

Financial Services Outsourcing in Switzerland – Cross Border Features

Olivier Bégoïn
Avocat (Geneva Bar)
Solicitor (England & Wales)
BMG Avocats

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B•M•G Avocats

Outsourcing in Switzerland – Cross Border Features

Synopsis:

1. business framework
2. legal & regulatory framework
3. contractual tools

Is Outsourcing “Trendy”?

- how old is the concept of outsourcing?

- etymology fairly recent (early 1980s):

“outside resourcing”

(American Glossary)

- but phenomenon not recent

- public sector (sovereign powers): Switzerland pioneer (as service provider)
- private sector: ITO, BPO, KPO

What is Outsourcing?

various definitions

- *“A situation in which a company employs another organisation to do of its work rather than using its own employees to do it.” (Cambridge dictionary)*
- *“Outsourcing is a practice used by different companies to reduce costs by transferring portions of work to outside suppliers rather than completing it internally.” (Investopedia)*
- *“The contracting or subcontracting of noncore activities to free up cash personnel, time, and facilities for activities in which a company holds competitive advantage. Companies having strengths in other areas may contract out data processing, legal, manufacturing, marketing, payroll accounting, or other aspects of their businesses to concentrate on what they do best and thus reduce average unit cost. Outsourcing is often an integral part of downsizing or reengineering. Also called contracting out.” (Business Dictionary)*

Why Outsource?

1. “cost”
 - a. cost **cutting**
 - b. cost **control**: contractual control vs. internal control → **predictability**
 - c. **improving** customer’s shareholders’ **return on capital**
2. strategic: internal skills to focus on core activities
3. service performance: introducing greater flexibility
4. service quality: benefit of pooling expertise → enhancing knowledge gaps through best-practice suppliers → streamlining / standardising processes
5. reallocation of business and regulatory risks

Types of Outsourcing

1. facilities management
 - airlines: baggage handling & catering
 - Swiss real estate: «régies»

2. IT Outsourcing (ITO) – contracting out of the customer's
 - technology infrastructure
 - applications infrastructure
 - Internet -related work (eg programming)
 - data storage

Types of Outsourcing

3. Business Process Outsourcing (BPO)

3.1 manufacturers' supply chain (historically, Coca-Cola)

3.2 front office (customer -facing) functions: marketing, call centres (sales, RM, technical support)

3.3 back office: HR (eg recruitment, payroll), accounting, investment operations & reporting (eg middle office reporting)

4. Knowledge Process Outsourcing (KPO)

4.1 pharmaceuticals: Research & Development ("R&D")

4.2 IP research (patent applications)

4.3 financial institutions: market research, credit risk monitoring

4.4 training, consultancy (incl. legal services)

Outsourcing – other terms

- Offshoring
- Nearshoring
- Insourcing
- Onshoring

“The practice of transferring a business operation that was moved overseas back to the country from which it was originally relocated.”

(Oxford Dictionary)

- Crowdsourcing (incl. Crowdfunding)
- Multisourcing

Technology around Outsourcing

- FinTech
- InsurTech
- RegTech
- Bitcoin (virtual currency)
- Blockchain (bitcoin's underlying technology)
- Cloud Outsourcing

Financial Services Outsourcing in Switzerland – cross border features

- in Switzerland
 - within
 - out of
 - into
- legal & regulatory considerations
 - Customer (Swiss) / Service Provider (Swiss)
 - Customer (Swiss) / Service Provider (non Swiss)
 - Customer (non Swiss) / Service Provider (Swiss)

Swiss Financial Services Outsourcing legal & regulatory framework

a broad typology of rules

- Privacy & FS standards
 - Banking Act (article 47 – banking secrecy)
 - business & professional secrecy (Criminal Code)
 - Telecommunications Act
 - Data Protection Act
 - FINMA Outsourcing Circular (2008/7 – to be amended)
- General contract law (Code of Obligations (“CO”))
- Employment law (CO, collective labour agreements)
- Corporate law (CO, Merger Act)
- Property law (Civil Code)
- Public law (Public Procurement Act, Inter-Cantonal Agreement on Public Procurement, WTO Government Procurement Agreement)
- Competition law (Cartel Act, Merger Control Ordinance)

FINMA Outsourcing Circular (2008/7)

– scope / scope of firms

- Scope: does not govern all FS outsourcing arrangements (MN 2-4)
 - “*outsourcing* pursuant to Circular whenever
 - a regulated firm entrusts another firm (supplier)
 - independently and sustainably
 - the provision of services which is essential”
- “Regulated Firms” (MN 4)
 - Banks
 - Securities dealers
 - Insurance companies (revised Circular 2017/xx)
 - not CISA -regulated firms, but CISO FINMA imposes similar rules
- Outsourcing out of Switzerland: extra-territorial reach (MN 5)

FINMA Outsourcing Circular (2008/7) – scope of services

What is “essential” provision of services?

- provision of services which have an impact on:
 - (i) determination;
 - (ii) limitation and
 - (iii) controlof firm’s risks (not only credit/market and transactional/execution risks, but also operational & reputational risks) (MN 2)
- goal of Circular: protection of sensitive data in accordance with DPA and banking secrecy (MN 1)

Financial Services legislation relevant to outsourcing deals

- Banking Act: article 47 – banking secrecy
 - allows transfer of encrypted customer data to supplier
 - requires consent of each customer (eg terms of business) for transfer of non-encrypted customer data
 - outsourcing agreement to set out security requirements
- other secrecy rules
 - supplier's obligations to comply with business, banking and professional secrecy rules

FINMA Outsourcing Circular (2008/7)

key principles (to remain in revised Circular)

- mandatory information of regulated firm's clients affected by the outsourcing (even if consent not needed) (Principle 6)
- careful selection, instruction and control of the supplier (Principle 2)
- written outsourcing agreement with the supplier (Principle 9)
- regulated firm continues to bear responsibility for the outsourced services (Principle 3) → ensure proper supervision of supplier
- audit rights on the supplier (Principle 7)
- foreign suppliers: regulated firm to gather evidence that it can assume and legally enforce control over the supplier abroad (eg legal opinion, confirmation of foreign supervisory authority) (Principle 8)
- possible additional capital requirements on regulated firms where increase of operational risks (see FINMA Operational Risks Circular 2008/21)

FINMA Outsourcing Circular (2008/7)

Intra-Group Outsourcing (to be rescinded)

Circular only partly applicable in respect of outsourcing

- by branches of foreign firms to their head office (or conversely)
- within a group of companies (eg Raiffeisen)
- to Swiss suppliers established in common by Swiss regulated firms

effect:

- applicability of “client & privacy” Principles only
 - business & professional secrecy and data protection (Principle 5)
 - mandatory information to clients (Principle 6)
 - compliance enforcement evidence for foreign suppliers (Principle 8)
- inapplicability of several Principles
 - Principles 1-4 (incl. diligence obligation re choice, instruction & control of supplier, liability of outsourcing party and definition of detailed security protocol)
 - Principles 7 & 9 (audit rights & written agreement)

FINMA Outsourcing Circular (2017/xx)

key new principles

Alignment of banks to requirements existing on insurance companies

- inclusion of insurance companies
- exemptions to intra-group outsourcings no longer applicable
- prohibition of outsourcing by systemic banks of critical services to affiliated companies
- requirement of an outsourcing management function to keep an inventory of outsourced functions, suppliers, customer's beneficial business function and responsible body

FINMA Outsourcing Circular (2008/7 and 2017/xx) concluding principles

- no authorisation by FINMA required
- exception: transfer of large quantities of client identifying data abroad: notification of FINMA required before the transfer (MN 37 revised Circular)
- possibility to seek a Principle dispensation from FINMA (MN 14)
- outsourcing of certain activities prohibited:
 - Board of Directors' duty of ultimate management, supervision and control
 - central conduct duties of the Board
 - opening and termination of business relationships

Financial Services Outsourcing Data Protection – general principles

- DPA principle
- DPA applied to outsourcing
- data subject approval
- Data Protection and Information Commissioner (DPIC)

Financial Services Outsourcing

transfer of personal data outside of Switzerland

- how to be compliant?

- criteria: jurisdiction providing “adequate data protection”
- if not, 3 options:
 1. contractual obligations;
 2. binding corporate rules; and
 3. safe harbour certification.

Outsourcing Agreements – qualification & effects of qualification

- Qualification

- contract for work & services (*contrat d'entreprise*) art. 363 ff CO
- agency contract (*contrat de mandat*) art. 394 ff CO
- contract of sale (*contrat de vente*) art. 184 ff CO
- lease (*bail à loyer*) art. 253 ff CO
- licence agreement (*contrat de licence*)
- simple partnership (*société simple*) art. 530 ff CO

→ qualification depends on actual nature of services and of obligations of the parties
(*substance over form principle*) SCD 124 III 456

- effects of qualification

- imperative provisions of CO
- supplementary provisions of CO (*dispositions supplétives*)
- liability regime
- applicable limitations periods

Outsourcing Agreements – Service Description, Service Levels, KPIs, Service Credits

- description of service specifications
- Service Levels: definition
- Service Levels: monitoring
- Service Credits

Outsourcing Agreements – protections for the customer

- Service Credits
- outsourcing governance
- loss of exclusivity
- step-in rights
- right of termination
- recourse to supplier's insurance
- parent company guarantee
- third party proprietary rights infringement indemnity from supplier

Outsourcing Agreements – protections for supplier

- force majeure
- liability exclusion for indirect & consequential loss or damage
- liability exclusion for direct loss of business, loss of profit or loss of revenue
- liability cap
- general indemnity for acting on behalf of customer (ca. 402 CO)
- compensation for early termination for convenience

Initial Outsourcings – specific features

transfer of assets or employees

- transfer of assets
 - outright transfer of property to supplier
 - right to use assets
- transfer of rights (IP rights under IT licences, etc.)
 - detailed DD before outsourcing so to define holders of rights
 - crafting of IP rights infringement indemnity(-ies) accordingly
- transfer of employees
 - transfer of business: art. 333 ff CO provide for automatic transfer of employees upon date of business transfer
 - outside business transfers: consent of each individual employee required

Outsourcing – term & termination

- **term:** according to intention of the parties
 - watch: competition law restrictions to long-term supply agreements
- **termination:** according to intention of the parties
 - customer's right to terminate for breach
 - consider rights to terminate for (i) insolvency & (ii) change of control
 - supplier's right to terminate for convenience
- **transition-out services**
- **post-termination points:** IP rights & know-how

Financial Services Outsourcing in Switzerland

conclusive comments

- Swiss legal & regulatory framework
 - overall flexible, also relatively to other jurisdictions (except certain client-facing activities)
 - revised Outsourcing Circular catch up on EU standards
 - requirement of an outsourcing management function
 - intra-group exemptions to be rescinded
- main restrictions: outsourcing out of Switzerland
 - banking secrecy (encryption requirement)
 - data protection
 - FINMA -specific restrictions:
 - notification of bank's clients
 - definition of a security protocol between customer & supplier
 - FINMA prior notification may be required for transfers of clients data abroad

Thank you for your attention

Olivier Bégoïn

olivier.begoïn@bmglaw.ch

B•M•G Avocats
8C, av. de Champel
1206 Geneva
022 839 49 49