

legitimacy and form of Circular 1 still hold true (see section 2 above and Gericke, Share Buy-back, op.cit. 12 s.) and certain of the new provisions may still deliver food for thought, Circular 1 by and large offers an adequate and practicable framework for share buy-backs.

It remains to be hoped that this positive outcome will not be impaired by the new proposal for the replacement of share buy-backs over a separate trading line by an auction procedure dated 22 March 2010 (the commenting period for which ended on 16 April 2010). Both the reasons for the proposal and the proposal itself do not seem to take into account that the separate trading line as a means of executing share buy-backs is driven by peculiarities of Swiss tax laws, which cannot be cured by the proposed procedure (see comments by Flavio Romerio/Claude Lambert dated 16 April 2010, publication forthcoming).

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## FINMA'S Circular 2008/8 Definition of Public Advertisement Violates CISA, Says the Swiss Federal Administrative Court

Reference: CapLaw-2010-30

FINMA Circular 08/8 on Public Advertisement for Collective Investment Schemes, in note 9, defines the term “public advertisement” as any type of promotion not exclusively directed to qualified investors pursuant to article 10 (3) and (4) Collective Investment Schemes Act (CISA) and article 6 (2) of its implementing ordinance (CISO). The legality of this broad definition has been questioned in learned writing. An enforcement case of FINMA against a group of companies engaged in certain financial services activities without bank, broker-dealer and investment fund licenses which was appealed to the Federal Administrative Court now provides clarity on this question. Namely, the court held in its decision of 14 December 2009 that based on article 3 first sentence CISA a promotion which is addressed to a quantitatively and qualitatively limited circle of persons does not constitute public advertisement even if the targeted persons are not qualified investors. Due to appeals to the Federal Supreme Court, the decision, however, is not final. (The case is also of interest for other reasons than the CISA-issue discussed herein. Namely, the decision upheld FINMA's practice to consider, when assessing whether a conduct was subject to banking regulation, activities of related companies and parties as being carried out by one party located in Switzerland, subject to certain conditions. This group perspective means that the segmentation, and outsourcing to abroad, of different elements of an activity subject to licensing may not help to avoid the prudential supervision—and enforcement in the absence of the required licenses.)

*By Sandro Abegglen*

### 1) Implication of Public Promotion

The issue at hand is of certain importance as the public promotion (as opposed to non-public offerings) is the criterion which determines whether foreign collective investment schemes may be distributed in Switzerland without a license (see article 120 (1) CISA) and whether the person engaged in the marketing and offering thereof is subject to licensing as fund distributor (see article 19 CISA).

### 2) Activity was Promotion

In the case at hand, 14 persons and an investment volume of approximately CHF 6 million in the aggregate were invested in a foreign collective investment scheme (Fund). Among the investors were the complainant and promoter of the Fund as well as his son and sister, and further relatives and acquaintances of the promoter and the son, who apparently also engaged in the marketing of the Fund. In addition, apparently two persons not known to the complainant and his son were invested in the Fund. It was undisputed that the Fund qualified as a foreign collective investment scheme pursuant to article 120 (1) CISA. While the complainant denied to have engaged not only in public promotion but in *promotion (Werbung)* as such, the Federal Administrative Court concurred with FINMA which in its enforcement decree had held, in line with the majority view in learned writing, that informing persons about a specific collective investment scheme with the aim of soliciting such persons as potential investors was deemed to constitute promotion.

Furthermore, although apparently there had not been any direct evidence that the complainant had contacted some of the relatives, the Federal Administrative Court concurred with FINMA which had taken the view that given that it would be highly unlikely that such relatives would *invest by mere coincidence* and without having been made aware of the Fund by the promoters—such coincidental investment furthermore not having been alleged, nor substantiated by the complainant—promotion *vis-à-vis* such persons had to be assumed. While this point relates to the proper establishing of the facts based on non-direct evidence, one may nevertheless derive from the foregoing that unless a foreign collective investment scheme is a well known product and has attracted attention in the media etc., it indeed may not be plausible why a larger number of persons would be invested in a no-name fund on their own (non-provoked) initiative.

### 3) Note 9 Circular 08/8 Violates Article 3 CISA

The *Federal Administrative Court*, however, *dissented* with *FINMA's* view that the above described promotion qualified as “public” in the sense of article 3 third sentence CISA. FINMA in line with note 9 FINMA Circular 08/8 had held that the promotion had been done in a public manner because the investors were not qualified investors as defined by articles 10 (3) and (4) CISA and article 6 (2) CISO. First, the Federal Administrative Court recapitulated the well-established view that as a body independent of the

administration it was *not bound by administrative ordinances* (*Verwaltungsverordnungen*) such as the FINMA Circulars, and that an administrative court could only consider such ordinances to the extent they allowed for a correct interpretation of the applicable statutory rules in the case at hand. Thereafter the Federal Administrative Court addressed the material issue of the case and analysed the meaning of article 3 CISA. The court held that based on a *systematic interpretation* of the provision, sentences 2 and 3 of article 3 CISA provided for exemptions to the principle set forth in the first sentence of article 3 as adopting the opposite view would render the provisions' first sentence irrelevant, and that therefore the second and third sentences would not define (*e contrario*) the term *public advertisement* in a conclusive manner. Applying the *historic method* of interpretation, the Federal Administrative Court noted that the explanatory note of the Swiss government to the draft bill (*Botschaft*) of 23 September 2005 to CISA defined public promotion as any promotion which, without regard to form, is *not limited to a narrowly described circle of persons* ("*jede Werbung, die sich nicht an einen eng umschriebenen Kreis von Personen richtet*"). The Federal Administrative Court further referred to the well-known Federal Supreme Court Decision BGE 107 I b 358, which held that an offering made to all 14,000 members of a German medical association was a public offering in the sense of the Investment Fund Act of 1966, and that a promotion could only be considered to have been made vis-à-vis a narrowly limited circle of persons if on the one hand the public was defined, and the other hand the public was small in number ("*Die Werbung richtet sich nur dann an einen eng begrenzten Personenkreis, wenn einerseits das Publikum bestimmt ist, und andererseits dieses auch zahlenmässig klein ist*"). On such basis, the Federal Administrative Court concluded that a narrowly defined circle of persons was characterized by two aspects: the persons being determined (*e.g.* on the basis of pre-existing relationships) on the one hand, and the persons addressed being small in number (*zahlenmässig klein*) on the other hand and that, accordingly, in order to exclude a public promotion both quantitative and qualitative elements had to be assessed.

#### 4) Imprecise Inversion by the Court

Unfortunately, while being absolutely correct in its result, the concrete assessment of the Federal Administrative Court in the case at hand appears to have been undertaken in an imprecise manner. In particular, after having made the above considerations, the court went on to state that the term *public advertisement* was defined by a qualitative and quantitative element. Such inversion is in so far incorrect, as read literally, it would mean that an offering made to a very large number of persons is not public if the circle of persons approached is defined.

Specifically, the Federal Administrative Court held that the larger part of the Fund's investors were relatives and acquaintances of the fund promoters, which constituted a narrowly defined circle of persons (qualitative element); in connection therewith, how-

ever, the court did not address the question whether the number of such persons (apparently just under 10) would fulfil the quantitative element. The quantitative element was only addressed by the Federal Administrative Court in respect of those two investors who had no pre-existing relationships with the fund promoters; in relation thereto the court said—rightly—that promotion vis-à-vis one or two interested parties would not be sufficient from a quantitative point of view to have the promotion be qualified as public.

### 5) Conclusion

As a preliminary conclusion with regard to the decision the following may be said:

- The Federal Administrative Court correctly held that note 9 FINMA Circular 2008/8 violates article 3 CISA in so far as it sets forth that non-public promotion requires the targeted investors to be qualified investors.
- Despite the criticism raised above regarding the inversion argument, it is very likely that the Federal Administrative Court, contrary to such literal reading of the inversion argument, takes the view that an offering to a large number of persons, even if the relevant circle of persons is defined, would constitute a public offering. In fact, in the case at hand the number of persons fulfilling the qualitative element was too small (below 10) to require an analysis of the quantitative element, and moreover the court explicitly referred to Federal Supreme Court Decision BGE107 Ib 358.
- It would also seem to follow from the decision that an offering to a small number of persons *per se* cannot be deemed to be public as such very term requires a certain size of persons approached. Hence, if read correctly, it is not correct to state (as, *in abstracto*, FSCD 107 Ib 358) that a *private offering* requires cumulatively a quantitative and qualitative element; rather, the correct answer should be based on a flexible interplay of the quantitative and qualitative elements meaning that a small number of persons approached may compensate for the non-existence of the qualitative element and vice versa so that even if the targeted persons are defined the sheer size of the quantitative element may superpose the qualitative element (as, *in concreto*, in FSCD 107 Ib 358).
- In other words, a promotion to a small number of persons, irrespective of whether such have a pre-existing relationship with the fund promoter or not, cannot be said to be public promotion (*öffentliche Werbung*) in the sense of article 3 CISA (and the same would seem to hold true for any promotion under any other financial services act and articles 652a Swiss Code of Obligations (CO) and 1156 CO). Because in the case at hand there were only two unrelated investors, naturally, the decision does not allow to determine up to which number specifically an offer can be qualified as non-public based on the quantitative element only.

- Against this background, and notwithstanding that the decision is apparently being appealed to the Federal Supreme Court, fund distributors for practical reasons may not rely on the Federal Administrative Court's decision as far as their strategic placement of non-licensed foreign funds is concerned (rather, they must rely on the qualified investor exemption for such purposes), but may use it for opportunistic offerings to a few selected persons.
- Finally, and notwithstanding that the decision remains of limited practical importance in its effect, it is from a rule of law point of view to be welcomed that the Federal Administrative Court insisted on a narrow interpretation of article 3 CISA and thereby upheld the principle of legality, as such provision does not only have a technical/regulatory relevance. One should in particular bear in mind (even though the court did not consider such point) that any public distribution of collective investment schemes in Switzerland without a license, even if done on a cross-border basis only, is subject to severe criminal sanctions (imprisonment of up to 3 years in case of intent and a fine of up to CHF 250,000 in case of negligence).

Against this background the decision of the Federal Supreme Court in this matter can be awaited with great interest.

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## Structured Products—Quo Vadis?

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The collapse of Lehman had a significant impact on the Swiss market for structured products. Following a thorough review of current market practices the Swiss regulator FINMA announced in March to review current regulations with a view to improve investor protection. This article explains the background and reasons for this new regulatory initiative and speculates at its outcome.

*By René Bösch*

During the last ten years the market in Switzerland for structured products was developing significantly and with such growth rates that the regulator became increasingly concerned about the protection of investors in structured products. In a first attempt to at least partially regulate structured products in June 2005 the Swiss Federal Banking Commission published a position paper for public comment on the applicability of the investment fund regulation for structured products. That draft position paper was very much guided by the notion that structured products could actually constitute a form of investment funds that needed to be significantly regulated under Swiss law. However,