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Investment Funds

Switzerland: Trends & Developments
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Trends and Developments

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Blum&Grob Attorneys at Law Ltd is a Zürich-based commercial law firm comprised of 35 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 compa-

nies, asset managers of investment funds, custodian banks, representatives and distributors; the support of regulated entities and pension funds in all regulatory and civil law aspects; advice in domestic and cross-border distribution and fund-raising of Swiss and foreign investment funds; investment fund-related tax advice; and advice concerning investment funds and pension funds in investment and financing situations (including direct investments and secondary transactions).

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On 1 January 2020 the Swiss Financial Services Act (FinSA), in addition to the Swiss Financial Institutions Act (FinIA), will enter into force. The laws will further harmonise Swiss financial markets law with European regulation, in particular the European Directive 2014/65/EU on Markets in Financial Instruments, and strengthen investor protection. The two acts will have substantial impacts on domestic as well as on foreign financial service providers that are active in Switzerland. This article thus focuses entirely on this legislative project, thereby addressing some key aspects relevant for the investment funds industry.

Introduction

The FinSA sets uniform rules for providing financial services and offering financial products. According to its Article 2 paragraph 1, the FinSA applies to financial service providers and client advisers as well as to producers and issuers of financial instruments (all as defined in the act). Hence, the FinSA will span the various financial sectors, thereby creating a level playing field. The new law particularly provides for a standardised client segmentation, sets the requirements for the provision of financial services, governs the offering of

financial instruments, regulates the provision of documents to clients and establishes a duty of financial service providers and client advisers to affiliate with an ombudsman for the pre-trial settlement of client disputes. Compliance with the FinSA is monitored by the competent Swiss supervisory authorities. The FinSA contains criminal provisions for those financial intermediaries not prudentially supervised by a Swiss regulatory body.

The FinIA sets the requirements for acting as a financial institution. It applies to portfolio managers, trustees, managers of collective assets (including collective investment schemes, or CIS), fund management companies and securities firms (Article 2 paragraph 1 of the FinIA). It further regulates Swiss branches and Swiss representations of foreign financial institutions (Articles 52 et seq. FinIA); specific financial intermediaries such as banks or investment fund vehicles will continue to be governed by laws other than the FinIA. The FinIA sets forth the licence requirements applicable to the different financial institutions and defines the supervisory framework. It contains criminal provisions in case of violation of certain rules. As with the FinSA, the FinIA takes a cross-sectoral approach by consolidating and integrating supervisory rules of various laws that already

apply to Swiss financial institutions. In addition, the FinIA contains real novelties, for instance a licence requirement for portfolio managers or new rules applicable to financial services provided from abroad.

Impacts of the FinSA and FinIA on the Investment Funds Industry

In 2013, the Swiss Collective Investment Schemes Act (CISA) was revised, predominantly for securing EU market access following the enactment of the European Directive 2011/61/EU on Alternative Investment Fund Managers. The revision of the CISA and its implementing ordinances led to major changes of the legal framework governing the Swiss funds industry. Due to this recent overhaul, the FinSA and the FinIA do not predominantly target but will have an impact on the production, management and marketing of investment funds.

Introduction of a New Fund Marketing Concept by the FinSA – Overview on Current Regime

The CISA currently in force defines distribution of CIS as any offering of and advertising for CIS that is not exclusively directed at prudentially supervised financial institutions (Regulated Financial Intermediaries), central banks and regulated insurance companies.

The CISA provides for various exemptions and clarifications, respectively; no distribution is assumed:

- if fund units are sold or respective information is made available at the initiative of an investor (reverse solicitation);
- in the context of discretionary portfolio management agreements with Regulated Financial Intermediaries or portfolio managers fulfilling certain regulatory requirements;
- if Regulated Financial Intermediaries publish prices, net asset values and tax data; or
- if employees are offered incentive compensation programmes in the form of CIS.

If a marketing action is considered ‘distribution’ in the sense of the CISA, the following core consequences apply.

- The distribution of foreign CIS to non-qualified investors in or out of Switzerland needs prior product approval by the FINMA. (For the sake of completeness: as of today, all domestic CIS need FINMA approval. This may change with the creation of a new Swiss fund type, the Limited Qualified Investor Fund, only requiring that the management company or the asset manager be FINMA licensed. However, if and when this legislative project will become reality is unclear at this time.)
- In order to distribute a foreign CIS in Switzerland, the foreign investment fund vehicle must appoint a Swiss representative and a Swiss paying agent.

- The distributor needs a respective FINMA licence, unless Swiss investment funds are distributed to qualified investors; in the case of distribution of foreign funds by a non-Swiss person, it is sufficient if that distributor is adequately supervised by its home country regulator.
- The CISA imposes various ‘point-of-sale’ duties on persons engaged in fund distribution. They must act loyally and carefully, fulfil specific transparency and information requirements, and keep documentary records if personal recommendations to buy investment fund units are made. These duties are further specified by the Collective Investment Schemes Ordinance (CISO) as well as by guidelines issued by the pertinent self-regulatory bodies, ie, the Swiss Funds & Asset Management Association and the Swiss Bankers Association (Self-Regulation).

Changes Under the FinSA

With the enactment of the FinSA, the current fund distribution concept will undergo the following major modifications:

From ‘distribution’ to ‘offer’

In the revised CISA (R-CISA) to enter into force simultaneously with the FinSA/FinIA the term ‘distribution’ will be abolished. Instead, Article 3 letter g of the FinSA will introduce the term of an ‘offer’ being “any invitation for the purchase of a financial instrument containing sufficient information on the terms of the offer and the financial instrument itself.” According to Article 3 paragraph 3 letter b of the current draft of the Financial Services Ordinance (D-FinSO), an offer must further typically aim to make potential investors aware of a specific financial instrument and to sell it. An offer should, therefore, only be assumed if it is definite enough to allow an investor to purchase a financial product without further information being necessary. If this interpretation, which seems to be supported by the Explanatory Report of the Federal Department of Finance on the D-FinSO and on the draft Financial Institutions Ordinance (page 20), is followed, the term ‘offer’ is more narrow than the current term ‘distribution’, which does not only include an effective offer to conclude a contract but also every advertisement intended to offer a product (cf FINMA Circular 2013/9 - Distribution of CIS, n 5). However, it remains to be seen whether the shift from ‘distributing’ to ‘offering’ will actually lead to a more liberal marketing approach for CIS. In any event, an offer for the acquisition of fund units following a respective concise enquiry by an investor (reverse solicitation) should not be considered an offer in the sense of the FinSA. The same will hold true for purchases of fund units in execution-only mandates.

In this context, it should also be noted that advertising a financial instrument is covered by Article 68 of the FinSA and must not be directed at clients who are not eligible for such an instrument (Article 95 paragraph 3 of the D-FinSO). Financial service providers organising client events promoting CIS will therefore have to make sure that only those

investors who are eligible to acquire the promoted products will be addressed, irrespective of such promotion constituting an 'offer' or not.

Cross-sectoral client segmentation

The FinSA introduces a client segmentation which applies across the different financial sectors. The segmentation distinguishes between institutional, professional and retail clients. Investor protection depends on the client segment, with retail clients benefiting from the highest and institutional clients facing the lowest standards. The FinSA allows certain investor types to shift segments to have their investor protection reduced (opting out) or enhanced (opting in).

Client segmentation is not new to Swiss law. In particular, the CISA already distinguishes between 'qualified' and 'non-qualified' investors. The revised CISA which will enter into force simultaneously with the FinSA/FinIA (R-CISA) will keep this differentiation by referring to the (compared to the CISA, slightly modified) client segmentation of the FinSA: accordingly, retail clients under the FinSA will count as non-qualified investors under the R-CISA and professional and institutional clients under the FinSA will count as qualified investors under the R-CISA. In addition, and in line with the respective concept already established under the CISA, retail clients with a written discretionary portfolio management or investment advisory agreement with a supervised Swiss or foreign financial intermediary will be considered qualified investors, unless they declare an 'opting-in' (Article 10 paragraph 3ter of the R-CISA).

Modifications regarding the offering of foreign CIS

The R-CISA will require that foreign CIS offered to non-qualified investors in Switzerland obtain a product approval by the FINMA which is similar to today's regime. An offering of foreign fund units out of Switzerland will not need any such approval; and like today, no product approval will be required if foreign fund units are offered to qualified investors in Switzerland.

Under the R-CISA, the offering of foreign investment funds to qualified investors in Switzerland will only require the appointment of a Swiss representative and of a Swiss paying agent, if wealthy individuals that opted out of retail investor protection (and who are thus considered qualified investors) are approached. If other qualified investors are targeted, these requirements will fall away. This will lead to a significant reduction of administrative burden in the context of marketing foreign investment funds in Switzerland.

Registration requirements for the offering of CIS

Contrary to the distribution regime under the CISA, the offering of CIS will not require a FINMA licence upon the FinSA/FinIA entering into force. At first sight, this appears to reduce investor protection. However, 'client advisers' pursuant to Article 3 letter e FinSA (ie, natural persons who per-

form financial services on behalf of, or in their own capacity as, financial service-providers) may carry out their activities only after their entry into the register of client advisers which will be newly introduced by Articles 28 et seq of the FinSA.

This registration duty only exists for client advisers of domestic financial service providers who are not prudentially supervised in Switzerland and (with some exceptions) for client advisers of foreign financial service providers. An entry is contingent on a client adviser fulfilling certain registration requirements. Such registration duty will not lead to an ongoing supervision of a client adviser's activities by a Swiss regulatory body but will nevertheless provide for some regulatory control comparable to the control currently exercised over distributors of CIS licensed by the FINMA.

A duty to become registered, however, depends on a client adviser performing 'financial services' pursuant to Article 3 letter c of the FinSA. The 'offering' of financial products (including investment fund units) is not per se a financial service. Therefore, the question arises whether such an offering falls under another category of financial services, notably the 'acquisition or disposal of financial instruments' or 'investment advice' in the sense of Article 3 letter c cipher 1 or 4 of the FinSA. An offering of CIS may, but does not necessarily have to, include a personal recommendation, ie, an 'investment advice'. Further, an offering does not seem to qualify as an 'acquisition or disposal of financial instruments'. Since, however, it was not the intention of the lawmakers that the offering of CIS be carried out without registration, Article 3 paragraph 1 of the D-FinSO (which was finalised after Parliament passed the FinSA/FinIA in June 2018) now seems to be bridging the gap by defining 'acquisition or disposal of financial instruments' as every activity "specifically directed at the acquisition or disposition of a financial instrument." This very broad definition would also cover an 'offering' in the sense of the law and it remains to be seen whether it will find its way into the final version of the FinSO. If so, the registration duty would according to Article 31 of the D-FinSO also apply to client advisers of foreign financial institutions offering foreign CIS in Switzerland, even if such an institution is adequately supervised abroad (with no consolidated supervision by the FINMA) and the offering is confined to institutional investors. If Article 31 of the D-FinSO is not amended in the further process, this will lead to an accentuation of the current fund distribution regime.

Point-of-sale duties

The 'point-of-sale' duties for persons engaged in fund marketing will – with some modifications which must be carefully analysed – be shifted from the CISA, the CISO and the Self-Regulation to the FinSA and its implementing ordinance. To the extent that the 'offering' will be considered a 'financial service' in the sense of the new law, the FinSA's point-of-sale duties will apply to all 'offerors' of CIS. Moreo-

ver, the very broad definition of acquiring or disposing of financial instruments (Article 3 letter c cipher 1 of the FinSA icw Article 3 paragraph 1 D-FinSO) might even lead to fund marketing activities not falling within the scope of an ‘offer’ to be considered a financial service to the extent that the provider of such services – as required for every financial service provider under the FinSA – will act on a commercial basis.

According to Article 20 of the FinSA, the point-of-sale duties will not be applicable vis-à-vis institutional clients and their scope is reduced with regard to, and can be further waived by, professional clients. This is in line with the current notion that fund marketing towards Regulated Financial Intermediaries and regulated insurance companies is not considered distribution under the CISA and therefore does not require compliance with point-of-sale duties at all and that self-regulation partially provides for less enhanced point-of-sale duties if professional clients are involved.

Other Noteworthy Modifications (Non-Exhaustive)

The FinSA and FinIA will extensively reshape the Swiss regulatory landscape and this chapter cannot cover all aspects relevant for the funds industry. However, the following modifications should additionally be highlighted.

- The duties to prepare and provide clients with key investor information documents as well as prospectuses on investment funds will in substance be transferred from the CISA to the FinSA.
- The provisions governing asset managers of CIS will be transferred from the CISA to the FinIA in a modified fashion: all asset managers of CIS today licensed and supervised by FINMA will be categorised as “Managers of Collective Assets” (Articles 24 et seq of the FinIA). Managers of foreign CIS that only target-qualified investors and whose assets do not exceed certain thresholds are today not subject to a Swiss licence requirement. This will change under FinIA, requiring them to apply for a licence as “Portfolio Managers” in the sense of Article 17 et seq of the FinIA. As “Portfolio Managers” they will have to fulfil less strict regulatory standards than “Managers of Collective Assets”.
- Pursuant to Article 98 paragraph 2 of the CISA, a general partner of a Swiss limited partnership for collective investment may only be active as a general partner in one partnership. Under the R-CISA, a general partner may become active for various partnerships if it is regulated as a Manager of Collective Assets in the sense of the FinIA. This implements a longstanding request from the Swiss private equity industry.

Closing Remarks

The FinSA/FinIA will impact the investment funds industry in various ways. Although, contrary to the acts, the implementing ordinances are not final yet, we today have a rather concise picture of the future regulation. Every financial intermediary should, therefore, carefully analyse the revised regime in due course, despite the new laws granting various transition periods. This applies particularly to financial service providers involved in the marketing, management and/or production of CIS, who should determine to what extent amendments to their internal organisation, guidelines, processes, marketing material, third-party relations and licence status will have to be made.

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