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Investment Funds

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Trends and Developments
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On 1 January 2020, the Swiss Financial Services Act ("FinSA") and the Swiss Financial Institutions Act ("FinIA") entered into force, together with the implementing ordinances (Financial Services Ordinance ("FinSO") and Financial Institutions Ordinance ("FinIO")). This article aims to highlight the major impacts of the new laws on the investment funds industry, and to give an overview of the introduction of a new Swiss fund category – the Limited Qualified Investor Fund.

FinSA and FinIA and their Major Impacts on the Swiss Funds Industry

Background

In March 2012, the Swiss Federal Council commissioned the Swiss Federal Department of Finance to develop a cross-sector regulation of financial products and services, as well as their distribution. The result of this mandate was the drafts of the FinSA and of the FinIA, which the Federal Council submitted for consultation in the summer of 2014. Some elements of the drafts for consultation met with harsh criticism. In particular, it was argued that the very extensive client protection provisions would severely restrict the freedom of movement of Swiss financial service providers and lead to excessive costs. After partial consideration of the criticism, the Federal Council released the revised drafts for parliamentary deliberations at the end of 2015. Swiss parliament concluded its discussions in June 2018. Following the working out of the implementing ordinances FinSO and FinIO in Q4 2019, the legislative package entered into force at the beginning of 2020.

The main goals of the new supervisory laws are to strengthen investor protection, to create uniform regulatory rules for the provision of financial services and the offering of financial instruments, and to harmonise Swiss financial market law with European requirements, particularly Directive 2014/65/EU on Markets in Financial Instruments (MiFID II), to ensure access for Swiss financial service providers to the European markets.

More specifically, the FinSA defines the conditions under which financial services may be rendered and financial instruments offered. It applies to financial service providers (ie, all natural or legal persons who provide financial services as defined by the law on a professional basis in Switzerland or for clients in Switzerland) and financial instruments makers. The FinSA will also have an impact on the performance of inbound cross-border services, which so far was only partially and – compared to EU and US regulations – extremely liberally regulated.

The FinIA sets the regulatory standards to be met by financial institutions as defined by the law. In the interests of client protection, the FinIA establishes uniform licensing conditions for certain financial service providers and creates new licensing categories. In particular, the FinIA imposes a state licensing and supervision regime on independent asset managers and trustees, which to date have not been prudentially supervised. As a further novelty, the FinIA imposes new licensing requirements for Swiss branches and representative offices of foreign financial institutions.

Impacts of FinSA and FinIA on the investment funds industry

Introduction of new fund marketing concept

So far, the marketing of collective investment schemes ("CIS") has been entirely governed by the Swiss Collective Schemes Act ("CISA"). Under the old regime applicable until the end of last year, the term "distribution" marked the separation line between regulated and unregulated marketing of CIS in and out of Switzerland. This term was defined in article 3 of the old CISA. In the course of the revision of the CISA in view of the entry into force of the FinSA, this provision was deleted, together with the "distribution" concept introduced in 2013.

Instead, as of 1 January 2020 the "offering" of CIS in Switzerland may trigger regulatory duties under the CISA, and to the extent it involves an interaction with an end client, the FinSA.

The term "offering" is defined in article 3 let. g FinSA to encompass "*any invitation to acquire a financial instrument that contains sufficient information on the terms of the offer and the financial instrument itself.*" The communication normally aims at drawing attention to and selling a particular financial instrument (article 3 para. 5 let. b FinSO).

The offering of units of CIS in Switzerland has the following consequences:

- Foreign CIS to be offered to non-qualified investors must be approved by the Swiss Financial Market Supervisory Authority (FINMA), and must appoint a Swiss representative and a Swiss paying agent.

- Foreign CIS to be offered to qualified investors do not have to be approved by FINMA, and the requirement to appoint a Swiss representative and a Swiss paying agent under the old CISA has been abolished, except for high net worth retail clients and private investment structures created for them that declare that they wish to be treated as professional clients (opting out) in accordance with article 5 para. 1 FinSA; if foreign CIS are offered to these types of qualified investors, a Swiss representative and a Swiss paying agent still need to be appointed.

The above consequences do not only apply to an offering but also to advertising foreign CIS in Switzerland (article 127a of the Collective Investment Schemes Ordinance ("CISO")). Whereas an offering is only assumed if the invitation to acquire a financial instrument is sufficiently detailed to allow the addressee to take an investment decision, less specific communication addressed to investors is considered advertising if it is aimed at drawing attention to specific financial services or financial instruments (article 95 para. 1 FinSO).

The previous CISA contained various code of conduct provisions that explicitly applied in the "distribution" context. These duties have basically been shifted to the FinSA. This law only applies if a financial service in the sense of article 3 let. c FinSA is concerned. The "offering" (as the "advertising") triggering duties under the CISA is not considered a financial service, per se. However, to the extent that the offering of CIS is "aimed directly at specific customers and specifically aimed at the purchase" of CIS-units (cf. article 3 para. 2 FinSO), or entails a personal recommendation for the acquisition, it is deemed a financial service in the sense of article 3 let. c ciph. 1 (acquisition / disposal of financial instruments) or ciph. 3 (investment advice) FinSA.

The applicability of the FinSA triggers the following core duties:

- Client segmentation (articles 4 and 5 FinSA): a financial service provider must categorise its clients, unless all clients are treated as retail clients. It should be noted that, different from the CISA, the FinSA does not distinguish between "qualified investors" and "non-qualified investors" but between "retail clients", "professional clients" and "institutional clients". There are nevertheless broad congruencies between the terms, since institutional / professional clients under the FinSA are deemed qualified investors under the CISA. In addition, retail clients with long-term asset management or investment advisory agreements with financial intermediaries prudentially supervised in Switzerland or abroad are also deemed CISA-qualified investors (but not professional clients under the FinSA), unless they declare that they wish to be treated as non-qualified (so-called opting-in).
- Compliance with the rules of conduct pursuant to articles 7 et seq. FinSA, which financial service providers must take into account when dealing with their retail and professional clients, such as information duties (articles 8 et seq. FinSA), the obligation to carry out appropriateness and suitability tests in the investment advisory and asset management space (articles 10 et seq. FinSA), the duty of documentation and accountability (articles 15 et seq. FinSA), and the duty to exercise transparency and diligence when executing client orders (articles 17 et seq. FinSA). Professional clients can dispense with the observance of certain of these rules. If financial services are provided to institutional clients, these rules can be disregarded entirely (article 20 FinSA).
- Furthermore, pursuant to articles 21 et seq. FinSA, a financial service provider must be adequately organised to safeguard an appropriate operational management organisation, to avoid conflicts of interest that could arise through the provision of financial services, and to prevent any disadvantages for clients as a result of conflicts of interest. Disadvantages that cannot be excluded must be disclosed to the clients.
- Client advisers of Swiss financial service providers that are not subject to supervision may carry out their activity only if they are entered in a register of advisers (article 28 FinSA). The same holds true for advisers of foreign financial service providers, unless they are adequately supervised abroad and provide their financial services exclusively to professional and institutional clients (article 31 FinSO). Under the previous CISA-distribution regime, distributors of CIS needed a distribution licence, unless they were prudentially supervised in Switzerland or abroad. This licence requirement lapses under the new CISA and is replaced by a client adviser's registration duty. Pursuant to article 3 let. e FinSA, a client adviser is a natural person who performs financial services on behalf of a financial service provider, or in its own capacity as a financial service provider. Accordingly, a former "distributor" generally needs to become registered with the register of advisers unless he or she works for a supervised entity (and, in the case of foreign institutions, if such institution only approaches professional or institutional investors). Please note that, due to the fact that "distribution of CIS" under the old regime also included advertising activities which under the FinSA are not considered financial services, not every former distribution activity leads to a registration duty with the register of advisers under the FinSA. Generally speaking, though, the new registration duty replaces the licence requirement for distributors under the old law. Pursuant to article 29 FinSA, in order to be registered, client advisers must be familiar with the FinSA rules of conduct and have the specialist knowledge required to carry out their activities (article 6 FinSA). Registration requires the conclusion of professional liability insurance or the existence of equivalent financial securities, as well as the

affiliation of the adviser or his or her employer / principal with an Ombudsman. Furthermore, negative registration requirements must be met (article 29 para. 2 FinSA): registration is not possible, for example, if an adviser has committed certain criminal offences or is prohibited from carrying out the profession or activity due to a violation of supervisory regulations. The registration requirements must be met on a continuous basis, and the registry must be informed of any changes in this regard.
- Financial service providers are obliged to join an Ombudsman's office (article 77 FinSA) upon commencement of their activities. They must also inform their clients at the time of entering into the business relationship and when rejecting a legal claim asserted by the client about the possibility of a mediation procedure before the Ombudsman (article 79 FinSA). The Ombudsman ensures that disputes about legal claims between clients and financial service providers can be settled in a confidential and cost-effective mediation procedure before trial. The Ombudsman should combine financial market law expertise with mediation expertise and thus be able to deal with the legal and factual aspects of such disputes. Its sole task is to mediate; it has no decision-making power whatsoever.

Articles 20 et seq. of the former CISA contained rules of conduct with which "licensees […] and their agents" had to comply. These rules were shifted to the FinSA to the extent that they specifically address point of sale situations. Outside the point of sale context, they remain applicable to "persons who manage, hold in safe custody or represent collective investment schemes and their agents." To the extent such persons and particularly their agents also carry out financial services according to the FinSA, they must adhere to the conduct rules of the FinSA and the CISA.

Other major changes introduced by FinSA and FinIA

Asset managers of Swiss CIS that perform their task on a mandate basis continue to be subject to a FINMA licence requirement. The same holds true for Swiss asset managers of foreign CIS that either (i) not only permit "qualified investors" within the meaning of article 10 para. 3 or 3ter CISA or (ii) manage total CIS assets above specific thresholds (open-ended structures: above CHF100 million / non-leveraged closed-ended structures: above CHF500 million). These asset managers previously governed by the CISA are now considered "Managers of Collective Assets" according to articles 24 et seq. FinIA. Swiss asset managers of foreign CIS that only permitted qualified investors and did not manage collective assets exceeding the thresholds mentioned above were so far not required to apply for a FINMA authorisation. These financial intermediaries are now considered "Asset Managers" in accordance with articles 17 et seq. FinIA and are newly subject to a licence requirement. Whereas FINMA is competent to grant and recall the licence, ongoing supervision over Asset Managers will be exercised by Supervisory Organisations yet to be authorised by FINMA. Managers of Collective Assets are licensed and supervised by FINMA, and must meet increased regulatory requirements compared to Asset Managers, which are substantially identical to those previously required under the CISA.

In terms of product documentation, the overriding principles applicable under the old CISA remain unchanged. In particular, a prospectus has to be drawn up for every Swiss CIS (articles 48 – 50 FinSA); the FINMA may grant exemptions on a case-by-case basis, provided that the CIS are open to CISA-qualified investors only and the protective purpose of the law is not impaired thereby. According to the explanatory report of the Federal Department of Finance on the implementing ordinances of FinSA and FinIA, p. 48, the new prospectus rules of the FinSA are not applicable to foreign CIS and the respective documentation requirements remain entirely governed by the CISA, including the permissibility to use offering memoranda drawn up under relevant foreign laws, subject to certain amendments. However, the entry into force of FinSA and FinIA and the adaptions that became necessary in this context led to several modifications with regard to the documentation requirements and the modalities according to which the documentation must be made available to the investors.

Transition periods

The revised CISA entered into force on 1 January 2020, like the FinSA and the FinIA. However, according to the FinSA and its implementing ordinance, various obligations do not have to be implemented until certain transition periods have expired. In particular, a two-year transition period applies for the duty to perform a client segmentation, to adhere to the rules of conduct and to implement the organisational requirements. To make sure that there is no lack of client protection during the transition period when marketing CIS in Switzerland, article 105 para. 3 FinSO states that, as long as a financial service provider does not implement the FinSA rules of conduct, the old CISA distribution rules must be adhered to. This also applies to the duty to comply with the distribution agreements that had to be entered between the representatives of foreign CIS and Swiss distributors, and which ensured that CIS are distributed in a professional and transparent manner in accordance with the Guidelines on the Distribution of Collective Investment Schemes promulgated by the Swiss Funds & Asset Management Association (cf. article 105 para. 5 FinSO). However, all CISA distributor authorisations issued by FINMA were cancelled as of 1 January 2020.

Financial institutions and client advisers must join an Ombudsman office within six months of the FinSA coming into force, or

(if later) after the Federal Department of Finance has recognised the responsible Ombudsman office.

Client advisers who are subject to registration must register with the registration office for entry in the adviser register within six months of the FinSA coming into force, or (if later) within six months of the approval of a registration office by FINMA.

Also, the FinIA contains transition provisions. Most importantly, financial institutions that newly require a FINMA authorisation under the FinIA (such as Asset Managers of CIS that were not yet subject to a FINMA licence requirement under the old legislation) must notify FINMA of their existence by 30 June 2020 and comply with the FinIA within three years of such law's entry into force. Within the same period (ie, by 31 December 2022 at the latest), they must further submit a licence application to FINMA if they were already active on 1 January 2020 (article 74 para. 2 FinIA). Shorter transition periods apply for Asset Managers that commence their activities within one year of the FinIA entering into force (article 74 para. 3 FinIA), and no transition periods apply for those that will commence their activities from 2021 onwards. Financial institutions that were already supervised by FINMA before the FinIA entered into force do not require a new FINMA licence but must comply with the new law within one year of its entry into force (article 74 para. 1 FinIA).

Limited Qualified Investor Fund

Switzerland is an important location for the asset management and distribution of CIS, but not so much for their production. This is due to restricted market access of Swiss investment fund products (and their managers) to the European Union, the Swiss withholding tax regime and the Swiss legal framework essentially providing for a licence requirement for the financial institution administering / managing the CIS as well as for a product approval, leading to internationally substandard time-to-market.

In an attempt to strengthen the competitiveness of the Swiss investment fund production site and the Swiss financial centre as such, the Federal Council proposes to introduce a new investment fund type, the Limited Qualified Investor Fund ("L-QIF"). In June 2019, a preliminary draft of the new CISA provisions governing the L-QIF ("L-QIF Draft") was released for general consultation, according to which the L-QIF shall have the following core features:

- An L-QIF shall not be subject to a product approval by FINMA, whereby the time-to-market will be substantially shortened.
- L-QIFs are to be set up in a form provided for by the CISA. Consequently, according to the L-QIF Draft it could be set up as open-ended (investment fund or investment company with variable capital ("SICAV")) or as a closed-ended structure (limited partnership for collective investment ("LP") or investment company with fixed capital ("SICAF")).
- L-QIFs are strictly reserved for qualified investors, as defined in the CISA.
- An L-QIF's administration shall be exercised by a fund management company (*Fondsleitung*) licensed by FINMA, unless an L-QIF is organised as an LP, in which case the fund administration could also be carried out by a bank or insurance company acting as general partner.
- The L-QIF's assets shall be managed by the fund management company responsible for the administration; delegation of asset management tasks to Swiss managers of collective investments according to article 24 FinIA (and financial institutions meeting higher regulatory standards such as banks, investment firms, other fund management companies, or insurance companies) as well as foreign managers of CIS adequately supervised abroad shall be permissible.
- The investment restrictions of the CISA shall not apply; neither does the L-QIF Draft specify the scope of possible investments nor the risk distribution limits, thereby permitting investments in all sorts of asset classes. Of course, the eligible investments and the investment and risk strategy pursued must be stated in the L-QIF's governing documents. Specific rules shall apply for real estate companies. According to the L-QIF Draft, the Federal Council may further regulate investment techniques and investment restrictions.
- According to the explanatory report on the L-QIF Draft of the Federal Department of Finance (p. 15), open-ended L-QIFs and L-QIFs organised as SICAFs need to appoint a FINMA-approved custodian bank. Every L-QIF shall further appoint an audit company performing regulatory and accounting audits.
- The name of an L-QIF in the legal form of a SICAV, LP or SICAF must contain the designation "Limited Qualified Investor Fund" or its abbreviation "L-QIF". Reference to the fund type must further be made in the fund documentation and in the marketing material. Furthermore, (potential) investors must be clearly informed that an L-QIF is neither authorised nor supervised by FINMA.

The consultation for the L-QIF Draft ended in October 2019. In general, the majority of reactions to the new law were positive. Specific criticism was raised, inter alia, with regards to the narrow circle of the financial institutions eligible for an L-QIF's fund administration and the requirement to appoint an L-QIF-specific audit company. It is now expected that, following the analysis of the 48 submissions made in the consultation proceeding, the Federal Council will rework the L-QIF Draft for parliamentary debate and that the new law will enter into force in 2022.

Blum & Grob Attorneys at Law Ltd is a Zürich-based commercial law firm comprised of more than 30 attorneys, with a strong focus on banking and finance. The financial services department has five lawyers who practise investment funds law, while the M&A, private equity and corporate finance department has eight fee earners. The key areas of practice in relation to the investment funds sector are the setting-up of collective investment structures; obtaining licences for collective investment schemes, fund management companies, asset managers of investment funds, custodian banks, and representatives; the support of regulated entities and pension funds in all regulatory and civil law aspects; advising on domestic and cross-border marketing and fund-raising for Swiss and foreign investment funds; providing investment fund-related tax advice; and advising on investment funds and pension funds in investment and financing situations (including direct investments and secondary transactions). Blum & Grob Attorneys at Law has closely followed the legislative process concerning FinSA and FinIA, and has set up a landing page (www.myfideg.ch) providing information on the new laws.

Author

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