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NewsLetter

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Liberalized Regulations for Investment Funds

Investment funds (mutual funds) have become worldwide very popular investment instruments. They are also an important part of the Swiss financial markets. To keep investment funds attractive and to increase competitiveness of Swiss investment funds, liberalized regulations have recently come into effect in Switzerland.

Continuing Growth of Investment Funds in Switzerland

The investment fund business has undergone a tremendous development in the last ten years. In 1990, a volume of less than fifty billion Swiss Francs was invested in funds distributed in Switzerland. Today, this volume has increased to almost 500 billion Swiss Francs invested in more than 2,500 different funds. Approximately 30 % of this amount has been put into Swiss investment funds that are governed by the terms of the Swiss Investment Fund Act ("IFA") and the respective ordinances. Accordingly, the vast majority of the assets have been invested in approximately 2,100 foreign funds that are distributed in Switzerland and licensed by the Federal Banking Commission ("FBC").

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New Regulations to Set Incentives

In the last few years, investment fund regulation has tried to create incentives to avoid a further migration of funds abroad, especially to Luxembourg, and to make the Swiss investment fund market in general more attractive. The new IFA, which came into force in 1995, with the respective Investment Fund Ordinance ("IFO") and the Investment Fund Ordinance of the FBC ("IFO-FBC") have partially succeeded in making the incorporation of domestic funds and the Swiss investment fund market in general more competitive. Nevertheless, new amendments to the IFO and the IFO-FBC, as well as tax incentives have been introduced in the last couple of months to further liberalize the Swiss investment fund market.

Since January 2001, investment funds in Switzerland are not subject to Swiss security transfer taxes any longer. This tax strangled the financial markets in Switzerland for many years.

Liberalization of Distribution

Until recently, any party who offered or distributed units of investment funds professionally on a continuing basis without being part of the fund management or the custodian bank, required authorisation from the FBC. Pursuant to the revised IFO, such an offering and distribution of units of funds is only considered professional, if public advertisement for the funds has been made. Any offering to less than 20 investors is not regarded as public and thus, does not have to be authorized. This amendment is especially useful to foreign investment funds since their legal definition, contrary to Swiss funds, does not depend on public advertising. So far, even private distributions of foreign funds needed an authorization by the FBC.

New Investment Techniques for Fund Managements

The basics of new investment techniques for the fund management are now provided by the amended IFO. The further details of these amendments are set forth in the totally revised IFO-FBC that came into effect as of 1 May 2001.

The IFO-FBC is quite a comprehensive product elaborated by the FBC in collaboration with the Swiss Funds Association ("SFA") and the Swiss Institute of Certified Accountants and Tax Consultants.

The main issues of the new IFO-FBC are (i) a new and very detailed regulation regarding the use of derivatives, (ii) the regulation of the newly permitted repurchase agreements and the liberalization of securities lending, and (iii) the incorporation of a limited self-regulation in the IFO-FBC. The IFO-FBC provides the fund management with more flexibility, but requires a greater amount of self-responsibility at the same time. The use of the new investment techniques must be laid down in internal guidelines.

Derivatives
It is quite unusual that a Swiss law or ordinance should contain so many definitions as it is now the case in the IFO-FBC. More than 18 definitions of derivatives and terms in connection with derivatives are provided by article 1 of the IFO-FBC. The definitions are to some extent even explained in English terms and not fully described in any official Swiss language. This is just another indication of the strong U.S.-American and English influence on the law dealing with the financial market in civil law countries.

The fund management has to define the use of derivatives in an internal guideline. Such guideline has to include the internal risk management and risk policy in connection with derivatives, as well as the documentation of the transactions and the chosen valuation of the derivatives. An annual revision of the guideline is mandatory. The prospectus of the investment fund and the investment guidelines have to describe the derivatives that may be used to implement the investment policy and have to disclose the risks that are involved in derivatives.

The fund management may only close transactions with derivatives through an exchange or on another market that is regulated and open to the public. Over-the-counter ("OTC") transactions are only permitted under certain restrictive conditions. A counter party to an OTC transaction must be a bank or a financial institution specialized in such business. In addition, OTC transactions have to be documented with a standardized agreement that corresponds to international standards.

Securities Lending, Repurchase Agreements
The adjusted provisions regarding securities lending allow the fund management more flexibility. They have been harmonized with the newly introduced regulation of repurchase agreements. The fund management now has more flexibility to choose the counter party to a securities lending transaction. It may lend the securities itself, or it may delegate an agent to provide the securities to a borrower. In particular, the counter party to the fund management does not have to be the custodian bank anymore. However, the fund management will need the custodian bank's consent if the custodian bank is neither the borrower nor the agent to the securities lending. Only banks, brokers or insurance companies or recognized clearing organizations may be borrowers or agents in such transactions.

An annually revised internal guideline has to formulate the rules of securities lending. The fund management has to use a standardized agreement with each borrower or agent. Such agreement has to contain, among others, that the borrower or agent has to pledge or transfer ownership of certain collateral to the fund management in order to secure the fund management's claim. Such collateral has to have a value at any time of at least 105 % of the market value of the securities lent. Shares that are quoted on an exchange or traded on another market open to the public in Switzerland, the European Union, the European Economic Area or the U.S. may be used as collateral if they are part of an index of highly capitalized values.

The same basic rules apply also to repurchase agreements.

Self-Regulation
A remarkable amendment has been introduced with the adjustment of the provisions governing the audit of investment funds: The auditors have to report whether the fund management has acted in accordance with the rules of the SFA. Thus, the rules of the SFA are applicable even if the fund management is not a member of the SFA. This means that self-regulations enacted by a private association have been raised to the level of statutory law. Among others, the rules of the SFA include the fund management's code of conduct.

NewsLetter

The ww&p **News**Letter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, adressees of this **News**Letter should seek specific advice on the matters which concern them.

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