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Continuing our Legal Focus feature on Funds, *Lawyer Monthly* speaks to Luis Pedro and Rodolphe Chatagny from Oligo Swiss Fund Services, a Swiss regulated company for the representation of foreign investment funds for Qualified and non-Qualified investors in Switzerland. Luis is the Chief Executive Officer of Oligo and can boast a solid experience in the analysis, selection process and due diligence of investment funds since 2007. Luis was the Chief Investment Officer of a fund of hedge funds. Rodolphe is the Chief Risk and Compliance Officer of Oligo. For 19 years, Rodolphe has held the positions of Chief Investment Officer and Chief Operating Officer for fund of private equity and hedge funds management companies.

### What is the process associated with creating a fund in Switzerland? FINMA regulates funds in Switzerland, what requirements must be met?

A Swiss-domiciled fund is very strictly supervised by the Swiss Financial Market Supervisory Authority (FINMA) and the legislation that regulates them is the Swiss Federal Act on Collective Investment Schemes (Collective Investment Schemes Act, CISA). An investment fund is defined as being a pool of assets raised from more than one investor. This pool of assets is managed by the fund management company for the account of the investors and making sure that the principle of risk diversification is accomplished.

Swiss-domiciled funds are divided into three categories:

- securities funds (harmonized with the European fund directive);
- real estate funds;
- other funds for traditional and alternative investments.

All parties managing a Swiss-domiciled fund, or its safekeeping, must obtain authorisation and be regulated by FINMA. This includes the following entities:

- Fund management companies;
- Custodian banks;
- Asset managers; and
- Distributors.

The authorisation is granted if, among others, the following conditions are met:

- Good reputation of the persons responsible for the management;
- Necessary professional qualifications from both the management and the responsible for business operation;
- Qualified (direct or indirect) equity holders have a good reputation and do not exert their influence to the detriment of judicious business practice;
- Compliance with the legal requirements is assured;
- Internal code of conduct to be followed by management and employees;
- Sufficient financial guarantees are available.

Swiss funds can be open-end collective investment schemes, either in the form of a contractual fund or an investment company with variable capital (SICAVs), or closed-end collective investment schemes, taking the form of a limited partnership

(LP) or an investment company with fixed capital (SICAFs).

Foreign investment funds distributed in Switzerland are also regulated by FINMA. In what concerns these funds, there are two types that must be differentiated:

- Funds distributed to Swiss based qualified investors (e.g. professional investors like pension funds, high net worth Individuals, insurance companies and banks). These funds are not directly supervised by FINMA but they must appoint a Swiss representative and a Swiss paying agent (i.e., a bank). It is up to the Swiss representative and paying agent to evaluate if the funds can be distributed in Switzerland. Swiss representatives are Swiss-based companies that are highly regulated and with very well defined internal procedures, that had to apply for a license from the FINMA. The representative represents the foreign investment funds with regard to Swiss based investors and FINMA;
- Funds distributed to retail investors. In addition to the requirement of having to appoint a Swiss representative and paying agent, application for FINMA authorisation is mandatory. Particularly, funds which are launched in an EU or EEA member state and comply with the EU UCITS Directive can apply for a fast track approval for obtaining the FINMA authorisation.

### What is the investment funds due diligence process in Switzerland? How long does it typically take to conduct due diligence investigations of investment funds?

Once again, it is important to distinguish funds domiciled in Switzerland from foreign funds distributed in Switzerland.

The due diligence on Swiss-domiciled investment funds is FINMA's responsibility and it is a process that implies asking for an authorisation as mentioned previously.

Within the foreign funds distributed in Switzerland it is also important to differentiate between funds distributed to qualified investors and funds authorised for retail distribution.

The due diligence process for foreign funds distributed to qualified investors in Switzerland depends mostly on the Swiss representative that the fund uses. The process can be relatively "light" or thorough depending on the quality of the Swiss representative. In our case, we dedicate an important amount of our time and resources to the due diligence. We believe that this was the motivation for the CISA revision, in order to guarantee a better protection for the Swiss based investors. In addition, it is our opinion that the due diligence work reflects the credibility of

the represented fund. Besides the due diligence work over the funds' and investment managers' documentation and a background check on the directors, we also carry an onsite operational due diligence over all funds that we represent. Some of the points that we verify include:

- Shareholders of the investment manager;
- Background/education of the key personnel as well as the history of the company and their founders;
- Operational risk procedures and how the board is informed about them;
- AML procedures;
- Availability of compliance and risk manuals;
- NAV calculation and validation procedures with the fund's administrator;
- Availability of in-house software systems and their maintenance;
- Business continuity disaster and continuity plans;
- Summary of portfolio construction focused on risk and valuation procedures;
- Known conflicts of interests;
- Fund distributors in Switzerland;
- Type and breakdown of investors;
- Detailed variation of the AuM;
- Type of reporting and how the fund communicates with their investors and/or potential investors.

Our onsite operational due diligence could take several hours and we meet with the Chief Operational Office, Chief of Compliance, portfolio manager and any other key personnel we consider important. The analysis time spent on documentation depends mainly on the complexity of the fund and on the celerity and collaboration of the fund in providing the required documentation.

Regarding retail distribution, the funds need to be approved by FINMA to be authorised for this type of distribution. Applying for this authorisation is not possible for all funds and is usually restricted to some jurisdictions and funds' legal structures. For example, having a European Union (EU) UCITS fund approved for retail distribution in Switzerland is a relatively quick and very standardized procedure. The Swiss regulator recognizes the due diligence and surveillance work done by its European peers and normally requires certified documentation of the fund and the fact that it is regulated in an EU country. Funds aiming for retail distribution in Switzerland also need to appoint a Swiss representative and a paying agent. →

**New regulation is in place affecting foreign investment funds distributing assets in Switzerland to qualified investors, what impact does this have on foreign investment in Switzerland? What types of funds require a Swiss representative?**

The new regulation on the distribution of foreign funds in Switzerland defined in the Federal Act on Collective Investment Schemes (CISA) entered into force on the 1st of March 2015. Six months after the regulation entered into force, an important number of funds that are distributed to Swiss based qualified investors are now compliant with Swiss regulation. Nonetheless, a lot of them are still not compliant, with the managers trying to understand if it makes sense to be present in the Swiss market or not.

In the revised CISA, the concept of distribution has replaced the concept of public solicitation, which was the one prevailing in the application of the previous CISA. Under the revised CISA, basically all marketing activities will be regarded as distribution, unless such activities are directed at specific prudentially supervised entities (regulated qualified investors). The law has evolved especially for funds addressed to qualified investors (previously considered private placement) which were not regulated in the past. While in the past requirements for qualified investors were minimal, as of March 1st 2015 all funds (for qualified investors and/or retail investors) must have a regulated representative in Switzerland. For example, if a foreign investment fund sends emails to potential clients, it is already considered as distribution. After appointing a Swiss regulated representative, a foreign fund (or any third-party marketer that is a regulated distributor) will be allowed to continue to be distributed in Switzerland.

As distribution is now regulated and Swiss distributors need to be regulated by FINMA, the number of funds that are allowed to be distributed to Swiss based qualified investors is lower when compared with the past. On the other hand, the funds that are allowed to be distributed in Switzerland since the 1st of March 2015 are better regulated as they need to appoint a Swiss representative and Swiss paying agent. It is the role of the Swiss representative to make sure that the funds are compliant with Swiss regulation. This is why in our case we conduct an onsite operational due diligence over all the funds represented by Oligo. This allows us to make sure that the funds represented by our company meet high standards in terms of their organization and their operations.

Foreign distributors (targeting Swiss based qualified investors) with a distribution license in their country are authorised to perform distribution in Switzerland if the distribution regulation in their country is equivalent to Swiss regulation. Their

distribution activities in Switzerland are supervised by the fund's representative. This is a very important difference between Swiss regulation and European regulation and it greatly simplifies distribution of foreign funds in Switzerland.

To answer your second question very shortly: all foreign funds distributed in Switzerland must appoint a Swiss representative and paying agent. In the specific case of foreign funds authorized for retail distribution, they are also under FINMA's supervision and they require to have FINMA's approval for retail distribution.

What is important to highlight is that when compared with other regulations, it is relatively quick and less expensive to be compliant in Switzerland to distribute a foreign fund to Swiss based qualified investors. Thus, based on the number of funds that have already appointed a Swiss representative or are in the process of appointing one, we foresee that the impact of the new legislation on foreign investment in Switzerland will be minimal.

**What other regulatory changes do you predict occurring in the near future, regarding investment in Switzerland? What impact will these changes have?**

In terms of investment funds we do not foresee any major changes in the near future. The new CISA was a very important revision with a lot of modifications with deep implications for foreign funds as well as for Swiss distributors and Swiss fund managers. Nevertheless, two important revisions of the regulation are in progress. The Federal Financial Services Act (FFSA, in French – Loi fédérale sur les services financiers 'LSFIN', in German – Bundesgesetz über die Finanzdienstleistungen 'FIDLEG') sets out the prerequisites for providing financial services and offering financial instruments. The Financial Institutions Act ('FinIA', in French – Loi fédérale sur les établissements financiers 'LEFin', in German – Bundesgesetz über die Finanzinstitute 'FINIG') provides a specific supervisory regime for financial institutions. These two acts are the basis of the legislation that applies to all actors on the financial market in Switzerland, as well as to the services and products. This important revision of the Swiss financial market's regulation will align the Swiss legislation with the European Union's standards, in particular the Markets in Financial Instruments Directive (MiFID II) and will add better protection for investors. This legislation sets a common ground of provisions related to the licensing regime that is uniformly applicable to all categories of regulated financial services providers. In particular, having in place good compliance policies, a proper corporate governance and risk management will be mandatory under the new regulation. Another outstanding point of this legislation is

the implementation of rules of conduct for all providers.

Within this major revision, the specific rules which are applicable to financial institutions already operating with a licence under existing laws, like the Federal Act on Banks and Saving Banks or CISA, will have probably no material changes.

The revision of the financial services, instruments and institutions will affect mostly the Swiss independent asset managers (wealth managers). These actors represent around 15% of the assets under management in Switzerland, over an estimated number of 2'000 companies. Currently, independent asset managers are self-regulated institutions that are subject to a mandatory AML audit every year but do not require a license or supervision from the Swiss regulator. In the future, independent asset managers will be supervised: either directly by the supervisor or by an institution with a specific license for that effect.

**How attractive is Switzerland as a place to set up a private investment firm? What difficulties do foreign individuals typically encounter when trying to set up a firm in Switzerland?**

Setting up an independent asset management company (wealth managers) in Switzerland is still a simple task. As the revision of the financial services, instruments and institutions did not enter into force yet, as of today an asset management company can be setup very quickly with little effort by applying for membership of one of the recognized Self-regulating Bodies (professionals associations) and applying the code of conduct of the professional association. Besides the mandatory AML yearly audit, there are no other main constraints. As we mentioned before, this will radically change in the near future when the new regulations on the financial services, instruments and institutions will be in place.

For fund managers the picture is different and already better defined, since they are subject to CISA. A Swiss fund manager can manage a fund domiciled in Switzerland or in a foreign country. For a fund domiciled in Switzerland the manager must be regulated by FINMA, unless the fund is distributed to qualified investors only and the total assets under management are less than CHF 100 million. For a fund in foreign jurisdiction the manager only needs to be regulated by FINMA if the total assets under management are over CHF 100 million.

Let us focus on Swiss fund managers managing foreign funds (e.g. Luxembourg or Cayman legal structure). While being a small fund manager (under the de minimis rule – i.e., managing total assets of less than CHF 100 million in investment funds) is relatively simple, being a Swiss fund

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manager managing over CHF 100 million is much more complicated. In the first case there is no requirement for being supervised by the regulator or for applying for any license. Depending on the complexity of the fund, a rather small structure of two professionals may be enough. When the assets under management in investment funds reach the threshold of CHF 100 million, the asset manager needs to apply for a fund manager license from FINMA. Obtaining (and applying) for this license usually implies a change of paradigm in the business model of the fund manager and a change of mind-set in terms of the company's organization. The Swiss regulator requires a fund manager to be very well organized and have enough resources, which includes (but is not limited to):

- at least 1/3 of independent board of directors;
- well-defined and independent executive roles;
- compliance and risk management activities must be well defined and separated from the investment management. A fund management company must have compliance and risk management officials;
- well-defined internal procedures;
- a minimum of CHF 200'000 capital of the company if managing Swiss domiciled funds, and a minimum of CHF 500'000 capital of the company if managing foreign funds.

Big fund managers are rather applying for FINMA licensing or relocating to other jurisdictions in the EU, while smaller ones are operating under the de minimis rule.

**What are the implications of the ESMA decision end of July 2015 on the AIFMD passport? What do you think this means for the fund industry in Switzerland?**

It is an interesting issue that follows up with the previous question on how attractive is Switzerland for fund managers. This will change in the near future. On July 30, 2015 the European Securities and Markets Authority (ESMA) published its advice to the European Parliament, the Council and the Commission on the application of the Alternative

Investment Fund Managers Directive (AIFMD) passport to non-EU alternative investment fund managers and alternative investment funds. ESMA has conducted a country-by-country assessment for six jurisdictions (Guernsey, Hong Kong, Jersey, Singapore, Switzerland and the United States), concluded positively that no obstacles exist to the extension of the passport to Guernsey and Jersey, while Switzerland will remove any remaining obstacles with the enactment of pending legislation, and offered no definitive decision on Singapore, Hong Kong or the United States.

This is of extreme importance to the Swiss fund management marketplace as it means that Swiss fund managers will be granted non-EU passport for their funds. In particular this may be very interesting if Swiss fund managers could use their non-EU passport to distribute non-EU funds in EU. As of today it's not completely clear how distribution will be influenced by this non-EU passport. It could have an impact for large investment companies that may think again to re-locate in Switzerland instead of other European countries.

**You have helped firms re-domicile to Switzerland, how successful have these firms been since their move? What were the main motivations for the relocation?**

So far we did not help any investment firms to relocate in Switzerland. Nevertheless we helped some firms to create a local distributor with a FINMA license. We also helped a lot of fund managers in structuring their funds to be managed from Switzerland. Our expertise is in the setup and

structuring of foreign funds (Cayman, Luxembourg, Ireland, Malta, etc.) rather than setting up Swiss-domiciled funds.

For big fund managers relocating to Switzerland there is the requirement of applying for the FINMA's fund manager's license, which is relatively costly. Smaller managers, like startups or niche funds under the de minimis rule, can be easily relocated to Switzerland.

We also helped Swiss fund managers with Swiss-domiciled funds to relocate their funds to an EU country. Although the fund management company stays in Switzerland, if the funds are transformed into a fund of one of the EU countries it will facilitate the distribution in EU by using an AIFM and, with very limited amount of work, also be distributed in Switzerland. As we mentioned before, for a foreign fund to be distributed in Switzerland to qualified investors it is sufficient to appoint a Swiss representative and a Swiss paying agent.

With the ESMA decision on the 30th of July this trend of relocating Swiss funds to EU funds may end, as Swiss fund managers would be able to apply for a non-EU passport for their funds.

**Is there anything else you would like to add?**

Overall, the Swiss market is very interesting, either from the distribution stand point or from the attractiveness of setting up an investment firm. It is a reality that regulatory changes have been in the agenda for a few years now and other are still being discussed. Nevertheless, the legislation revisions should be seen as a positive aspect both from the point of view of the investor, who will get better protection, and by the funds, that have more means to show their quality by being more regulated.

The Swiss regulator did a very good work when revising CISA: it is easier for foreign investment funds to be Swiss-compliant and the associated costs are relatively low when compared with other jurisdictions, while investors are better protected. **LM**

For any questions regarding funds representation and distribution, as well as on fund structuring please feel free to contact Oligo Swiss Fund Services (a regulated Swiss representative for funds addressed to both Qualified and Retail Swiss investors): [info@oligofunds.ch](mailto:info@oligofunds.ch).

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