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1. WHAT TYPES OF REGULATORY ACTION (INCLUDING ENFORCEMENT, THEMATIC REVIEWS ETC,) AND LITIGATION HAVE RESULTED FROM FAILINGS IN THE DISTRIBUTION OF RETAIL INVESTMENT PRODUCTS REGIME?

There have been a number of regulatory enforcement actions, thematic reviews and civil proceedings concerning the distribution of retail investment products. These have concerned, in particular, mis-selling and/or incorrect investment advice, most prominently in connection with the Madoff fraud and Lehman Brothers collapse.

The Swiss Federal Supreme Court recently rejected a claim by an institutional investor against a bank alleging that the bank had failed to disclose risks associated with Lehman products and to monitor the investment portfolio (decision 4A-525/2011). It was clear that the allegation regarding the disclosure of risks was without merit. As regards the supervisory duty, the court held that, where the relationship is purely advisory, the bank is not obliged to monitor the investment portfolio and give warnings based on the monitoring (subject to certain exemptions). This is in contrast to discretionary investment management mandates where such duty exists.

"Qualified investors" comprised the bulk of those affected by the Madoff affair, given that investment funds open for public distribution would not normally have invested in Madoff products or would have done so only to a very limited extent due to diversification rules. Qualified investors are defined by article 10 paragraph 3 of the Swiss Federal Act on Collective Investment Schemes (CISA) and include retail investors who are high net worth individuals with net bankable assets of over CHF2 million (approximately US$2.1 million). However, many non-high net worth retail clients were also affected by the Lehman Brothers bankruptcy, as many had bought capital-protected structured products issued or guaranteed by Lehman based, to some extent, on advice given by banks and other financial intermediaries, on their own initiative or without advice. Note that the CISA definition of qualified investors is being revised (see section 3 below).

2. WHAT ARE THE KEY ASPECTS OF THE CURRENT REGULATORY REGIME FOR DISTRIBUTORS OF INVESTMENT PRODUCTS TO THE RETAIL MARKET?

1) What restrictions exist on distributors describing their services as independent?

In Switzerland, there are currently no specific legal provisions or restrictions which regulate when the term "independent" can be used by distributors of investment products to the retail market. However, see section three below on reforms by the Swiss Financial Market Supervisory Authority (FINMA) to the distribution rules.

2) What product disclosure requirements are in place?

Generally required disclosure at the point of sale

The Swiss Federal Act on Stock Exchanges and Securities Trading (SESTA) requires securities dealers to inform clients about the risks associated with certain types of transactions and investments. The Swiss Bankers' Association has issued a publication which contains information about these risks. This obligation is dependent on the client's level of experience and specialist knowledge in the area concerned. Clients must be informed about the risks of transactions that entail high levels of risk or have a complex risk profile but not about the specific risks of individual transactions. These rules do not, as a matter of principle, distinguish between various types of products (in contrast to the below).

Structured products

Structured products which are authorised to be offered publicly in or from Switzerland can be distributed only where they are issued, guaranteed or distributed by specific categories of entities, and where a simplified prospectus is available which complies with the following requirements:

- it describes, in accordance with the standard format, the key characteristics of the structured product (key data), its profit and loss prospects, and any significant risk for investors;
- it is easily understandable by the average investor; and
- it refers to the fact that the structured product is not a collective investment scheme and requires authorisation by FINMA.

Mutual funds and other collective investment schemes

Investors must be provided with certain documents (as approved by FINMA) depending on the type of fund vehicle. For example:

- investment funds – the collective investment contract;
- SICAVs and SICAFs (types of open-ended collective investment schemes) – the articles of association and investment regulations;
- limited partnerships for collective investment – the company agreement; and
- foreign collective investment schemes – relevant documents such as the sales prospectus, articles of association or fund contract.

Public offerings of shares and bonds

If an equity or debt offering is made by an issuer without a concurrent listing in Switzerland, the information documents disseminated to investors on the offering are not subject to filing with, or approval by, any Swiss regulatory or self-regulatory authority. In Switzerland, unlike many other jurisdictions, shares and bonds can be offered to the public on the basis of a prospectus that has never been vetted by a local regulator. Public offerings of new shares or bonds by Swiss companies are, however, subject to requirements to disclose certain information in prospectuses as set out in article 652a and 1156 of the Swiss Code of Obligations.

3) What restrictions exist on how clients are charged?

As a matter of principle, Swiss law does not contain any specific restrictions on how clients may be charged for investment products and services, subject to certain specific exemptions for collective investment schemes. However, a number of rules and guidelines exist on:

- the disclosure of charges;
- retrocessions being dealt with appropriately; and
- conflicts of interest not causing investor detriment.

For example, the Portfolio Management Guidelines issued by the Swiss Bankers' Association state that for discretionary investment management mandates, the method and elements of a bank's charges must be agreed with the client in writing. Banks must also agree who will be entitled to any third party payments or commission. Further, at the time asset management agreements are executed, banks must disclose how such payments are calculated or the scope of such payments. For individual products or product classes, banks may combine individual products in product classes and are free to define product classes as they see fit. Disclosure obligations may be satisfied by the publication of fact sheets and securities account statements or information via the internet. Banks are also obliged to inform clients of any conflicts of interest arising from the receipt of payments from third parties and to put in place structural measures to prevent clients from being disadvantaged by any conflicts of interest.

4) What requirements are in place to ensure that products are suitable for clients?

Swiss law does not impose a general duty on providers of financial products and services to ensure that investments are suitable for clients. There are, however, specific rules for execution only clients (ie, where the client does not receive any type of advice or recommendation), advisory relationships and discretionary investment management mandates.

For execution only clients, a bank's duty to provide information to clients, the extent of which may vary subject to certain conditions, does not extend to an obligation to ensure that investment products are suitable.

There are currently no regulatory rules imposing suitability obligations with regard to advisory relationships. However, Swiss case law has established that providers of investment advice (note that providing a product recommendation may amount to investment advice) could be subject to an extensive duty to assess whether recommended investments are appropriate and, in certain situations, suitable for the client. The fact that these duties are currently contained only in case law is an area of concern for both FINMA and investment advisers. It is, therefore, hoped that FINMA will clearly define investment advisers' duties at the point of sale.

The situation is much clearer for discretionary investment management mandates. Self-regulatory rules issued by the Swiss Bankers'Association, such as the Portfolio Management Guidelines, expressly contain a duty to establish clearly whether an investment is suitable for a client. Consistent with established academic doctrine, banks are obliged to discuss investment objectives directly with the client and maintain appropriate records. Further, FINMA's Guidelines on Asset Management (Circular 2009/1) set out obligations on asset managers, which include a duty of loyalty, the exercise of due diligence and disclosure obligations. Regarding the exercise of due diligence in particular, asset managers must ensure that investments are always in line with the client's investment objectives and restrictions. Asset managers must review the investment strategies employed regularly and ensure adequate risk diversification etc.

5) Are investors entitled to any prescribed cancellation periods?

When purchasing investment products, investors are not entitled to any prescribed cancellation periods. This is subject to certain exemptions for insurance products, "door to door transactions" and similar contracts.

3. REFORM

1) What domestic reforms have been proposed in this area?

FINMA project on new distribution rules

Following the findings of FINMA's thematic reviews and investigations regarding the Madoff fraud and Lehman Brothers collapse, as discussed above, FINMA concluded that existing legislation and regulation did not adequately protect investors or adequately balance the rights and obligations of providers of investment products and services, on the one hand, and retail investors, on the other. FINMA, therefore, believes that a review of the supervisory and legal framework for investment product intermediation is needed. Accordingly, it has launched a "Distribution Rules" project to conduct a cross-sector examination of the existing rules. A discussion paper was published on 10 November 2010 to promote dialogue to enhance the protection of clients when financial products are marketed and purchased.

FINMA proposed a package of measures to strengthen client protection on 24 February 2012. In its position paper, it proposed rules for business conduct for financial services providers and better product documentation. It also sees the strategic extension of supervisory powers as necessary. The proposed measures are to be implemented through legislation. At the core of the proposed package of measures are standardised cross-sector rules of business for banks, insurers and portfolio managers. All clients will have to be informed of the content of a service and the characteristics of financial products, and must be warned about the risks. Clients will also have to be informed clearly about all costs associated with a service or the purchase of a product. Further, financial services providers will have to furnish clients with complete and readily understandable product documentation.

The following measures have been proposed.

Rules for financial products

- Improved documentation requirements at the point of sale by expanding duties to produce a prospectus and notification duties at product level.
- Clients should be provided with a clear and concise product description before acquiring compound financial products. The 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.
- 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

Financial services providers must do the following.

- Inform clients about their own business activities and their authorisation status before they carry out a financial transaction.
- Inform clients of the content of their specific service. They may describe themselves as being independent only if they do not accept incentives from third parties when performing services for their clients.
- Inform clients of the characteristics, risks and costs of the type of transaction under discussion before they perform the service in question.
- Provide product documentation. In particular, they must provide retail clients with a product description for compound financial products. Prospectus documents are to be made available only on request. During contact with the client, advertising material should be clearly separated from the documents required under supervisory law.
- Determine the client's experience and knowledge of the type of product in question or the service to be provided before carrying out a transaction for a retail client. If they consider a transaction to be inappropriate, they should warn the client.
- Determine whether a transaction is suitable for the client before giving personal advice. For this purpose, they must ascertain their client's 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.
- Carry out transactions with financial products for a retail client without an appropriateness test only 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.
- Document the scope and subject matter of the agreed service. They should also duly account for the services provided.

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Extension of supervision

- All portfolio managers that are not supervised under current law should be supervised. They must comply with the rules of business conduct and have an appropriate organisation and adequate capital.
- 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 adviser or product distributor meets the corresponding quality standards.
- Cross-border services may be provided to clients in Switzerland from other countries only 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

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

Creation of Financial Services Act

- 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 will be firmly established in a new law (Financial Services Act).
- The rules on the authorisation and supervision of portfolio managers will be incorporated into the SESTA.
- 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.

Proposed CISA revision to bring about fundamental change in regulating investment funds distribution

Against the background of new regulatory developments in the EU, Swiss parliament is currently debating a partial revision of the CISA. The proposed legislative amendments focus on subjecting Swiss-domiciled asset managers of foreign collective investment schemes to Swiss licensing and supervision requirements and introducing a new concept for the regulation of the distribution activities of collective investment schemes.

On 13 June 2012, the Council of States dealt with the partial revision of the CISA as the first chamber. The Council of States' Committee on Economic Affairs and Taxation put forward various amendments to the Federal Council's proposed text and these have now been mostly approved. Swiss parliament passed the revision of the CISA on 28 September 2012. The new law is expected to enter into force on 1 January 2013.

Overview

Under current law, the criterion for determining whether a foreign collective investment scheme is subject to licensing and prudential regulation in Switzerland is whether the product is being publicly promoted. If so, the foreign collective investment scheme must be approved by FINMA, must appoint a FINMA-approved Swiss representative and may be distributed only by FINMA-licensed distributors. If no public promotion is undertaken, no financial services regulatory restrictions or requirements whatsoever need to be observed. This somewhat outdated "either highly regulated or complete freedom" concept has now been changed fundamentally. This will mean that any form of distribution of collective investment schemes will be regulated. However, foreign collective investment schemes to be distributed to qualified investors would not need FINMA approval, with only certain requirements as described in the CISA needing to be met.

Substitution of the term "public promotion" by "distribution" as a key criterion for regulating collective investment schemes offerings

Public promotion is stated to be any advertisement addressed to the public (article 3, first sentence CISA). Advertising directed exclusively towards qualified investors is deemed to be non-public (article 3, third sentence CISA). FINMA has interpreted this to mean that only advertising directed at qualified investors is considered to be non-public. The Federal Administrative Court and the Federal Supreme Court have both, however, held that this restrictive interpretation is without legal basis under the CISA.

In view of the indisputable uncertainty, the term "public promotion" has been abolished and substituted by "distribution". Under the revised CISA, any marketing activities will be regarded as distribution activities, unless these activities are solely directed at regulated financial intermediaries such as banks, securities dealers, fund management companies or regulated insurance institutions. Further, the purchase of fund units for clients by either regulated asset managers such as banks or unregulated independent asset managers meeting certain minimum standards will not be considered to fall within the definition of "distribution".

Changes to definition of "qualified investor"

A high net worth individual with at least CHF2 million net assets will be regarded as a qualified investor only if he or she expressly decides so and he or she has sufficient experience in financial matters ("opting in").

Structured products – FINMA report identifies shortcomings in protecting investors

FINMA made and reviewed representative spot checks of simplified prospectuses and sales documentation for structured products and published its report on 9 December 2011. The project was prompted by FINMA's investigations into the Lehman bankruptcy case.

The law prescribes the provision of simplified prospectuses for structured products which can be easily understood by the average investor, describe profit and loss prospects in a standard format, and explicitly point out that structured products neither are a collective investment scheme nor require authorisation by FINMA.

FINMA found that although the content of most of the prospectuses was complete, key legislative requirements were not satisfactory fulfilled. Most of the prospectuses checked were not easy to understand and were too long and technical. They were lacking in explanatory scenarios and charts and were not structured uniformly, making it difficult to compare different products. Also, the prospectuses were often available only in English.

None of FINMA's reviews revealed any evidence of sanctionable violations of the prospectus rules but they did show that investors – in the view of FINMA – are not adequately protected under current regulations. Furthermore, FINMA considered the existing self-regulatory provisions of professional associations to be unsatisfactory. Thus, it expects an improvement in the regulatory basis. As proposed by FINMA as part of the ongoing partial revision of the CISA, providers should be subject to clear rules of conduct. They should, therefore, be required to provide full transparency on their products.

2) What are the key issues and implications?

The forthcoming reforms will be likely to result in the need for firms to introduce amendments to how investment products and services are offered and sold, with the main focus being at the point of sale (rather than on the production side).

3) What is the timescale for implementation?

As mentioned above, the Swiss parliament passed the revision of the CISA on 28 September 2012. The revised CISA is expected to enter into force on 1 January 2013. The Financial Services Act will not enter into force before 2015/16, according to FINMA.

FINMA issued its position paper on distribution rules on 24 February 2012. Past experience indicates that it may take several years before legislative measures come into force. It would be faster to implement a Federal Council ordinance on rules of business conduct in securities trading and the distribution of collective investment schemes, even though this would be limited to certain financial services providers who are already subject to prudential supervision.

4) What can firms do to prepare for implementation?

Once key details of the proposed reforms are known, financial institutions should engage in the consultation process and consider the likely impact of the reforms on their business models.

4. CONSUMER REDRESS

1) What are the current domestic mechanisms for consumer redress?

Swiss Banking Ombudsman

The Swiss Banking Ombudsman is an independent body which mediates complaints against banks based in Switzerland, free of charge. Since the Ombudsman's establishment in April 1993, the office has dealt with an increasing number of enquiries and complaints (currently about 1,400 a year).

The volume of cases submitted for mediation reached a record level of 4,757 cases in 2009. In 2010, the number of cases fell to 2,000 cases, but the complexity of cases, specifically in the areas of investment advice and discretionary wealth management, remained the same. In 2011, a total of 1889 cases were submitted. This represents a small decrease in comparison to 2010. This number, however, is still considerably higher than the volume recorded before the all-time highs in 2008/2009.

At present, there is no other body with dedicated jurisdiction to consider retail complaints against other types of financial institution. Consumers may lodge complaints with FINMA, although it is not under an obligation to consider them. As noted above, FINMA has proposed the establishment of an ombudsman with jurisdiction over all financial services providers to provide for a binding, simple and fast mechanism for the settlement of disputes involving retail clients.

Class actions do not exist in Switzerland.

The revised Lugano Convention on jurisdiction and the enforcement of judgments in civil and commercial matters took effect in Switzerland on 1 January 2011. The Lugano Convention determines the international jurisdiction of the courts of signatory states. It also ensures that judgments from one signatory state are recognised and enforced in the other signatory states. The most important innovation regarding the revised Lugano Convention is the extension of its territorial scope to the new EU member states. The revised Convention will also have a bearing on courts' powers to review contracts between financial institutions and clients from Convention member states. This will enable clients to take legal action in their home country where the bank has "directed" its services to that country or member state. The term "direct" still needs to be precisely defined by case law.

2) Are there any domestic reforms planned to improve consumer redress?

There are no substantial reforms pending. The suggested Financial Services Act is, however, intended to provide a cost-effective and efficient consumer court/arbitration process.

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Sandro is a legal committee member of the Swiss Funds Association, the self-regulatory body of the Swiss fund and asset management industry, and was appointed by the Swiss Finance Department to advise, as one of only five external experts, on the design of a new Swiss Financial Services Act, which is intended to enter into force in 2015/16.

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