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Stay the course

The challenge of compliance in the age of transparency

Game changer for Swiss trustees

SANDRINE GIROUD AND **MATTHIAS GSTOEHL** DETAIL THE INTRODUCTION OF A REGULATORY REGIME FOR TRUSTEES UNDER THE *SWISS FINANCIAL INSTITUTIONS ACT*

SWITZERLAND'S TRUST INDUSTRY has remained largely unregulated, apart from standard anti-money laundering regulations. This is about to change with the *Financial Institutions Act* (FinIA) and *Financial Services Act* (FinSA), which are currently in the final stages of approval (entry into force is expected in 2019 or 2020) before the Swiss parliament. The proposed rules will introduce a regulatory regime for trustees operating in Switzerland, obliging them to obtain an authorisation to carry out their activities.

NEW RULES FOR THE SWISS FINANCIAL INDUSTRY

The objectives of the FinIA and FinSA are twofold: to create a uniform competitive landscape for financial intermediaries and to improve client protection. The FinIA sets the basic obligations for acting as a financial institution (FI) in or from Switzerland, whereas the FinSA outlines the basic requirements for the provision of financial services and governs the offering of financial instruments.

Although not initially included, the Swiss government finally decided to include trustees in the definition of FIs provided under the FinIA. This development marks an important move for the Swiss trust industry towards a regulated system.

NEW RULES FOR TRUSTEES OPERATING IN SWITZERLAND

Under the new regime, trustees will be supervised by the Swiss Financial Market Supervisory Authority (FINMA), which will delegate the day-to-day supervision to a supervisory body to be created and authorised by FINMA.

KEY POINTS

WHAT IS THE ISSUE?
The introduction of a regulatory regime for Swiss trustees.

WHAT DOES IT MEAN FOR ME?
Trustees operating in Switzerland will become subject to regulatory supervision obliging them to obtain an authorisation. They will also have to be particularly vigilant when delegating and monitoring the management of trust assets.

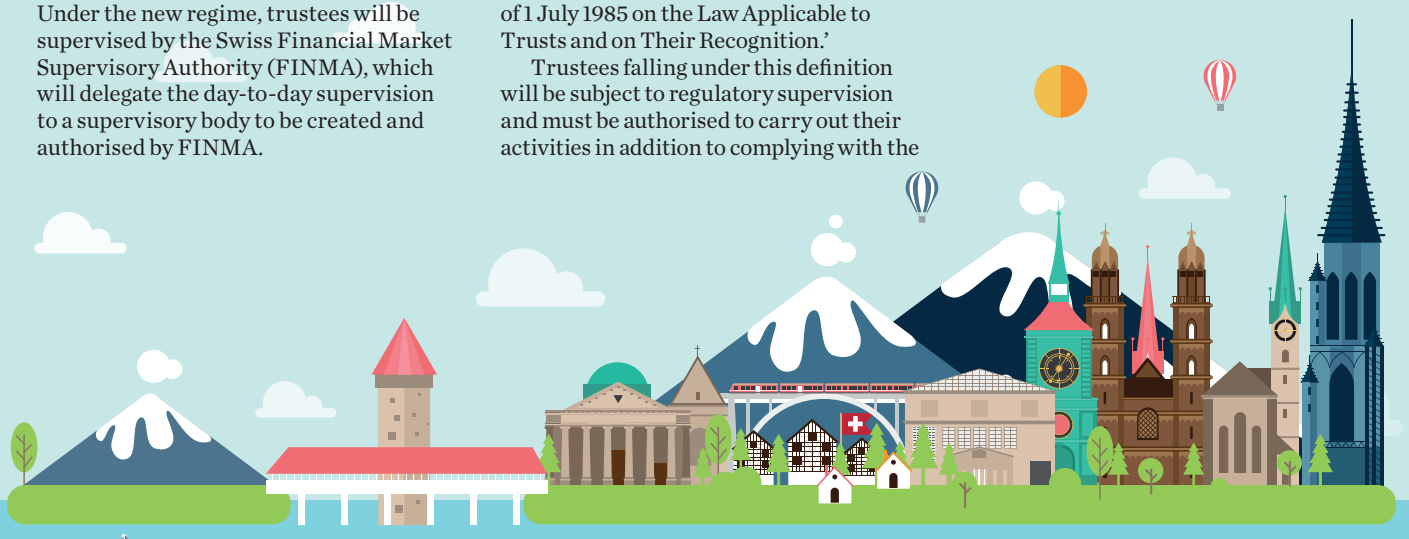
WHAT CAN I TAKE AWAY?
The proposed rules sometimes overlook the specificities of trusts and apply to trustees measures aimed primarily at asset managers. The proposed regulatory regime, while generally welcomed, will inevitably give rise to uncertainties and challenges requiring particular attention from trustees operating in Switzerland.

The new legislation will apply not only to trustees incorporated in Switzerland (Swiss trustees), but also to foreign trustees maintaining a presence in Switzerland, such as a branch or a representation, or those carrying out cross-border activities.

Under the FinIA, a trustee is defined as 'whoever on a professional basis manages or disposes of a separate fund for the benefit of a beneficiary or for a specified purpose based on the instrument creating a trust within the meaning of the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on Their Recognition.'

Trustees falling under this definition will be subject to regulatory supervision and must be authorised to carry out their activities in addition to complying with the following structural, organisational, business-conduct and audit requirements:

- **Structure:** a trustee can take the form of sole proprietorship, commercial enterprise or cooperative, and can be registered in the commercial register only once authorised. There is a minimum requirement of paid capital of CHF100,000, with the obligation to maintain adequate financial coverage or professional liability insurance.
- **Organisation:** a trustee's management must be exercised by at least two 'qualified persons', defined in the FinIA as persons with adequate training to act as trustee and with sufficient professional experience. In addition, a trustee must have an appropriate corporate and management organisation, risk management, and adequate internal control systems. Finally, the effective place of management must be in Switzerland.
- **Business conduct:** trustees and those persons responsible for trust administration and management must be fit and proper, uphold a good reputation and attain the necessary professional qualifications.
- **Audit:** trustees are subject to an annual audit, which may be extended to once every four years, with the obligation to submit an annual report on the conformity of their activities when no annual audit is conducted.



The FinIA provides for a transition period, during which existing trustees must report to their supervisory body within six months from FinIA's effective date. In addition, application for authorisation must be made within three years of the FinIA's entry into force.

Under the bill, violations of professional confidentiality, the prohibition of fraud and the obligations to report are subject to criminal sanctions, whereas the general liability of FIs and trustees will be governed by the Swiss Code of Obligations.

As always, the devil will be in the details. Many of the general obligations set out in the FinIA are still to be specified in the implementation ordinance, such as the requirements for trustees' training and qualification, standards of sufficient collateral, and adequate professional liability insurance. Moreover, the one-size-fits-all approach favoured by the Swiss legislator sometimes fails to grasp the specificities of trusts, thus creating uncertainty in the interpretation and implementation of certain provisions. The rules for civil liability are a confusing example; they essentially amount to applying a civil-law remedy to a common-law institution.

In this respect, an important question remains as to whether the FinSA should apply to trustees. At present, the FinSA essentially applies to financial service providers, financial advisors and providers of financial products. It aims to protect their clients. As trustees do not have 'clients' and do not provide financial services as defined under the FinSA, it is arguable whether they should fall under the scope of the FinSA and the regulatory obligations it imposes. The requirements for trustees under the FinSA will thus require further clarification by the legislator and the courts.

DUTY TO SUPERVISE FINANCIAL SERVICE PROVIDERS

Irrespective of the direct application of the FinSA to trustees, the enhanced obligations imposed by the FinSA for the provision of financial services will translate into an increased duty of supervision in cases of delegation of trust asset management.

KICKBACK PAYMENTS

Under the current legal framework, a trustee may already be under an obligation to claim against another financial service provider in breach of its obligations. In 2012, the Swiss Supreme Court considered a case of inducement in which it ruled that, absent any valid waiver, inducements are to be restituted to the principal.[1] A typical example involved a fund distributor paying kickbacks to a bank, or an asset manager corresponding to a fixed percentage of client assets invested in a given fund. Following this decision, FIs faced a series of claims from clients demanding restitution of kickbacks received during the last ten years – the statutory limitation period for contractual claims.

A popular defence raised by financial service providers was to argue that kickbacks are periodic payments and thus subject to a statutory five-year limitation period. Scholars were split as to whether the limitation period was five or ten years. Absent any case law, this theory worked as an effective deterrent to many claimants, who did not want to risk being time-barred on half of the claims. In a recent decision,[2] the Swiss Supreme Court clarified that the limitation period for inducement claims is ten years.

For trustees (and more generally for any person owing fiduciary duties to third parties) holding or managing assets in Switzerland, there is a statutory duty to claim back such kickbacks from the bank or asset manager. However, many trustees have not done so, exposing them to potential damage claims and criminal sanctions. In light of the Supreme Court's recent confirmation of the ten-year limitation period, the volume of the claims will likely increase along with the potential liability for failing to claim restitution for inducements.

CONCLUSION

The introduction of the FinIA and FinSA will be a game changer for trustees, who will become subject to regulatory supervision obliging them to obtain an authorisation. The recent decision by the Swiss Supreme Court on claiming restitution of kickbacks illustrates the necessity for trustees to proactively monitor their obligations under the new regime.

While the scope of application will be further defined by the legislator and courts, the new regime should reinforce the general reputation and competitiveness of Switzerland as a financial centre. It should also ensure the quality, integrity and accountability of the Swiss trust industry. However, the bills sometimes overlook the specificities of trusts and applies to trustees measures aimed primarily at asset managers. The proposed regulatory regime, while generally welcomed by the industry, will inevitably give rise to uncertainties and challenges requiring particular attention from trustees operating in Switzerland.

1 Decision of the SSC 4A_127/2012 and 4A_141/2012 dated 30 October 2012 **2** Decision of the SSC 4A_508/2016 dated 16 June 2017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