

BULLETIN SEPTEMBER 2024

FINMA's New Circular on Consolidated Supervision of Financial Groups

I. INTRODUCTION

On September 2, 2024, the Swiss Financial Market Supervisory Authority (FINMA) published a draft of the new circular on consolidated supervision of financial groups under the Swiss Banking Act and Financial Institutions Act (the **Draft Circular**)¹. The Draft Circular will be under public consultation until November 1, 2024. It aims to enhance transparency on FINMA's supervisory practices in this area, which have previously been communicated through case-by-case decisions. This bulletin outlines the institutions concerned by the circular (*infra* II), the criteria for including group companies in the consolidation perimeter (*infra* III) and the scope of consolidated supervision (*infra* IV).

II. FINANCIAL INSTITUTIONS CONCERNED

A. Scope of the Draft Circular

The Draft Circular is aimed at financial groups under the Swiss Banking Act (BA) and banks that are part of financial groups. It also applies *mutatis mutandis* to financial groups dominated by securities firms or institutions with a fintech license², as well as to securities firms and institutions with a fintech license that are part of financial groups. Collectively, entities falling within the scope of the Draft Circular are referred to as 'institutions'.

Under the BA and the Swiss Financial Institutions Act (FinIA), two or more companies are deemed to be a 'financial group' if (i) at least one of them operates as a bank or a securities firm, (ii) they primarily operate in the financial sector and (iii) they form an economic unit or other circumstances suggest that one or more of the companies under individual supervision are *de jure* or *de facto* obliged to provide support to group companies³. A 'financial conglomerate' is a financial group primarily engaged in banking or securities trading that includes at least one economically significant insurance company⁴. Both financial groups and financial conglomerates are collectively referred to as 'financial groups'.

B. Consolidated Supervision Requirement

FINMA's ability to assess the stability of an institution integrated into a group structure requires oversight of the entire financial group. Consolidated supervision is therefore essential for effective prudential oversight, particularly in assessing group-wide risks and implementing appropriate prudential measures.

Accordingly, if a bank or a securities firm is part of a financial group, FINMA may require adequate consolidated supervision by a financial supervisory authority as a

¹ Download link.

² See Art. 1b BA.

³ Art. 3c para. 1 BA and 49 para. 1 FinIA.

⁴ Art. 3c para. 2 BA and 49 para. 2 FinIA.

prerequisite to granting a license⁵. FINMA may subject to consolidated supervision (a) financial groups that control a bank, an institution with a FinTech license or a securities firm incorporated in Switzerland as well as (b) financial groups incorporated abroad but effectively managed from Switzerland⁶. Where foreign supervisory authorities concurrently claim the full or partial supervision of the financial group, FINMA shall agree with those authorities on responsibilities, modalities and scope of the supervision⁷. Due its importance in protecting creditors and maintaining market stability, waiving consolidated supervision must remain a strict exception.

C. Alternative Measures

The Draft Circular indicates that in rare and exceptional cases, specific risks may be addressed through preventive measures rather than consolidated supervision. Specifically, in instances where adequate consolidated supervision by a foreign authority is lacking, FINMA may impose ‘ring-fencing measures’ to isolate the Swiss institution from the foreign financial group. These measures are implemented when risks can be effectively mitigated in this way, essentially severing ties between the foreign financial group that lacks adequate (consolidated) supervision abroad and the institutions belonging to it and having their headquarters or (effective) management in Switzerland.

Possible ring-fencing measures, often used together, include (i) corporate governance measures aimed at strengthening the independence of the institution’s management and decision-making bodies from the financial group, (ii) financial safeguards to protect client assets or limit financial dependencies on the financial group, (iii) structural measures affecting the structure of the financial group, (iv) reduction of operational interdependencies, access to group systems, client contributions or obligations imposed on business activities and (iv) specific reporting and disclosure obligations. However, as mentioned, because these measures do not provide the same level of oversight as consolidated supervision, they must remain rare exceptions.

III. REGULATORY CONSOLIDATION PERIMETER

A. Assessment Criteria

The inclusion of a group company in the regulatory consolidation perimeter is based on two main factors: (i) the company’s activity in the financial sector and (ii) the existence of an economic unit between entities⁸.

First, the business activities of the group company must fall within the financial sector, which is presumed to be the case. Unlike the EU law, Swiss law does not provide an exhaustive list of such activities. The Draft Circular states that the concept of ‘activities within the financial sector’ under Art. 4 OB includes a broad range of services beyond those requiring authorization or registration under Swiss law. It generally includes the provision of financial services for one’s own account or as an intermediary. Beyond the non-exhaustive list in Art. 4 para. 1 let. a OB, activities such as financial leasing, factoring, credit card operations, securities issuance, custody services, payment services and the issuance and custody of payment instruments (including payment tokens) also fall within the financial sector. *Ad hoc* entities, such as Special Purpose Vehicles (SPVs), are also considered to engage in financial activities if their purpose is to provide or intermediate financial services for the financial group or third parties. On the other hand, group companies engaged solely in artisanal, industrial or administrative activities outside the financial sector are excluded from the consolidation perimeter.

Second, the inclusion of a group company in regulatory consolidation perimeter requires the existence of an economic unit between entities, which can arise from (a) holding a majority of capital or voting rights or (b) indicators of ‘control by other means’ or an ‘obligation to provide support’ non-exhaustively listed in the Draft Circular.

Control by other means may be exercised through (i) the control of voting rights based on agreements with other shareholders (*e.g.*, voting or shareholder agreements), (ii) the direct or indirect right to appoint or remove the majority of members of the top management or administrative body or (iii) the exercise of significant influence over management (*e.g.*, the ability, by contract or other arrangements, to exert decisive influence over the company’s management or policies, such as through participation rights in key decisions). These indicators may be combined and linked to an additional minority shareholding.

An obligation to provide support may arise from a contract or other arrangements or from circumstances. The Draft Circular mentions indicators such as (i) interdependence of strategic, financial, organizational, or personnel resources, (ii) collaborations or dependencies, (iii) use of a common business name, (iv) a unified market presence or (v) letters of comfort or similar guarantees⁹. Other factors may similarly establish support obligations if they create the impression to third parties that there are ties between the

⁵ Art. 3b BA.

⁶ Art. 3d para. 1 BA.

⁷ Art. 3d para. 2 BA.

⁸ For banks and institutions with a fintech license, see Art. 3c BA and 21-24 BO; for securities firms, see Art. 49 FinIA.

⁹ Art. 21 para. 2 BO.

entities involved. The Draft Circular specifies that the higher the ownership stake, the less important these other factors need to be to justify inclusion in consolidated supervision.

It follows that the potential inclusion of a company in the consolidated supervision perimeter must be evaluated on a case-by-case basis, considering all relevant circumstances. This assessment is initially conducted by the institution or financial group itself and is subsequently confirmed by the audit firm. The Swiss Financial Market Supervision Act (FINMASA) further requires institutions to report any changes in the regulatory consolidation scope when they (a) they expand or reduce their regulatory consolidation perimeter or (b) refrain from making such an adjustment despite a significant event that impacts the regulatory consolidation perimeter¹⁰. Any event that could lead to a change in the regulatory consolidation perimeter qualifies a ‘reportable event’, particularly when it results from a change in circumstances within a financial group. Such events include, but are not limited to, (a) the initiation, expansion, or termination of an activity abroad¹¹ or (b) when an entity operating in the financial sector (or whose involvement in the financial sector cannot be excluded) holds or is entitled to hold at least 20% of the capital or voting rights, exercises control by other means, or when the existence of a *de jure* or *de facto* obligation to provide support cannot be ruled out.

B. Financial Group Structures

The Draft Circular proposes assigning financial groups to specific reference structures:

- Parent Company Structure. When a financial group is controlled by a parent company, the regulatory consolidation includes the parent company and one or more group companies active in the financial sector¹².
- Holding Company Structure. If the financial group is controlled by a holding company (or multiple layered holding companies), the regulatory consolidation perimeter generally includes the highest-level holding company active in the financial sector. However, FINMA may exclude a holding company from consolidation if deemed ‘non-significant’¹³, based on four criteria: (i) it does not control any company active in the financial sector other than the institution, (ii) it has no business activities in the financial sector aside from its participation in the institution, (iii) it does not influence the institution’s business activities and (iv) it

is not significantly financed by third parties. The Draft Circular thus codifies FINMA’s long-standing practice. If an institution is controlled by a holding company that primarily holds qualified participations in companies not active in the financial sector, FINMA may impose ring-fencing measures (*supra* II.C) to isolate the institution from the financial group. Holding companies headquartered abroad may also be included in the consolidation perimeter, particularly when the financial group is effectively managed from Switzerland¹⁴ or when consolidated supervision is not adequately ensured by a foreign supervisory authority.

- Atypical Structures. These include contractual groups, similar arrangements and *de facto* financial groups (*i.e.*, parallel-controlled structures). The latter are headed by one or more individuals who, in addition to controlling an institution with its headquarters or effective management in Switzerland, directly or indirectly control other companies active in the financial sector. The rules applicable to other types of financial groups are generally applied by analogy to atypical structures.

Additionally, sub-groups of foreign financial groups constitute a distinct structure. They are typically under consolidated supervision of their foreign home state supervisory authority, with FINMA acting as host supervisor for the sub-groups in Switzerland. Financial groups supervised by FINMA that have sub-group structures are subject to consolidated supervision at subordinate levels.

C. Significant Group Companies

Consolidated supervision by FINMA covers all financial group companies active in the financial sector¹⁵. If key functions necessary for the continuation of licensed activities are outsourced to an unlicensed group company, the question arises whether that company should be included in the regulatory consolidation perimeter. The Draft Circular indicates that the consolidation perimeter shall include ‘significant’ group companies, *i.e.* those that perform ‘important functions for licensed activities’ and are based in Switzerland. Group companies’ functions are significant for licensed activities when they are necessary for the continuation of important operational processes. Art. 3a BO non-exhaustively mentions liquidity management, treasury, risk management, data administration, accounting, HR, IT, trading, settlement, legal, and compliance. Such companies would not be considered active in the financial sector because they do not provide any financial services on

¹⁰ Art. 29 para. 3 FINMASA.

¹¹ See Art. 3 para. 7 BA *cum* 20 BO.

¹² Art. 4 para. 1 *cum* 22 BO.

¹³ Art. 23 para. 2 BO.

¹⁴ Art. 3d para. 1 let. b BA.

¹⁵ Art. 23 para. 1 *cum* 4 para. 1 BO.

their own behalf or as an intermediary. Even though this goes against the strict interpretation of Art. 4 para. 1 BO, FINMA considers that the inclusion of such group companies in the consolidation perimeter is necessary to align with the purpose and objectives of consolidated supervision, with the main aim being to ensure uniform competence of FINMA in the event of insolvency. FINMA designates these companies¹⁶, thus exercising discretion. *Ad hoc* companies, such as SPVs, must also be included in the regulatory consolidation perimeter regardless of their legal form, provided the corresponding legal conditions are met¹⁷.

IV. SCOPE OF CONSOLIDATED SUPERVISION

The scope of consolidated supervision is defined in Art. 24 OB, in other chapters of the OB (organization, financial reporting), in several federal ordinances and in FINMA's own ordinances. FINMA's practice in these areas is further clarified through several of its circulars. This complex regulatory environment complicates the overall view of the group-wide requirements. The Draft Circular breaks down these requirements into qualitative and quantitative elements. This distinction is important for exempting non-significant group companies from the scope of consolidated supervision.

The 'qualitative' elements cover organization, internal control systems, risk management, guarantee of sound business conduct, corporate governance and financial group auditing. In these regulatory areas, it is generally challenging to justify exemptions from group-wide requirements for non-significant group companies, as the adequacy of organizational, internal control and risk management standards at the group level is considered on a case-by-case basis.

The 'quantitative' elements, on the other hand, cover capital (including interest rate risks), risk concentration, liquidity and financial reporting. In these areas, consolidation typically adds little value if the results on a consolidated basis do not significantly differ from those of the individual entity. The financial group may therefore be exempt from some or all of the quantitative elements (*e.g.*, an exemption from consolidated capital requirements may be justified when individual capital requirements differ only insignificantly from those on a consolidated basis). The relevant basis for determining the significance of a group company depends on the regulatory area in question (*e.g.*, in terms of financial reporting requirements, the share of relevant balance sheet and income statement items provides a relevant basis).

¹⁶ Art. 2bis para. 3 BA.

¹⁷ Art. 3c para. 2 BA *cum* 4 para. 1, 21 and 22 BO.

YOUR CONTACTS



Philippe Jacquemoud, Partner
philippe.jacquemoud@jslegal.ch
+41 22 716 96 96



Constantin Khovrin, Associate
constantin.khovrin@jslegal.ch
+41 22 716 96 96

OUR OFFICE

Jacquemoud Stanislas
Place des Philosophes, 10
P.O. Box
1211 Geneva 4, Switzerland
Telephone +41 22 716 96 96
jslegal.ch



Jacquemoud Stanislas déménage

*Nous aurons le plaisir de vous accueillir
dès le 1^{er} octobre 2024 à l'adresse suivante:*

29, rue de la Coulouvrenière, 1204 Genève - CP 1211 Genève 8

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