

Financial Services News No.

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**Foreign investment funds distributed** to Swiss qualified investors need to appoint a Swiss representative and a Swiss paying agent prior to initiate distribution activity in Switzerland. The foreign placement agent requires to be appropriately supervised in its home jurisdiction. Important questions regarding the new fund distribution rules are still subject to discussion among the Swiss representatives, foreign fund providers and their legal counsel. The open issues relate to the requirements on the appropriate supervision of the foreign placement agent, the requirements of the fund documents and the pre-marketing and reverse solicitation rules. This newsletter addresses these issues.

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## Distribution of foreign investment funds to Swiss qualified Investors

### New fund distribution rules

Most fund managers are well aware of the new Swiss rules on distribution of foreign funds to qualified investors. Since 1 March 2015, an alternative fund manager subject to the Alternative Investment Fund Management Directive (AIFMD) – or a US investment adviser – distributing investment funds to certain Swiss qualified investors have to appoint a Swiss representative and a Swiss paying agent. In addition, any placement agent of the fund active in Switzerland (or the fund manager itself should no third party placement agent be appointed) must be subject to appropriate supervision in its country of domicile and shall enter into a distribution agreement with the Swiss representative.

Funds and their managers are only exempt from having to comply with these new regulatory requirements if they solely market to certain exempt qualified investors in Switzerland, which are regulated financial intermediaries (banks, broker dealers, fund manager and asset managers of investment funds), regulated insurance companies or sell fund interests to investors that have approached the fund on their own initiative without prior solicitation of the fund manager (reverse solicitation).

Given that these rules are relatively new and have been enacted with only limited guidance from the Swiss Financial Market Supervisory Authority (FINMA), many

aspects remain uncertain. These mainly relate to the specific functions and duties of the Swiss representative and paying agent, the requirements on the fund documents and the reverse solicitation rules.

### Pre-marketing rules

The law requires that prior to distributing foreign funds in Switzerland, the fund manager must appoint a Swiss representative and paying agent. Distribution is defined as any offering and any type advertising of certain investment funds. Contrary to regulations in EEA member states, also most cases of so-called «soft-marketing» are captured by this very broad definition. In practice, it is difficult to determine whether fund raising prior to finalization of the fund structure would already be deemed to be distribution of a fund, considering that the fund has not been established, yet. The Swiss Funds & Asset Management Association (SFAMA) is of the view that once the investment policy, the fee structure, the depository bank (if any) and the fund manager (this is of course regularly the case) have been determined, the tipping point would have been passed. According to this interpretation, the sending of teaser documents or pathfinder PPM would already constitute fund distribution and would trigger the requirement to appoint a Swiss representative and paying agent.

The interpretation of the law by SFAMA is rather broad. The law refers to distribution of investment funds, not investment policies. In our view, the appointment of a Swiss representative and a paying agent

is certainly required once the subscription document is available and provided to a potential investor whose execution would validly bind the investor (and the fund manager). From that point of time a Swiss qualified investor should be able to rely on the protection of Swiss representative and paying agent. Before that tipping point, there are good arguments in our opinion that a teaser or a pathfinder PPM may be provided to Swiss qualified investors without a Swiss representative and paying agent being required yet.

#### **Requirements on the fund documents and the fund**

Once the appointment of a Swiss representative and paying agent is required, their names and addresses have to be disclosed in all fund documents. «Fund documents» is not a legal term but generally understood as PPM, the subscription agreement, financial statements. In our view, general marketing material of the fund would not qualify as fund documents. In addition, the place of jurisdiction has to be disclosed in the fund documents.

Unfortunately, many Swiss representatives still insist that fund managers state in the fund documents that the «*place of performance and jurisdiction for units of the fund distributed in Switzerland is the registered seat of the Swiss representative*». This is largely based on a model annex for fund documents published by SFAMA but not supported by Swiss law. The Swiss Federal Act on Collective Investment Schemes (CISA) provides for a legal place of performance at the registered seat of the representative and independently thereof, requires funds to disclose the place of jurisdiction in the fund documents. Clearly, the CISA does not require the place of jurisdiction to be in Switzerland and the fund manager is free to agree with the investor on any

other place of jurisdiction. The place of jurisdiction has to be distinguished from place of performance which pursuant to Swiss law is the place where the investor may require performance of an obligation. The exact legal relevance for the investor, however, and the rights that may be derived from such place of performance, if any, must be determined pursuant to the law applicable on the contractual relationship between the fund and its investor (which typically is not Swiss law).

Swiss representatives are further of the opinion that foreign fund managers need to comply with the Guidelines on Duties Regarding the Charging and Use of Fees and Costs (Transparency Guidelines) issued by SFAMA. The Transparency Guidelines have been recognized as a minimum standard by FINMA. The Transparency Guidelines require funds to disclose all charges and fees incurred directly or indirectly by the investors and their appropriation. While the CISA only burdens licensees under the CISA and their agents with these disclosure requirements, SFAMA has in its Transparency Guidelines extended the applicability of these guidelines to foreign placement agents and foreign fund managers. In our view, the Transparency Guidelines need not be regarded by foreign placement agents and foreign fund managers as the extension by SFAMA lacks a sufficient legal basis. In practice, Swiss representatives are adamantly requiring a respective contractual undertaking in the distribution agreement. From a general liability perspective, it is of course advisable to specify all applicable charges and fees in the PPM.

With respect to the foreign fund manager, Swiss law finally requires that the fund's name must not provide reasons for confusion or deception, e.g., fund investing in European equities shall not be labelled as Asian equity fund.

#### **Requirements on the distributor**

A financial intermediary may only distribute foreign investment funds to qualified investors if it is subject to appropriate supervision in Switzerland or its country of domicile. According to the respective ordinance the financial intermediary may distribute foreign funds to qualified investors in Switzerland if it is admitted for fund distribution in its country of domicile and concludes a written distribution agreement with the Swiss representative of the fund manager. Yet, the requirements on appropriate supervision or admission for fund distribution are not specified. Any fund manager subject to the AIFMD would meet the requirements. We are of the view that any SEC registered investment adviser would also be deemed to be appropriately supervised since Swiss law is not requesting an equivalent supervision.

As stated, the distributor has to enter into distribution agreement with the Swiss representative. The distribution agreement is usually a tripartite agreement between the fund manager, the placement agent (distributor) and the Swiss representative. The fund manager acts as principal of the distributor and the distributor is approved (and not appointed, as wrongly stated in the SFAMA model agreement) by the Swiss representative for purposes of distribution in Switzerland. We recommend that the Swiss distribution agreement is aligned with the global distribution agreement in place between the fund manager and the placement agent, if any. In the event, the fund manager would act as distributor for its own funds, the distribution agreement may be consolidated with the representative agreement to avoid contradicting provisions. The distribution agreement has to be governed by Swiss law.

### Duties of the Swiss representative

The Swiss representative represents the fund with regard to Swiss investors and thus shall serve as point of contact for enquiries and claims of Swiss investors. In that sense, the Swiss representative has to ensure that qualified investors may obtain from the representative the fund documents. Given that these documents are confidential, the Swiss representative should make them available to existing investors only. Some Swiss representatives also require a quite extensive involvement in the fund distribution activity. Swiss law, however, only requests the Swiss representatives to (i) ensure that a written paying agent agreement is entered into, (ii) have any distributor for Switzerland sign a written distribution agreement compliant with the Swiss distribution rules (including the Provisions for Distributors by SFAMA), (iii) ensure that the fund documents contain the mandatory disclosures and (iv) make the fund documents available to Swiss investors upon request. Where violations of the law become known to the Swiss representative, it has (v) to take appropriate measures. In our view, the Swiss representative has no further mandatory duties and in particular, it is not required to attend any investment presentation or be involved in any communication between the fund manager and Swiss investors.

Finally, the representative shall represent the foreign fund before the Swiss regulator should this ever be required. This last duty is rather unusual because neither the foreign fund manager nor the Swiss representative has any registration or reporting duties regarding the foreign fund before the Swiss regulator. Nevertheless, the law requires that the power of the Swiss representative shall not be restricted in this respect. In our view, the representative has a general contractual obligation to first consult with the fund manager before submitting any notification to FINMA.

### Duties of the Swiss paying agent

Only banks under the Swiss banking act and supervised by the Swiss regulator FINMA may act as Swiss paying agent. Swiss investors may request the issuance and redemption of the fund interests at the office of the paying agent. Thus, the Swiss paying agent would theoretically have to execute all transactions with regard to Swiss investors. However, for the latter, using the Swiss paying agent is only an additional option. All transactions and transfers can also be processed by the foreign bank of the fund manager directly. In practice, Swiss paying agents are only rarely used for investments and disinvestments. Most paying agents are not requesting the fund manager to open an account with them.

In our view, this reality should be taken into account by the legislator by abolishing the duty to name a Swiss paying agent if a foreign fund is only distributed to qualified investors. For the time being, such duty only represents a regulatory burden and does not result in any practical protection or easement for Swiss investors.

The Financial Services Newsletter provides comments on new developments on the regulation of banks, brokers, insurance companies, fund managers, exchanges and clearing houses. It also covers significant issues in relation to financial products and financing. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this Newsletter should seek specific advice on the matters which concern them.

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