Licensing process for trustees – practical experience with FINMA and supervisory organisations

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Licensing process – summary

a) Preparation of FINMA application including annexes

Before beginning to draft a FINMA application, it is strongly recommended that each trustee complete a critical self-assessment. What does the current organisation look like? What are the services and products? Who are and will be the clients of the trustee? Once there is clarity about the goals and business plan, the changes required in connection with organisation, processes, resources, etc. must be taken into consideration. Only then will a trustee be able to submit a meaningful licence application to FINMA.

b) Affiliation with a supervisory organisation

Trustees are subject to supervision by a supervisory organisation (SO), which is in turn authorised and supervised by FINMA. As of today, five SOs have been authorised by FINMA, and trustees are free to choose which one to affiliate with. The decision must be made at the latest when submitting the licence application on the FINMA application platform (EHP). SOs must ensure that trustees comply with the Financial Institutions Act (FinIA). As the SOs only recently began operating, they are still in the process of establishing their systems and processes.

c) Review of FINMA application by the SO

Before submission to FINMA, the trustee's licence application is sent electronically to the SO chosen by the trustee. So far, our experience with the SOs has been very positive. Collaboration has been quick and efficient so that the licence applications could be submitted to FINMA without delay.

d) FINMA licence

FINMA does not grant licences on a voluntary basis – either a trustee is within the scope of FinIA or it is not. Also, the licence is always granted on the level of the individual institution and not for the entire group.

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Since the FinIA entered into force, a small number of individual portfolio managers has obtained a FINMA licence but no trustee so far. FINMA recently introduced certain fundamental principles related to trustees but it is not yet clear whether and in which form these will be communicated. Nevertheless, as announced by FINMA on 16 September 2021, it is highly recommended to file a trustee licensing application with the SO by 30 June 2022 at the latest. Otherwise, trustees – and of course also portfolio managers – run the risk that FINMA will not be able to handle the high number of licensing applications expected for Q3/Q4 next year; FINMA already announced that it will not be able to grant those licences until 2023. Also, it cannot be excluded that FINMA will tighten its practice for trustees at a later stage. We saw similar developments when the licensing requirements for managers of foreign funds were introduced on 1 March 2013.

Key issues related to organisational requirements

a) Adequate organisation/internal directives

It is important to prove that adequate risk management and effective internal controls are in place and that the trustee ensures that statutory and internal provisions are complied with. Although trustees not providing financial services in the sense of the Financial Services Act (FinSA) do not require a FinSA directive, FINMA nevertheless requires on the basis of Art. 24 para. 4 Financial Institutions Ordinance (FinIO) that trustees have a directive in place covering a number of duties, including:

i. Duty of loyalty and care

- Preserve and enhance the value of the funds and assets in a trust
- Trust deed must be in writing
- Earmarked use of the trustee's assets
- Duty to invest
- Avoid conflicts of interests
- Ensure that the interests of the beneficiaries' interests in trust property are protected
- Duty of care when making decisions to protect the beneficiaries' interests
- Impartial towards beneficiaries
- In case of discretion: take appropriate account of different interests

ii. Organisational measures

- Duty to segregate funds and not mix or commingle their own personal funds with the assets in the trust
- Access to specialist function in the relevant jurisdictions including tax advisers, bookkeeping, etc.

- Duty of accounting of and keeping records for all financial transactions concerning the trust property (one separate accounting for each trust). Trustee must be able at any time to provide information related to assets, business activities and entitlements related to the trust
- Contact details for both settlor and beneficiaries of the trusts must be kept up to date by the trustee

Another focus of FINMA is cross-border activities. FINMA requires knowledge and experience on the level of the trustee for both domiciles of trust structures and beneficiaries. These requirements can often be satisfied with a current country manual or legal opinions obtained from a local law firm. Generally, based on our experience so far, we can say that FINMA sets the bar quite high when it comes to knowledge and experience of the persons in charge at the trustee company.

According to the letter of the law, only services as per Art. 19 FinIA constitute material tasks. However, when it comes to the requirements applicable to outsourced activities, FINMA exercises its discretion to analyse such outsourced tasks on a case-by-case basis to establish whether they qualify as a material task. Such material tasks certainly include risk management/compliance but, depending on the circumstances, can also include IT, for example. If a material task is outsourced, the trustee is required to apply the FINMA Circular 'Outsourcing' in analogy.

Finally, FINMA expects a description of the life cycle management for trustee mandates.

b) Business plan

Both the business plan and the organisational regulations must contain a clear description of the products and services offered, including domiciles of settlors and beneficiaries of the trusts. Very important is that the business plan must be consistent with the other documents to be filed with FINMA. Business plans are certainly one of the key documents and FINMA reviews them carefully. Whenever a trustee intends to expand its activities, either by providing new services or targeting clients in new countries, it must seek prior FINMA approval to change its organisational regulations.

c) Lack of resources as required by FINMA

FINMA sets the bar quite high when it comes to knowledge and experience of the persons covering the key functions as required by law and FINMA practice. If these requirements cannot satisfied with the current organisation of the trustee, outsourcing of certain functions would be one of the options. Nevertheless, even when outsourcing, the trustee remains responsible for the outsourced activities.

d) High-risk business model

It is up to FINMA to interpret the legal term 'high-risk business model'. In the past, FINMA has considered the following circumstances as high-risk business models, despite the thresholds discussed before. For pure trustee companies, however, most of them are not applicable to them:

- De minimis management of occupational pensions scheme assets or funds ('de minimis asset manager')
- Involvement of foreign custodian banks (risky mainly for AML reasons)
- Heterogeneous structure of foreign client base or serving a large number of different countries or focus on a particular foreign region with increased AML risks
- Use of investment instruments with potential conflicts of interests, for example lack of transparency regarding multiple billing of fees
- Trustee holds unrestricted power of attorney
- High volume of AuM (above CHF 1 billion)

In addition, FINMA may consider trustees with more than five different trust jurisdictions or more than 10 different domiciles of beneficial owners (e.g. beneficiaries) as companies with a high-risk business model. The same applies if the trustee has more than 20% operative companies, 20% real estate or 10% real assets including planes, boats, art, jewellery, etc. in its entire book of business. Certain mitigation measures will apply in these cases such as segregation of risk management function from operative activities, risk analysis, ICS, etc.

FINMA's risk-based approach and its practice on high-risk business models

a) Risk-based approach

FINMA has no 'one size fits all' approach but instead makes a risk-based review of licence applications to ensure uniform quality standards. The goal is that simple applications/business models should be processed in a standardised way, whereas complex and risky business models are reviewed in more detail. Therefore, institutions with risky business models must take appropriate risk-mitigating steps.

Eligibility for a FINMA licence is conditional upon the inherent risks being adequately limited and monitored, and no licence will be granted until any adjustments required by FINMA are made. Such adjustments include additional staff, segregation of risk and compliance function, ongoing support of people involved, etc.

b) Basic principles

Most importantly, trustees – like other regulated institutions – must have an adequate risk management and effective internal controls in place. Also, they must ensure that they comply with statutory and internal provisions, and that basic principles of risk management and risk tolerance are defined. Such measures include any business activity, not only the regulated ones. Therefore, all material risks of the trustee must be identified, assessed, controlled and monitored.

c) Organisation of risk management

How should risk management best be organised? It can be either carried out internally by qualified managers, qualified employees or delegated to a qualified third party. Assuming a high-risk business model as per FINMA's definition for trustees above the thresholds defined by law (namely five FTEs or more, or annual gross earnings of more than CHF 2 million), the risk management function must be independent of the business. In any event, persons performing risk management tasks may not be involved in the performance of activities they monitor. In other words, control of own activities shall not be permitted.

d) Mitigating measures for risky business models

As a result, the higher the risks inherent in a business model, the higher the requirements for its eligibility for a licence. Mitigation measures include appropriate organisation, internal processes, directives, training requirements of staff, as well as risk control functions, risk management and compliance. As is the case for managers of collective investment schemes, FINMA may require separation of risk control and compliance from operational units, irrespective of the thresholds defined by law. Also, the associated risks must be addressed in the internal directives of the trustee.

Timeline and next steps

Obtaining a FINMA licence can be challenging. We have observed over the years that many FINMA licence applicants struggle either when applying for or after having received their licence, simply because they were not fully aware what the licencing requirements really mean. As a first step, we strongly recommend that any trustee critically review its current business model and organisation and compares it to the FinIA trustee licensing requirements. For example, what are the financial obligations? What should the corporate governance structure of the trustee look like, etc.?

Further, any trustee should be aware of the costs of obtaining and maintaining a FINMA licence. The contemplated organisational structure needs to be checked against FINIA requirements at the level of the trustee itself, its qualified shareholders, board members and all other relevant functions. Internal working processes need to be reviewed and formalised including a set of internal guidelines, which are to the point. This process will take time, and – especially for institutions not yet subject to prudential supervision – obtaining a FINMA licence will be a major achievement.

In our experience, FINMA licensing processes are time-consuming mainly due to insufficient documentation supporting the licence application, meaning that FINMA must request further details. It is therefore vital to have a well-drafted, concise application. As a starting point, templates for directives as seen in the market can be helpful, however, they need to be tailored to the specific business model in order to be accepted by FINMA.

In terms of timing, the duty of existing trustees to notify FINMA expired on 30 June 2020. They must comply with the legal requirements and submit an application to FINMA by 31 December 2022 at the latest. Trustees will be permitted to continue their activities until FINMA's decision on the licence provided, that they are affiliated to a self-regulatory organisation for anti-money laundering purposes.

In our view, now is certainly a good time to start the licensing process. FINMA has gained experience with the first trustee licensing applications but is not yet swamped with applications. Q3 and Q4 next year will presumably become very busy for FINMA as the FinIA transitional period will expire by the end of next year.

No legal advice

This legal update provides a high-level overview and does not claim to be comprehensive. It does not represent legal 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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