

Closed-end funds

How are they affected by the new distribution rules in Switzerland?

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Under the amended Swiss Collective Investment Schemes Act ('CISA') open-ended funds need to appoint a Swiss Representative and a Swiss Paying Agent. It is less clear what is required of closed-end funds.

The revised CISA states that all marketing and distribution activities that fall within the scope of the new definition of "distribution" are subject to regulatory requirements – see article Distribution of foreign collective investment schemes to qualified investors in Switzerland – The basics (<http://open-funds.ch/index.php/news>). This means fund distributors can only continue to market open-ended funds in Switzerland if they appoint a Swiss Representative and a Swiss Paying Agent, although "grandfathering rules" allow them until 28 February 2015 to become compliant with the new regulations.

For closed-end funds, the grandfathering rules can – and are – being interpreted differently, especially for funds that had their distribution ended before the implementation of the revised CISA on 1 March 2013. The following two case scenarios bring into sharp focus the question of whether close-end funds are required to appoint a Swiss Representative and a Swiss Paying Agent in accordance with the new regulatory requirements:

1. A closed-end fund that actively distributed to Swiss-based investors and had a first closing before the revised CISA came into force on 1 March 2013
2. A closed-end fund that actively distributed to Swiss-based investors before the revised CISA came into force on 1 March 2013 and had a first closing after the revised CISA came into force

In our view, the legislator is unclear when it comes to these two cases. In the first case, the distribution activities clearly happened under the old CISA, as part of what was known at the time as the "private placement regime", without any requirement for a Swiss Representative or a Swiss Paying Agent. In the second case, distribution activities also took place under the old regime, but the closing took place after the introduction of the new regime. Which rules should apply: those of the old regime, or of the new CISA?

We reckon the answer to this question can be found by starting with the overriding objective of the new regime, which is to strengthen investor protection and rights.

1. Strengthening investor protection and rights

The first article of the revised CISA makes it clear that the aim of the new regime is to improve and strengthen investor rights:

“This Act aims to protect investors and to ensure transparency and the proper functioning of the market for collective investment schemes.”

For Swiss-based investors to gain protection under the law, their rights need be based on Swiss law. This is unproblematic if they are invested in a Swiss fund. But if they hold an investment in a foreign fund the only practical way they can gain protection is if the foreign fund has signed a representation agreement with a Swiss Representative. These requirements apply equally to funds distributed to retail investors and those aimed at qualified investors. CISA Article 125 makes it clear where the “place of performance” is:

Para 1 - The place of performance for units of the foreign collective investment schemes distributed in Switzerland is the registered office of the representative.

Para 2 - It shall continue to be the registered office of the representative after the revocation of authorisation or following the dissolution of the foreign collective investment scheme.

Should a foreign fund be exempted from having a Swiss Representative, a Swiss-based retail or qualified investor would be subject to the law of the jurisdiction in which the fund is incorporated, which could mean the investor’s protection and rights might be limited. Applying a simple literary interpretation of the law, we therefore conclude that even closed-end funds distributed under the old CISA regime need to appoint a Swiss Representative and a Swiss Paying Agent.

The question that still needs answering is: How much protection do qualified investors need?

2. Degree of protection needed for qualified investors

As mentioned earlier, the previous regulatory regime allowed the private placement and distribution of foreign funds to financial institutions, companies with professional treasury operations, and high net worth individuals (defined as individuals with financial assets of at least CHF 2m) and did not foresee a situation where private placements might become subject to specific requirements or restrictions.

If the two test case scenarios were viewed through the lens of the old rules, one could argue that because distribution took place under the old CISA, the closed-end funds fall under the old rules and therefore a Swiss Representative and a Swiss Paying Agent do not need to be appointed. How-

ever, in our opinion, such an interpretation is not aligned with the will of the legislator.

A summary analysis of the new CISA and its logic tells us a lot about the will of the legislator.

1. The new CISA expressly requires a Swiss Representative and a Swiss Paying Agent for all foreign funds, including those distributed to qualified investors. Article 158d para 4. CISA introduces a grandfathering rule that allows existing foreign collective investment schemes intended for distribution exclusively to qualified investors in Switzerland until 28 February 2015 to meet the conditions stipulated in Article 120 para. 4 and Article 123. After this date however, foreign funds need to appoint

a Swiss Representative and a Swiss Paying Agent. This point is also clearly addressed in the Newsletter 48/2013 of the Swiss Financial Market Supervisory Authority ('FINMA'). Under the chapter "transitional provisions" the discussion on the distribution of foreign collective investment schemes catering to qualified investors states: "The transitional provisions of Article 158d para. 4 CISA apply to collective schemes distributed before 1 March 2013 as well as those distributed after 1 March 2013". The two Articles concerned specify that the precondition for distributing foreign collective investment schemes in or from Switzerland is that the fund management company must appoint a Swiss Representative and a Swiss Paying Agent.

2. The same two Articles state clearly that a Swiss Representative and Swiss Paying Agent need to be appointed even if the funds are no longer to be distributed in Switzerland. In fact, the role and duties of the Swiss Representative and Swiss Paying Agent go beyond the distribution of funds. The Swiss Representative continues to be responsible for how the fund is represented to investors after investors have purchased their units in the fund, for example

by sending them the fund documentation if it changes after the distribution, and by receiving claims from investors. And the role of the Swiss Paying Agent is also not confined to the distribution process, lasting instead until the day investors sell their holdings. This applies equally to open-ended and closed-end funds. Even qualified investors have the right to address any requests to the Swiss Representative or request the Swiss Paying Agent to reimburse their investment or cash-distributions if the official custodian bank is unable to do so.

3. Article 10 para 5 CISA leads us to the same conclusion. According to this rule, the FINMA may fully or partially exempt collective investment schemes from certain provisions of CISA, provided the schemes are open exclusively to qualified investors and provided the protective purpose of CISA is not impaired. The rule specifies the circumstances under which the exemption applies without even mentioning the Swiss Representative or the Swiss Paying Agent. This suggests clearly that the legislator deems it necessary for both entities be appointed even if the distribution is aimed at qualified investors.

3. Conclusion

The tenor of these requirements and the intent behind them clearly suggest that closed-end funds, even if they are closed and are no longer being distributed to investors, would well be advised to appoint a Swiss Representative and a Swiss Paying Agent prior to 1 March 2015.

The views expressed in this paper are those of the authors and should not be used without appropriate advice.