Swiss parliament supports the Swiss asset management and fund industry in face of major regulatory changes

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In reaction to international regulatory developments, new regulations for Swiss asset management and fund industry will become effective in early to mid-2013 and impose new regulations and requirements. Switzerland, as an important domicile for private equity and notably hedge fund managers, is thereby ensuring that Swiss market participants are eligible to continue to serve collective investment schemes domiciled or distributed in member countries of the European Union.

On September 29, 2012, the Swiss parliament discussed and resolved to change the regulatory regime governed by the Swiss Federal Act on Collective Investment Schemes (CISA), which will be amended in order to implement standards equivalent to those of the European Alternative Investment Funds Managers Directive (AIFMD). This will lead to a significant change in so far as under the new law, asset management for any type of foreign collective investment scheme shall be subject to prudential licensing and supervision.

The importance of such amendment may only be fully appreciated against the background that today, except when provided to Swiss collective investment schemes, asset management is not a regulated activity but only subject to supervision for purposes of anti-money laundering and terrorist financing prevention.

In the course of the AIFMD-driven revision of the CISA, the rules on distribution of units of collective investment schemes and the regime applicable to the custody of fund assets will also be tightened. The CISA amendments will enter into force on March 1, 2013. The Swiss parliament has changed the government's original proposal from 2011 considerably, thereby supporting a more liberal approach to the regulation.

New rules for asset managers managing assets of Swiss/foreign collective investment schemes

Asset management and administration of Swiss collective investment schemes

Current regulatory environment for asset managers

The current regulations applicable to Swiss asset managers are generally limited to anti-money laundering matters (to the extent they qualify as financial intermediaries) and as such must become subject to the direct supervision of the Swiss Financial Markets Supervisory Authority (FINMA), or an indirect supervision of FINMA (by becoming a member of a FINMA recognised selfregulatory organisation) for anti-money laundering purposes. Thereby, they are though not subject to prudential supervision for other purposes.

In cases where an asset manager manages Swiss collective investment schemes, it must be licensed and be subject to prudential supervision by FINMA. An application for voluntary supervision by FINMA is possible if, among other conditions, the asset manager shows that applicable foreign rules governing the management of assets of foreign collective investment schemes require that the Swiss asset manager be prudentially regulated.

New rules becoming effective in March 2013

New regulations for asset management services

On September 28, 2012, the proposed amendments to CISA (for which the referendum period lapsed on January 17, 2013) were published. On February 13, 2013, the Swiss Federal Council published the final version of the amended Swiss Federal Ordinance on Collective Investment Schemes (CISO). The concept of regulating the asset management industry with respect to the assets of Swiss and foreign collective investment schemes, as currently contemplated, can be summarised as follows:

- asset managers domiciled in Switzerland that manage Swiss or foreign collective investment schemes and asset managers domiciled outside Switzerland that manage Swiss collective investment schemes must be prudentially supervised (in case of foreign asset managers such supervision must be recognised as such by FINMA);
- individuals and cooperatives (*Genossenschaften*) cannot obtain a licence as a Swiss asset manager of collective investment schemes;
- Swiss branches of foreign asset managers may apply for a licensing by FINMA, which will only be

granted if:

– the foreign asset manager (including its Swiss branch) is subject to an "adequate" prudential supervision in its home state;
– the foreign asset manager is sufficiently organised and has sufficient capital and qualified personel in order to operate the Swiss branch; and
– an agreement is in place regarding the cooperation and exchange of information between FINMA and the foreign regulator(s) supervising the foreign asset manager (and the Swiss branch);

- the CISA is not applicable to asset managers that manage assets of collective investment schemes that have exclusively qualified investors (in the sense of CISA) as investors and in addition one of the following criteria is met:
  – the assets under management are not more than SFr100m,
  – the assets under management are solely such of non-leveraged collective investment schemes, which in each case do not allow for a redemption for five years after the first investment was made, and the so managed assets do not exceed SFr500m, or
  – the investors in the collective investment schemes managed by the asset manager are exclusively part of a group of which the asset manager is also a part.

  The first two exceptions (so called *de minimis* – exemption rules) are not fully self-explanatory and FINMA is expected to clarify them in an amended ordinance yet to be published. For the purpose of the calculation of the monetary thresholds (SFr100/500m) for an asset manager, assets managed directly or through a delegation and assets managed by other entities subject to a common management or direct or indiret control must be taken into account. The licensing requirement is triggered if one of the above outlined criteria is no longer met whereupon within 30 days a filing for a licence must be made with FINMA.

  Asset managers falling within one of the above exemptions can apply voluntarily for a licence if the laws where the relevant collective investment scheme is set-up or units are distributed require that the asset manager is subject to a prudential regulation.
- FINMA is authorised to grant additional exemptions from the Swiss regulations to asset managers if (a) such exemption does not prejudice the protective aim as contemplated by CISA and if (b) the asset management was delegated to them by licensed entities in the sense of CISA (other than custodian banks) or foreign (fund management) companies which are subject to foreign rules regarding organisation and investor rights equivalent to those under the amended Swiss rules.

  While asset managers shall primarily offer asset management and risk management services for collective investment schemes, they may also offer other administrative services such as investment advice, asset management for individual portfolios, distribution and representative functions. In case fund management services are being offered by Swiss asset managers to foreign collective investment schemes, an agreement on cooperation and exchange of information between FINMA and the competent foreign regulator(s) must be in place if this is required by the applicable foreign law.

Delegation of asset management services

Swiss fund management companies may in principle freely delegate asset management services to other persons as long as such delegation favours a proper administration of the collective investment scheme and the proper instruction, supervision and control of the party assuming the respective tasks is ensured. However, investment decision competences shall only be delegated to asset managers that are subject to prudential supervision by FINMA or a "recognised" foreign regulator and in the case of a foreign asset manager, an agreement regarding the cooperation and exchange of information between FINMA and the competent foreign regulator(s) must be in place if such an agreement is required by the law by which the foreign asset manager is regulated.

With respect to collective investment schemes for which a facilitated distribution in the EU is possible based on a treaty, investment decision competencies shall not be delegated to the custodian bank of such collective investment schemes or to companies with interests that could conflict with the interests of the fund management company or investors.

These rules generally also apply in case of a subdelegation of asset management services by an asset manager to another party. In all cases, the Swiss fund management company remains liable for the conduct of the mandated persons to which it delegated asset management services, as if engaged itself in such services.

Transition periods under CISA

Swiss asset managers that manage foreign collective investment schemes must notify FINMA within six months after the amendments to CISA will come into force (unless they fall within one of the the

above outlined exemptions) and within two years thereafter, they must comply with the statutory requirements and must have submitted an application for a licence to FINMA. Asset managers that start asset management activities for collective investment schemes after the amendments to CISA become effective cannot benefit from such transition periods.

Existing delegations of asset management services by Swiss fund management companies to foreign asset managers in a jurisdiction where FINMA does not have a cooperation agreement with the foreign competent regulator must, if the law of the jurisidiction where the asset manager is domiciled requires such agreement, promptly report such delegations to FINMA and must, within one year after the new law comes into force (such period can be extended by FINMA in exceptional cases), submit to FINMA declarations by the competent foreign regulatory authority wherein the latter obliges itself to cooperate and exchange information with FINMA.

For the administration of EU collective investment schemes or collective investment schemes distributed into the EU, this transition period will not be of much help. In case of UCITS-compliant investment schemes, asset managers must already be prudentially regulated and for other investment schemes falling within the scope of the AIFMD, it is required that assets managers are prudentially regulated as from mid-2013.

New custody rules

The revised CISA establishes certain new rules about custody of collective investment schemes. As the explanatory report states, the current rules regarding custody of collective investment schemes are of a rudimentary nature and do not comply with current international standards. The new rules did not lead to massive controversies in the discussion before the submission of the bill, with the exception of provisions on the liability of depositary banks. The following changes were made:

Expanded obligations to have a depositary bank

Under the current rules, open collective investments schemes (contractual funds and SICAVs) must use a depositary bank; furthermore, depositary banks need a special licence in addition to their Swiss banking licence. Closed collective investment schemes (SICAFs and the KGK, Limited Partnership for Collective Investment), on the other hand, did only have to appoint a custodian and a paying agent. Contrary to a depositary bank, such custodian and paying agent do not require an authorisation of the supervisory authority and have no obligation to control the activities of the other parties involved in the collective investment scheme. Under the new rules, closed collective investment schemes in the form of a SICAF also have to use a depositary bank. KGKs continue to be exempted from this obligation (as only qualified investors may invest in a KGK). Furthermore, it was confirmed that openended collective investment schemes can be exempted from using a depositary bank by FINMA under certain conditions. In the case of a SICAV, this applies if it is only open to qualified investors; provided the execution is done by prime brokers being under an equivalent supervision; and provided that the prime brokers or the competent foreign supervisory authorities supervising the prime brokers provide all information and documents to FINMA which FINMA needs for its own supervision. In case of contractual schemes this applies only to the category of "other funds for alternative investments" and under even more restricted conditions.

More specific regulation of the tasks and obligations of depositary banks

Today, the tasks of depositary banks are only stated in rudimentary form in art. 73 CISA. Under the new rules, the law states explicitly that depositary banks have to be adequately organised in view of their specific tasks as depositary banks, which will be monitored by the banking law auditors of such banks; that banks need an additional licence to act as depositary banks of Swiss collective investment schemes. The amended CISO will contain more specific requirements for the activities of the depositary banks.

According to the CISO, a depositary bank needs to have at least three full time employees with signatory powers dedicated to the depositary bank activities; its tasks include the holding of accounts and deposits, the timely execution of transactions, the keeping of adequate records to keep the assets of a collective investments scheme separated, and verification of the ownership of the scheme's assets if they cannot be taken into physical possession by the depositary bank.

New rules on delegation of functions and on liability

Depositary banks are permitted to delegate the custody of the funds to third parties in Switzerland and abroad. The new rules state that such delegation may only be made provided that the delegation is in the interest of an adequate custody and provided that the third party custodians are supervised in their home countries (even though supervision does not need to be adequate to the Swiss supervision).

A bank has to provide evidence to FINMA within two years after the entry into force of the new provisions that the new obligations are being

complied with. The rules apply to financial instruments only; hence, custody of other assets such as gold or commodities should not fall under the new regulations. In case of a delegation, depositary banks are currently only liable for due care when choosing and instructing the third party custodian. The liability will now be increased, as depositary banks delegating the custody will in the future also have to supervise any third party to which they delegate custody.

A proposed even further-reaching liability of the delegating bank was rejected by parliament. The draft ordinance specifies that the delegating bank has to verify on a regular basis that the custodian is adequately organised, financed and qualified for its taks, that it is periodically audited, that the assets are kept separated and that it complies with the rules applicable to the depositary bank.

Possibility to introduce securities deposit insurance

The new law grants competence to the Federal Council to introduce an insurance for securities deposits, similar to the protection granted by directive 97/9/EC on investor compensation in the EU, in case a fund manager or an asset manager is not in a position to return to the investor such investors' assets. By delegating the competence to issue such rules to the Federal Council, the legislator wishes to assure that such rules will continue to be in compliance with international standards.

Offerings and distribution of units of collective investment schemes

Overview and status quo

Under current law, the criterion to determine whether a foreign collective investment scheme is subject to licensing and prudential regulation in Switzerland is whether public promotion is being made for the product or not.

- If so, the foreign collective investment scheme must be approved by FINMA (the fund prospectus and several other documents need approval of FINMA), appoint a FINMA approved Swiss representative, and may only be distributed by FINMA licensed distributors. Non-compliance with such requirements may qualify as a criminal offence.
- If no public promotion is undertaken, no financial services regulatory restrictions or requirements whatsoever need to be observed.

This will be changed fundamentally under the new rules. Namely, any form of distribution of collective investment scheme will be regulated; along with this concept goes the abolition of the notion of "public promotion". The regulatory requirements for distribution will vary depending on the category of targeted investors.

"Distribution" as a key criterion for triggering additional licensing or other regulatory requirements for the offering of collective investment schemes in Switzerland

The term public promotion altogether has been abolished and substituted by "distribution" as the new key regulatory criterion to govern the offering of collective investment schemes.

The new law defines "distribution" as any offering of and promotion for a collective investment scheme. Under the new rules, the purchase of collective investment schemes (a) exclusively based on the investor's own initiative (reverse solicitation); (b) under a discretionary investment management and advisory agreement (subject to this agreement and the asset manager fulfilling certain requirements); or (c) under employee participation plans structured in the form of a collective investment scheme (as often seen with employee participation plans of French companies) is not deemed to be "distribution", subject to certain conditions.

It is evident that this new regulatory concept in respect of (a) above will lead to difficult discussions on when an interest of an investor is not "provoked", and subject to what legal and factual features a discretionary investment management agreement or its fulfilment would have to be deemed (indirect) collective investment scheme distribution.

If a collective investment scheme is promoted or sold to non-qualified investors, the situation under the new rules will not substantially change compared to today's law. In particular, the collective investment scheme needs FINMA approval and must be represented by a FINMA licensed collective investment scheme representative, and it may only be distributed by a FINMA licensed distributor. In addition to these conditions, the new law requires – in adapting the similar requirement of AIFMD – that the collective investment scheme home regulator and FINMA have entered into a cooperation and information exchange agreement.

Distribution to Cat. II qualified investors also to be regulated

Under the new rules, any type of collective investment scheme distribution would in the future be prudentially regulated, whereby the degree of regulatory requirements will depend on the category of investors to whom the collective investment scheme are distributed (into, within, or from Switzerland):

- Under the revised CISA, distribution to the following qualified investors (hereinafter "Cat. II Qualified Investor") triggers the requirement to mandate a Swiss representative and paying agent: (i) public entities and pension schemes with

professional treasury operations; (ii) companies with professional treasury operations; and (iii) high net worth individuals (having elected in writing to be deemed qualified investors and if no exemption pursuant to art. 3 revised CISA applies).

- Explicitly outside the definition "distribution" are (i) offering or marketing to regulated financial intermediaries such as banks, securities dealers, fund management companies, asset manager of collective investment schemes, central banks and insurance companies ("Cat. I Qualifiied Investor").

If distribution of collective investment schemes starts before entering into force of the revised CISA, foreign collective investment schemes which are distributed in Switzerland to Cat. II Qualified Investor must meet the requirements with respect to a Swiss representative and paying agent no later than two years after the revised CISA has entered into force.

More restrictive definition of "qualified investor"

The regulation relating to the distribution of foreign collective investment schemes into, in or from Switzerland will become even more restricted due to the fact that the definition of certain Cat. II Qualified Investor types will be tightened, resulting in more distribution initiatives falling within the highly regulated distribution to non-qualified investors, as opposed to the less burdensome regime applicable to distributions limited to (Cat. II) qualified investors (as described above).

E.g., today's Cat. II Qualified Investor category of individuals with net financial assets of at least SFr2m (high net worth individuals, HNWI) would be substituted by an opting-in concept. Further, pursuant to the revised CISO, the investor must prove that either (i) he has, based on his personal education and professional expertise or similar experience in the financial sector, sufficient knowledge to understand the risk of investments and financial assets of at least SFr500k, or (ii) assets of at least SFr5m.

Pension schemes regulation

An (already adopted) amendment of the Federal Law on Occupational Pension Schemes generally requires asset managers of Swiss occupational pension schemes to be prudentially regulated as from January 1, 2014.

Outlook

On March 28, 2012, the Federal Council instructed the Federal Department of Finance, with the assistance of the Federal Office of Justice and FINMA, to commence work on the Financial Services Act project to prepare the legal basis and submit a consultation draft to the Federal Council by autumn 2013.

A corresponding project has since been established under the aegis of the Federal Department of Finance, and work has commenced. Representatives from various authorities and selected experts are members of the working groups (distribution, product, subjection, cross-border and enforcement).

Summary

The Swiss Parliament has approved amendments to the current regime of collective investment schemes which will enter into force on March 1, 2013. The key elements of the currently proposed changes are the following:

- Swiss regulations and licensing requirements for the mentioned industry are strengthened in line with international regulatory developments (in particular the AIFMD) in order to ensure that Swiss market participants have a level playing field with their foreign competitors.
- The proposal still shows a tendency for a certain "Swiss finish" meaning that the new rules may be slightly stricter than in other highly regulated jurisdictions (EU, US). However, the originally planned amendments have been weakend during the parliamentary debate in 2012.
- Under the revised CISA, distribution to Cat. II Qualified Investors newly triggers the requirement to mandate a Swiss representative and paying agent.
- The scope of private placements exemptions is being somewhat limited and more aligned with the AIFMD standards.
- A larger number of Swiss asset managers needs to become supervised by FINMA; the delegation of functions is more strictly regulated.

Further, due to a change of pension fund law, as of 2014 asset management services to Swiss pension funds as a rule may only be provided by prudentially supervised institutions.

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