Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

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Regulation of the production and distribution of financial products

(FINMA position paper on distribution rules)

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Key points

In its discussion paper on regulating the production and distribution of financial products to retail clients dated October 2010 ("FINMA Distribution Report"), FINMA noted that the law as it stands **does not adequately protect clients**. In FINMA's view, the following measures should be taken to improve client protection:

Rules for financial products

1. To improve client protection on the Swiss financial market, a prospectus requirement should be introduced for all standardised financial products offered in Switzerland. Prospectuses should be drawn up in accordance with a prescribed format and should contain all the key information about the producer and the product itself.
2. Clients should be provided with a clear and concise product description before acquiring compound financial products. The product description should set out the key product characteristics, risks and costs. To increase comparability between the different product types, the legislature should enact regulations governing the composition of the document.
3. The prospectus requirement and the obligation to draw up a product description should apply primarily to products aimed at retail clients.

Stricter rules on business conduct and organisation for financial services providers

4. Financial services providers have to inform clients about their own business activities and their authorisation status before they carry out a financial transaction.
5. Financial services providers should be obliged to inform clients of the content of their specific service. They may only describe themselves as being independent if they do not accept incentives from third parties when performing services for their clients.
6. Financial services providers must inform clients of the characteristics, risks and costs of the type of transaction under discussion before they perform the service in question.
7. Financial services providers must provide product documentation. In particular, they must provide retail clients with a product description for compound financial products. Prospectus documents are only to be made available on request. During contact with the client, advertising material should be clearly separated from the documents required under supervisory law.
8. Before carrying out a transaction for a retail client, financial services providers should be obliged to determine the client's experience and knowledge of the type of product in question or the service to be provided. If they regard a transaction as being inappropriate, they should warn the client.
9. Before issuing personal advice, financial services providers should determine whether a transaction is suitable for the client. For this purpose, they must ascertain their clients' experience and knowledge, investment objectives and financial situation. Before taking on portfolio management mandates, they must also ascertain whether the client has understood the significance of issuing the order and whether the chosen investment strategy is suitable for the

client.

10. Financial services providers may only carry out transactions with financial products for a retail client without an appropriateness test if the client instructs the provider to carry out the transaction on their own initiative and the products in question qualify as simple financial products. Simple financial products are readily understandable, do not impose any obligation on the client over and above the acquisition costs, and may be regularly sold on the market or returned to the producer.
11. Financial services providers should document the scope and subject matter of the agreed service. They should also duly account for the services provided.

Extension of supervision

12. All portfolio managers that are not supervised under current law should be made subject to supervision. They must comply with the rules of business conduct and must have an appropriate organisation and adequate capital.
13. Those who have contact with clients should prove in a test that they have sufficient knowledge of the rules of business conduct, the principles of financial planning and the products distributed. Their specialist expertise should be improved through regular further training. Clients should also be able to check via a publicly accessible register whether their client advisor or product distributor meets the corresponding quality standards.
14. Cross-border services may only be provided to clients in Switzerland from other countries if those clients enjoy the same protection as they would if the financial services provider were based in Switzerland. The Swiss regulations on the distribution of financial products should therefore be extended to cover activities from abroad.

Enforcement

15. Enforcement of the claims of retail clients against financial services providers should be improved.

Creation of a financial services act

16. Implementation of the measures will require the creation of a new statutory basis. To ensure that the conduct and product rules at the point of sale apply across all sectors and without exception, they should be firmly established in a new law (financial services act).
17. The rules on the authorisation and supervision of portfolio managers should be incorporated into the Swiss Stock Exchange Act.
18. The introduction of cross-sector business conduct and product regulations necessitates changes to the applicable financial market laws and the Swiss Code of Obligations. Existing provisions on the documentation and distribution of financial products should continue to apply only when sector-specific circumstances require special arrangements.

The proposed **measures are mutually complementary**. Improved documentation on a financial product can only be effective if providers forward that information to their clients. Furthermore, financial services providers can only advise their clients with due care if they are aware of those clients' financial situations, investment objectives, experience and knowledge. Finally, rules of business conduct only offer clients comprehensive protection if they have to be adhered to by all financial services providers. The proposals that follow are therefore always to be placed in the overall context of client protection and not viewed in isolation.

1 Background

Swiss financial market law aims at safeguarding the functionality of the Swiss financial market and protecting clients, i.e. creditors, investors and policy holders. These two goals are supported by ensuring an adequate flow of information between market participants. An efficient financial market, and the trust of market participants in that market, can only exist if the key information on products traded and services offered is available to all market participants in a timely, comprehensive and easily comprehensible form. Creating transparency for all market participants is therefore vital to the implementation of the goals that are firmly established in law.

In its discussion paper on regulating the production and distribution of financial products to retail clients dated October 2010 ("FINMA Distribution Report"), FINMA noted that the law as it stands does not ensure that all market participants have appropriate access to key information, with the result that clients are not adequately protected. The report invited discussion on a number of regulatory measures to rectify the shortcomings identified. In their comments on the FINMA Distribution Report, many of the consultation respondents also called for regulatory adjustments to strengthen client protection (see FINMA consultation report dated February 2012).

In this position paper, FINMA sets out specific policy proposals designed to improve the protection offered to clients under Swiss law. The proposals aim to redress the information imbalance between clients and providers of financial products, ensuring that Swiss clients are aware of the opportunities and risks associated with a financial product or service before they purchase or use it. The proposals relate to the production and distribution of financial products by banks, insurance companies, fund management companies, portfolio managers and other market participants. The term "financial products" is in principle deemed to include all products issued and traded on the Swiss financial market. Primary focus is in particular on financial products with investment character, including savings products; they do not cover consumer credit and mortgage products.

The proposals to improve client protection follow a threefold approach. First, requirements on financial product documentation are to be incorporated into supervisory law (section 2). Second, the requirement for providers to supply information to clients is to be strengthened via rules of business conduct (section 3): financial services providers are to be compelled to inform their clients about the service offered and their interest in it, and to treat their clients fairly. Third, client protection is to be enhanced via supervision of portfolio managers, improved knowledge on the part of client advisors, and increased regulation of cross-border services (section 4). Regulatory measures in this area extend beyond mere requirements on transparency: they ensure that those who have contact with clients are competent, and that supervisory measures can be taken to deal with any inappropriate conduct.

The proposed measures are mutually complementary. Improved documentation on a financial product can only be effective if providers forward that information to their clients. Clients must be familiar with the service and the interests of the provider if they are to interpret correctly the statements made by that provider concerning various products. Furthermore, financial services providers can only advise their clients with due care if they are aware of those clients' financial situations, investment objectives, experience and knowledge. Finally, rules of business conduct only offer clients comprehensive protection if they have to be adhered to by all financial services providers. Hence, protection should also be extended to clients using financial services supplied by foreign providers. The comments that follow are therefore always to be placed in the overall context of client protection and not viewed in isolation. This is the only way to compensate adequately for existing information asymmetries without drastically curtailing the freedom of action enjoyed by market participants.

2 Rules on financial products

2.1 Problem: inadequate compliance with the obligation to provide information on financial products

The law as it stands imposes widely differing requirements concerning documentation of the characteristics of the numerous types of product on offer. Not all product types are subject to rules governing the composition of prospectuses. Only in isolated cases are there rules on drawing up a concise information document setting out the key characteristics and risks of a product ("product description").

Inconsistent and incomplete compliance with the obligation to provide prospectuses

Swiss regulations on prospectuses for financial products differ widely and contain gaps. For example, unlisted shares in a Swiss company can be offered for public sale without any requirement to inform the investors addressed about the opportunities and risks of the investment. Where issues of foreign securities are concerned, opinion is divided as to whether there is a prospectus requirement at all. There are also different requirements for prospectuses for structured products, bonds and collective investment schemes. These discrepancies in the regulatory requirements are especially problematic if different product types are similar from an economic perspective. This is especially true for structured products and collective investment schemes. Additionally, the distinction between simple derivatives, structured products and bonds with a variable interest rate is not always clear.

An example of inconsistent compliance with the obligation to provide prospectuses: bonds and structured products

Under Article 1156 of the Swiss Code of Obligations, issuing prospectuses for unlisted bonds are required to contain only rudimentary information about the issuing company and the products themselves. Current law does not require the prospectus to point out the risks associated with acquiring the bond. In the case of listed bonds, the documentation provided to investors is substantially more comprehensive. Moreover, different requirements apply in respect of debt securities that constitute structured products within the meaning of Article 5 of the Collective Investment Schemes Act. The distinction between the various types of debt securities is not always clear. The wide range of prospectus requirements means that investors receive different information when acquiring debt securities. This makes it more difficult to compare the various products and can render it impossible for a client to assess the impact on their assets of acquiring a product.

As a result of the varying requirements concerning prospectuses for standardised financial products, the information available to clients differs depending on the type of product involved. With many products, issuers are also free to use the prospectus chiefly as advertising material or to shield them against any claims by investors. Additionally, the differing prospectus requirements lead to variations in the liability conditions for issuers and other persons involved in drawing up a prospectus. Finally, current law takes insufficient account of the changes that products undergo during their term.

Inadequate regulation of sales documentation

The purpose of prospectuses is to inform investors. For many clients, however, these documents are too detailed and insufficiently clear. Particularly where compound financial products are concerned, it is difficult for clients to appreciate their characteristics and profit and loss prospects on the basis of a detailed prospectus. As a result, when acquiring financial products clients are generally guided not by the detailed prospectus but by the accompanying documentation supplied by the product provider.

However, providers design this advertising material in different ways. Swiss law contains no minimum standards governing the documentation on financial products that providers supply to their clients. This omission leads to misunderstandings and false expectations on the part of clients and complicates the task of comparing different products. Finally, clients are often unable to tell from the sales documentation what costs are involved in acquiring a financial product.

An example of inadequate sales documentation: the costs of structured products

Structured products are generally created by a bank's investment banking unit. The issuance of these products is linked to a whole range of financial incentives for producers. In most cases, producers are permitted to dispose freely of investors' money once a product has been issued, and they can also charge their clients fees for the distribution and management of the products. Moreover, they make a profit on the structuring of the product. The price of structured products containing an option component, for instance, is routinely calculated using a volatility that differs slightly from the producer's own expectations. Finally, producers also generate income by acting as a market maker for their products on the secondary market (via the bid-ask spread). Not only producers but also mere distributors of structured products receive remuneration that is charged directly or indirectly to investors.

Under current law, only a fraction of the income from the production and distribution of structured products is disclosed to the client. This means that clients do not know exactly what the acquisition of a compound product is actually costing them. Moreover, the incentives for the production and distribution of such products are often not apparent to them. This lack of transparency is particularly unsatisfactory because producers take account of these sources of income in their internal earnings calculations and thus in determining the salaries of their staff. This increases the incentive to sell clients the products that have the highest possible margin.

2.2 Prospectus requirement for all standardised financial products

The gaps in client information detailed above can be closed by introducing a uniform prospectus requirement for all standardised financial products. The term "standardised financial products" applies in particular to equities, bonds or structured products issued on a large scale. For collective investment schemes, by contrast, there are already detailed regulations governing prospectus requirements under current law. It is not the intention to abandon these fund-specific regulations. Rather, the aim is to ensure that the new prospectus requirement results in clients having a comparable level of information on fund-like standardised financial products. Equally, there is no intention to impose a prospectus requirement for insurance products. The existing insurance-specific documentation already ensures that clients are informed about such products. Finally, there will not be a prospectus requirement for pure savings products.

In principle, the requirement to compile a prospectus is to apply to all products distributed in Switzerland. It should essentially be immaterial whether the producer or distributor has their registered office in Switzerland or abroad, or whether or not a product is listed on an exchange. Prospectuses are to be drawn up in accordance with a prescribed format and should contain all the key information about the producer, third parties involved – such as guarantors – and the product itself. They should also include a clear indication of the risk factors associated with the issuer or products. When determining the prospectus requirements, the characteristics of particular product types are to be taken into consideration. As far as possible, however, the prospectuses of all standardised financial products should have a uniform structure. If a given issuer issues a large number of similar products, the prospectus documentation could be provided in the form of a basic prospectus, with specific information on the individual issues being contained in separate documents. Appropriate checks must be carried out before the offer is published, to ensure that the prospectuses comply with the legal requirements.

In cases where financial products can change after they are issued, clients must be constantly informed of such changes. The requirement for this follow-up publicity is particularly acute in the case of compound products that are actively managed and whose composition and risks can change substantially during their term.

Key point 1

To improve client protection on the Swiss financial market, a prospectus requirement should be introduced for all standardised financial products offered in Switzerland. Prospectuses should be drawn up in accordance with a prescribed format and should contain all the key information about the producer and the product itself.

2.3 Product descriptions for compound financial products

Concise and easily comprehensible documentation – in the form of a product description – should be available at the time of offering for all compound financial products offered to clients in Switzerland. It must summarise the key characteristics and risks of a product and provide transparency concerning the costs associated with acquiring the product. The risk disclosure must in particular explain the share price, issuer and foreign currency risks. The product description should also contain a clear reference to the product type and set out any restrictions on returning the product for redemption, such as lack of liquidity or long terms to maturity. It should also state whether the provider is also the producer of the product.

The term “compound financial products” is to be understood as covering all products that are made up of different components. Whether the product is issued in standardised form or designed in accordance with an individual client requirement is not relevant in this regard. The term therefore covers in particular structured products and insurance products with investment character, such as unit-linked life insurance. In the latter case, the product description stands alongside the insurance company’s information requirements under Article 3 of the Insurance Contract Act / Article 12 of the draft complete revision of the Insurance Contract Act of September 2011. While the information duty under insurance law requires the client to be informed about the characteristics of the insurance contract itself, the product description should inform the client about the structure of the product as well as the characteristics and risks of the components used.

To increase comparability between product types and between the products of different producers, the legislature should enact strict regulations governing the composition, sequence and length of the document. The requirements for securities funds under Article 76 of the Collective Investment Schemes Act or the so-called Key Investor Information Document (KIID) for European UCITS funds may serve as models for this documentation.

Key point 2

Clients should be provided with a clear and concise product description before acquiring compound financial products. The product description should set out the key product characteristics, risks and costs. To increase comparability between the different product types, the legislature should enact regulations governing the composition of the document.

2.4 Standardised rules to better protect retail clients

The imbalance between financial services providers and clients is particularly marked in the case of retail clients. The term “retail clients” in principle covers all individuals (natural persons), regardless of their financial situation. It also includes companies that do not possess special knowledge of the financial markets. By contrast, market participants such as institutional clients, supervised investors – e.g. banks, insurance companies and securities dealers – as well as larger companies are normally able to obtain the information relevant to a transaction. Such professional clients do not necessarily require a prospectus or clear product description.

For this reason, the product transparency rules set out above should essentially only apply to retail clients. However, professional clients should be given the opportunity to “opt in” to the protection offered to retail clients, while retail clients with a certain level of assets and adequate professional qualifications in the market segment concerned should be able to “opt out” of the enhanced protection.

The legislature should set out standard criteria for this client segmentation in respect of all financial products. The client segmentation should be based on that stipulated in the ongoing partial revision of the Collective Investment Schemes Act. The permitted conditions for opting in or opting out should also be set out in the regulations. Opting out should be allowed only if the client concerned has sufficient assets as well as the specialist knowledge and experience required to understand the financial products in question and the risks they involve.

Key point 3

The prospectus requirement and the obligation to draw up a product description should apply primarily to products aimed at retail clients.

3 Stricter rules on business conduct and organisation for financial services providers

3.1 Problem: insufficient regulations on the business conduct of financial services providers

For clients it is often not apparent whether financial services providers are acting solely in the client's interest when providing services or whether they are motivated by additional incentives. There is also a lack of clear supervisory regulations governing how financial services providers must inform clients about financial products and their risks.

Lack of information on the financial services provider

Financial services providers are not always subject to official supervision. Pure investment advisors and external portfolio managers may operate without having to apply for a corresponding authorisation. Even in the case of authorised financial services providers, there are considerable differences in the extent of the supervision. For example, the authorisation requirements for unaffiliated insurance intermediaries are significantly less stringent than those for a bank or insurer. The law as it stands does not take sufficient account of these differences. In accordance with Article 3 of the Financial Market Supervision Act (FINMASA), all financial services providers may refer to themselves as supervised persons and entities if they are "persons and entities that under the financial market acts require to be licensed, recognised, authorised or registered by the Financial Market Supervisory Authority". There is no clear distinction between service providers subject to constant supervision and entities that are only supervised in certain respects, and this leads to misunderstandings among clients. In particular, the impression may arise that the assets and interests of clients are equally well protected when dealing with all supervised persons and entities as defined under Article 3 FINMASA.

An example of insufficient disclosure of authorisation status: DSFIs

Under the Anti-Money Laundering Act (AMLA), persons who on a professional basis accept or hold on deposit assets belonging to others must be affiliated to a self-regulatory organisation or require authorisation from FINMA. If a financial services provider opts for direct supervision by FINMA, they are a directly subordinated financial intermediary (DSFI) and thus a supervised person/entity as defined under Article 3 FINMASA. However, FINMA only checks whether a DSFI complies with the requirements specified in the AMLA. There are no further requirements with regard to the organisation or capitalisation of these persons/entities. DSFIs are not subject to any special requirements to provide information, warnings or advice to their clients. The reference to a DSFI as a supervised person/entity does not provide any information in this regard, and can lead to false expectations among clients with regard to the supervision of these market participants.

Insufficient knowledge of the subject matter of the service and the motivation of the financial services provider

Clients are not always sufficiently informed with regard to the service a financial services provider is performing for them. In addition, as a rule they assume that a client advisor primarily represents the interests of the clients. The existing supervisory regulations only partly correct these false expectations. For example, there is no duty to disclose client advisors' incentives within their firms to clients. Furthermore, current supervisory law does not comprehensively cover the permissibility and disclosure of remuneration from third parties. The corresponding rights and duties of clients and financial services providers are therefore largely defined by the legal relationship between the parties under civil law. As a result, it is difficult for clients to predict how transparent their client advisor has to be in a specific instance.

An example of incomplete information on incentives: trailer fees and finder's fees

In Swiss supervisory law, no act or ordinance clearly and comprehensively regulates how financial services providers must treat payments they receive from third parties as part of conducting their client transactions. The duties of service providers are therefore largely defined by civil law. For example, in its ruling of 22 March 2006, the civil section of the Swiss Federal Supreme Court decreed that portfolio managers must disclose to their clients any remuneration received from third parties and the amounts should in principle be passed on to the clients. However, the ruling did not fully clarify the question of distribution remuneration. It was only in its ruling of 29 August 2011 that the Federal Supreme Court set out in detail the circumstances under which a client may waive the passing on of remuneration in advance. For remuneration of third parties made in different circumstances, there remains insufficient legal certainty even after this ruling.

Inconsistent and incomplete compliance with obtaining and providing information and warnings

The current rules on business conduct do not comprehensively define how financial services providers must inform their clients about the financial products in question before they carry out a transaction. In the case of financial services providers that are not subject to the rules on business conduct set down in the Collective Investment Schemes Act, Stock Exchange Act or Insurance Contract Act, their duties to provide information are based on the civil law relationship between the providers and their clients.

Swiss supervisory law also does not contain any general duty for financial services providers to obtain information on the experience and knowledge of a client before a transaction is concluded and to warn the client if a transaction is not appropriate for them. For example, Article 11 of the Stock Exchange Act only obliges securities dealers to inform clients of the risks associated with certain types of transactions; it does not contain any explicit duty for financial services providers to warn a client if they regard a transaction as being inappropriate for that client. The requirements for obtaining information and providing warnings based on civil law do not provide sufficient clarity.

An example of insufficient provision of information: unit-linked life insurance plans

Unit-linked life insurance plans are capital-forming insurance plans. They pay benefits upon the death of the policy holder or on the expiry of a contractually agreed period. The insurance companies invest part of the premiums they receive in units of collective investment schemes. The benefits they provide depend on the performance of these fund units. Unlike traditional life insurance, with unit-linked life insurance the policy holder therefore bears the investment risk. As with all life insurance, unit-linked life insurance plans are also based on the policy holder being tied to the plan for the long term.

Retail clients in particular are unaware of the characteristics of unit-linked life insurance unless they are informed by the product provider. However, under current law providers of these products are not subject to any adequate requirements for providing information or warnings. In particular, they are not obliged to inform their clients comprehensively about the characteristics of the products and to warn them of the possible risks of an investment. The packaging of collective investment scheme units in an insurance product can therefore lead to clients being less well informed when such products are distributed than they would be if they had bought the same fund units in “unpackaged” form.

3.2 Information on the financial services provider’s authorisation status and area of activity

If clients are to be able to make an appropriate assessment of a financial service, they have to know who is providing this service. Financial services providers should therefore be obliged to disclose their authorisation status and area of activity before carrying out their service. They must inform clients in writing whether they are supervised by an authority and which activities are covered by this supervision. Service providers should only be able to refer to themselves as a supervised person or entity if their business conduct and organisation is subject to ongoing official supervision. The information requirements for insurance intermediaries to be introduced as part of the ongoing complete revision of the Insurance Contract Act can serve as the basis for the creation of institution-specific duties to provide information. The information may be provided in standardised form.

Key point 4

Financial services providers have to inform clients about their own business activities and their authorisation status before they carry out a financial transaction.

3.3 Disclosure of the service and interests of the financial services provider

Before performing the service, financial services providers should inform their clients about which service they plan to provide, what interests they represent when doing so, and what costs the service entails. In particular, if a financial services provider’s advisory services pertain only to its own products, it must make clear reference to this fact. Furthermore, if a financial services provider receives remuneration from third parties on the distribution of certain products, it must disclose this fact. If client advisors receive remuneration within their companies for the distribution of certain products, the client must also be informed about this arrangement.

Financial services providers should only be allowed to refer to themselves as being independent if they do not accept any incentives from third parties and are not tied to third parties in any other way, for example by contractual obligations or obligations under company law. Independent client advisors must consider a representative product range for the different types of product. In the case of insurance intermediaries, there is already a distinction made in the current law between affiliated and unaffiliated service providers. This categorisation is also to be retained in the ongoing complete revision of the Insurance Contract Act.

Key point 5

Financial services providers should be obliged to inform clients of the content of their specific service. They may only describe themselves as being independent if they do not accept incentives from third parties when performing services for their clients.

3.4 Information on the characteristics, risks and costs of products

The requirements for providing information applicable to securities dealers and licensees of collective investment schemes should apply to all financial services providers. Financial services providers should have to inform their clients about the characteristics, risks and costs of the type of transaction in question before they perform a corresponding service. The requirements with regard to the information on product characteristics and risks should go beyond the current self-regulatory standards in the securities trading business (cf. the Swiss Bankers Association brochure on special risks in securities trading, 2008). On the basis of the information, a client must be able to judge whether a product of a certain type is a viable option for them at all, and whether they can understand and assess the risks involved themselves. The information must therefore contain a reference to the potential for loss that the investment entails, and to the costs that may be incurred on the acquisition and sale of the product as well as during its term. The information may be provided in standardised form, but must take into account the experience and knowledge of the client group being addressed.

Key point 6

Financial services providers must inform clients of the characteristics, risks and costs of the type of transaction under discussion before they perform the service in question.

3.5 Providing the product documentation

The duty to draw up prospectuses and product descriptions as set down in section 2 is primarily incumbent on the producers of the products. However, even if there is full and clear product documentation this only helps clients if they can actually obtain the corresponding documentation before acquiring the product. The product descriptions for compound financial products as set down in subsection 2.3 allow retail clients to form a view of the key characteristics and risks of the product in question. Financial services providers should therefore be obliged to present clients with product descriptions as soon as they offer them a product. However, the prospectus documentation as set out in subsection 2.2 contains detailed information on the product and the producers. Not all clients require these comprehensive documents to make a purchase decision. Financial services providers may therefore restrict themselves to only making prospectuses available to clients on request.

Financial services providers should be obliged to make a clear distinction between the documents to be drawn up in accordance with supervisory law, such as product descriptions, prospectuses, and general insurance terms and conditions on the one hand, and advertising materials on the other. Advertising brochures should be marked as such and may only be used in conjunction with and not instead of the documents required under supervisory law.

Key point 7

Financial services providers must provide product documentation. In particular, they must provide retail clients with a product description for compound financial products. Prospectus documents are only to be made available on request. During contact with the client, advertising material should be clearly separated from the documents required under supervisory law.

3.6 Checking the appropriateness of financial products

Transactions with financial products can under certain circumstances have considerable implications for clients' assets. Clients should therefore be made aware when they are entering into financial transactions whose characteristics and risks they cannot appreciate. Financial services providers should thus be obliged to check the appropriateness of a transaction beforehand. They should have to obtain information on the experience and knowledge of their clients and, based on this, assess whether the type of product in question or the service to be provided is appropriate for the client concerned. If they conclude that the client does not have the experience or knowledge of the area in question, they must warn the client accordingly before carrying out the transaction. After receiving this warning, the client is free to have the transaction carried out nevertheless.

If a client is a professional investor, the financial services provider may in principle assume that the client has sufficient experience and knowledge to appreciate the risks of a transaction. Hence the appropriateness test only applies to retail clients as a rule.

Key point 8

Before carrying out a transaction for a retail client, financial services providers should be obliged to determine the client's experience and knowledge of the type of product in question or the service to be provided. If they regard a transaction as being inappropriate, they should warn the client.

3.7 Providing information on the suitability of investments in the case of advice and portfolio management

Financial services providers may give a client advice on the acquisition of a financial product only if, in addition to having determined the client's experience and knowledge, they are also aware of the client's financial situation and investment objectives. They should therefore be obliged to ask the client about these factors before issuing personal advice. Furthermore, financial services providers must check whether the product is suitable for the client against this backdrop, and whether it tallies with the client's risk awareness and willingness to take risks. The suitability test must also take into account the risk diversification of a client's portfolio. Personal advice is deemed to be any recommendation given to a certain client that relates to a transaction with a specific financial product. Advice is not deemed to be personal, however, if it is addressed to the general public and not to a specific investor. If a financial services provider does not receive sufficient information to check the suitability of a financial product for a client, they must inform their client of this situation. In such cases, they may not give the client any personal advice on a specific product.

If a financial services provider takes over the management of clients' portfolios, they must also carry out a suitability test. This test should focus on the one hand on the portfolio management itself. The financial services provider must therefore check before concluding the portfolio management agreement whether the client understands what "portfolio management" means and whether the investment strategy chosen corresponds with the objectives and financial situation of the client. On the other hand, the portfolio manager must also check whether the individual transactions are suitable for the client in question. Unlike with advice-only services, this decision in respect of portfolio management does not require any detailed test in advance. Rather, an investment should in principle be deemed suitable if the chosen investment strategy, the applicable investment guidelines and the existing investments have been taken into account in making the investment decision. The investments in the client's portfolio are to be constantly monitored.

Key point 9

Before issuing personal advice, financial services providers should determine whether a transaction is suitable for the client. For this purpose, they must ascertain their clients' experience and knowledge, investment objectives and financial situation. Before taking on portfolio management mandates, they must also ascertain whether the client has understood the significance of issuing the order and whether the chosen investment strategy is suitable for the client.

3.8 Restriction of execution-only services for retail clients

As a rule, the characteristics and risks of exchange-traded equities and bonds are readily understandable for all clients. In addition, the clients have sufficient information on these financial products to obtain a picture of their key facets. Retail clients can also decide on the acquisition of such simple financial products without the financial services provider having to check the appropriateness of the transaction in advance. If a retail client approaches a financial services provider on their own initiative and instructs the provider to acquire a simple financial product, the requirement for an appropriateness test as specified in subsection 3.6 can therefore be waived. A supervisory law decree must specify which financial products are deemed to be simple.

The key criteria for categorising a financial product as a simple product are (a) the ease of understanding how it works, (b) the regular possibility of selling or redeeming the product, and (c) the amount of product information publicly available. Furthermore, it is also relevant that (d) in purchasing the product the client does not enter into any obligations that go beyond the acquisition costs. Products with derivative components are as a rule not simple financial products.

Key point 10

Financial services providers may only carry out transactions with financial products for a retail client without an appropriateness test if the client instructs the provider to carry out the transaction on their own initiative and the products in question qualify as simple financial products. Simple financial products are readily understandable, do not impose any obligation on the client over and above the acquisition costs, and may be regularly sold on the market or returned to the producer.

3.9 Documentation on the service provided

Financial services providers should have to document the subject matter of the service. Subsequent uncertainty over the scope of the service due can thus be avoided. The documentation must set down the key aspects of the agreed financial service and must contain information on the remuneration structure. In the case of advisory services and portfolio management mandates, the product universe should also be described. In addition to this, a written framework agreement with the client must be documented. Furthermore, the results of the appropriateness and suitability tests specified in subsections 3.6 and 3.7 as well as the key information on services actually provided should be recorded.

Key point 11

Financial services providers should document the scope and subject matter of the agreed service. They should also duly account for the services provided.

4 Extension of supervision

4.1 Problem: incomplete coverage of financial services providers under supervisory law

Current law does not impose comprehensive supervision on all financial services providers, and does not stipulate any clear requirements with regard to the knowledge of those who have contact with clients. As a result, clients have only insufficient protection in various situations.

Gaps in supervision of portfolio managers

Portfolio managers decide independently on the investment of client assets within the framework of the agreed investment strategy. Although clients are informed of the investments made after the fact, they are not involved in taking the decision themselves. The activities of portfolio managers are regulated to differing extents. While supervised market participants such as banks or securities dealers are subject to supervision in the performance of portfolio management agreements, pure portfolio managers are in principle not supervised. It is therefore possible for clients to delegate decision-making powers over their assets to persons/entities that are not subject to any requirements under supervisory law in respect of business conduct, organisation or capital adequacy. Clients often only become aware of incorrect conduct by the portfolio manager after their portfolio has incurred considerable losses. Once this has occurred, the clients affected have little prospect of success in claiming damages against an unregulated portfolio manager.

Insufficient checks on the knowledge of persons who have contact with clients

Prior to transactions in financial products, clients are reliant on competent and appropriate guidance. Current supervisory law does not contain clear requirements with regard to the knowledge and level of training for all persons who have contact with clients. Explicit requirements on the proof of sufficient specialist qualification apply only in the case of insurance intermediaries. This gap can result in clients dealing with persons that themselves have only insufficient specialist knowledge and do not know what rules of conduct they must observe in dealing with their clients. Clients are typically not informed that those they are dealing with lack the requisite knowledge.

Insufficient protection in the case of cross-border financial services

If financial services are provided to clients in Switzerland from other countries, under applicable law those clients do not always have the same protection as they would if the service were supplied by a Swiss provider. In particular, foreign service providers that have no physical presence in Switzerland are not subject to any regulatory and supervisory law requirements even for activities that would in principle require authorisation in Switzerland. Irrespective of their authorisation status, they can actively contact a Swiss client to offer them banking services or financial products. Clients are typically unaware of this discrepancy in protection between supervised Swiss providers and those from abroad. They therefore do not appreciate the additional risks entailed in accepting services from other countries.

4.2 Introduction of supervision of all portfolio managers

The extensive decision-making powers held by portfolio managers require special protection for the clients in question. Even hitherto unsupervised portfolio managers should therefore be subject to a requirement to obtain authorisation and to ongoing supervision. Under this supervision, portfolio managers should be required to comply with the business conduct rules set down in section 3 and put in place an appropriate organisation. Furthermore, those responsible for management and business operations must have a good reputation, provide an assurance of proper business conduct, and possess the requisite specialist qualifications. Finally, portfolio managers should also have adequate capital.

Key point 12

All portfolio managers that are not supervised under current law should be made subject to supervision. They must comply with the rules of business conduct and must have an appropriate organisation and adequate capital.

4.3 Quality test for all client advisors and product distributors

The knowledge and skills of persons who have contact with clients prior to financial transactions are central to the quality of the services provided. In addition to extending supervision to institutions that provide financial services, quality standards should therefore also be ensured for all those who have contact with clients. To ensure that client advisors and product distributors meet appropriate minimum requirements on providing professional support for their clients, they should have to prove their knowledge of the rules of business conduct vis-à-vis clients by means of a test. The test should also ensure that client advisors know the principles of financial planning and have sufficient knowledge of the products they distribute. The test can be conducted by FINMA or a third party. Client advisors should also regularly improve their knowledge by taking further training courses.

Only those who pass the test and can prove that they have completed the required further training should be included on a publicly accessible register of client advisors. Based on these register entries, clients can assess whether the person they are dealing with is qualified to support them competently in the execution of financial transactions.

The register and test regime described must apply to all individuals who have contact with clients. The test should also be obligatory for client advisors who work for supervised financial services institutions as employees or on a contract basis. The institutions must be obliged to only use registered client advisors and product distributors. The introduction of the new quality standards does not release supervised institutions from their duty to train their staff appropriately for their specific tasks. The existing supervision of insurance intermediaries and distributors of collective investment schemes should be integrated into the quality test for all persons who have contact with clients.

Key point 13

Those who have contact with clients should prove in a test that they have sufficient knowledge of the rules of business conduct, the principles of financial planning and the products distributed. Their specialist expertise should be improved through regular further training. Clients should also be able to check via a publicly accessible register whether their client advisor or product distributor meets the corresponding quality standards.

4.4 Client protection in the case of offers from financial service providers based abroad

If providers based in other countries provide services for Swiss clients that require authorisation in Switzerland, they should in principle be subject to comparable rules to Swiss providers. This means firstly that foreign financial services providers must be authorised for the activity in question in their home country, and must be supervised appropriately. A cooperation agreement (Memorandum of Understanding) should be concluded between the foreign supervisory authority responsible and FINMA. If the provider supplies services to retail clients, it must also be ensured that those clients have appropriate access to the financial services provider. The foreign provider must therefore have a Swiss branch or subsidiary, unless effective supervision from Switzerland and clients' ability to enforce their legal rights can be equally ensured by other measures. Secondly, foreign financial services providers should be obliged to comply with Swiss rules on business conduct. Thirdly, the staff of financial services providers from other countries must also meet the quality standards set down in subsection 4.3.

Existing requirements that go beyond these standards should be retained. In particular, the provisions on the distribution of foreign collective investment schemes and the guidelines for foreign insurance companies active in Switzerland should remain in force.

Key point 14

Cross-border services may only be provided to clients in Switzerland from other countries if those clients enjoy the same protection as they would if the financial services provider were based in Switzerland. The Swiss regulations on the distribution of financial products should therefore be extended to cover activities from abroad.

5 Enforcement

Litigation between clients and financial services providers entails high costs and uncertainty. For this reason, retail clients in particular typically refrain from asserting their legal claims against financial services providers before the courts. FINMA is not responsible for the interpretation placed by the civil courts on agreements between financial services providers and their clients. For that reason, this position paper does not address in detail the issue of individual civil law procedural measures to improve client protection. However, FINMA believes that civil law measures can provide a sensible complement to the supervisory instruments available to enforce compliance with the proposed product rules and rules of business conduct. For this reason, the options for enforcing the claims of retail clients against financial services providers should therefore be improved.

Key point 15

Enforcement of the claims of retail clients against financial services providers should be improved.

6 Harmonisation with international standards

The measures proposed are in line with international requirements concerning regulation of the production and distribution of financial products. In particular, they take account of the Principles on Point of Sale Disclosure published by the International Organization of Securities Commissions (IOSCO) in February 2011. They also essentially correspond to the duties set out in the EU regulations on prospectus requirements and rules of business conduct for the financial markets. The introduction of a prospectus requirement for standardised financial products parallels the requirements set out in the EU Prospectus Directive. The basic tenor of the proposed rules governing the conduct of financial services providers towards their clients mirrors the conduct of business rules set out in the EU Directive on Markets in Financial Instruments (MiFID). The extension of supervision to external portfolio managers, the enhanced quality requirements for client advisors, and the supervision of cross-border services, also reflect the key facets of international developments.

The alignment of Swiss law with international standards brings with it advantages for both clients and providers. Clients benefit from increased protection and clarity as to where they stand. Financial services providers, for their part, no longer need to distinguish between foreign – in particular European – and Swiss clients when distributing financial products, but can instead apply largely uniform standards. Finally, improvements to the quality of Swiss financial services also enhance the reputation of the Swiss financial centre abroad and prevent Switzerland from becoming a target for unregulated and inadequately trained financial services providers.

7 Creation of a financial services act

7.1 "Financial services act" covering the products, business conduct and knowledge of financial services providers

The comments above indicate how FINMA believes the protection of clients under Swiss financial market law should be improved. The measures in respect of products, business conduct and supervision that are proposed can only be implemented coherently and comprehensively by means of legislative changes to the basis for regulation.

The rules contained in existing financial market legislation are geared to the individual sectors of the Swiss financial market, and the product and business conduct regulations in force are therefore spread across a wide range of legislation. This results in a lack of clarity concerning the scope of application of the regulations and brings with it the danger that certain products or market participants will be regulated inadequately or not at all. The new provisions on enhancing transparency at product level and improving the rules of business conduct should not therefore be incorporated into the existing financial market legislation. Instead, they should be set out in a cross-sector law – a financial services act. This act should also include regulations on supervisory tests of the quality of all client advisors and ensure that clients receive the same protection when using the services of foreign financial services providers as they do with Swiss ones.

Key point 16

Implementation of the measures will require the creation of a new statutory basis. To ensure that the conduct and product rules at the point of sale apply across all sectors and without exception, they should be firmly established in a new law (financial services act).

7.2 Supervision of portfolio managers via an amendment to the Stock Exchange Act

The extension of supervision to all portfolio managers also requires a new legal basis. The existing authorisation conditions and the organisational and capital requirements for market participants are firmly established in sector-specific financial market laws. This system is to be retained when introducing supervision of hitherto unsupervised portfolio managers. Portfolio managers regularly engage in securities trading when managing the portfolios of their clients. In part, their activities are very similar to those of securities dealers. The authorisation conditions for portfolio managers and the requirements in respect of organisation, minimum capital and the assurance of proper business conduct should therefore be incorporated into the Swiss Stock Exchange Act. This approach will ensure that the new supervision of portfolio managers is in line with the existing rules for securities dealers.

Key point 17

The rules on the authorisation and supervision of portfolio managers should be incorporated into the Swiss Stock Exchange Act.

7.3 Amendments to existing financial market legislation and the Swiss Code of Obligations

The introduction of cross-sector regulations on the documentation of financial products and the conduct of Swiss and foreign financial services providers necessitates amendments to the existing financial market legislation. All the cross-sector regulations should in principle be incorporated into a new financial services act, leaving only those rules of business conduct that reflect the specific features of individual sectors to be governed by the existing financial market laws. The regulations on the cross-border activities of financial services providers should also in principle be transferred to the new financial services act.

The current rules on prospectuses are partly established in financial market law; those on equity and bond prospectuses are contained in the Swiss Code of Obligations. The introduction of prospectus rules for standardised financial products under a financial services act would result in adjustments to the current law on prospectuses, involving separating the applicable provisions from the existing financial market legislation and the Code of Obligations. The documentation requirements for collective investment schemes and insurance products would not be affected by this change.

Key point 18

The introduction of cross-sector business conduct and product regulations necessitates changes to the applicable financial market laws and the Swiss Code of Obligations. Existing provisions on the documentation and distribution of financial products should continue to apply only when sector-specific circumstances require special arrangements.