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Entry into force of the new Swiss investment funds regulation

The new regulation which entered into force on 1 March 2013 not only affects the investment funds market, it also has an impact on asset managers – What are the principal changes?

In September 2012, the Swiss parliament passed an amendment to the Swiss Collective Investment Schemes Act ("CISA"). As mentioned in our April 2012 newsletter, this amendment aimed on the one hand at filling the existing gaps in the area of investors' protection and on the other hand at adapting the Swiss legislation to the international requirements regarding management, custody and distribution of collective investment schemes (i.e. funds).

In order to implement the September 2012 amendment to the CISA, a partial revision of the Collective Investment Schemes Ordinance ("CISO") was published in February 2013.

The CISA and the CISO entered into force on 1 March 2013, with the exception of certain provisions relating to the definition of qualified investors, the key information for the investors and the mandatory journal, which will only apply as from 1 June 2013, respectively 1 January 2014.

The entry into force of this new regulation brings about important changes, particularly as to the concept of distribution (especially given the new definition of qualified investors) as well as regarding the provisions applicable to distributors, foreign funds, custodian banks and asset managers of funds.

1. The concept of distribution

The former concept of *"public advertisement"* has been replaced by that of *"distribution"*.

The new law defines distribution of funds as consisting of *"any form of offering or advertising pertaining to funds that is not exclusively addressed to investors in the sense of article 10 paragraph 3 letters a and b"*, i.e. regulated financial intermediaries, such as banks, securities dealers, fund management companies and asset managers of funds, as well as regulated insurance undertakings.

Conversely, any offering or advertising to other types of qualified investors, as for instance high net worth individuals or pension funds, is considered as distribution (see point 2 below).

The CISA however allows for a certain number of exceptions. The provision of information and the acquisition of funds is not deemed to be distribution:

- in the context of a written discretionary asset management agreement with a regulated financial intermediary, such as a bank;
- upon incitation or initiative of the investor, in particular in the context of an advisory agreement (see point 1.1 below); or
- in the context of a written discretionary asset management agreement with an independent asset manager, provided the latter fulfils a certain number of conditions (see point 1.2 below).

FINMA has indicated that they would soon issue a circular further specifying the concept of distribution, in replacement of the FINMA-Circular 08/8 relating to the concept of public advertisement.

1.1. Upon initiative of the investor

Unsolicited offers ("execution only" transactions) are not considered to be distribution if the investor requests information or acquires fund units without intervention or prior contact for instance by the fund asset manager or the distributor.

Advice given in the context of an advisory agreement is not either regarded as distribution provided the advisory contract:

- aims at a long term, remunerated advisory relationship;
- is concluded in writing with a regulated financial intermediary or an independent asset manager that fulfils the conditions of article 3 paragraph 2 letter c CISA (see point 1.2 below).

1.2. Written asset management mandate with an independent asset manager

The following conditions must be fulfilled in order for the acquisition of fund units in the context of a discretionary asset management agreement with an independent asset manager to not be regarded as distribution:

- the asset management contract has been concluded in writing;
- the asset manager is subject to the Swiss Anti-Money Laundering Act as a financial intermediary;
- the asset manager is subject to the rules of conduct issued by a professional organisation that are recognised by FINMA as minimal requirements; and
- the asset management contract is in line with the recognised guidelines of a professional organisation.

2. The concept of qualified investor

Contrary to what prevailed under the previous CISA, the characterisation as qualified investor primarily serves to determine whether an entity or individual may or not have access to funds reserved for qualified investors. This characterisation does however not serve to avoid the qualification as distribution, except within the scope of the aforementioned exceptions.

The following are considered as qualified investors according to the new CISA:

- regulated financial intermediaries;
- regulated insurance undertakings;
- public entities and pension funds with professional treasury operations;
- companies with professional treasury operations;
- high net worth individuals having requested in writing to be considered as qualified investors (opting-in clause).
  The CISO defines the high net worth individual as an investor, who:
  - demonstrates (i) having the necessary knowledge to understand the risks of the investment based on his/her education or professional experience or a comparable experience in the financial sector and (ii) owning assets of at least CHF 500'000; or
  - confirms in writing owning assets of at least CHF 5 million.
- investors having concluded a discretionary asset management contract in line with the requirements referred to above, unless they have declared in writing that they do not wish to be considered as qualified investors (opting-out clause).

The CISO specifies that it is up to the asset managers to inform the investors, who have entered into an asset management agreement (i) that they are considered as qualified investors, (ii) of what the ensuing risks are and (iii) of the opting-out option. It is recommended to provide this information in the asset management contract.

The new definition of qualified investors will only enter into force on 1 June 2013.

Furthermore, the CISA foresees that high net worth individuals, who do not “opt-in” and do therefore not meet the requirements of the new definition of qualified investors by 31 May 2015 will no longer be allowed to invest in funds reserved for qualified investors.

3. Implications of the new concept of distribution for distributors

Entities performing distribution activities according to the new CISA (see point 1 above) must obtain an authorisation from FINMA. They will therefore have to on the one hand (i) contact FINMA within 6 months, i.e. by 31 August 2013, and on the other hand (ii) fulfil the requirements of the CISA and (iii) file a request for authorisation by 28 February 2015. This applies even in case of distribution of foreign funds to qualified investors only (see point 2 above), although distributors subject to an appropriate supervision in their home country do not require an (additional) distribution authorisation from FINMA.

Furthermore, a new requirement shall apply to distributors as from 1 January 2014: they will need to keep a journal in which in particular the client’s needs and the reasons for having recommended in each case the purchase of a specific fund unit will have to be recorded. The journal will have to be handed out to the client. The Swiss Fund Association, SFA, is expected to publish in the course of spring 2013 an amendment to its fund distribution directive, which will among other things specify this duty to keep a journal.

4. Implications of the new concept of distribution for foreign funds

As already foreseen under the previous CISA, a foreign fund which is distributed in Switzerland to non-qualified investors requires an authorisation and must amongst other things nominate a Swiss representative.

The new CISA has extended the obligation to nominate a representative to foreign funds distributed to qualified investors other than regulated financial intermediaries or insurance undertakings, namely to high net worth individuals and pension funds for instance. These foreign funds have until 28 February 2015 to nominate a representative.

In addition, the CISO requires that the representative enters into (a) Swiss law distribution contract(s) with the distributor(s).

As regards the authorisation for foreign funds distributed in Switzerland to non-qualified investors, the conditions for approval have hardly been modified. However, a new requirement has been introduced, namely the existence of an agreement for cooperation and exchange of information between the foreign authorities concerned by the distribution and FINMA. FINMA is expected to soon publish the list of countries with which it has entered into such agreement.

5. Custodian banks

The provisions applicable to custodian banks have been reinforced, namely in terms of internal organisation, delegation and responsibility.

Indeed, according to the CISA, the custodian bank must dispose of an *"appropriate organisation which is adapted to its activity as a custodian bank"*. The CISO stipulates in this respect that the custodian bank must among other things dispose of at least three full-time positions dedicated to the activity of funds' custody.

In case of delegation, the sub-custodian must as a rule be subject to supervision. In addition, in terms of responsibility, the custodian bank is no longer only liable for applying due diligence when choosing and instructing the sub-custodian and controlling the on-going compliance with the selection criteria, but also for the due diligence with which it supervises the sub-custodian. However, contrary to European law, the responsibility of the custodian bank has not become a strict liability. The CISA indeed merely provides for a reversal of the burden of proof in favour of the investor. In other words, in case of litigation, the custodian bank will be presumed not having fulfilled its obligations.

Finally, it is important to note that custodian banks will henceforth have to obtain a supplemental authorisation should they wish to act as a foreign funds' representative.

Custodian banks must satisfy the new organisational requirements and, if applicable, submit an authorisation request as a foreign funds' representative within a one-year transitional period.

6. Asset managers of funds

Under the new CISA, not only the asset managers of Swiss funds, but also those of foreign funds now require an authorisation, subject to certain exemptions particularly based on the *de minimis* rule.

The *de minimis* rule provides that asset managers of funds for qualified investors are not subject to the CISA if their assets under management do not exceed the following thresholds:

- CHF 100 million, including those assets purchased with leverage; or
- CHF 500 million, if the assets are unleveraged and the fund is closed-ended for a five-year period from the first investment.

The CISO describes in detail the manner in which these thresholds must be calculated. If they are exceeded, the asset manager must inform FINMA within 10 days and only has 80 more days to submit a request for authorisation.

Fund asset managers that do not benefit from the *de minimis* rule are subject to a number of obligations, in particular in terms of internal organisation, capitalisation and equity. The CISO specifies that the asset managers of Swiss funds must dispose of a minimal share capital of CHF 200'000 paid up in cash. The corresponding amount for asset managers of foreign funds is CHF 500'000. As to equity, it must amount to 0.02% of the total assets under management in excess of CHF 250 million, but at least a quarter of the fixed costs of the last accounting period.

Asset managers that already hold an authorisation will need to comply with the new organisational, capitalisation and equity requirements within one year from the entry into force of the CISA, i.e. by 28 February 2014.

Asset managers of foreign funds which need to obtain an authorisation according to the new CISA must on the one hand (i) contact FINMA within 6 months, i.e. by 31 August 2013, and on the other hand (ii) fulfil the requirements of the CISA and (iii) file a request for authorisation by 28 February 2015.

Conclusions

Even though the entry info force of the CISA has clarified a number of points, several uncertainties remain, for instance as to whether an independent asset manager having signed an asset management contract in line with the new requirements can be regarded as a qualified investor.

Certain of these questions will only be answered in the context of the next application circulars of FINMA or through case law.

Given the important changes imposed by the new regulation, all entities and persons active in the field of asset management and, more particularly, of investment funds must now ensure that their activities are compliant with the new legislation.

In this respect, and given that the new regulation foresees an obligation to contact FINMA within 6 months after the entry into force of the CISA, i.e. by 31 August 2013, it is particularly recommended for asset managers of foreign funds and for distributors to rapidly evaluate the need to obtain an authorisation and, should this be required, to contact FINMA within the given timeline.

Contacts

The content of this newsletter is for information purposes only and does not constitute a legal advice or opinion. Should you require specific advice in this matter, please get in touch with your usual contact at ALTENBURGER or with one of the below authors of this newsletter.

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