

Transaction-related investment advice under FinSA

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Introduction

The Swiss Financial Services Act (FinSA) entered into force on 1 January 2020 and regulates a number of activities performed by financial service providers by setting out specific obligations regarding their clients. The provision of investment advice constitutes a typical financial service covered by the new act. In this respect, FinSA has introduced the category of so-called 'transaction-related investment advice', a new type of investment advice that needs to be distinguished from portfolio-related investment advice. In addition to the categorisation of clients as private clients, professional clients and institutional clients (for further details please see "[Client segmentation under FinSA](#)"), the differentiation between these two types of service is important to determine the scope of the obligation of financial service providers to perform an appropriateness or suitability test before initiating a transaction for the relevant client.

In fact, while only an appropriateness test is necessary when providing transaction-related investment advice, a more comprehensive suitability test must be performed where the service provider advises with a view to the entire portfolio of a particular client (such tests being of limited scope in case of professional clients and not applicable in case of institutional clients). The EU Directive on Markets in Financial Instruments (2014/65/EU) (MiFID II), by contrast, does not recognise such distinction: under MiFID II, any investment advice provided on an independent basis requires a suitability check, as is the case with portfolio management services. Therefore, the differentiation between transaction-related and portfolio-related advice constitutes a Swiss peculiarity.

FinSA's more liberal approach to transaction-related investment advice is a significant facilitation for financial service providers, but may also lead to uncertainties regarding its actual scope. This article aims to give some clarity on the sometimes difficult differentiation between the different types of investment advice and on the regulatory consequences of this categorisation.

Appropriateness and suitability

The obligation to assess the appropriateness and/or suitability of a service for an individual client belongs to the core of the new conduct rules for financial service providers. The rationale behind this requirement is the consideration that the services offered in the context of portfolio-related investment advice or a portfolio management relationship can be provided optimally (from the client's perspective) only if the financial service provider is aware of certain information concerning the specific client (eg, their individual status, portfolio and investment objectives) and, in the case of merely transaction-related investment advice, if the client has at least knowledge of and experience with the financial instrument concerned.

The appropriateness test is regulated in Article 11 of FinSA and applies to transaction-related investment advice. In order to determine the appropriateness of a financial instrument for the client concerned, the financial service provider must first enquire about the client's knowledge and experience with the type of transaction in question. It must then check whether the envisaged transaction is appropriate for that client, taking into account their knowledge and experience.

If holistic investment advice relating to a client's portfolio is provided or agreed to be provided or in case of a portfolio management relationship, Article 12 of FinSA requires a suitability test, part of which consists in the aforementioned appropriateness test. However, in addition to the client's knowledge and experience, their financial circumstances and investment objectives must be

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assessed. This includes information on the client's regular income, properties, liquidity needs and, in some cases, their personal situation (including family circumstances), as well as the time horizon and purpose of the investment, risk appetite and tolerance and any particular investment restrictions. Based on this data, the financial service provider will prepare a risk profile and agree with the client on a specific investment strategy.

The suitability test is clearly more burdensome on the financial service provider and requires more interaction with the client than a mere appropriateness assessment. Moreover, all the relevant information must be carefully documented (Article 15 of FinSA), and the services performed as well as the proof of compliance with the agreed investment strategy will be periodically reported to the client (Article 16 of FinSA). Further, while professional clients can exempt the service provider from some of its conduct obligations, appropriateness and suitability checks cannot be validly waived, but can only be adapted to the professional status of such clients. The service provider can assume that:

- the professional client has the necessary knowledge and experience; and
- the investment risks associated with the financial service are financially acceptable (Article 13(3) of FinSA).

This means that, as long as there are no red flags causing the firm to doubt on the client's understanding of the service and its implications, the suitability test can be limited to the client's investment's objectives, while an appropriateness test becomes unnecessary. In contrast, regarding institutional clients, Articles 11 and 12 of FinSA (as well as the other conduct rules of that chapter) do not apply at all.

Investment advice and execution-only transactions

Article 13(1) of FinSA contains an important exemption from the obligation to check and document the suitability and appropriateness of a particular transaction. In the case of a mere execution or transmission of client orders (so-called 'execution-only transactions'), no appropriateness or suitability test must be carried out. The client has only to be clearly informed that the service provider performs no such examination. Further, with regard to this aspect, MiFID II has a stricter approach, since its Article 25(4) allows financial service providers to skip the appropriateness test only if the transaction at issue concerns non-complex financial instruments (eg, equities).

The exemption for execution-only transactions makes clear that the obligation to perform appropriateness or suitability checks applies only to cases where there is an actual, personal advice rendered to the client. This is only the case if the advice relates to financial instruments that are in (or will be purchased for) the portfolio of the client in question. There is no investment advice within the meaning of FinSA if the financial service provider merely informs their client of the general expectations of their institution or third parties regarding the development of certain financial instruments. An example can be advertising material about investment products, which the financial service provider transmits to their clientele or otherwise makes available to them, or general statements by a client adviser about current trends in a specific product market (eg, automotive or a particular sub-segment of that industry). Orders following this kind of general information therefore qualify as execution-only transactions and require neither a suitability nor an appropriateness test.

Transaction-related and portfolio-related investment advice

Considering the differences between the two tests, the correct qualification of the investment advice required by the client is of fundamental importance for financial service providers. A mistake in the categorisation can lead to an insufficient assessment for purposes of the service concerned and an infringement of FinSA's conduct rules can trigger regulatory penalties, which, depending on the case, could even be followed by a civil law suit against the financial service provider for a breach of its contractual duties. The same risk exists with regard to the abovementioned distinction between investment advice in general and execution-only transactions, determining whether there is an assessment obligation of the service provider in the first place.

However, assuming that there is an advisory relationship, the distinction between transaction-related and portfolio-related investment advice is not always easy. First, besides the transaction-related and the portfolio-related investment advice whereby the latter takes into account the whole client portfolio, the financial service provider and client may agree on a third kind of investment advice, which considers only a part of the client portfolio. According to the Federal Council's Accompanying report on FinSA, this type of service will qualify as portfolio-related investment advice. This makes clear that, in the legislature's mind, the obligation to conduct a mere appropriateness test (which in practice as explained above applies in its full debt only to private clients) should be limited to purely transactional investment advice, which stands somewhere between the traditional, portfolio-related investment advice relationship and an execution-only service.

The above clarification and in particular the possibility to give investment advice taking into account only a part of the client portfolio does not make the distinction between transaction-related and portfolio-related advice any easier. As already seen with the distinction between execution-only transactions and investment advice, in order to assume an investment advice in the first place, the advice in question will relate to financial instruments that are in the portfolio of the client or will concretely be added (ie, there must be a reference to the actual client portfolio). It is therefore essential to understand what extent this portfolio reference should have for the advice to qualify as a privileged transaction-related investment advice.

The answer should be that for transaction-related investment advice, the reference to client portfolios should be limited to instrument-specific aspects. If the client for instance intends to invest a certain amount in shares of a specific sector, the financial service provider will at most consider whether that client already has shares of issuers in that particular sector or even shares of a specific issuer in its portfolio, but it will not take into account the other financial instruments in the client portfolio in order to ensure a sufficient risk diversification or a better return-on-investment profile. The responsibility in this regard remains with the client, which can either monitor and assess the portfolio as a whole or switch to a portfolio-related investment advice to be rendered by the financial service provider.

While the extent of the portfolio reference plays a decisive role in the distinction between transaction-related and portfolio-related advice, the frequency of the investment advice is irrelevant for the qualification. Further, there are many other factors, which may seem to suggest the existence of a portfolio-related investment advice relationship, but are not *per se* relevant. For example, the fact that for a part of the client portfolio there is a portfolio-related advice relationship, meaning that the financial service provider already knows the overall financial situation and investment objectives of that client, does not mean that there cannot be a transaction-related advice concerning a different part of that portfolio. In addition, the existence of a written investment advice agreement, perhaps with a separate fee in addition to the usual transaction fees, does not exclude a transaction-related advice.

The same applies also to a (voluntary or contractual) monitoring of client investments held by the bank, as long as the monitoring activities do not result in a personal advice of the clients based on their portfolio information. There is no investment advice where the bank merely notifies the client about a specific risk without advising them on how to mitigate it (eg, by selling or purchasing financial instruments). Nevertheless, an examination of all the circumstances of the case may be recommended, to ensure that the service provided does not result in a circumvention of FinSA's categorisation rules and assessment obligations.

Comment

FinSA's approach to investment advice services is much more liberal than MiFID II. With the introduction of transaction-related investment advice, FinSA has created a subcategory of investment advice subject to milder assessment obligations – namely, a simple appropriateness test instead of the significantly more burdensome suitability test due with portfolio-related investment advice and portfolio management. The less far-reaching obligations of the service provider when conducting an appropriateness test are also reflected in its (accordingly reduced) documentation duties. Moreover, when dealing with professional clients, this test will be rather limited. However, the distinction between portfolio-related and limited transaction-related investment advice is not always simple.

Uncertainties may arise in particular as to when transaction-related advice can still be assumed despite the client's portfolio being partly taken into account. As already suggested by the wording of Articles 11 and 12 of FinSA, the decisive criteria to determine the kind of service at issue – and the related assessment obligation – is the extent to which the financial service provider refers to the portfolio of the client. In case of merely transaction-related advice, only a minimum reference to the client portfolio is allowed and it should be limited to instrument-specific aspects. Other factors, which may suggest the existence a portfolio-related investment advice relationship, are not *per se* decisive for the analysis, but may nevertheless require a closer examination in order to avoid any later claims of a circumvention of the new assessment obligations by the client if the investment did not perform as originally anticipated.

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