ATTORNEYS AT LAW

SCHELLENBERG WITTMER

APRIL 2013

Newsletter



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BANKING & FINANCE

Revision of the Collective Investment Schemes Act: Substantial Changes in the Field of Asset Management and Distribution

On 1 March 2013, most of the provisions of the revised Collective Investment Schemes Act (**CISA**) and of the consequently amended Collective Investments Schemes Ordinance (**CISO**) entered into force. Amongst other things, the revision entails substantial changes in the field of the asset management and the distribution of collective investment schemes (**CIS**).

1 GOALS OF THE REVISION

The goal of the revision is to close gaps in the Swiss regulation resulting from the continued development of the international standards. Primary objectives are to **strengthen investor protection** and to preserve the **quality and competitiveness of the Swiss asset management industry**. Particularly, the access of Swiss asset managers and of their (offshore) products to the financial markets in the European Union (**EU**) shall be ensured by aligning the CISA with the European Alternative Investment Fund Managers Directive (**AIFMD**). The AIFMD will introduce a protectionist third-country regime. The member states of the EU will have to implement the AIFMD not later than 22 July 2013.

We will outline the most important changes in the field of the asset management and the distribution of CIS below. Before doing so, we discuss the adjusted definitions of CIS and of qualified investors as well as the new agreements on cooperation and information exchange (**Cooperation Agreements**) to be entered into by the relevant regulatory authorities.

2 DEFINTIONS

2.1 COLLECTIVE INVESTMENT SCHEME

The CISO substantiates the term "CIS" in regard to the minimum number of investors: At least **two investors** have to raise the managed CIS funds in a legally and factually **independent manner**. This provision aims to prevent, for example, married couples from holding their common assets tax-efficiently as a CIS.

2.2 QUALIFIED INVESTORS

The provisions regarding qualified investors, which will enter into force on 1 July 2013, were partly adjusted to the European Markets in Financial Instruments Directive (**MiFID**). First of all, (i) regulated financial intermediaries (i.e. banks, securities dealers, fund management compa-

nies as well as – newly – **asset managers** and **central banks**), (ii) regulated insurance institutions, (iii) public-law bodies and occupational pension institutions with professional treasury as well as (iv) companies with professional treasury are deemed to be qualified investors.

With the revision, wealthy individuals are no longer automatically qualified investors. However, they may declare in writing that they want to be considered as such (**opting-in**). For this purpose, individuals have to evidence that they dispose over bankable assets in an amount of at least **CHF 500,000** and possess the necessary education or **experience in the financial sector** to understand the involved investment risks. Alternatively, individuals may declare in writing that they own assets in an amount of at least **CHF 5 million** (real estate property may be partially considered in the calculation). Except for the latter, purely quantitative criterion, the new provisions are similar to the **MiFID concept**. The requirements for the professional qualification, however, are somewhat **less stringent** than those of the MiFID.

Finally, under certain circumstances (see para. 4.2 below), **asset management clients** of regulated financial intermediaries and independent asset managers are classified as qualified investors as it was already the case under the previous law. Again in line with the MiFID, however, these investors newly have the right to declare in writing that they do not want to be considered as qualified investors (**opting-out**).

2.3 COOPERATION AGREEMENTS

The revised CISA states that the Swiss Financial Market Supervisory Authority (**FINMA**) has to conclude Cooperation Agreements with the respective foreign supervisory authority or authorities involved. This is in some cases mandatory, in other cases necessary only if required under foreign law. These agreements mainly deal with the **exchange of information, cross-border on-site inspections** and support in **law enforcement**. The European Securities and Markets Authority, in the name of all competent national supervisory authorities of the EU, agreed with the FINMA on general principles that should apply as from 21 July 2013. However, the respective national supervisory authorities **have not yet signed or ratified** any Cooperation Agreements.

3 ASSET MANAGEMENT

3.1 REQUIREMENTS FOR THE LEGAL FORM

An asset manager has to be organized as a legal person, a limited partnership or a general partnership. The revised CISA also accepts **branches** of foreign asset managers if certain conditions are met (in particular, if a Cooperation Agreement exists, see para. 2.3. above). **Natural persons**, however, can no longer be asset managers under the CISA.

3.2 GENERAL LICENSING REQUIREMENT AND CONDITIONS THEREFOR

One of the most crucial aspects of the revision is the general **licensing requirement** for **asset managers of foreign CIS**. Exceptions apply for corporate groups as well as, according to the *de minimis* rules (see para. 3.3 below), for managers of smaller CIS that are only available to qualified investors (see para. 2.2 above).

In regard to the **internal organization** of asset managers and to the necessary equity capital, the revision sets forth **stringent requirements**. Following the AIFMD, the revised CISA, particularly, expressly obliges asset managers to ensure the portfolio management and the **risk management** for the managed CIS. It also contains a non-exhaustive list of further tasks that an asset manager may perform. Under the new law, a delegation of tasks is still permissible, provided, amongst other requirements, that the **delegation** serves the purpose of an appropriate management.

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3.3 NO APPLICABILITY OF THE CISA: *DE MINIMIS* RULES

Asset managers of CIS for qualified investors (see para. 2.2 above) only are not subject to the CISA and, accordingly, the licensing requirement, if the following requirements are met:

- all CIS assets under management, including any assets acquired through the **use of leverage**, do not exceed a threshold of **CHF 100 million**; or

- the CIS assets under management comprising funds that are **unleveraged and closed-ended** for a period of five years do not exceed a threshold of **CHF 500 million**. By virtue of its wording, this CISA provision only applies to funds of funds. It appears that this restriction is a legislative error. The goal of the exception was indeed to generally exclude asset mannagers of smaller closed-ended funds (e.g. private equity funds) from the scope of the CISA.

3.4 EXEMPTION FROM THE SCOPE OF THE CISA

The FINMA may partially or fully **exempt** asset managers that are subject to the licensing requirement from the provisions of the CISA. The prerequisite for such an exemption is that the protective purpose of the law (i.e., investor protection) is not impaired and that the relevant asset managers received their asset management mandate assigned either from (i) a **Swiss** fund management company, a CIS or another asset manager or (ii) a **foreign** fund management company or corporation that is subject to a **supervision equivalent** to Swiss law.

4 DISTRIBUTION

4.1 FROM "PUBLIC ADVERTISING" TO "DISTRIBUTION"

The revision abandons "public advertising" as criterion for activities to be 'in scope' of the CISA. Instead, the term "**distribution**" (including the exemption thereof, see para. 4.2) is decisive. From now on, the distribution of Swiss and foreign CIS **in Switzerland** or **from Switzerland** generally falls within the scope of the CISA. Exempted are persons that distribute, **from Switzerland**, **foreign CIS** that are reserved for qualified investors in the sense of the CISA or foreign law.

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4.2 DEFINITION OF DISTRIBUTION

Any offer or advertisement for CIS **not exclusively directed towards supervised financial intermediaries and supervised insurance institutions** qualifies as distribution. The term **distribution** does, amongst other things, also **not include**:

- the making available of information and the purchasing of CIS on the **request of the investor** (reverse solicitation), particularly, if such actions are performed (i) within the framework of a long-term written advisory contract with one of the below mentioned supervised financial intermediaries or independent asset managers or (ii) in the course of an execution only transaction;
- the making available of information and the purchasing of CIS within the framework of a written **asset management contract** with a r**egulated financial intermediary**;
- the making available of information and the purchasing of CIS within the framework of an **asset management contract** with **an independent asset manager**, provided that the asset management contract complies with an industry organization's guidelines recognized by the FINMA as minimum standard and that the independent asset manager is subject to the Anti-money Laundering Act and an industry organization's code of conduct recognized by the FINMA as minimum standard; and
- the offering of **employee participation plans** in the form of a CIS. Here, certain restrictions were introduced on the level of the CISO.

4.3 NEW PROVISION FOR THE DISTRIBUTION OF FOREIGN CIS TO CERTAIN QUALIFIED INVESTORS IN SWITZERLAND

As a consequence, the distribution of foreign CIS to Swiss **public-law bodies, occupational pension institutions and companies with professional treasury** as well as to **wealthy individuals** who have opted in (see para. 2.2 above) is newly subject to the CISA. The following conditions have to be fulfilled. Firstly, the distributing financial intermediary has to be **adequately supervised** in Switzerland or his home jurisdiction. Secondly, a **FINMA-licensed representative** (with whom the just mentioned distributing financial intermediary has to enter into a distribution contract) **and a paying agent** in Switzerland have to be appointed. Finally, the name of the CIS **must not lead to any deception or confusion**. Contrary to the first draft of the CISA revision, **the products** themselves **do not need to be authorized** by the FINMA.

4.4 NEW PROVISIONS FOR THE DISTRIBUTION TO NON-QUALIFIED INVESTORS IN SWITZERLAND AND FROM SWITZERLAND

For the distribution of foreign CIS to non-qualified investors (also **wealthy individuals** who have not opted in and **asset management clients** who have opted out; see para. 2.2 above), it is necessary, like under the previous law, to obtain a **distributor license** and a **product authorization** from the FINMA. The conditions for the authorization remain substantially unchanged. However, the revision newly requires that, in addition to the CIS itself, also its service providers have to be subject to a **public supervisions** aiming to protect the investors, and its custodian has to be subject to **equivalent regulation** in regard to organization, etc. in its home jurisdiction. Furthermore, a **Cooperation Agreement** (see para. 2.3 above) has to be concluded.

4.5 OTHER OBLIGATIONS

The revised CISA provides for the duty to **inform** the investors completely, truly and in a comprehensible manner about **distribution remuneration** received. Additionally, as from 1 January 2014, the licensees and all persons engaging in the distribution must, in the course of their distribution activities, keep **minutes** about the client needs and the investment recommendations. These minutes are to be provided to the clients. Form and content of the minutes will have to comply with the code of conduct of a self-regulation recognized by the FINMA.

5 TRANSITIONAL PROVISIONS / ACTIONS REQUIRED

The revision sets forth several transitional provisions which result in need for action. The following are worth highlighting:

- **Asset managers** that are newly subject to the CISA (see para. 3.2 above) must announce themselves to the FINMA until **31 August 2013**. They will have to fully comply with the licensing requirements and submit a license application to the FINMA not later than **28 February 2015**. Until the FINMA will have decided on the application, the asset managers may continue their operations.
- The above mentioned rules also apply for **representatives** of foreign CIS and **distributors** who newly fall within the scope of the revised CISA (see para. 4.3 and 4.4 above).
- **Foreign CIS** that are only distributed **to qualified investors** in Switzerland have to comply with the requirements described above in para. 4.3 until **28 February 2015**.
- **Foreign CIS** that are distributed to non-qualified investors in Switzerland and from Switzerland have to comply with the requirements described above in para. 4.4 until **28 February 2014**.
- **Wealthy individuals** who do not meet the new requirements (see para. 2.2 above) are deemed to be qualified investors until **31 May 2015**. If they do not fulfill the requirements until this date, they must no longer make investments in CIS that are reserved for qualified investors.

6 CONCLUSION

The new provisions **tighten** the so-far liberal Swiss asset management and distribution regime, in particular, with respect to **foreign CIS**. The result will be higher administrative burdens and, consequently, **increased costs** for the affected market players. This constitutes a high hurdle for

asset managers of those foreign CIS that marginally exceed the *de minimis* thresholds. It has to be noted that the new CISA applies to CIS for qualified investors even if they have no connection to the EU at all and are, therefore, outside of the scope of the AIFMD.

Nevertheless, the revision of the CISA is an important step towards an adjustment to international standards – especially to the EU regulations – so that the **access for the Swiss fund industry to the EU** should not be completely blocked. It remains, however, uncertain whether the Swiss provisions will be recognized as being equivalent to those of the EU. In regard to the cross-border distribution of CIS for alternative investments into the EU, there are anyway considerable obstacles for these third-country CIS until 2015. Not before then will it be possible to distribute these third-country CIS with a so-called passport within the EU, the detailed conditions therefor also still being unclear. Fortunately, the AIFMD allows for the national private placement regimes to stay in force until at least 2018. Also for this distribution channel, however, the AIFMD sets forth certain requirements to be complied with as of mid-2013. To date, Switzerland has not yet fully implemented these requirements.

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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. Should you seek advice with regard to your specific circumstances, please contact your Schellenberg Wittmer liaison or any of the following persons:

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