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## Current Issue in Banking & Financial Services

### Final deadline to adapt asset management contracts to the FINMA Circular 2009/1 and the codes of conduct

On December 31, 2010 the last deadline for independent asset managers to adapt their management agreements to the FINMA Circular 2009/1 and the codes of conduct will expire. Indeed, in compliance with this Circular, some professional organizations have issued a code of conduct or reviewed their existing codes to be compatible with its provisions. Under most of the codes of conduct, starting from January 1<sup>st</sup>, 2011, independent asset managers will be monitored by their respective professional organization that will ensure that their contracts and their activities are compliant with the applicable code of conduct.

#### Purpose of the FINMA Circular 2009/1

Besides the provisions of the Swiss civil code, in particular the rules applicable to mandate contracts, until the end of December 2008, the activities of independent asset managers were mainly subject to the anti-money laundering legislation and direct supervision was done by self-regulating bodies that limited their monitoring to the prevention of money laundering. Since the entry into force of the FINMA Circular 2009/1 on Asset Management, in addition to this self-regulation concerning the prevention of money laundering, independent asset managers who engage in public advertising of collective investment schemes are also subject to minimum standards that are stipulated and self-regulated by each relevant professional organization.

The purpose of the FINMA Circular 2009/1 is therefore to regulate the activities of some independent asset managers based in Switzerland. The Circular sets out minimum standards to guide professional organizations in drafting their own codes of conduct on asset management.

As of today, seven professional organizations have had their code of conduct on asset management recognized by FINMA, including ARIF, SAIFA, Polyreg, VQF, OARG and SAAM.

Each professional organization has its own specific rules by which independent asset managers must be bound. As a consequence, even though all of these codes of conduct comply with the minimum requirements set out by the FINMA Circular 2009/1, each code is different. Some codes (e.g., SAIFA's code of conduct) only contain the minimum requirements requested by the Circular, whereas others (e.g., SAAM's code of conduct) provide for duties and a level of control that go beyond the requirements of the Circular.

#### Who must comply with a code of conduct?

Essentially, as per the FINMA Circular 2008/8 on public advertising of collective investment schemes, any independent asset manager who purchases units in collective investment schemes for his/her clients based on a signed power of attorney will

have to be bound by and comply with an approved code of conduct of a professional organization, in particular with the duty to act under a compliant asset management contract. According to FINMA, "it makes no difference whether the collective investment schemes are Swiss or non-Swiss, authorized or non-authorized".

The main exception to this principle is the purchases of units in collective investment schemes for "qualified investors", which definition includes notably banks or individuals owning more than CHF 2 million in financial assets. Indeed, units in collective investment schemes can be purchased for such qualified investors without the asset manager having to be affiliated to a professional organization, respectively without having to be bound by a code of conduct.

## Main consequences for the day-to-day business

### Asset management contracts

The principal change that results from the new Circular is that every independent asset manager will now have to have a signed asset management contract with his/her clients, which must comply with the requirements set out in the chosen code of conduct. When drafting a contract, the independent asset manager will not only have to comply with the requirements set out by his/her professional organization, but (s)he shall also ensure that it covers his/her specific activities. Indeed, the contract shall be coherent with the scope and characteristics of each independent asset manager's business and it must suit the particular needs of that manager's clients. It is recommended that each independent asset manager thus prepare a personalized model contract which clearly sets out the manager's specific activities in sufficiently clear details.

### Retrocessions

The FINMA Circular 2009/1 sets high new standards in terms of disclosure as to compensation, commissions, retrocessions or other financial benefits received from third parties by the independent asset manager in the course of his/her management activities. In this respect, the calculation parameters or spread of any such compensation, commission, retrocession or other financial benefit received by the independent asset manager will have to be explained in writing to the clients when signing the asset management contract, or else the independent asset manager will be violating the code of conduct.

### Other duties

In addition to having to operate under a compliant asset management contract and to having to disclose the range of potential retrocessions, the FINMA Circular 2009/1 provides for some other standards in terms of:

- conflicts of interest;
- compliance with investment objectives and restrictions;
- risk diversification; and
- reporting to the clients.

As a consequence, independent asset managers have to adapt their activities to those standards or to even higher standards as provided by that manager's chosen professional code of conduct.

## Disciplinary actions in case of violation

Different types of sanctions are provided for in each recognized code of conduct. A violation can be simply punished by an official warning or a fine, or it can lead to the exclusion from the relevant professional organization. Exclusion will result in the concerned independent asset manager no longer being able to purchase units in collective investment schemes for his/her clients (unless they are exclusively qualified investors).

In this respect, an independent asset manager who purchases units in collective investment schemes for non-qualified investors, without authorization, may face criminal charges.

Furthermore, such a violation may affect the concerned manager's requirement of irreproachable business activity and, as a result, (s)he may lose her/his license to practice as a financial intermediary in Switzerland.

Therefore, the obligations imposed by professional organizations should be strictly observed, as the consequences of a violation of a code of conduct may result in an independent asset manager no longer being able to pursue his/her regular business.

## Control of the implementation of each code of conduct

### Scope of control

Each approved professional organization has put in place a system to ensure and control compliance with its code of conduct and to enforce it in the event of any violations.

FINMA intends to supervise the monitoring systems implemented by each professional organization.

Each professional organization will have to file an annual report with FINMA with respect to audits and other monitoring measures that it has taken. Moreover, in the event of a disciplinary action, which can virtually lead to the exclusion of the asset manager, the professional organization must immediately inform FINMA.

The scope of control will vary from one professional organization to another. Some organizations will only check whether an independent asset manager's model contract conforms to its code of conduct and whether the disclosure duties are fulfilled, whereas others may also monitor for example the independent asset manager's compliance with the investment objectives set out by his/her clients.

In addition, FINMA reserves the right to carry out on-site inspections at each professional organization's offices, or directly at the offices of independent asset managers.

### Recommendation and timing

In order to simplify the inspection process, we would recommend that independent asset managers keep a copy and a register of all of their signed contracts with each client, and that they document any information given to the clients in accordance with their disclosure duties.

According to the minimum requirements set out by the FINMA Circular 2009/1, the activity of the independent asset managers should already comply with their chosen professional organization's code of conduct since September 30<sup>th</sup>, 2009.

The ultimate deadline to amend the asset management contracts for all existing clients is December 31<sup>st</sup>, 2010. Thus, as of January 1<sup>st</sup>, 2011 independent asset managers will need to ensure they have a signed and compliant asset management contract in place for each of their clients.

As a consequence, most professional organizations will start to police compliance with their codes of conduct in 2011.

## Conclusion

It is of the utmost importance for independent asset managers to be registered with an approved professional organization and to comply with its code of conduct should they wish to purchase units in collective investment schemes for non-qualified investors. Indeed, a violation of these rules can lead to

criminal charges and even to the closing down of an asset manager's business.

Therefore, independent asset managers should ensure they have compliant model contracts in place, and should seek advice from specialist counsels should they have any doubts as to how to comply with any organization's code of conduct, in particular when drafting their model asset management contract, when describing specific products or services they will be offering, when explaining their compensation incentives and when exercising their disclosure duties.

## Contacts

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