Rules of conduct under FinSA: FINMA codifies its practice

In a nutshell: FINMA has adopted a Circular on rules of conduct under the Financial Services Act. After observing uneven application of these rules among supervised entities, the regulator seeks to provide interpretative clarifications based on its practice. The new Circular will come into effect on January 1, 2025.

I. Transparency and legal certainty

Following a consultation process marked by extensive debate, FINMA has just published its new Circular on the Financial Services Act (FINMA Circular 25/2 "Rules of Conduct under FinSA and FinSO", available in French; the "**Circular**"). The Circular will come into force on January 1, 2025, with certain obligations subject to a transitional period until June 30, 2025.

Although many participants in the consultation process called for the project on a circular on rules of conduct to be abandoned, FINMA considers it necessary to address issues of interpretation. The Circular clarifies several matters covered by FinSA and its Ordinance. This new regulation aims to ensure uniform implementation of the rules of conduct stemming from FinSA.

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II. Scope of application

The Circular will apply to all financial service providers subject to direct supervision by FINMA or a supervisory organization, *i.e.*, mainly banks and portfolio managers.

III. Key elements

a. Duty to provide information

The Circular highlights the importance of clear and complete communication to enable clients to make informed decisions. Regarding advisory mandates, it is recalled that the service provider must explicitly inform whether the advice provided corresponds to a global approach (portfolio-based advice) or a transactional approach (transaction-related advice).

FINMA has identified major shortcomings in risk disclosures regarding complex products. In particular, contracts for difference (CFDs) require explanations that include potential losses, margin call obligations, and unexpected price fluctuations.

The Circular also emphasizes the need to inform clients about concentration risks in their portfolios. It refers to the following thresholds as potential indicators of unusual concentration: (i) a 10% concentration in individual securities and/or (ii) a 20% concentration in securities from the same issuer.

b. Appropriateness and suitability

These verifications should not follow a one-size-fits-all approach. Specifically, the evaluation of the client's knowledge and experience must be tailored to the characteristics of the investment strategy, the financial instruments involved and the complexity of the risk profile of the contemplated investments.

As regards portfolio management mandates and advisory mandates at the portfolio level, knowledge and experience must be assessed in relation to the financial service and taking into account the characteristics of the investment strategy as well as the types of financial instruments used. Whether these requirements are compatible with Article 12 FinSA, which stipulates that clients' knowledge and experience relates to the financial service, but not to individual transactions, is open to debate.

Although this topic is not explicitly addressed in the Circular itself, the Report on the Consultation Results (available in French) highlights that the assessment of suitability must be conducted on an ongoing basis for portfolio management mandates. As for advisory mandates, the assessment of suitability may need to be repeated, requiring periodic updates of the information regarding clients' financial situation and investment objectives.

c. Securities lending

The Circular outlines the minimum information to be provided to the client as part of the risk assessment in the context of securities lending, taking over the rules that already prevailed before FinSA came into force.

d. Compensation from third parties

FINMA reiterates certain principles stemming from case law on retrocessions. Financial service providers must disclose information in the form of amounts or estimated ranges tailored to the investment strategy. These details must be highlighted in the contractual documentation, for instance using bold text or other visual emphasis.

When the exact amounts cannot be specified, the calculation criteria and relevant ranges must be disclosed, in particular for execution-only relationships or transaction-related advice. In the context of portfolio management and portfolio-based advice, additional information must be provided on the remuneration range based on the portfolio's value and the agreed investment strategy.

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The right to access information on retrocessions (Article 26 para. 2 FinSA) cannot be contractually restricted and must, in principle, be free of charge. Fees for providing information are permitted only if exceptional efforts have been required.

e. Managing conflicts of interest

Financial service providers must inform their clients whether the market offering taken into account for the purpose of selecting financial instruments is made of (i) only their own instruments[1] , (ii) a mix of their own instruments and third-party instruments, or (iii) exclusively third-party instruments.

In the case of an open architecture, the provider's own financial instruments must be compared with third-party instruments using a selection process based on objective criteria. Financial service providers are prohibited from incentivizing the placement of their own financial instruments through specific remuneration schemes for employees. If only the provider's own financial instruments are used, clients must be informed of the conflict of interest and the associated risks.

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IV. Observations

Although the legal basis and justification of certain rules may be subject to debate, this new Circular has the merit of clarifying FINMA's expectations regarding the implementation of the rules of conduct under FinSA. For the financial service providers subject to this new regulation, the development of rules in this area implies a thorough review of their processes and documentation. This is particularly true with regards to the assessment of suitability and the management of conflicts of interest when offering in-house products.

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This note is of a general nature and does not constitute legal advice. We remain at your disposal should you have any questions regarding the above.

[1] Own financial instruments should be understood to include not only financial instruments issued by the financial service provider or a company within its group but also financial instruments issued or offered by third parties with which the financial service provider has economic ties (*e.g.*, private/white label products, products for which the financial service provider acts as guarantor, or third-party products for which the financial service provider receives retrocessions) (Comments of October 31, 2024 supporting the Circular [available in French], footnote Nr. 22).