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Switzerland's Revised Collective Investment Schemes Act: New Rules on Foreign Investment Fund Distribution, Asset Managers

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In March 2012, the Swiss Federal Council published a proposal to revise the Swiss Federal Act on Collective Investment Schemes ("CISA") (*see WSLR, May 2012, page 10*). The main goal of the partial revision was to align the rules regarding the management, safekeeping, and distribution of collective investment schemes to international standards, in particular the EU Alternative Investment Fund Managers Directive ("AIFMD"). The proposal also aimed to strengthen investor protection and the competitiveness of the Swiss fund industry, and to ensure access of Swiss financial services providers to the EU market.

The Federal Council's proposal was heavily criticised by the fund industry for exceeding its intended purpose. Market participants argued that the proposed new provisions of the CISA were too strict compared to the requirements under the AIFMD and would negatively affect Switzerland as an asset management centre.

The Swiss parliament subsequently revised the original proposal. Both chambers of the Swiss parliament voted in September 2012 in favour of a leaner bill to revise the CISA, which nonetheless has notable implications for the distribution of foreign funds in Switzerland and the regulation of Swiss asset managers of such funds.

The revised law went into effect on March 1, 2013.

On the same date, the revised Ordinance on Collective Investment Schemes, which supplements the CISA, took effect.

It should be noted that revisions of the guidelines of the Swiss Financial Market Supervisory Authority ("FINMA") which further define the distribution rules for fund interests are still pending. As of today, these guidelines ("FINMA Guidelines") are only available in draft form. Therefore, this article is subject to the final FINMA Guidelines, which are expected to take force in the fourth quarter of 2013.

Distribution of Investment Fund Units or Shares

Previous Rules

Under the previous laws and regulations, public distribution or advertisement of Swiss or non-Swiss investment funds in or from Switzerland triggered authorisation and licensing requirements for both the funds and the Swiss distributor. Safe harbour rules were provided for private placements of foreign fund units. Under the previous private placement regime, no licence or authorisation was required if: 1) the solicitation targeted "qualified investors" as defined in the CISA; and

2) only marketing materials or activities that are typical for qualified investors were used. Under the previous law, financial institutions, companies with professional treasury operations and high-net-worth individuals (*i.e.*, individuals with financial assets of at least CHF2 million (U.S.\$2.1 million)) were considered qualified investors. The distribution of foreign fund units to such companies or individuals fell under the private placement regime without any requirements or restrictions applicable.

The Revised CISA

The revised CISA no longer uses the term “public marketing”. In lieu thereof, the revised CISA introduces a comprehensive definition of the term “distribution”. All marketing and distribution activities that fall within the scope of the new definition are now subject to regulatory requirements. All other activities (*i.e.*, all activities which are not captured by the definition) continue to be regarded as private placements and are not subject to any regulation. With regard to distribution, the revised CISA differentiates between distribution to qualified investors only and distribution to non-qualified investors.

Private Placement

Under the revised CISA, a safe harbour rule for private placements remains in force. The provision of information and the distribution of fund units or shares by the Swiss or foreign distributor or the foreign fund to the following entities are not captured by the new definition of distribution and, therefore, are not regulated, and may be performed without any authorisation, approval or licence from FINMA:

- to licensed financial institutions (banks, securities dealers, fund managers, asset managers of investment funds and central banks);
- to regulated insurance institutions;
- to any investor on an unsolicited basis, which, according to the relevant ordinance, is the case where an investor on his own initiative requests information, in particular in the context of long-term, non-gratuitous written advisory agreements or where an investor actively requests information or purchases/subscribes fund units without having been contacted or solicited prior to its request. If a third party, rather than the investment advisor, offers fund interests to either the investor or the investment advisor, then this exception to the distribution will not apply, according to the FINMA Guidelines; and
- to any investor which has concluded a written discretionary asset management agreement with a FINMA licensed financial institution (*i.e.*, bank) or a financial intermediary if information is provided via such financial institution or such independent asset manager. The financial intermediary must 1) in its capacity as financial intermediary, be regulated by anti-money laundering regulation; 2) be governed by the code of conduct employed by a specific self-regulatory body recognised by FINMA; and 3) comply

with the recognised standards of the self-regulatory body. Again, if a third party, rather than the financial intermediary, offers fund interests to either the investor or the financial intermediary, then this exception to the distribution will not apply, according to the FINMA Guidelines.

The publication of prices, indexes, net asset values and tax information by a regulated financial institution are also covered by the revised private placement rules.

Distribution to Qualified Investors Only

However, all marketing of fund interests outside the private placement regime is now subject to the newly implemented regulations. The revised CISA differentiates between distribution to qualified investors only and distribution to non-qualified investors. Whereas, for distribution to non-qualified investors, the requirements of the old “public marketing” must be met, less stringent rules apply if fund interests are exclusively distributed to qualified investors.

Under the revised CISA, “qualified investors” are defined as follows:

- public entities and retirement benefits institutions with professional treasury operations;
- corporates with professional treasury operations; and
- high-net-worth individuals who declare themselves to be qualified (opting in). It is required that such high-net-worth individual either 1) owns assets in an amount exceeding CHF5 million (U.S.\$5.4 million) or 2) owns banking assets of CHF500,000 (U.S.\$537,937) and additionally has sufficient understanding of the risks of the respective investment based on personal education or professional experience.

Strictly speaking, licensed financial institutions, regulated insurance institutions and investors which have concluded a written discretionary asset management agreement also are qualified investors. But since they fall under the private placement regime, they are not discussed in this section.

Foreign collective investment schemes that are distributed only to qualified investors do not need authorisation from FINMA, but, as a new rule, they have to appoint a Swiss representative and a Swiss paying agent for the distribution of the units or shares in Switzerland. The Swiss representative shall serve as a point of contact for Swiss investors and must obtain a licence from FINMA. As the Swiss paying agent, a bank under the Swiss Banking Act must be appointed. Neither the Swiss representative nor the Swiss paying agent may terminate its mandate without the prior consent of FINMA.

The foreign investment fund must authorise the Swiss representative to fully represent the fund with respect to Swiss investors and FINMA and provide it with all necessary information needed to fulfil its duties. The foreign investment fund’s documents must refer to the Swiss representative and the Swiss paying agent and provide for the jurisdiction of Swiss courts. The documents must

also disclose all fees as well as account for remuneration and advantages. Furthermore, the collective investment scheme's designation may not provide cause for confusion or deception.

Foreign investment funds which shall be distributed exclusively to qualified investors may be distributed only by a financial intermediary that is adequately supervised in Switzerland or in its home jurisdiction. This provision will allow a fund management company licensed as an alternative investment fund manager under the EU AIFMD in an EU member state to distribute the interests of an offshore fund to qualified investors in Switzerland (provided that its license from the home regulator allows for fund distribution).

As a new rule, however, a distributor of a foreign investment fund needs to sign a distribution agreement with the Swiss representative of each fund it distributes. The agreement must be governed by Swiss law, and the distributor must therein undertake to exclusively use fund documents which refer to the Swiss representative and the Swiss paying agent and provide for the jurisdiction of Swiss courts.

Distribution to Non-Qualified Investors

Distribution to non-qualified investors under the revised CISA corresponds to the old "public marketing". The foreign fund requires the prior approval of FINMA and it has to appoint a Swiss representative and a Swiss paying agent (*e.g.*, a Swiss bank). The representative has to represent the fund with regard to investors and the FINMA. It further observes all statutory obligations to report, publish and inform FINMA and the investors according to the Swiss regulations and the code of conduct of the industry organisation (in particular of the Swiss Funds Association). The representative's name and address must be disclosed in every publication of the fund.

A foreign fund is generally granted authorisation for distribution in Switzerland, provided that:

- the fund or the fund management company, the asset manager and the depository bank are subject to adequate supervision by an applicable foreign regulator;
- the fund or the fund management company and the depository bank are subject to regulation considered adequate relative to Swiss regulation;
- the designation collective investment scheme does not provide cause for confusion or deception;
- a representative and a paying agent are appointed for the distribution of the units in Switzerland; and
- FINMA has concluded a cooperation agreement with the applicable foreign regulator.

Regulation of Asset Managers

Under the previous law, asset managers of funds administered outside Switzerland did not require a licence from FINMA. However, such asset managers could apply

for a licence if the home country of the fund required the asset manager to be licensed. This provision enabled Swiss financial services providers to manage undertakings for collective investment in transferable securities ("UCITS") under the EU UCITS Directives 2001/107/EC and 2001/108/EC.

The CISA revision changes this licensing and supervision scheme from voluntary to mandatory. In general, asset managers of foreign investment funds now have to obtain a licence from FINMA. In order to obtain the licence, the asset manager must, *inter alia*, demonstrate equity capital of at least CHF200,000 (U.S.\$215,175) and sufficient personnel.

The new rules also allow a foreign asset manager to establish a licensed branch in Switzerland. This possibility aims to strengthen Switzerland as a centre for asset management. It is noteworthy that the possibility to open a licensed branch in Switzerland will most likely be limited to a foreign asset manager but not be permitted to a foreign management company.

The revised CISA includes some exceptions regarding the duty to obtain a licence. For instance, asset managers of funds limited to qualified investors are excluded from the licensing requirement, provided that 1) the assets under management (including assets acquired through the use of leverage) do not exceed CHF100 million (U.S.\$107.6 million); or 2) the assets are below CHF500 million (U.S.\$537.9 million) (provided that the managed portfolio is not leveraged and that investors do not have redemption rights exercisable for a period of five years following the date of the initial investment); or 3) all investors belong to the same financial group as the asset managers. These provisions should be in line with the *de minimis* rule introduced by the EU AIFMD, under which voluntary licensing by the asset manager remains possible. In addition, FINMA may partially or completely exempt asset managers of foreign funds from provisions of the revised CISA upon request, in certain justified cases.

The Swiss asset manager may delegate its services to a foreign entity, provided that a cooperation agreement between FINMA and the foreign entity's regulator is in place (if such cooperation agreement is required by the foreign jurisdiction, *e.g.*, the EU AIFMD).

Transitional Rules

By March 1, 2015, every foreign investment fund distributed to qualified investors in Switzerland must have appointed a Swiss representative and a Swiss paying agent and comply with all regulations corresponding to such representative. Foreign investment funds further have to ensure within the same period of time that their designation does not give cause for confusion or deception.

Distributors of foreign investment funds which have not yet been subject to the CISA have to contact and register with FINMA within six months after the entry into force of the revised CISA (*i.e.*, before September 1, 2013) and apply for a FINMA licence within two years (*i.e.*, before March 1, 2015), if not sufficiently licensed in their home country. Furthermore, distributors must

sign a distribution agreement with the Swiss representative of each foreign investment fund they distribute by March 1, 2015.

The distribution of fund interests within the revised limited private placement regime set forth above is not subject to regulation, and respective distributors are not affected by this reform.

Generally, the transitional rules apply to Swiss asset managers of foreign investment funds. Asset managers of foreign investment funds which have not yet been subject to the CISA have to contact and register with FINMA within six months after the entry into force of the revised CISA (*i.e.*, before September 1, 2013) and apply for a FINMA licence within two years (*i.e.*, before March 1, 2015).

Trends and Outlook

The new provisions of the CISA only recently entered into force, with the goal of preserving the quality and competitiveness of Swiss asset management services. We certainly welcome the Swiss parliament's passage of a reform bill that should not overly burden the Swiss asset management industry.

However, it is hard to understand why stricter rules on private placement have been implemented in Switzerland, while national private placement rules of the EU

member states will potentially be phased out in 2018 under the EU AIFMD.

Previous revisions of Swiss regulations on collective investment funds have not brought about the hoped-for positive results, but instead have had a negative impact on the Swiss investment fund market. It is difficult to say whether the revised CISA will meet expectations this time.

First, the new rules lack provisions concerning the remuneration of asset managers, which is required under the EU AIFMD. Whether Swiss alternative investment fund managers will thus be able to benefit from a pan-EU passport with regard to their marketing and management activities from 2015 on remains unclear.

Second, there is concern that the duty to appoint a Swiss representative and a Swiss paying agent for the distribution of funds to high-net-worth individuals and institutional investors will mainly have a negative effect on the cost side without achieving additional true investor protections. These new rules are clearly burdensome on the distribution of foreign fund interests in Switzerland.

The text of the revised CISA, in German or French, is available at http://www.admin.ch/ch/d/sr/c951_31.html.

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