to estimate approximately how many more authorisation applications will be submitted. According to FINMA, this should be 2,521 portfolio managers and trustees.

The vast majority of the notifications were made by portfolio managers who were already active before FinIA came into force. Overall, applications for authorisation are being submitted later than reported, which is why FINMA expects that the majority of applications will not be processed until 2023. FINMA is therefore trying to anticipate the expected flood of applications at the end of 2022 and is proactively informing the industry.

Findings and practical experience from the approval process

According to FINMA, only complex and risky models are examined in depth; thus, a risk-based approach is taken when examining the application for authorisation. FINMA uses various criteria to determine whether a business model is associated with increased risks and thus to decide the depth of the review. Criteria include the type, number and domicile of clients; the volume of assets under management; the investment strategies and products used; and the number and types of services offered. It cannot be ruled out that business models with increased risks will not be approved. These include, but are not limited to, the following business models:

- Involvement of foreign custodian banks
- Foreign client structures
- Use of investment instruments with potential conflicts of interest
- Compensation of third parties (retrocessions, etc.)

FINMA has published its expectations in connection with the pursuit of risky business models. For example, the involvement of foreign custodian banks must be explainable or make sense. FINMA expects the risks associated with this involvement to be addressed in the directives and controls. Furthermore, risk and compliance functions should be separated from the operational areas.

The three abovementioned requirements are also expected to apply mutatis mutandis in the case of foreign client structures. In addition, client advisors who are also involved in foreign client structures should have relevant experience and appropriate professional qualifications and receive regular training.

If investment instruments with potential conflicts of interest are used, FINMA expects, among other things, that internal regulations regarding the avoidance and disclosure of conflicts of interest are created and that the proprietary investment instruments are limited in percentage terms in line with the investment strategy. Any multiple fee settlements are to be disclosed and their handling defined. In addition, portfolio managers and trustees are expected to implement separation of risk and compliance from the operating units.

If third parties are compensated, this compensation must be in compliance with the requirements of Art. 26 FinSA. FINMA also expects related risks to be addressed in the directives

Our experience from supporting authorisation applications

In addition to the above remarks on FINMA’s findings, our experience of supporting clients with authorisation applications is as follows.

Organisational regulations in an official language

As is generally known, the application for authorisation must be accompanied by organisational regulations that define the implementation of the organisational requirements for the applicant. These organisational regulations must be submitted in an official language. Organisational regulations exclusively in English are therefore not sufficient.

Individual signing authority for 'small' applicants

Particularly in the case of applicants with a lean organisational structure, the question often arises as to whether a person authorised to represent the applicant can also sign alone. Art. 23 para. 1 Financial Institutions Ordinance (FinIO) assumes in principle that two persons must sign jointly, subject to Art. 20 para. 2 FinIA. If the applicant has chosen the legal form of a company limited by shares (AG/SA), the only member of the board of directors may also be the only qualified managing director.

In such cases, the question often also arises as to whether it is appropriate to separate management and governance. In addition, it should be noted that the exercise of a board of directors mandate and an executive management mandate in personal union could be rejected by FINMA if the applicant has ten or more full-time positions or annual gross revenues of more than CHF 5 million and the nature and scope of its activities require a separation of these two tasks (Art. 23 para. 3 FinIO). In this case, the individual signing authority is consequently not possible.

In summary, in our experience, there is nothing to prevent the provision of an individual signing authority, provided that the requirements set out here are met.

Reporting of all delegations of tasks

With regard to the delegation of material tasks and the related reporting obligation to FINMA, our experience is that, contrary to the wording of the law in Art. 64 para. 1 FinIA, all outsourced activities must be reported to FINMA, including 'immaterial' ones. FINMA subsequently decides on a case-by-case basis whether, in their view, outsourcing is material or immaterial. In particular, in our experience, FINMA assesses the outsourcing of compliance and risk management as 'relevant' outsourcing even in the case of portfolio managers.

Overall, the FINMA circular on outsourcing can be applied analogously to outsourcing of activities of portfolio managers and trustees. We therefore recommend adhering to the FINMA standard for all outsourced activities according to the circular and to report all outsourced activities to FINMA when submitting the application.

Information on the domicile of the contracting party and the beneficial owner

Furthermore, as part of the information on business activities, the applicant must disclose whether it has only Swiss or also foreign customers and, in the case of foreign customers, also specify their region of domicile. However, the region of domicile or the domicile of the customer may be different from the domicile of the beneficial owner, who must be identified as part of the obligations under the Anti-Money Laundering Act AMLA).

For the authorisation application as such, these two domiciles must be treated separately, as the domicile of the beneficial owner must first be indicated in the AMLA section. However, we

recommend addressing both domicile regions in the geographical description within the organisational regulations.

Conclusion and outlook

The above remarks as well as the presentation of FINMA have shown that the legal basis as well as the explanations of the authorities in individual cases do not provide conclusive answers to open questions, and that practice for the new forms of authorisations is still emerging in some respects. This uncertainty may also be a reason why many existing independent portfolio managers and trustees are still waiting to submit their applications. However, in view of the figures published by FINMA, which suggest a flood of applications at the end of 2022, the licensing process should be started as soon as possible. Otherwise, applicants risk waiting longer than planned for the review of their application.

Our team has many years of experience with license applications and is in active contact with the authorities. We would be happy to support you in the authorisation process.

Visit our Swiss Financial Market Regulation site to benefit from the latest guidance, tailored to your specific financial sector.

No legal or tax advice

This legal update provides a high-level overview and does not claim to be comprehensive. It does not represent legal or tax advice. If you have any questions relating to this legal update or would like to have advice concerning your particular circumstances, please get in touch with your contact at Pestalozzi Attorneys at Law Ltd. or one of the contact persons mentioned in this Legal Update.

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