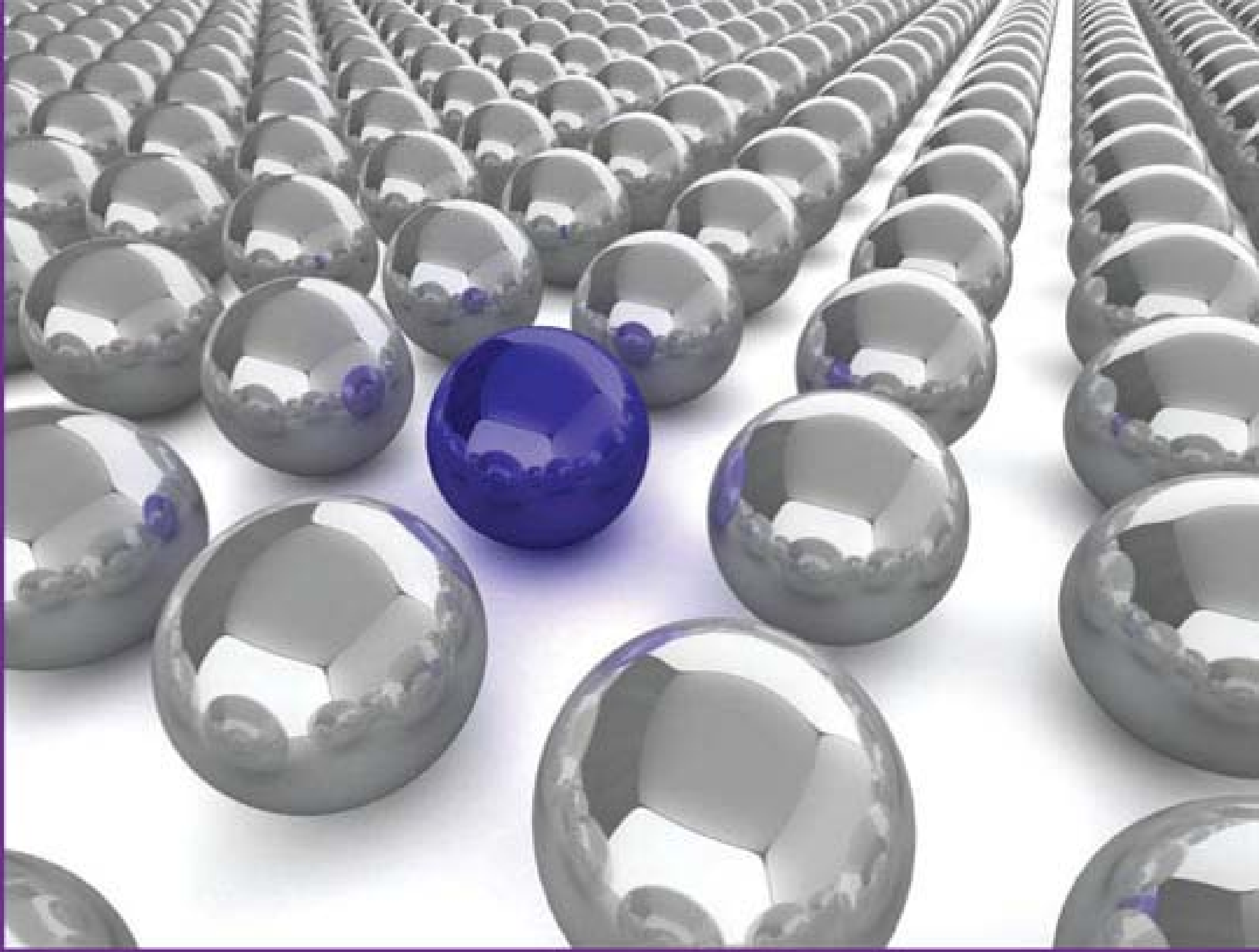

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Developments of asset management regulation in Switzerland

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The trend towards increased financial services regulation continued in 2013 with many of the regulatory initiatives enacted in response to the financial crisis or with the aim to bring Swiss regulation in line with a rapidly changing global (and, in particular, EU) regulatory environment, resulting in the initiation of new legislative projects as well as the publication or entering into force of new rules that will impact the asset management industry through: new regulation of financial market infrastructure; new regulation of financial services; more detailed rules regarding the handling of retrocessions; new rules for asset managers of and distribution of collective investment schemes; changes in anti-money laundering legislations; and new insider trading and market abuse rules.

Aims of regulatory changes

The main legislative regulatory initiatives shall:

(i) improve investor and, in particular, consumer protection;

(ii) preserve and foster system stability and the reputation of the Swiss financial market;

(iii) further increase Switzerland's position as a tier one hub for international asset management;

(iv) achieve better access for Swiss institutions to important foreign markets, most notably the EU; and

(v) increase competition and competitiveness in the financial market.

Prospective regulation of financial market infrastructure (FINFRAG/FMIA)

On November 29, 2013, the Federal Council published its proposal for a new Federal Act on Financial Market Infrastructure (FMIA). The voluminous act (148 articles) is intended to provide comprehensive regulation of financial market infrastructures such as stock exchanges, central counterparties, central securities depositaries and transaction registers. Securities traders will no longer be governed by the Swiss Act on Stock Exchanges and Securities Traders to the extent that they are considered issuers, derivative traders, authorised traders or market makers, but rather by the FMIA.

In response to the activities of the G-20 and of the Financial Stability Board, the new act will subject trades with derivative products to duties substantively corresponding to the comparable rules applicable in the EU. However, the new proposed rules will not follow all of the rules applicable in the EU (i.e. European Market Structure Regulation (EMIR/MiFid II) and Central Securities Depositary Regulation (CSDR)) to the extent that Switzerland will continue to subject stock exchanges to self-regulation.

The act also does not prohibit operators of organised trade systems from conducting trades for their own account on the system operated; however, its does stipulate that customer interests have to be safeguarded (draft art. 37). Contrary to the EU rules, there is no duty to immobilise or de-materialise securities. Finally, and contrary to the rules in EMIR, even if foreign financial market supervisory authorities are permitted to access the Swiss transaction registry (subject to a respective treaty) the forwarding of such data to other foreign authorities shall only be permitted if judicial assistance were possible.

Prospective regulation of financial services (FIDLEG/FSA)

The new Financial Services Act (FSA) is currently being drafted. The new law is expected to regulate the creation of financial products and related services (including distribution). The FSA targets cross-sector regulation of financial products and services, extended investor protection at the point of sale, and enhanced supervision of (some) market participants.

In particular, the FSA will contain requirements concerning product documentation, i.e. the prospectus and a Key Investor Information Document (KIID) for non-qualified investors. Furthermore, it will comprise rules of conduct for financial product related services (including provisions concerning suitability checks for specific financial products at the point of sale). In addition, the new law aims to implement prerequisites concerning the minimal education/expertise of investor-facing advisors. More specifically, the following key points of the new law are expected:

(i) prospectus duty for all securities;
(ii) introduction of a Key Investor Information Document (KIID) for all complex financial products;
(iii) duties at the point of sale (including, the obligation to perform suitability checks);
(iv) client segmentation;
(v) regulation of external asset managers;
(vi) licensing requirements for individual client advisors; and
(vii) regulation of cross-border activities into Switzerland.

The proposed law will have a strong impact on banks, securities dealers, issuers and distributors of financial products, fund management companies, external asset managers, and individual client advisors, with respect to the legal structuring and distribution of financial products. The entering into effect of the new law is expected in 2016-2017.

Retrocessions; revision of Swiss bankers asset management guidelines

The year 2013 saw further developments in the area of inducement payments/retrocessions, including the revised Swiss Bankers Association asset management guidelines providing for improvements in the disclosure of and agreement with clients on the retention, if any, of retrocessions. Also, there seemed to be a clear shift away from the use of retro-loaded investment products in asset management mandates and in formal and compensated-for advisory mandates, driven in part by the fund industry increasingly offering inducement-free share classes for pertinent constellations.

With effect of January 1, 2014, the Swiss Bankers Association's asset management guidelines have been revised. The key changes concern more detailed rules on the duty to ensure suitability of the envisaged strategy against the client's needs, financial situation and risk appetite, and the above mentioned retrocessions.

Recent developments for asset managers and distributors of collective investment schemes

The year 2013 was also characterised by the entry in force of the revised Swiss Federal Act on Collective Investment Schemes (CISA) on March 1, 2013. The CISA revision has had a fundamental impact on Swiss asset managers and distributors of collective investment schemes (CIS or Collective Investment Schemes) in various respects.

For Swiss asset managers of *foreign* Collective Investment Schemes, the revision's most notable effect was that they became subject to a new licensing requirement and prudential supervision by FINMA, a regulated status that under the old CISA only applied when managing assets of Swiss CIS. Transition periods apply for those asset managers operative on February 28, 2013, requiring compliance with the licensing requirements by February 28, 2015.

In the context of the numerous licensing procedures caused by the revision, the organisational requirements for the licensed status have been refined by FINMA, providing applicants for a licence with a clear picture of the consequences of becoming a regulated institution.

For anyone distributing Collective Investment Schemes, the "sea change" resulting from the CISA revision is that even if the distribution of Collective Investment Schemes is limited to qualified investors, licensing requirements and conduct rules for the distributor as well as certain requirements at the product level apply (*inter alia* the need to appoint a Swiss paying agent and Swiss representative). Interestingly, foreign distributors who only distribute on a cross-border basis to qualified investors are not subject to such licence requirements if the foreign regulatory status is deemed adequate.

The following recently published guidelines provide important interpretative guidance on the applicable CISA distribution rules:

- FINMA Circular 2013/9 on Distribution of Collective Investment Scheme;
- Swiss Bankers Association Guidelines on the Protocol Duty pursuant to Article 24 Para. 3 CISA.

The "protocol duty" further defined in the latter guideline applies when a distributor issues a personal recommendation to buy units in Collective Investment Schemes. The relevant protocol must state the investment objectives of the investor, information on the risk profile as well as the reasons for the recommendation. Such protocol has to be shared with the client, unless the client waives this right.

In other areas, legal uncertainties remain despite the publication of the two guidelines referred to above. This is particularly true with regard to the correct handling of the transition periods, the consequences of an opting-out declaration, the new transparency requirements regarding remuneration, marketing and placement activities carried out by use of third party intermediaries (i.e. family offices), and the classification of high-net worth individuals.

It remains to be seen whether the anticipated self-regulatory distribution guidelines by the Swiss Funds and Asset Management Association (SFAMA) will shed further light on these issues. These guidelines are currently being reviewed by FINMA for approval.

Anti-money laundering issues

Various changes to Swiss anti-money laundering legislations that were made in 2013 and are expected in 2014 may affect asset managers.

Amendment of Stock Exchange Act

Amendments made to Switzerland's Stock Exchange Act that entered into force on May 1, 2013 may indirectly have an impact on asset managers. Pursuant to the changes, both insider trading and market manipulation were re-qualified as crimes under Swiss law (fulfilling revised FATF-recommendations). As a consequence thereof, both offenses may qualify as predicate offenses to money-laundering under the Swiss anti-money laundering legislation.

Exchange of information

On November 1, 2013, a partial revision of the Swiss Anti-Money Laundering Act became effective. Under the revision, the Swiss Financial Intelligent Unit MROS ("Money-Laundering Reporting Office"), a member of the Egmont-Group, may request financial intermediaries to amend submitted notifications and may require third parties to provide information in connection with notifications made to MROS.

Furthermore, MROS was granted permission to enter into Memorandums of Understanding with foreign financial intelligence units, to cooperate with such foreign financial intelligence units and to exchange information with them. The information exchanged with foreign financial intelligence units may not only be used in connection with a notification made, but also for the purpose of analysing money-laundering, organised crime and financing of terrorists or for the purpose of initiating criminal proceedings or supporting judicial assistance requests in connection with crimes which may qualify as predicate offense for money-laundering.

Revision of the Swiss Due Diligence Convention

The well-known Swiss Bankers' Association Due Diligence Convention which sets out the rules to be applied by Swiss banks for anti-money laundering in detail was last revised in 2008. It was generally expected that a revised version would be published in 2013. However, due to pending changes to the Swiss legal environment (as discussed further below), the revision was delayed and is now expected to be published in 2014.

New Due Diligence requirements for financial institutions

In a report by the Federal Council on International Financial and Tax Matters published in 2013, the Federal Council prepared a concept for new due diligence requirements for financial institutions (the so-called "Financial Integrity Strategy"). The Federal Council intended that when accepting new assets, financial intermediaries should take into account not only the risks of money-laundering and terrorist financing, but also tax considerations. In addition, the Swiss authorities took into account the revised FATF recommendations published in 2012.
Consultation by interested parties was initiated on February 27, 2013. The consultation drafts included the following key initiatives:

- qualification of serious tax offences as a predicate offense to money-laundering;
- increased transparency of legal entities (disclosure obligation for holders of bearer and registered shares of unlisted companies in order to enhance the transparency of legal entities);
- clarification of due diligence requirements with respect to the determination of beneficial owners in particular of legal entities;
- extension of due diligence requirements to domestic PEPs as well as persons working for international organisations using a risk based approach; and
- introduction of an obligation for payments for purchases above a certain monetary threshold to be processed via a financial intermediary subject to anti-money laundering rules; namely, purchases of real estate and movables may be paid for in cash only up to a sum of SFr100,000, payments of larger sums will need to be processed via a financial intermediary.

According to the initial proposal, financial intermediaries would also be required to assure tax compliance of customers (new customers and existing ones), which was heavily criticised in the consultation process. The Federal Council has withdrawn the proposal and intends to re-submit a revised proposal once further treaties with partner states are concluded regarding automatic information exchange as per international standards.

The other proposals mentioned above were submitted to parliament on December 13, 2013 and are expected to be addressed by parliament in 2014.

New Swiss rules on insider dealing and market manipulation entered into force on May 1, 2013

On May 1, 2013, the Stock Exchange Act (SESTA) and the implementing Stock Exchange Ordinance of the Swiss Federal Counsel (SESTO) were amended to include:

- new administrative law rules on market abuse (articles 33e and 33f SESTA), which (i) will be enforced by FINMA, (ii) apply to all market participants (i.e., not only FINMA regulated entities), and (iii) apply irrespective of any intent and financial benefit on the part of any relevant person (differing from criminal market abuse); and
- revised criminal law rules on insider dealing and market price manipulation (articles 40 and 40a SESTA), which will be prosecuted by the Swiss federal prosecutor and tried before the Swiss Federal Criminal Court.

They bring about a fundamental change in Swiss administrative and criminal law and will have a significant impact on Swiss practice.

Articles 55a-55g SESTO define certain safe harbour rules relating to share buy backs, tender offers, dealings in connection with statutory or contractual duties.

Market abuse under administrative law

The new administrative law regime prohibits all natural persons and legal entities from engaging in insider dealing and market manipulation. Prior to this, FINMA could only enforce market conduct rules against certain supervised market participants. The administrative market abuse rules have been further specified in the FINMA circular 2013/8 "Market Conduct Rules" which became effective on 1 October 2013 and in the FINMA-Newsletter 52.

Insider dealing under administrative law

Article 33e SESTA states that any person who knows or should know that information constitutes inside information acts unlawfully (subject to certain safe harbour rules included in the amended SESTO) if it:

- exploits (ausnützt (German)/exploite (French)/sfrutta (Italian)) such information to acquire or dispose of securities admitted for trading on a stock exchange or on a similar platform in Switzerland or if it uses financial instruments derived from such securities; or
- communicates such information to another person; or
- exploits such information to make a recommendation to another person to acquire, dispose of or use financial instruments regarding any securities covered by the first bullet above.

Market manipulation under administrative law

Article 33f SESTA states that any person acts unlawfully, if it:

- publicly disseminates information, of which such person knows or should know that this will send a false or misleading signal in relation to the offer, demand or price of securities admitted for trading on a stock exchange or on a similar platform in Switzerland; or
- carries out any transactions or executes buy-or sales orders, of which such person knows or should know that this will send a false or misleading signal in relation to the offer, demand or price of securities admitted for trading on a stock exchange or on a similar platform in Switzerland.

Market abuse under criminal law

The provisions on criminal insider dealing and market price manipulation have been transferred from the Swiss Penal Code into the SESTA. While the offence of insider dealing has been substantially expanded and stated more precisely, the offence of market price manipulation has remained substantially unchanged. In addition, both offences are now subject to federal jurisdiction.

As opposed to market abuse provisions under administrative law, any breach of the market abuse provisions under criminal law requires that the offender acted with intent (Vorsatz) and that a "financial advantage" was obtained.

Insider dealing under criminal law

According to the new article 40(1) SESTA, any person, who as an officer or member of an executive or supervisory body of an issuer or a person controlling or controlled by the issuer, or as a person who due to its participation or activity is supposed to have access to inside information (all such persons being "primary insiders") will be punished with of up to three years of prison or with a fine, if he/she obtains for himself/herself or for another person a financial advantage by:

- exploiting such inside information to acquire or dispose of securities admitted for trading on a stock exchange or on a similar platform in Switzerland or by using financial instruments derived from such securities; or
- communicating such information to another person; or
- exploiting such information to make a recommendation to another person to acquire, dispose of or use financial instruments regarding any securities covered above.

If the financial advantage resulting from an act covered by article 40(1) SESTA exceeds SFr1m, the sanction will be up to five years of prison or a fine (article 40(2) SESTA). This also means that such qualified cases will become predicate offences to money laundering.

Also, the new insider dealing provision covers insider dealings by (a) "tippees", meaning persons who have received inside information from a primary insider or through (another) crime or felony or (b) persons who are not a primary insider or a tippee if they obtain (for themselves or another person) a financial advantage by exploiting inside information.

As a result of these recent changes, the Swiss criminal law provisions regarding insider dealing have been expanded in many respects. Namely, the term "primary insider" is much wider than before, the scope of prohibited actions has been broadened, and the potential sanctions are heavier. Moreover, even persons who accidentally become aware of inside information are now potentially subject to criminal liability.

Market price manipulation under criminal law

Any person will be punished with of up to three years of prison or with a fine, who, with the aim to significantly influence the price of securities admitted for trading on a stock exchange or on a similar platform in Switzerland and thereby achieves a financial advantage for itself or another person:

- against better judgment, disseminates wrong or misleading information; or
- effects sales and purchases of securities, which on both sides directly or indirectly are made for the account of the same person or persons that are affiliated for such purpose (simulated transactions).

If the financial advantage exceeds SFr1m, the sanction will be up to five years of prison or a fine. This also means that such qualified cases of market price manipulation will also constitute predicate offences to money laundering.

Notably, the definition of market price manipulation under criminal law is much narrower than under administrative law in that it is limited to simulated transactions.

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