

Distribution of foreign collective investment schemes to qualified investors in Switzerland

The basics

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In September 2012 the Swiss Parliament passed amendments to the Swiss Collective Investment Schemes Act (CISA). In February 2013 the Swiss Federal Council adopted an amendment to the Collective Investment Schemes Ordinance (CISO) that effectively completed the process of turning the revised CISA into law.

While both enactments came into effect on 1 March 2013, transitional provisions have been in place to allow marketers of foreign collective investment schemes enough time to adjust to the new regulations. By 28 February 2015 all market players must be in compliance with the new regulations.

This article focuses on the impact of the revised CISA and CISO on the distribution of foreign collective investment schemes in Switzerland and from Switzerland to qualified investors as defined by CISA and CISO.

1. A new distribution concept

The revised Swiss Collective Investment Schemes Regulations enact a new distribution concept. Whereas under the old law only distribution of collective investment schemes to the wider public, i.e. retail investors, was subject to regulation, the revised CISA regulates all forms of distribution, whether public or not. The previous concept of "public advertising" has been replaced by the more encompassing term "distribution".

1.1. Who is and is not affected by the new concept of distribution?

Since the new concept of distribution is broad, it is really the status of the investors that now matters most. Article 3 of the CISA describes distribution as follows:

1. The distribution of collective investment schemes pursuant to this Act is defined as any offering of and advertising for collective investment schemes that is not exclusively directed at regulated financial intermediaries such as banks, securities traders, fund management companies, asset managers of collective investment schemes, insurance institutions as well as central banks (qualified investors, as per Article 10 para 3 lit. a and b CISA).
2. The following are not deemed to be distribution:
 - a. the provision of information and the subscription of collective investment schemes at the instigation of or at the own initiative of investors, especially in the context of investment advisory agreements or for execution-only transactions;
 - b. the provision of information and the subscription of collective investment schemes based on a written discretionary management agreement with financial intermediaries as defined in Article 10 para. 3 lit. a;
 - c. the provision of information and the subscription of collective investment schemes based on a written discretionary management agreement with an independent

asset manager which:

- in its capacity as a financial intermediary is governed by Article 2 para. 3 lit. e of the Anti-Money Laundering Act of 10 October 1997,
 - is governed by the code of conduct issued by a specific industry body, such code of conduct being recognized as the minimum standard by the Swiss Financial Market Supervisory Authority ('FINMA'),
 - has a discretionary management agreement that complies with the standards of a specific industry body, such standards being recognized as the minimum standard by FINMA;
- d. the publication of prices, net asset values and tax data by regulated financial intermediaries;
 - e. the offering of stock option schemes in the form of collective investment schemes to employees.

Therefore fund promoters must now distinguish between distribution that is within the regulator's scope and placement activities, which are not considered distribution at all and therefore not within the regulator's scope. In cases of distribution within the meaning of the law, one must further differentiate between:

- distribution to non-qualified investors; *and*
- distribution to qualified investors.

1.2. The three levels of distribution

The CISA recognizes three levels of distribution, each of them with different legal implications.

Level 1: Placement

Placement activities do not qualify as distribution in terms of the CISA and are therefore not subject to the CISA regulations. Placement can be defined as any offering and any type of advertising for collective investment schemes that:

- is exclusively aimed at qualified investors as per Article 10 para. 3 lit. a and b CISA *or*
- falls under the exception as per Article 3 para. 2 CISA.

Since placement activities are not subject to CISA, there is no regulatory requirement to be adopted in order to place Swiss or foreign funds.

Level 2: Distribution to qualified investors

Distribution to qualified investors are all those activities targeting:

- a. public entities and retirement benefit institutions with professional treasury operations (Article 10 para. 3 lit. c CISA);
- b. companies with professional treasury operations (Article 10 para. 3 lit. d CISA);
- c. HNWI (with more than CHF 5 million or CHF 500k with experience within the financial sector) that have decided to opt-in independently and because of their status (Article 10 para. 3bis CISA);
- d. not FINMA regulated independent asset managers/family offices, managing assets of their clients, but which are subject to the Money Laundering Act, are governed by the code of conduct employed by a specific industry body and the discretionary management agreement

complies with the recognized standards of a specific industry body.

The revised CISA does not consider independent asset managers to be qualified investors. Distribution activities targeting independent asset managers are considered to count as distribution to qualified investors only if the asset managers confirm in writing that they fall within Article 3 para. 2 lit. c CISA and that they will only use information so obtained for clients who are themselves qualified investors. This confirmation needs to be requested by the distributor before the distributor initiates a discussion and introduces any investment product to an independent asset manager/family office.

Any distributor involved in distributing foreign funds to qualified investors needs to be authorized as a distributor. In case of a Swiss distributor by FINMA. In case of a foreign distributor for foreign funds by the supervisory authority of his home country. The foreign funds do not need to be approved by FINMA, but need to have a representative and a paying agent in Switzerland.

Level 3: Distribution to retail investors

All other distribution activities are classified as distribution to retail investors, for which authorization is needed for both Swiss and foreign funds. Foreign funds do need to be approved by FINMA and a representative and paying agent are required.

These rules are summarized in the table on the following page.

Collective Investments Schemes

Distribution		Placement
<p>Qualified investors</p> <ol style="list-style-type: none"> Public entities and retirement benefits institutions with professional treasury operations (Article 10 para. 3 lit. b-d CISA). HNWI who declare in writing that they want to be considered as qualified investors (Article 10 para. 3bis CISA). Asset managers that confirm in writing that they will use relevant distribution related information only for their qualified customers, including those who signed an asset management mandate and did not ask not to be considered as qualified. (FINMA Circ. 13/9, mn 19). 	<p>Non qualified investors</p>	<ol style="list-style-type: none"> Activities strictly addressed to regulated entities (Article 3 para. 1 CISA). Purchase upon client's request (Article 3 para. 2 lit. a CISA). Funds purchased under a discretionary management agreement signed by banks and securities dealers (Article 3 para. 2 lit. b CISA). Funds purchased by clients under a discretionary management agreement signed by other intermediaries provided those intermediaries are: i) subject to the Money Laundering Act; ii) governed by the code of conduct employed by a specific industry body; and iii) provided the discretionary management agreement complies with the recognized standards of a specific industry body (Article 3 para. 2 lit. c CISA). Purchase of funds under an asset management mandate signed by other asset managers that do not meet the requirements of point 4 (above), – this applies only to Swiss funds and only to qualified investors (FINMA Circ. 13/9, mn 12). Information given as part of an advisory mandate aimed at a long-term advisory relationship in return for a fee agreed with the relevant regulated intermediary or independent asset manager (Article 3 para. 2 and 3 CISO). The publication of prices from a regulated entity (Article 3 para. 3 CISA). Offers of participating plans extended to collaborators (Article 3 para. 4 CISA and art. 3 par. 6 CISO). Distribution of life insurance products paired with investments funds (FINMA Circ. 13/9, mn 54).

Requirements

<ol style="list-style-type: none"> Authorization for the distributor (only for foreign funds) No approval for the foreign fund Representative required Paying agent required 	<ol style="list-style-type: none"> Authorization for the distributor Approval of the foreign fund Representative Paying agent 	<ol style="list-style-type: none"> No distribution authorization No approval needed for foreign funds No representative No paying Agent
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1.3. What activities count as distribution?

Distribution means any type of activity that aims to encourage the acquisition of units of collective investment schemes by an investor (FINMA Circ. 13/9 mn 6), including:

- issuance of print and electronic media of any kind, such as newspapers and magazines, direct mail, brochures, fact sheets, recommendation lists and information letters sent to the clients of a bank or of another financial intermediary;
- offers to financial intermediaries (that do not have the status of qualified investors as per Article 10 para. 3 lit. a and b CISA) for forwarding to their clients;
- information on opportunities to subscribe to collective investment schemes (e.g. securities number, subscription agent);
- press conferences, telemarketing, unsolicited phone calls (cold calling), presentations (road shows), trade shows, sponsored reports on collective investment schemes, home visits by financial intermediaries of any kind;
- websites and other forms of e-commerce, subscription slips and online subscription opportunities and emails.

Distribution also includes indirect distribution. This is why offering or advertising “managed fund accounts”, in particular, constitutes the distribution of collective investment schemes.

“Managed fund accounts” are effectively regarded as collective investment schemes based on a specific concept, and their economic effect is comparable to a fund of funds or an asset allocation fund (FINMA Circ. 13/9, mn 7).

The use of a website requires different rules, depending on the level of distribution:

- Providers of websites aimed exclusively at qualified investors in Switzerland, must have distribution authorization and a disclaimer and access limitation to ensure that only qualified investors gain access to the content of the website (FINMA Circ. 13/09, nm 81 ff).
- If a website makes any direct or indirect reference to Switzerland – be it a contact address, or a NAV expressed in CHF – and is not restricted to qualified investors, the website provider must have distribution authorization. A disclaimer stating that the website is not meant to be accessed by Swiss domiciled visitors is inadequate in legal terms. The website disclaimer must explicitly exclude investors in Switzerland and investors in Switzerland must be barred from accessing the website.

These new measures became effective immediately after they were announced. Distributors are therefore advised to undertake immediate reviews of the information they make available through their websites.

2. Distributing foreign collective investment schemes to qualified investors in Switzerland

Following the revision of the CISA, the Swiss Fund & Asset Management Association ('SFAMA') had to amend its distribution guidelines (the 'Distribution Guidelines'). They were recognized by FINMA as minimum standards for the funds industry at the same time that the Transparency Guidelines and entered into force on July 1, 2014.

The Distribution Guidelines are aimed at "ensuring high quality standards on the Swiss market for collective investment schemes" distributed in Switzerland "with regard to the information and advice provided to investors". They are applicable to so called 'fund providers', i.e. Swiss fund management companies, SICAVs, SICAFs and representatives of foreign collective investment schemes. The guidelines require fund providers to contractually oblige their distributors to live up to certain standards when selling fund units either directly or via electronic communication means. The standards are designed to ensure that fund distributors protect the interests of the (potential) investors, and fund providers must enter into model distribution agreements issued by SFAMA with distributors.

Fund providers are obliged to carefully select and control distribution agents. The Distribution Guidelines, together with the Transparency Guidelines and the Swiss Bankers Association's guidelines on the duty to keep documentary records pursuant to Article 24 para. 3 CISA, constitute the set of self-regulatory standards intended to increase investor protection at the point of sale of fund units.

The following provisions now apply to the distribution of foreign funds to qualified investors. These must be implemented by 28 February 2015:

1. The foreign fund does not require a FINMA approval

Funds catering to qualified investors do not need to be registered, nor do they need to be approved by FINMA, however they require a Swiss representative and a Swiss paying agent.

2. The foreign fund requires a representative and a paying agent in Switzerland

Distribution of a foreign collective investment scheme to qualified investors has become more stringent as per Article 120 para. 4 and 123 CISA. A foreign fund already marketed in Switzerland (on a private placement basis and to qualified investors only) will be required, as of 1 March 2015, to appoint a Swiss representative and a paying agent. The paying agent needs to be a Swiss Bank. The representative needs to be duly authorized by FINMA.

3. The foreign funds must have fund documentation with notes on distribution in Switzerland (Article 30a para. 2 and 133 para. 2 CISO)

The following must be indicated in the publications and marketing material:

- a. the country of domicile of the collective investment scheme;
- b. the name of the representative;
- c. the name of the paying agent;
- d. the location where fund documents can be obtained.

4. Distribution must take place based on a distribution agreement between the representative and the respective distributor in accordance with Swiss law (Article 131a CISO)

5. If distribution is performed in Switzerland by a foreign financial intermediary, it must be supervised appropriately in the intermediary's home country (Article 19 para. 1bis CISA).

3. Who can distribute foreign collective investment schemes to qualified investors within Switzerland?

In order to distribute foreign collective investment schemes, a Swiss financial intermediary must either have a distribution license issued by the FINMA or be exempted on the grounds that it is already authorized to act as a bank, a securities dealer, an insurance or an asset manager as per Article 8 CISO (Article 30a CISO in analogy).

According to Article 19 para. 1bis CISA, a foreign financial intermediary may only distribute foreign collective investment schemes intended solely for qualified investors if that intermediary is subject to appropriate supervision in Switzerland or in its country of domicile and is authorized to distribute collective investment schemes (Article 30a CISO). The regulator has not issued any guidelines as to what is deemed appropriate supervision, but it is anticipated that supervision by any European Union or United States regulator will be deemed appropriate.

This provision was probably aimed primarily at foreign fund managers planning to distribute their products themselves (that is, without a distribu-

tion network) in Switzerland to specific qualified investors. A case in point would be an investment fund domiciled in an offshore location whose fund manager had neither a product license nor additional distributor authorization: the fund may still be distributed to qualified investors in Switzerland, provided the fund manager is appropriately regulated in its country of domicile (e.g. as an asset manager) and has authority to distribute collective investment schemes. Without adequate supervision in its country of domicile, an asset manager will only be permitted to distribute foreign collective investment schemes to qualified investors in Switzerland if it appoints a Swiss or foreign distributor as described above.

Swiss and foreign financial intermediaries have until 28 February 2015 to adapt to the changes required by the CISA and its implementing ordinance. The enforcement department of FINMA will prosecute intermediaries involved in unauthorized distribution activities and impose sanctions if it finds that laws have been infringed.

4. What else needs to be considered

4.1. Maintenance of consultation transcripts

The partially revised CISA makes it mandatory for distributors to maintain consultation transcripts. This means that when distributors offer their clients investment funds for purchase they must justify their recommendations in writing, provide their clients with a transcript of the consultation, and retain a copy for their own records. The transcript must demonstrate that the distributor has based the recommendation to purchase a certain fund on a clear assessment and understanding of the needs of the investor. The aim of the new measures is to strengthen investor protection by ensuring high standards in the provision of information and advice on collective investment schemes. The measures came into force on 1 January 2014.

4.2. Disclosure of costs and fees

The revised transparency and distribution guidelines adopted by SFAMA entered into force on 1 July 2014. Both guidelines were recognized by FINMA as minimum standards for the funds industry.

SFAMA's revised Transparency Guidelines apply to all FINMA licensees and their agents, and to Swiss as well as foreign collective investment schemes, irrespective of whether funds are being distributed to qualified or non-qualified investors. According to the guidelines, all fees and costs charged to a fund and the anticipated amount must be adequately disclosed in the fund documents. The fees and costs actually charged must be disclosed in the (semi-) annual report.

Fund documents must indicate if fees are to be paid to third parties and for what services, although it is not a requirement that service providers be named. The Transparency Guidelines grant existing and former investors the right to enquire about fees and costs, subject to relevant terms and conditions.

Costs and fees not being charged to the fund need not be disclosed except in the following circumstances:

- Retrocessions need to be made transparent. The Transparency Guidelines define retrocessions as “payments and other soft commissions paid by fund management companies, SICAVs and SIVAFs and their agents for distribution activities in respect of fund units”. Retrocessions are effectively distribution fees in the broadest sense, regardless of whether they are charged to investors or paid out of management or distribution fees.
- Rebates need to be disclosed. Rebates are defined as “payments by fund management companies, SICAVs and SIVAFs and their agents directly to investors from a fee or cost charged to the fund with the purpose of reducing the said fee or cost to a contractually agreed amount”. Asset managers usually pay rebates to investors to reduce management fees. Rebates are permitted if:
 - they are not charged to the fund;
 - they are paid based on objective criteria;
 - all investors meeting such objective criteria are treated equally; and
 - they are transparently disclosed in fund documents.

Fund documents need to be revised to meet the new disclosure requirements. The deadline for revisions is 1 March 2015 in the case of Swiss collective investment schemes, and 1 June 2015 for foreign collective investment schemes.

5. From the old CISA to the new CISA – transition arrangements

As the CISA and CISO do not specify the conditions applicable to the transition periods, FINMA's interpretation of the transition period is based primarily on a distinction between distributors/financial intermediaries that were active as distributors to qualified investors before 1 March 2013 and those that were not.

a. The following conditions apply to distributors/financial intermediaries that distributed funds to qualified investors in Switzerland before 1 March 2013:

- If domiciled in Switzerland:
 - Notification to FINMA up until 31 August 2013
 - Filing of application for FINMA licence as a fund distributor (if not yet sufficiently authorized) by 28 February 2015;
- Regardless of domicile:
 - Fulfill all applicable legal requirements according to the revised CISA (including the requirements to enter into a distribution agreement with a representative and to obtain adequate supervision) by 28 February 2015.
- Foreign fund (regardless if the fund has been distributed in Switzerland before 1 March 2013 or not):
 - Appointment of a representative and a paying agent by 28 February 2015;

b. A distributor/financial intermediary that has only been distributing to qualified investors in Switzerland since 1 March 2013 may not benefit from any transition period and has to meet all applicable legal requirements (including entering into a distribution agreement with a representative and adequate supervision) before undertaking distribution activities.

FINMA Circular 13/9 has helped to clarify certain transitional provisions of the CISA relating to the status of qualified investors:

- Investors in funds offered to qualified investors only under the old CISA are not required to sell their investments under the new CISA even if they cannot be considered qualified investors under the new CISA.
- Investors who received information on funds under the old CISA and who now contact the funds will be considered to be initiating a reverse solicitation; in such cases foreign funds are allowed to provide information on request without contravening the CISA.
- Investors who subscribed funds under the old CISA are allowed to receive information related to their funds (NAV, exit issues, annual reports, etc.).
- All other information not strictly related to their fund investment may only be provided on a strict reverse solicitation basis as mentioned above.

6. Conclusion

The aim of the revised legislation (CISA and CISO) that came into force on 1 March 2013 was to ensure legislative compatibility with the European directive 2011/61/EU on Alternative Investment Fund Managers (AIFM Directive). While both enactments came into effect on 1 March 2013, transitional arrangements have been put in place to give groups marketing foreign collective investment schemes time to adjust to the new requirements. The deadline for complying with the new regulations is 28 February 2015.

In our view the Swiss regulator has established a set of rules for distribution of foreign collective investment schemes to qualified investors only based on a pragmatic, business-oriented approach. The requirements for foreign funds or duly authorized and supervised distributors (both Swiss and foreign) to continue doing business in Switzerland are relatively simple, clear, implementable and inexpensive.

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

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