

Alert

Top 10 Things You Should Know About the New Swiss Rules on Distribution of Funds

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A new regime governing the distribution of non-Swiss funds to Swiss investors comes fully into force on 1 March 2015, when the current transitional period expires.

The new regime segments Swiss investors into three categories: (1) unregulated qualified investors (pension plans, corporates, family offices, family trusts and high-net-worth individuals); (2) regulated qualified investors (a more restricted list of Swiss-regulated financial entities, such as banks, securities dealers, fund managers and insurance companies); and (3) non-qualified investors (effectively retail). This *Alert* focusses on investors in categories (1) and (2).

Investment managers who expect to be distributing their funds to unregulated qualified investors in Switzerland on or after 1 March 2015 must comply with the new requirements by that date. These include, amongst other things, requirements for the fund to appoint a Swiss-licensed representative and a Swiss bank as a paying agent and for the fund's investment manager to enter into a distribution agreement with the appointed Swiss representative.

Investment managers should consider whether they want the ability to distribute their funds to unregulated qualified investors and, if so, take steps to comply with the new requirements as soon as possible. Complying with the new regime is not a particularly onerous exercise.

1. How Does Swiss Law Regulate the Marketing of Non-Swiss Funds in Switzerland?

The marketing and sale of non-Swiss funds to Swiss investors is governed by the Swiss Collective Investment Schemes Act ('CISA') and the Swiss Collective Investment Schemes Ordinance ('CISO'). Broadly speaking, there are two regimes — one governing the distribution of funds to non-qualified investors, and the other governing distribution to qualified investors.

Distribution to non-qualified investors (effectively retail) requires the fund to be registered with the Swiss Financial Market Supervisory Authority ('FINMA'), the Swiss regulator, and is an onerous process requiring translation and submission of various documents to FINMA for approval, the payment of initial and annual registration fees and the appointment of a Swiss-licensed representative and paying agent who will supervise the marketing of the fund. FINMA also imposes strict eligibility criteria including a requirement for regulatory supervision of the fund which is comparable to the Swiss funds regime, and approval usually takes several months to obtain. FINMA's current practice is that registration is only open to UCITS funds and is not possible for hedge or private equity funds.

Distribution to qualified investors is permitted without the prior registration of the fund with FINMA. However, it is important to note that qualified investors are divided into two categories — regulated qualified investors and unregulated qualified investors — which are treated differently. The new Swiss representative and paying agent, etc. requirements described below will only apply where distribution of the fund's shares will occur to unregulated qualified investors. The key concepts are 'distribution', 'regulated qualified investors' and 'unregulated qualified investors'. This *Alert* focusses on the new requirements for distribution to unregulated qualified investors.

2. What Is 'Distribution'?

Distribution for this purpose is very broadly defined as 'offering' or 'advertising' funds, which are defined to include 'any type of activity whose object is the purchase' of shares or other interests in a fund. Offering or advertising via whatever means and type of document is covered — in writing, emails, calls, Internet/websites, Offering Memoranda, subscription documents, brochures, factsheets, presentations, etc.

Where a fund is distributed solely to regulated qualified investors (see 4 below), the new requirements imposed by CISA/CISO do not apply. In contrast, where a fund is to be distributed to unregulated qualified investors (see 5 below), the new requirements imposed by CISA/CISO will apply. Those new requirements include, among other things, the appointment by the fund of a Swiss-licensed representative and a Swiss bank as paying agent, certain mandatory disclosures to Swiss investors and the entry into a Swiss-compliant distribution agreement (see 7 below).

As to the scope and type of funds affected, note that the new requirements will apply (where distribution to unregulated qualified investors occurs) in respect of a UCITS fund as well as to a non-UCITS fund, such as a hedge fund or private equity fund.

3. Can You Avoid 'Distribution'?

Article 3 of CISA/CISO contains five specific examples of conduct and behaviour which are deemed *not* to be distribution and therefore will not trigger the new requirements. The specific examples which will have most interest or relevance to non-Swiss managers and funds relate to reverse inquiry, discretionary management clients and the publication of prices and net asset values.

Reverse Inquiry

Distribution will only be deemed not to have occurred where the provision of information and the subscription of a fund's shares is 'at the instigation of or at the own initiative of investors', which requires the request or purchase to be made in respect of a *specific fund* and '*without prior action or contact*' from the investment manager, distributor or other representative of the fund. This deeming provision is framed very narrowly and most investment managers will find it difficult to rely on this route as a viable means of avoiding the need to comply with the new laws. It is also important to note that FINMA is expected to take a restrictive approach to interpreting and applying this going forward.

Discretionary Management Clients

The provision of information and the subscription of a fund's shares based on a written discretionary management agreement with a Swiss-regulated financial intermediary or an independent asset manager (subject to certain conditions — see 5 below) is deemed not to be distribution. FINMA's Circular on the distribution of funds makes it clear that this deeming provision is not applicable to

the acts of a third party, such as a fund's investment manager, who is not party to the discretionary management mandate.

If a Swiss bank introduces your fund to its discretionary management clients who invest in your fund, directly or indirectly, this is unlikely to amount to distribution by the fund's investment manager, provided that the investment manager has no direct contact with and does not itself forward any fund-related documents or materials to the investors. The Swiss bank may, subject to compliance with its own obligations under Swiss law, forward fund-related materials and documents to certain of its investors pursuant to the discretionary management arrangement.

In contrast, if an investment manager has direct contact with and/or sends fund-related documents or materials to such investors, this is likely to amount to distribution and should be avoided unless the investment manager has appointed a Swiss representative and paying agent and taken steps to ensure that the relevant investors are qualified (for example, that any high-net-worth individuals have opted in).

Publication of Prices, Net Asset Values and Tax Data

The publication by Swiss (and appropriately supervised foreign) regulated financial intermediaries of prices, net asset values and tax data is deemed not to be distribution, provided that such publication does not contain any contact information.

4. Who Are 'Regulated Qualified Investors'?

Regulated qualified investors are Swiss regulated financial intermediaries and institutions. These are:

- A bank authorised and supervised by FINMA under the Swiss Federal Act on Banks and Savings Banks
- The Swiss central bank
- A securities dealer authorised and supervised by FINMA under the Swiss Federal Act on Stock Exchanges and Securities Trading
- A fund manager or an asset manager of collective investment schemes authorised and supervised by FINMA under CISA
- An insurance company authorised and supervised by FINMA under the Swiss Federal Act on the Supervision of Insurance Companies

Investment managers who want to avoid the new requirements should consider whether they are comfortable restricting their promotional activity to these categories of investors. Note, for example, that this would mean that direct promotion to, and contact with, Swiss pension funds, family offices, family trusts and other high-net-worth individuals would not be possible, unless genuinely unsolicited in accordance with the strict test noted under 'Reverse Inquiry' in 3 above.

5. Who Are 'Unregulated Qualified Investors'?

Unregulated qualified investors are:

- A public institution (Canton, municipality, other state-owned institution) managing its treasury on a professional basis
- A pension fund organised under the Swiss Federal Act on Professional Contingency managing its treasury on a professional basis
- A commercial or industrial enterprise managing its treasury on a professional basis
- A high-net-worth individual who meets the conditions set out in article 6 of CISO which are a written statement by the high-net-worth individual that he wishes to be deemed a qualified investor (opting in) and that he or she has either:
 - At least CHF 5 million of assets; or
 - At least CHF 500,000 of assets and has sufficient knowledge of the risks of the investments from education and professional experience or based on comparable experience in the financial sector (comparable experience here means that the individual has executed an average of 10 transactions of significant size in each quarter in the relevant market over the previous four quarters)

The verification of a high-net-worth individual's status must be documented separately. Note that there are certain limits on the type and amount of assets which are eligible to be counted and that an individual who does not opt in will be treated as a non-qualified investor.

- An investor subscribing in accordance with a written discretionary management agreement made with: (1) a regulated financial intermediary; or (2) an independent asset manager that is subject to the Swiss Federal Act on the Prevention of Money Laundering and the Financing of Terrorism in the Financial Sector and to a professional code of conduct recognised as minimum standard by FINMA, and such discretionary management agreement complies with the recognised guidelines of a professional organisation, provided that the investor does not exercise its right to opt out of qualified investor status.

6. If You Only Distribute to 'Regulated Qualified Investors', What Do You Need to Do?

If your fund will only be distributed to 'regulated qualified' Swiss investors (e.g., regulated banks, insurers and wealth/asset managers — see 4 above), it will not be required to appoint a Swiss representative and paying agent under the new laws, and the investment manager will not be required to enter into a Swiss-compliant distribution agreement. However, the action points here are likely to be:

Diligence in Advance

In some cases (particularly where it is not clear who the ultimate investor is) you may need to do some diligence in advance to confirm that the relevant prospective investor you wish to approach is in fact 'regulated qualified', as defined.

Representations as to an Investor's Swiss Status

As a precaution, suitable Swiss representations could be included in the fund's subscription document or in a separate certification to confirm that the investor is a 'regulated qualified investor'.

Swiss Selling Legends

The wording of any Swiss selling legends currently used in the Offering Memorandum, marketing materials, any other publications and, if applicable, on the investment manager's website should be reviewed and amended appropriately, given that your fund should only be offered or advertised to 'regulated qualified investors'.

7. If You Distribute to 'Unregulated Qualified Investors', What Do You Need to Do?

If your fund will be distributed to 'unregulated qualified' Swiss investors (e.g., pension funds, ordinary corporates, high net worth individuals, family offices etc. — see 5 above), you and your fund will be required to take a number of steps. The action points are likely to be:

Swiss Representative Agreement

A Swiss Representative Agreement will need to be entered into by the fund with a licensed Swiss representative. The Swiss representative's role is to represent the fund and be a point of contact both for Swiss investors and for the Swiss regulator, FINMA. Note that there is an SFAMA (Swiss Funds and Asset Management Association) model representative agreement which Swiss representatives will want to use or have regard to. It is permissible for the fund's manager or investment manager to also be party to the agreement.

Swiss Distribution Agreement

A Distribution Agreement will need to be entered into between the Swiss representative and, typically, the investment manager acting as distributor. There is also an SFAMA model distribution agreement which Swiss representatives will want to use or have regard to. The distribution agreement does not have to be two-party: For example, the fund could also be party to it or, where relevant, the manager as well as the investment manager. When acting as distributor the investment manager will be obliged to comply with two sets of guidelines which have been prepared by SFAMA and approved by the Swiss regulator as the minimum required standards. These are guidelines on distribution and on charging and disclosure of fees and expenses.

Duty to Monitor and Annual Compliance Confirmation

The Swiss representative has a duty to monitor the distribution activities of the investment manager in Switzerland and to ensure that the fund is only being advertised and offered to qualified investors and that the investment manager is complying with the guidelines on distribution. This will include ensuring that the relevant fund documents and any marketing materials contain the required specific disclosures (see 'Disclosure Requirements' below). Also, note that the investment manager will be required to provide an annual written confirmation to the Swiss representative (in standard format as part of the SFAMA template) as to its compliance with the guidelines on distribution and the specific disclosure requirements. There is no requirement for the Swiss representative to accompany or chaperone the investment manager when acting as distributor.

Swiss Paying Agent

The fund will also need to enter into a separate agreement with a Swiss bank under which it will

agree to receive subscription monies from a Swiss investor or to pay redemption proceeds to a Swiss investor, in each case if a Swiss investor so requests. In practice, it is expected that Swiss investors will continue to make payments to, and receive payments from, the fund directly via the administrator and that the Swiss paying agent will probably do little or nothing.

Disclosure Requirements

There are some specific disclosure requirements (including the Swiss representative's identity) which must be met that will impact the content of the Offering Memorandum, any investor presentation or other marketing materials.

Swiss Selling Legend

The wording of the Swiss selling legend currently used in the Offering Memorandum, any investor presentation or other marketing materials should be checked and may need to be amended in light of the new regime.

Subscription Document Reqs

Consider including suitable Swiss investor representations in the fund's subscription document.

Website

The Swiss regulator's Circular 2013/9 on the Distribution of Collective Investment Schemes in Switzerland addresses distribution through websites and requires the use of certain disclaimers and access restrictions. An investment manager should, prior to 1 March 2015, review its current website content with the new Swiss rules in mind and assess whether it amounts to 'distribution' for Swiss purposes and, if so, make any appropriate changes.

8. How Onerous Is It to Comply?

Complying with the new regime is not a particularly onerous exercise. The agreements required to be entered into should be based on the approved templates containing the minimum standards, and it should not take more than a few weeks to agree to terms and documents with a suitable licensed representative and paying agent.

Investment managers should note that they will be required to give an annual written compliance confirmation to the Swiss representative and will want to focus carefully on the duty of care and liability provisions in the agreements. There are however no specific regulatory reporting or remuneration disclosure requirements to be complied with (for example, there is no equivalent of Annex IV reporting or remuneration disclosure under the AIFMD regime).

Expect typical Swiss representative fees in the range of CHF 10,000 to 15,000 per annum and typical paying agent fees of CHF 2,000 to 4,000 per annum.

9. What Are the Penalties and Remedies for Non-Compliance?

Breach of the new requirements is a criminal offence under Swiss law but would not result in the contract between the fund and the investor being regarded as unenforceable. A Swiss investor could however bring a damages claim under Swiss law if he or she is able to show that he or she has been improperly solicited and his or her fund investment has declined in value.

10. When Does the New Law Apply?

A transitional period applies to the distribution of funds until 1 March 2015. There are some eligibility criteria to be met in order to rely on the transitional period, and there have also been some differences in how Swiss legal advisers are interpreting the transitional period.

Investment managers who expect to be distributing funds to unregulated qualified investors on or after 1 March 2015 must satisfy the CISA/CISO requirements by that date.

Whilst there are over approximately three months to go before new arrangements need to be put in place, we expect that there will be a rush to do so from January onwards and it may take longer than expected to get a Swiss representative and paying agent on board. Those managers and funds who expect to be distributing to unregulated qualified investors could therefore usefully begin the selection process and seek to agree to commercial terms as soon as possible.

Useful Links

Copies of the CISA, the CISO and an unofficial English translation of Circular 2013/9 are available via the SFAMA website:

<http://www.admin.ch/opc/en/classified-compilation/20052154/index.html>

<http://www.admin.ch/opc/en/classified-compilation/20062920/index.html>

<https://www.sfama.ch/regulation/finma-decrees>

A list of the licensed Swiss representatives is available on FINMA's website. There are currently over 80 licensed representatives, although in practice some of them do not offer representative services to third-party funds. The list of FINMA-licensed Swiss representatives is here:

http://www.finma.ch/institute/pdf_e/eflvervt.pdf

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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